CREDIT CARD INTERCHANGE FEES

HEARING

BEFORE THE

ANTITRUST TASK FORCE

OF THE

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JULY 19, 2007

CREDIT CARD INTERCHANGE FEES

THURSDAY, JULY 19, 2007

HOUSE OF REPRESENTATIVES,
ANTITRUST TASK FORCE
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Task Force met, pursuant to notice, at 2:11 p.m., in Room 2141, Rayburn House Office Building, the Honorable John Conyers, Jr. (Chairman of the Antitrust Task Force) presiding.

Present: Representatives Conyers, Berman, Boucher, Lofgren, Delahunt, Waters, Cohen, Chabot, Keller, Cannon, Issa, and Smith.

Mr. CONYERS. Good afternoon. The hearing of the Antitrust Task Force will come to order. We are delighted to have this stellar group of all-male witnesses.

The issue that brings us together today is about a fee that affects the American consumer. Most people are unaware it even exists and how much of it they are paying, and so we are going to learn today some of the truths about the hidden interchange fee. You see, every time you use a payment card at the mall, at the grocery store, on the Internet, the merchant is charged a fee, which gets divided up three ways, between the merchant's bank, the consumer's bank, and the credit card company. It covers processing fees, fraud protection, billing statements, and other costs.

Almost 90 percent of this fee is a so-called interchange fee, which is the payment made by the merchant's bank to the consumer's bank. The percentage of this amount is set by the credit card companies, generally Visa or MasterCard, and averages 1.75 percent of the total purchase. Last year, these fees totaled $36 billion, an increase of 117 percent since the year 2001. These fees are ultimately passed onto consumers in the form of higher prices for goods and services, whether they purchase these items by credit card, check or cash.

Merchants are increasingly concerned about these fees because, as the rates rise and credit cards become more and more ubiquitous—and they cite the lack of public awareness about interchange fees among consumers, inconsistent charging practices, and the possibility that Visa and MasterCard may be setting the interchange fees—dare I say it—collusively, instead of allowing competition to work.

Now, the payment card industry defends these fees, arguing that the credit card companies don't prohibit disclosure of interchange fees to consumers, the fees are a result of healthy competition and are vital to the entire system of payment cards. In this regard, we are trying to clear up a couple questions: Are interchange fees im-

posing unfair costs on the consumer? Are interchange fees increasing at too rapid a rate, and why? And, finally, are our friendly credit card companies engaged in anti-competitive behavior?

Now, I come to this hearing with as open a mind as I can, but I think the proof is on the credit card companies to give us some reassurance. And so I look forward to a frank discussion with all of you here today.

I am happy to recognize now my friend, Steve Chabot, the Ranking Member.

Mr. CHABOT. Thank you, Mr. Chairman. I want to thank the Chairman, the distinguished gentleman from Michigan, for holding this important hearing today, examining the role that credit card interchange fees play in our economy. We have an expert panel of witnesses with us today, and I look forward to hearing their perspectives on this issue.

This hearing is yet another example of how technology has changed the way that we live, the way we work, we do business, and travel. Credit cards have brought consumers and merchants together in ways never thought possible. Coupled with the increased use of Internet, buying and selling has never been easier.

And recent statistics prove it: there are more than 14,000 card issuers in the United States today, with one billion cards in use. Think of that. We have about 300 million people in this country, yet we have a billion credit cards in use. In 2002, consumers bought more than $43 billion worth of goods on the Internet. That figure rose to $100 billion in 2004. Experts predict that, by 2009, U.S. consumers will spend more than $5 trillion using electronic payment systems.

Today's hearing is about the costs of doing business with credit cards. In our market economy, supply and demand sets the prices of goods and services, and the Sherman Act was enacted to protect consumers from anti-competitive behavior. Recently, concern has been expressed that the interchange payment system is anti-competitive; yet, it is no secret, especially with the statistics that I just read, that the number of Americans buying on credit has increased. Consumers continue to obtain and use credit and debit cards for their convenience, ease, and, in certain instances, their rewards programs.

However, this increase in consumer use has brought with it increased concern that merchants are paying disproportionately high transaction costs associated with credit and debit electronic payments. Businesses large and small want a more competitive and transparent system. In my district, I have received a number of letters from retailers and grocery stores and other merchants expressing concern about the impact that these fees have on businesses and their ability to provide goods and services.

I look forward to hearing from our witnesses today and to gaining a better understanding of the market for credit cards, the origins of the interchange fees, the role that these fees play in facilitating transactions, and learning whether Government intervention is appropriate. I said in the last three antitrust hearings that we have had in this particular Committee that we have held that Government intervention is not always the best remedy, and we must be careful not to do more harm than good. Of course, sometimes

Government action is appropriate, and it is for us to determine, and this is one of those hearings that will help us to decide that particular issue. But I think most of us are trying to keep an open mind on this.

This hearing is a necessary first step in fulfilling our oversight responsibilities, and I again want to thank the Chairman for holding this hearing, and I want to also thank each of the members of the panel here for their attendance this afternoon. And we are hoping to learn a great deal.

I yield back.

Mr. CONYERS. Thank you very much, Steve Chabot. We will incorporate all other opening statements in the record.

And I yield now to the distinguished gentleman from Virginia, Rick Boucher, to introduce one of our witnesses.

Mr. BOUCHER. Well, thank you very much, Mr. Chairman. And I commend you, also, for organizing today's hearing. Unfortunately, after this introduction, I am going to need to depart, but I look forward to receiving the benefit of testimony provided here today and learning more about this very important matter.

I have the privilege this afternoon of introducing to the Committee a person who is not only a constituent of mine, but also a personal friend. His name is Steve Smith. He is the Chairman of the Food Marketing Institute, which includes 1,500 member companies, both food retailers and also food wholesalers. He is also the President and Chief Executive Officer of K-VA-T Food Stores, which operates more than 90 Food City grocery stores, 67 pharmacies, and 46 refueling stations in Virginia, Kentucky and Tennessee.

Of particular interest to me is the focus that Steve Smith, through his various stores, has placed on the need to acquire from local farms in our region locally grown produce and also locally produced meat. He has worked with my office to foster the market in our region for sheep and value-added beef farming, as well as fruits and vegetables purchased from local farms, benefiting our economy and also providing very fresh local produce for the benefit of my constituents.

So it is a privilege to welcome today one of our region's most successful businessmen, who I know will have enlightening testimony for the Committee. And I am pleased to introduce to the Committee Mr. Steve Smith.

And thank you very much, Mr. Chairman, for allowing this time.

Mr. CONYERS. Mr. Smith, you have been introduced by one of our stars in the Congress, so I won't add anything to it, but except to tell you, you have got a heavy burden to prove here. We welcome you, though, nevertheless. Please feel free to proceed.

TESTIMONY STEVEN C. SMITH, PRESIDENT AND CHIEF EXECUTIVE OFFICER, K-VA-T FOOD STORES, INC.

Mr. SMITH. Well, thank you very much, Congressman Boucher, for that kind introduction.

And, Chairman Conyers and Members of the Committee, I am honored to appear before you today and present information of great concern to my company, to members of the Food Marketing Institute, and to the American consumers. I am here today to shed

light on the best-kept secret, I think, of the credit card industry, and that is the hidden tax that has been thrust upon consumers due to the ever-increasing interchange fees that credit card companies charge retailers as a result of the collective pricing setting by Visa and by MasterCard and their respective card-issuing banks.

This collective price setting does not occur in isolation. Rather, it is part and parcel of a system that imposes collectively set rules that effectively require merchants to keep the cost of accepting cards secret from their customers. The rules also prevent merchants from refusing to accept particular types of credit and debit cards that impose higher fees, including premium and corporate cards. Further, we cannot make brand preference based on card or payment type. Thus, the card systems can—and do—increase their collectively set interchange fees without any fear of resistance by the cardholders who remain unaware of the increased costs that they are imposing and incurring.

The grocery industry is comprised of a variety of retailers, from big box retailers, nationally known, to small mom-and-pop retailers on the corner. Our industry serves probably the broadest cross-section of the retail industry that I can think of. And each of our consumers enjoy a very competitive marketplace that exemplifies what most Americans believe the free enterprise system to be. Because of this healthy competition, the profit margin in the grocery industry is generally in the 1 percent range. Now, I don't know of any other industry that operates in such a competitive, low-margin environment.

Now, when we first started accepting credit cards, our interchange rate was around 1 percent, about the same as our profit margin. The initial volume of card payments was low. And, quite frankly, our industry expected the rate charges would fall as transaction volume increased. This would be consistent with basic economic theory and our experience with various other aspects of our business. However, the exact opposite proved true.

As credit card usage has become more prevalent and interchange fee rates have climbed, our costs have increased exponentially, resulting in a 700 percent rise in total interchange fees over the last 10 years. Today's high rate of credit card usage, combined with the fact that credit card companies are allowed to collectively set interchange rates, leaves retailers faced with the "take it or leave it" system. The retailer's only practical option is to pay up and pass this uncontrollable expense onto our consumers. Because of these factors, the grocery industry now faces credit card interchange fees that can be over 2 percent of a sale, nearly double our industry's profit margin of 1 percent.

As FMI chairman, I represent over 26,000 retail food stores with combined annual volume of over $340 billion. These retailers have been put in the position of having to pass along to consumers over $4 billion annually in interchange fees. In the grocery industry, our very survival depends on customer attraction and retention amidst an intensely competitive marketplace.

Every entity of the retail world is faced with some form of competition, and this competition serves as a safeguard to ensure that our practices and prices remain in check. Yet the reverse is true of the credit card companies. Visa and MasterCard, accounting for

over 80 percent of the industry transaction volume, each work collectively with their members to drive rates upward rather than maintaining a healthy balance. In their non-competitive market, normal pressures do not apply.

Visa regularly increases its collectively set interchange fee to encourage the issuance of cards, and MasterCard does the same. Meanwhile, the unsuspecting consumer is the conduit for the rise in fees, thanks in part to those collectively set rules that prevent merchants from responding competitively to the increased cost of particular cards.

Fair and rigorous competition is the foundation of our industry. We are not lobbying to deny credit card companies their reasonable profits. We only ask that we not be faced with costs imposed on us that have been set collectively by card systems and their member banks in an environment that is deliberately designed to deprive American merchants of any freedom of competitive action. Given Visa and MasterCard's market share, we simply don't have the ability to say no to the card systems' all-or-nothing proposition.

The conventional wisdom tells us that, as volume grows, prices should fall, but instead credit card companies have created much greater volume and raised fees and costs substantially. This is contrary to the basic concepts of the American free enterprise system, and the situation is the result of card systems controlling 80 percent of an industry collectively setting prices in violation of the antitrust laws.

And the great shame of it, my friends, is that the consumer bears the cost, and this fact has been effectively hidden from them. I don't know of any other industry which is allowed to blatantly abuse both the consumer and the retailer. Credit card companies should be required to operate in the same competitive environment as any other facet of business throughout our Nation.

Thank you very much, and I will be happy to answer questions at the appropriate time.

[The prepared statement of Mr. Smith follows:]

PREPARED STATEMENT OF STEVEN C. SMITH

Chairman Conyers and Members of the Committee, I am honored to appear before you today and present information of great concern to my company, K-VA-T Food Stores, Inc., the members of the Food Marketing Institute and American consumers.

I serve as President and CEO for K-VA-T Food Stores, Inc., a retail supermarket chain operating 95 stores under the Food City banner in Kentucky, Virginia and Tennessee. We are a family owned business, dating back to 1955. 16% of our company is owned by our associates through our Employee Stock Ownership Plan and we currently employ over 11,000 associates.

Also, I serve as Chairman of the Food Marketing Institute, commonly referred to as "FMI." FMI is a national trade association that has 1,500 member companies made up of food retailers and wholesalers in the United States and around the world. FMI's members operate approximately 26,000 retail food stores with combined annual sales of $340 billion, representing three quarters of all retail food store sales in the United States. FMI's retail membership is composed of national and regional chains as well as independent grocery stores. Our international membership includes some 200 companies from 50 countries.

I am here today to shed light on the best kept secret of the credit card industry; that is, the great hidden tax that has been thrust upon consumers due to ever increasing interchange fees that credit card companies charge retailers as a result of collective price setting by Visa and by MasterCard and their respective card-issuing banks.

This collective price setting—which looks to me like price fixing under the antitrust laws—does not occur in isolation. Rather, it is part and parcel of a system that

imposes collectively-set rules that effectively require merchants to keep the cost of accepting cards secret from their customers. The rules also prevent merchants from refusing to accept particular types of credit or debit cards that impose higher fees. Thus, the card systems can, and do, increase their collectively-set interchange fees without any fear of resistance by their card holders who remain unaware of the increased costs they are imposing and incurring.

My testimony today will focus on three topics: First, I would like to give you some understanding of the supermarket industry in today's marketplace; Second, the history of electronic payment transactions in our industry; and last, the effect of interchange fees on the retail industry today and the hidden "tax" burden it has laid upon the consumers.

The grocery industry is comprised of all types of businesses—from national "big box" chain stores to the traditional "mom & pop" store on the corner. It is my opinion that this industry serves a broader cross-section of the American public than any other retail industry. Each of those consumers enjoys a very competitive marketplace that exemplifies what most Americans believe their free enterprise system to be—specifically, each member of our industry has to fight, each and every day, to offer the consumer the best product at the fairest price in order to win them as a customer.

Because of this healthy competition, the profit margin in the grocery industry is generally in the 1% range; that is, our operators generally only make $1 of profit for $100 of sales. I like to say that we are a "penny" business—I know of no other industry that operates in such a competitive, low-margin environment.

Back in the early 1990's, supermarkets first began experimenting with credit and debit card acceptance. When we signed on to accept credit/debit cards, the issuing banks actually paid retailers to accept their cards and offered a variety of incentives to entice retailers to "sign up" and join the system.

Over time, our interchange fees were increased. And even though our profit margin was right around 1%, the same amount as our 1% introductory interchange fees, the initial volume of credit card payments was low. The industry fully expected that the rate charges would fall as transaction volume increased—this would be consistent with basic economic theory and our experience with various other aspects of our business. However, the exact opposite proved true.

Today consumer use of credit and debit cards is at an all time high, with 60–65% of all payments in our industry made with plastic. As the credit card payment method has become more and more prevalent, and interchange fee rates have increased, our interchange fee volume began to increase exponentially—resulting in a 700% increase in total interchange fees over the past 10 years. Today's high rate of credit card usage combined with the fact that credit card companies are allowed to collectively set interchange rates leaves retailers faced with a take it or leave it system—basically it comes down to a decision to either swallow hard and pay high fees that are set with no competitive influences or turn your back on the 65% of your revenue from customers who have been influenced by the card industry's advertising to believe they are social outcasts if they pay with actual cash. The retailer's only practical option is to "pay up" and be forced to pass this uncontrollable expense on to consumers.

Because of these factors, the grocery industry now faces credit card interchange fees that can be up to 2% or more of a sale. Please recall my earlier statement that our industry is a "penny business" or 1% of sales. Therefore, the effect is that fees set collectively by the credit card companies are now double the industry's profit margins.

As FMI Chairman, I represent 26,000 retail food stores with combined annual sales of $340 billion, or three quarters of all retail food store sales in the United States. These retailers have all been put in the position of having to pass-along the costs of these credit card interchange fees. As a result, consumers pay over $4 billion annually in FMI member stores and because the fees remain hidden, they don't even realize it!

To the "injury" of higher interchange fees, our members must add the "insult" of the anticompetitive, Visa and MasterCard Operating Rules. These rules prevent stores from setting minimum charges; require retailers to accept all cards, even premium rewards or corporate cards which carry a higher interchange fee and are not available to the majority of consumers; don't permit retailers to make preferences based on card type or even payment type; and prevent retailers from reviewing the rules of practice without obtaining a signed nondisclosure agreement.

In the grocery industry, our very survival depends upon customer attraction and retention amidst an intensely competitive marketplace. Every entity of the retail world is faced with some form of competition—from the contractors that build our stores and suppliers that provide our products to our utility companies. This com-

petition serves as a safeguard to ensure that our practices and prices remain in check.

Yet the reverse is true of credit card companies. Visa and MasterCard, accounting for 80% of industry transaction volume, each work collectively with their members to drive rates upward rather than maintaining a healthy balance. In their non-competitive market, normal pressures do not apply. Visa regularly increases its collectively-set interchange fees to encourage the issuance of its cards and MasterCard does the same. Meanwhile, the unsuspecting consumer is the conduit for this rise in fees—thanks in part to those collectively-set rules that prevent merchants from responding competitively to the increased cost of particular types of cards. The only beneficiaries are those lucky few who qualify for the premium cards packed with rewards on airline miles, cash back, hotel rooms, etc. But even they often find that the greatly touted rewards programs lack the promised substance.

My company operates 95 stores in 3 states. We see credit cards from every state in the country and I have yet to find even one bank that chose to offer an interchange rate lower than those collectively set and agreed upon by Visa or MasterCard. Fair and rigorous competition is the foundation of our industry. We are not lobbying to deny credit card companies their reasonable profit. We only ask that we not be faced with costs imposed on us that have been set collectively by card systems and their member banks, in an environment that is deliberately and collectively designed to deprive America's merchants of any freedom of competitive action: given Visa and MasterCard's market share we simply don't have the ability to say "no" to the card systems' all-or-nothing proposition.

The conventional wisdom tells us that as volume grows prices should fall, but instead credit card companies have created much greater volume AND raised fees and costs substantially. This is contrary to the basic concepts of the American free enterprise system. This situation is the result of card systems controlling 80% of industry volume collectively setting prices in violation of the antitrust laws. And the great shame of it all is that the consumer bears the costs and this fact has been effectively hidden from them. I hope that you can work with representatives of FMI and other merchant groups to develop solutions to end the anticompetitive conduct of the major card systems. I know of no other industry which is allowed to blatantly abuse both the consumer and the retailer. Credit card companies should be required to operate in the same competitive environment as every other facet of business throughout our nation.

Thank you for the opportunity to testify.

Mr. CONYERS. Thank you very much, Mr. Steven Smith.

Our next witness is the chairman of the Payment and Technology Committee of the Independent Community Bankers of America, known as ICBA. Mr. John Buhrmaster is the chairman of this ICBA committee, the only national trade association that exclusively represents community banks. He is the president also of the First National Bank in Scotia, New York, and has been recently appointed to the ICBA Bank as a director. He also served on the association's Hurricane Katrina disaster task force.

And we welcome you to this hearing.

TESTIMONY OF JOHN BUHRMASTER, PRESIDENT, FIRST NATIONAL BANK OF SCOTIA, NEW YORK

Mr. BUHRMASTER. Thank you, Chairman Conyers and Ranking Member Chabot, Members of the Task Force. My name is John Buhrmaster, and I am president of First National Bank of Scotia, a $270 million community bank located in Scotia, New York, upstate New York. I am pleased to be here today on behalf of the Independent Community Bankers of America and its nearly 5,000 member banks, just like myself.

Today, I would like to focus on two key aspects of the interchange debate: how interchange affects consumers in the market and the impact of interchange on competition.

It is important to realize that, for a community bank like mine, which is engaged in credit and debit card activities, both as an ac-

quiring bank and a card issuer, our customers are both the consumers who trust us with their personal banking needs and our many local merchants. This might not seem obvious, but as consumers can shop around for a bank that best meets their financial needs, merchants setting up a credit card acceptance process can also shop around for a level of service, customer support, and a range of fees that best suits their business plan.

If a merchant opts to sign with First National, it is getting a tremendous value because of the interchange system. Small business in and around my community can set up a deal with my bank where they are paying competitive fees, can accept plastic, and are assured a consistent payment experience, backed by sophisticated fraud detection systems. This acceptance is very important to the economic base of my community.

The payment system in our country is not free. It did not materialize overnight and should be paid for by those choosing to take advantage of it. We don't want our merchants to pay high fees, but interchange is a cost of doing business for them and is a cost to the acquiring side of my bank's business.

My aunt runs a winery in the Finger Lakes of New York. In setting up her business, she made the choice to accept credit cards. She told me that interchange is a good value for her business, because credit cards allow people to buy who might otherwise not. Sometimes they even purchase more if it is on a card, rather than if they are paying with cash. She views the interchange as a part of her overhead, and it helps her reach more consumers.

Contrary to popular belief, for many community banks, the services we are able to provide thanks to the existence of a negotiated interchange fee system are not huge profit centers. For me and many community bankers, the variety of products and the high level of personal service we are able to offer consumers is what makes the system most valuable, not the profit opportunity.

Some have also stated that the interchange system is not transparent and that these rates should be printed on payment card receipts. I have no problem telling the merchants the cost they incur to accept debit and credit cards, but printing interchange rates on customer receipts, beside adding an additional expense, would be the equivalent of my aunt telling her customers how much it cost the venue to pick the grapes.

The interchange system enhances competition and functions so well that thousands of small community banks are able to stand toe to toe on both the issuing and acquiring side of the business and offer services to consumers in direct competition to banks like Citigroup and Bank of America, while providing the type of consumer experience that only a community banker can give.

Our bank was founded in 1923, and I am the fourth generation of my family to serve as president. If we were forced to compete in an environment without the card networks negotiating interchange against the mega-banks with national footprints, our relatively small size would put us at a competitive disadvantage that would be difficult to overcome.

I also want to point out that the interchange rates we currently receive as an issuer and pay as an acquirer are on a level playing field with the largest banks in our country. Consumers and mer-

chants are not always better served by something just because it is big, and that is where a community bank plays a vital role.

I believe that aspect is often overlooked in this debate, because it is so easy to focus on the largest issuers and acquirers. I also believe it is inaccurate and misleading to characterize interchange as a hidden tax on consumers. It is no more a hidden tax than is the cost of check processing or the cost of counting cash or the cost of making change. And if anything, interchange is more transparent than the cost of other services.

Interchange is a fee for a valuable service provided to the merchant. It is a fee that allows a bank like mine to support local businesses and give those businesses the ability to accept and to attract more customers with additional payment choices and allows those customers the flexibility of paying on credit. That is the benefit of a balanced market that works the way it is supposed to, with an intermediary like Visa or MasterCard standing in for us, successfully bringing together and meeting the payment needs of banks, merchants and consumers alike.

Again, thank you, Chairman Conyers and Ranking Member Chabot for the opportunity to testify on behalf of ICBA and community banks in this country. I look forward to your questions.

[The prepared statement of Mr. Buhrmaster follows:]

PREPARED STATEMENT OF JOHN BUHRMASTER

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

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

THE IMPACT OF INTERCHANGE ON CONSUMERS

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

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

There was a time when, if you wanted to use credit for a purchase, you had to shop at a large department store that could afford an in-house credit program. Today, most consumers can use credit to shop at even the smallest merchant because most consumers carry a line of credit in the form of a credit card in their wallets. What small retailer could afford its own proprietary card nowadays? Because

of my ability to issue cards and be a merchant acquirer, small businesses in and around my community can set up a deal where they are paying competitive fees, can accept plastic, are assured a consistent payment experience, and are protected against the fraud I described earlier. This acceptance is important to the viability of my local merchants and the economic base of my community.

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

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

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

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

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

THE IMPACT OF INTERCHANGE ON COMPETITION

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

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

as an acquirer, are the same rates paid by the largest banks in our country. Without our market-driven system, how would a small bank compete against the clout of mega-banks?

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

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

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

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

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

Mr. CONYERS. Thank you very much.

We now have the consumer advocate with the U.S. Public Interest Research Group, Ed Mierzwinski. He has been before the Congress and State legislatures. He has written extensively on consumer issues. He is frequently quoted. You may have seen him on TV even, or read about him in the *New York Times*. And now we have him before us today.

We welcome you, sir.

TESTIMONY OF EDMUND MIERZWINSKI, CONSUMER PROGRAM DIRECTOR, U.S. PIRG

Mr. MIERZWINSKI. Thank you very much, Mr. Chairman. And we appreciate all your leadership on consumer issues over the years, as well.

I am Ed Mierzwinski, and I am consumer program director with U.S. PIRG. My testimony today is also on behalf of the Consumer Federation of America and Consumer Action, two leading consumer groups. After I submitted my testimony, Consumers Union also endorsed it, so some of the leading consumer groups all agree that interchange is a significant problem for the Congress to consider.

A prime purpose of our organization is to advocate for a fair and competitive marketplace. And, quite frankly, we believe that the financial services markets work best when there is vigorous competition and consumers are protected from anti-competitive practices. The work of your Committee is very important in this regard.

I have one simple message today: The deceptive and anti-competitive practices of the Visa and MasterCard payment networks have injured both consumers and merchants for many years. Interchange fees are, in fact, hidden taxes or charges paid by all Americans, whether they use credit cards, whether they use debit cards, whether they use checks, or whether they pay with cash. There may be some modest benefits to those cardholders who use cards and get some rewards, but I think those benefits are offset dramatically by the costs that all consumers pay, because, again, interchange is paid by all of us because of the way that the system works.

The consumers who don't use credit cards basically subsidize credit card usage by paying inflated products, prices inflated by the $36 billion of dollars of anti-competitive interchange fees paid each year. We present six main points. Again, all consumers, even those who pay with cash, pay more at the store and more at the pump because these interchange fees are passed along in higher costs of goods and services.

The significant increased interchange fees signal a broken marketplace. Visa and MasterCard have tremendous market power. Merchants have no choice but to accept their cards on their terms. It is not surprising that interchange fees have increased significantly, even though costs have gone down and are much higher in the U.S. than in any other country due to these anti-competitive practices. In a competitive market, prices would fall when costs fall.

Third, the card associations' rules prevent merchants from informing consumers about the costs of payment and limit the ability of merchants to direct consumers to the safest, lowest cost, and most efficient forms of payment. I never use a debit card myself. I use an ATM card, but not a debit card. Debit cards are risky when you use them in a signature-based transaction. The rules that protect you are not as good as the rules when they use a credit card, but merchants would prefer you to use an online transaction, the PIN-based debit, but the Visa and MasterCard rules prohibit them from doing so. There are a variety of unfair and deceptive practices that they use to drive you to the higher cost payment, and rewards is simply one of them.

Fourth, neither the card issuance nor the card network markets are competitive. Because of the lax merger policy of the Government regulators, the card issuance market is essentially an oligopoly. Interchange and consumer fees have increased as concentration has increased to enormous levels.

And, finally, I want to point out that interchange is only one problem of this oligopoly of the card networks. The issuing banks have become so concentrated that they are able to engage in a number of unfair practices to consumers. Owning a credit card company issuing credit cards is essentially a license to steal. The top 10 companies now control 90 percent of the market. Their contracts with consumers allow them to change the rules at any time for any reason, including no reason. And consumers are subjected to unfair mandatory arbitration if they want to change or dispute anything on their contract.

You might ask, why would I be talking to you about these practices at the Antitrust Task Force? Well, there are three reasons. First, the industry will suggest the limitless benefits of credit cards. I submit to you that the story of the benefits is far more ambiguous, and I submit to you that the purpose of rewards, for example, is simply to get either merchants to pay more in merchant interchange fees or to get consumers to rack up high-cost credit card debt. And the concentration of the market facilitates these deceptive and onerous practices. The ability of the dominant card issuers to maintain this tight oligopoly is contributed to by these unfair practices.

We urge the Committee to examine closely the competition issues that allow this oligopoly to treat customers so unfairly. In particular, we ask you to question whether DOJ, in approving virtually every recent credit card company merger with no conditions, has adequately reviewed the competition implications of the mergers.

And, finally, we believe these deceptive and anti-consumer practices demonstrate the lack of competition in the card network market. Visa and MasterCard have the ability to prevent many of these unfair practices; they choose not to. About the only rule we know of that they have enforced—and enforced in a bad way, as you will hear from the merchants—is preventing merchants from offering discounts for cash.

So we think that there is a lot of serious problems before the Committee. We are very pleased we have the opportunity to testify on behalf of consumers today. We look forward to your questions.

[The prepared statement of Mr. Mierzwinski follows:]

PREPARED STATEMENT OF EDMUND MIERZWINSKI

Testimony of Edmund Mierzwinski

Consumer Program Director,
U.S. Public Interest Research Group (U.S. PIRG)

On behalf of Consumer Action, Consumer Federation of America
and U.S. PIRG

Hearing On

Credit Card Interchange Fees

Before the Antitrust Task Force
Of the House Judiciary Committee

Honorable John Conyers, Chairman

July 19, 2007

Testimony of Edmund Mierzwinski
Consumer Program Director, U.S. PIRG
On behalf of Consumer Action, Consumer Federation of America and U.S. PIRG
Before the Antitrust Task Force
House Judiciary Committee
July 19, 2007

Chairman Conyers and Ranking Member Chabot, thank you for the privilege for testifying today on the important subject of credit card interchange fees. I am testifying today on behalf of U.S. Public Interest Research Group, Consumer Federation of America, and Consumer Action. As nonpartisan and nonprofit advocates of consumers we welcome the House Judiciary Committee's formation of the Antitrust Task Force and its particular attention to credit card interchange rates. As you know, over 25 years ago Supreme Court Justice Marshall spoke of the importance of the antitrust laws as the "magna carta of economic freedom." Thus, the vigilance of the Committee's Task Force in assuring the aggressive enforcement of the antitrust laws is important to every U.S. consumer.

A primary purpose of our organizations is to advocate on behalf of all consumers for a fair and competitive marketplace. We regularly advocate before state and federal regulators and legislators on both consumer protection[1] and competition policy issues[2] in the credit card marketplace. We recognize that financial service markets work best where there is vigorous competition protected from anticompetitive practices. The work of your Committee in overseeing enforcement of the antitrust laws plays a vital role for this important marketplace.

Today I have a simple message: the deceptive and anticompetitive practices of the two credit card associations – Visa and MasterCard -- have injured both consumers and merchants for many years. Interchange fees are hidden charges paid by all Americans, regardless of whether they use credit, debit, checks or cash. These fees impose the greatest hardship on the most vulnerable consumers – the millions of American consumers without credit cards or banking relationships. These consumers basically subsidize credit card usage by paying inflated prices – prices inflated by the billions of dollars of anticompetitive interchange fees.

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[1] For example, see recent testimony on unfair consumer credit card practices by Edmund Mierzwinski, U.S. PIRG, House Subcommittee on Financial Institutions and Credit, Hearing on "Improving Credit Card Consumer Protection: Recent Industry and Regulatory Initiatives," 7 June 2007; available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/htmierzwinski060707.pdf; testimony of Linda Sherry, Consumer Action, House Subcommittee on Financial Institutions and Credit, Hearing on "Credit Card Practices: Current Consumer and Regulatory Issues," 26 April 2007, available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/htsherry042607.pdf and Travis Plunkett, Consumer Federation of America, Hearing "Examining the Billing, Marketing, and Disclosure Practices of the Credit Card Industry, and Their Impact on Consumers." Senate Banking Committee, 25 January 2007, available at http://banking.senate.gov/_files/ACF4353.pdf

[2] For example, see also see the joint testimony of U.S. PIRG and the Consumer Federation of America, by Edmund Mierzwinski, Consumer Program Director, U.S. PIRG, before the House Committee on Energy and Commerce, Hearing on The Law and Economics of Interchange Fees, Subcommittee on Commerce, Trade, and Consumer Protection, 15 February 2006 available at http://energycommerce.house.gov/reparchives/108/Hearings/02152006hearing1774/Mierzwinski2730.htm .

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

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

It also lacks the information necessary for both consumers and merchants to make informed choices. It lacks adequate information for consumers to detect the fraudulent and exploitative practices of many card-issuers. For merchants, it lacks adequate information because the associations prevent merchants from accurately informing consumers of the costs of credit card acceptance or attempting to direct them to more efficient and lower priced payment mechanisms. Moreover, the banks and associations engage in other deceptive practices to increase the interchange problem. Since the costs of accepting cards are passed on in the overall costs of goods, all consumers – affluent, working-class, and poor – ultimately pay these hidden charges. Low-income Americans, most without bank affiliations, are paying more for goods and services to fund credit card company programs for which they are not even eligible.

We present six main points:

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

Interchange Fees Force Consumers to Pay Higher Prices

The interchange fee system is hidden from consumers and the public. The card associations do not disclose publicly their fees or the basis for these fees. Some public reports maintain that, on average, interchange fees cost merchants 1.6 percent or more of each transaction on a credit or signature debit card. In 2006, credit card interchange fees alone cost merchants and consumers an estimated $36 billion.

Like all other costs incurred by merchants, interchange fees are included – at least in part – when pricing goods and services. Card associations may suggest that interchange fees fund attractive rewards programs. Setting aside the question of the value of these programs, many consumers with credit cards do not use them and those without credit cards receive no benefits.[3] Over 27 percent of Americans do not have credit cards. For these consumers, interchange fees are especially pernicious and regressive.[4] These low-income Americans subsidize interchange fees for "services" that they are not eligible to use. No charge could be as regressive as one in which low income consumers receive no benefits.

The regressive nature of this charge is exacerbated because interchange fees are assessed as a proportion of overall sales. For example, when gas prices averaged $1.87 per gallon in 2004, interchange fees totaled about $12.5 million per day. In 2005, gas prices averaged about $2.75 per gallon nationally: credit card companies then made $18.4 million a day. These companies made an additional $2.2 billion dollars per year simply because of rising gas prices.[5] This problem will increase if gas prices continue to increase. It is difficult enough for low and moderate income consumers to afford skyrocketing gasoline prices without having to pay additional fees that are passed on to them.

Increases in Interchange Fees Signal a Broken Market

Credit card interchange fees were intended to compensate card-issuers for certain costs, such as the costs of issuance, fraud, risk of loss, float and processing. Yet as all these costs have decreased in the past decade credit card interchange fees have increased. According to the Food Marketing Institute (FMI), these fees have increased over 20 percent in the past few years even though all the costs of card processing and issuance have fallen. The United States appears to be the only country in which credit card interchange fees are increasing and it has far higher fees that almost any other industrialized country. FMI projects that these fees will increase 22 percent annually.[6]

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[3] We seriously doubt consumers receive anything close to $36 billion in benefits through rewards programs. Some of the interchange fees undoubtedly fund industry marketing efforts, such as the more than 8 billion annual mail solicitations consumers receive 9source CardTrak.com) for credit cards. Moreover, credit card issuance is a tremendously profitable line of business.

[4] U.S. Census Bureau, *Statistical Abstract 2006*, Table 1176.

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

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

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

In the Justice Department case against Visa and MasterCard, the Court determined that both associations had market power because merchants were compelled to accept these cards even in the face of a significant price increase. Almost all merchants are forced to accept Visa and MasterCard's terms, no matter what the interchange rates or contractual terms. Armed with this market power, credit card companies can, and do, increase interchange fees without suffering any repercussions.

Are these substantial interchange fees necessary? Examples outside the United States suggest this is not the case. In other countries, interchange rates are about one-third less than they are in the United States. In the United Kingdom, merchants pay about 0.7 percent. After a government mandated reduction in interchange fees in Australia from 0.95 to 0.55 percent, Australians saved over $300 million US per year.[7] In Australia, the reduction in interchange fees ultimately benefited consumers in the reduction of card costs, greater innovation, and greater competition leading to lower interest rates. At worst, there has been some reduction in rewards programs offered, but these programs only benefit some users.[8] In the United States, where interchange fees are considerably higher, the potential savings for each consumer would be far greater.

Another example is the debit market in Canada. In that market, there are no interchange fees. Even without interchange, there is higher debit card usage and merchant acceptance than in the United States. Some consumers pay direct fees for debit card use but because those fees are transparent there is active competition to reduce those fees. Ultimately everyone in Canada pays less for the cost of payment services.[9]

Deceptive Practices Increase Prices for Consumers

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

First, Visa and MasterCard rules prevent merchants from disclosing fees to their customers or attempting to steer consumers to lower-priced payment options, such as cash or

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[7] "An Interchange Tussle With a Twist: Retailers Against Zero Pricing," *Digital Transactions*, September 10, 2004.
[8] Some banks have also increased annual fees, however, the overall cost of credit cards in these countries is lower than in the U.S.
[9] Gordon Schnell and Jeffrey Shinder, "The Great Canadian Debit Debate," *Credit Card Management*, May 2004. http://www.constantinecannon.com/pdf_etc/TheGreatCanadianDebit.pdf.

online debit cards. They cannot charge a distinctive price or surcharge based on payment options. They cannot attempt to direct consumers to lower cost options such as cash, checks and online debit.[10]

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

This lack of disclosure is especially problematic with the recent efforts of the card associations to "convert" cardholders from regular credit cards to so-called "premium cards" such as the Visa "Signature" or the MasterCard "World" cards. These cards have a significantly higher interchange fee than traditional cards, among the highest of all interchange fees. For example, a premium card may cost merchants well over 2.0 percent compared to 1.6 percent for a traditional card. These premium cards focus only on the highest-income consumers. However, they offer minimal additional benefits. Consumers do not realize they pay higher prices on goods and services with a premium card and are wholly unaware of how converting to a premium card will ultimately cost all consumers more. Nor, as stated above, can merchants refuse to accept these cards or attempt to direct consumers to lower priced cards through differential pricing. These premium cards are simply a scheme to substantially increase hidden interchange fees.

Third, although merchants can't surcharge or use differential prices to direct consumers to the most efficient and lowest priced payment options, banks do have that power. Not surprisingly, they use it to direct consumers to less efficient, higher cost options. The debit card market illustrates this problem. Signature based debit is more expensive and less secure than online debit because online debit transactions are instantaneous. Online debit has a far lower rate of fraud. Online debit transaction interchange fees are capped at fixed levels; they only cost merchants between $0.17 and $0.50 per transaction.[11] Conversely, credit and signature debit cards cost merchants up to 2% of the entire transaction, no matter how large. Instead of promoting online debit which is safer and less costly, banks increasingly surcharge consumers seeking to make these transactions with penalty fees of as much as 50 cents a transaction.[12]

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[10] We note that the standard canned industry response is that "nothing in our rules prevents cash discounts from being offered." But requiring that there be separate price markings for each product with the higher interchange price and the lower cash price makes cash discounts very hard to offer. Fuel is a relatively simple example, but even there with a variety of different octane grades and products (gasoline, diesel, etc.) card association rules can make discounting more difficult than it ought to be. And if it is difficult for fuels, imagine the logistical difficulties created for offering cash discounts at a convenience store with a thousand different items, let alone a grocery store with thousands of different items for sale. The card associations may not technically prohibit cash discounts, but they do what they can to make sure it doesn't happen very often.

[11] November 2004, Federal Reserve Board, Report to the Congress on Disclosure of Point-of-Sale Debit Card Fees, See Figure 4, page 14 available at http://www.federalreserve.gov/boarddocs/rptcongress/posdebit2004.pdf (last visited 17 July 2007).

[12] A 2003 NYPIRG report found that 89% of the banks surveyed assess a fee for online debit PIN-based transactions. The average fee assessed is 70¢. The fees ranged from 10¢ to $1.50. See "Pricey Plastic: A NYPIRG Report and Survey of Plastic Card Fees," 2003, available at http://www.nypirg.org/consumer/cards/debit.html (last visited 18 July 2007). While a Federal Reserve study found substantially lower numbers of banks imposing PIN debit fees, it found fees in the same range: "At sampled institutions that charge fees for PIN debit, the fees range

Consumers are paying more for a less safe and more costly product. These penalties effectively steer consumers to the less efficient, less secure, more costly signature debit product. While the use of online debit cards is the best option for both consumers and merchants, deceptive and manipulative tactics ensure the most expensive payment possible is used.

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

Increased Consolidation of Card-issuing Harms Consumers

The credit card issuing market has become significantly more concentrated over the past few years as numerous card issuers have merged. For example in the past few years we have seen mega-mergers such as Bank of America's acquisitions of Fleet and MBNA. The top ten card issuers now have over 90% of the market, and the level of concentration has increased from an HHI of about 1100 in 1998 to an HHI of over 1800 today, a level that the Department of Justice Merger Guidelines define as highly concentrated. Unfortunately the Department of Justice has not challenged any of these mergers and there is little to suggest that concentration in this market will not continue to increase dramatically.

Of course, we expect the card associations and their members to suggest that the credit card issuance market is unconcentrated and vigorously competitive.[13] But the facts are to the contrary. There have been numerous antitrust suits alleging that card issuers and the associations have colluded over fees, exchange rates, and important contractual terms.[14] While concentration has increased dramatically over the past seven years, interchange fees, other fees charged to consumers, deceptive practices, and interest rates have increased significantly. Although the parties to these mergers suggested that there would be significant efficiencies from these mergers, consumers have seen few, if any, benefits. After years of consolidation the bad news for consumers is clear: an oligopolistic market which is a fertile environment for collusion, higher prices, more hidden fees, and more deceptive practices.

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from roughly $0.10 to $2.00 per transaction (figure 5). The median (and mean) fee is approximately $0.75." See "Report to the Congress on the Disclosure of Point-of-Sale Debit Fees," November 2004, Federal Reserve Board of Governors, available at http://www.federalreserve.gov/boarddocs/rptcongress/posdebit2004.pdf (last visited 18 July 2007).

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

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

The Credit Card Oligopoly Also Allows Issuers To Use Anti-Consumer Practices Against Cardholders

In recent testimony by each of our organizations to the banking committees of the two Houses, we describe a series of egregious practices conducted by card issuers against their cardholders. These practices, include the use of punitive penalty interest rates, imposition of questionable late and over-the-limit fees, manipulation of teaser rates, and other practices designed to increase and extend high-cost credit card debt to consumers. In our testimony we documented the seduction of vulnerable populations including youth and recent immigrants into acquiring credit cards. We set forward the practice of using certain contractual terms in the issuers' one-sided contracts with consumers, including a clause asserting the right to "change the rules at any time for any reason, including no reason," and a clause subjecting cardholder disputes to extra-judicial binding mandatory arbitration.[15]

As a result of its ability to engage in these practices, the credit card industry, already the most profitable form of banking according to Federal Reserve Board annual reports to Congress, has seen its profits grow to new heights on the wings of revenue derived from punitive APRs of 32% or more, imposition of late and over-the-limit fees of up to $39 issued on a repeat basis for violations that may not have been violations and from deceptive disclosures of the true cost of credit, which encourage the most at-risk segment of the customer base to carry large unpaid balances at unaffordable interest rates. Numerous credit card complaints to us allege that companies raised rates when bills were paid on time. Others allege that rate increases were due to alleged late payments to someone else; yet, the banks have told other Congressional panels that they do not engage in this practice, known as universal default.

To elaborate, the most common unfair credit card issuer practices include the following:

- Unfair and deceptive telephone and direct mail solicitation to existing credit card customers – ranging from misleading teaser rates to add-ons such as debt cancellation and debt suspension products, sometimes called "freeze protection," which are merely the old predatory product credit life, health, disability insurance products wrapped in a new weak regulatory structure to avoid pesky state insurance regulators;[16]
- Increasing the use of unfair penalty interest rates ranging as high as 30-35% APR or more, including, under the widespread practice of "universal default," imposing such rates on consumers who allegedly miss even one payment to <u>any</u> other creditor, despite a perfect payment history to that credit card company;
- Imposing those punitive penalty interest rates retroactively, that is on prior balances, further exacerbating the worsening levels of high-cost credit card debt;

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[15] Last week, Rep. Hank Johnson (D-GA), a member of this Committee, and several other Committee members, introduced important legislation, HR 3010, the Arbitration Fairness Act, to amend chapter 1 of title 9 of United States Code with respect to unfair use of mandatory arbitration in a variety of consumer, small business and employee contracts. We encourage the Committee to act favorably on this proposal, which is supported by a variety of civil justice, consumer, small farmer and other organizations. Companion Senate legislation, S. 1782, was introduced by Senator Russ Feingold (D-WI).

[16] See an Office of the Comptroller of the Currency (OCC) regulatory interpretative letter endorsing debt cancellation and debts suspension products at http://www.occ.treas.gov/interp/jan01/int903.doc

- Imposing higher late payment fees, which are often levied in dubious circumstances, even when consumers mail payments 10-14 days in advance;
- Using a variety of mail trickery, such as changing the due dates of monthly bills, making the due date a Sunday but not posting on the weekend; shortening the period between when a bill is mailed out and when that bill is due, etc;
- Increasing the use of aggressive and deceptive marketing to new customer segments, such as college students with neither a credit history no an ability to repay and to persons with previous poor credit history;
- Making partnerships with telemarketers making deceptive pitches for over-priced freeze protection and credit life insurance, roadside assistance, book or travel clubs and other unnecessary card add-ons;
- Imposing unfair, pre-dispute mandatory arbitration[17] as a term in credit card contracts to prevent consumers from exercising their full rights in court; and the concomitant growing use of these arbitration clauses in unfair debt collection schemes;
- The failure of the industry to pass along the benefits of what, until recently, were several years of unprecedented the Federal Reserve Board interest rate cuts intended to provide economic stimulus, through the use of unfair floors in credit card contracts; and
- Using the clause "Any term can be changed at any time for any reason, including no reason" in credit card contracts as allowed by Delaware and other safe harbor state laws.

You may ask why we are raising these practices before an Antitrust Task Force. There are three reasons. First, the representatives of the card industry will suggest the manifold, almost limitless benefits of credit cards. We think this Committee should recognize that the story of benefits is far more ambiguous.

More important, the oligopolistic market structure of the card-issuance market facilitates these deceptive and onerous practices. The ability of these dominant card-issuers to impose these terms is derived from the tight oligopoly that the largest issuing firms maintain in the marketplace. We urge the Committee and its Antitrust Task Force to examine closely the competition issues that allow this oligopoly to treat customers so unfairly. In particular, we urge you to question whether the Department of Justice, in approving every recent credit card company merger with no conditions, has adequately reviewed the competition implications of the mergers.

Finally, we believe these deceptive and anticonsumer practices demonstrate the lack of competition in the card network market. Visa and MasterCard have the ability to prevent many of these practices through their regulation of card-issuers. Yet these associations -- that are aggressive in regulating merchants (e.g., preventing them from offering cash discounts) -- seem rather timid when it comes to restricting the deceptive practices of their bank members. If there was active competition in the card network market one would expect Visa and MasterCard would compete in trying to self-regulate and stop these anticonsumer practices. Similarly, if there were not substantial entry barriers one might expect a more consumer friendly card

[17] The consumer organizations testifying today, and many others are all members of a broad campaign to educate the public and the Congress about the need to eliminate one-sided binding mandatory arbitration (BMA) clauses in consumer contracts. See http://www.givemebackmyrights.org/

network to arise. But the dominance of Visa and MasterCard and the substantial entry barriers effectively protect these deceptive and anticonsumer practices.

Conclusion

In his testimony last year on behalf of the Electronic Payments Coalition, Timothy Muris alleged that "[i]f consumers understood the threat that the merchants' campaign [against interchange] poses to the plastic in their wallets, I suspect that we would see nothing less than a revolt." He could not have been more wrong. If consumers understood the existence or the dimensions of the hidden fees assessed by the banks and associations, they would truly rebel. Credit card companies make billions of dollars each year through interchange fees, which ultimately all consumers must pay, including the millions of Americans without credit cards. The credit card market lacks the critical foundations of healthy competition – choice and adequate information. As consumer advocates, we are gravely concerned about the fairness and legality of bank schemes to increase credit and debit card fee income. We urge your Task Force to suggest that we follow in the steps of the Australian government and the European Union in carefully investigating interchange fees. We look forward to working with you in protecting consumers from anticompetitive tactics in this vital market.

Thank you for considering this testimony. I welcome your questions.

APPENDIX: Background on the groups

US PIRG

The United States Public Interest Research Group (U.S. PIRG) serves as the federal lobbying office for the state PIRGs. State PIRGs are non-profit, non-partisan consumer, environmental and good government watchdog groups with over 500,000 members around the United States. U.S. PIRG places a special emphasis on predatory financial practices and financial education and maintains a website at www.truthaboutcredit.org for consumers to obtain non-partisan information and fact sheets about credit card company practices. Recent major PIRG reports on credit card practices include the following: Graduating Into Debt: A Survey of On-Campus Credit Card Marketing In Maryland (2004); Deflate Your Rate: How To Lower Your Credit Card APR (2002) and The Credit Card Trap: How To Spot It, How To Avoid It (2001). www.uspirg.org

Consumer Federation of America

The Consumer Federation of America is non-profit organization of approximately 300 organizations (representing 50 million individuals) that, since 1968, has advanced the consumer interest through research, advocacy, and education. Comprised of approximately 300 nonprofit organizations from across the nation and more than 50 million individuals, CFA has been the voice of consumers since 1968. CFA is particularly concerned about issues affecting low and moderate income consumers. www.consumerfed.org

Consumer Action

Consumer Action is a national non-profit advocacy and education organization designed to serve consumers through the advancement of consumer rights. Founded in 1971, Consumer Action has built its reputation based on its multilingual education and advocacy efforts, particularly in the fields of credit, banking, privacy, insurance, and utilities. Along with its advocacy programs, Consumer Action provides educational and technical assistance to more than 9,000 community – based and government agencies in order to ensure access to consumer education. Staff and leaders of Consumer Action are often called upon by the media to provide expert commentary on consumer-based issues. Consumer Action also operates The National Consumer Resource Center (NCRC), which educates and informs clients about current consumer issues. Consumer Action conducts an annual survey of credit card practices. www.consumer-action.org

Mr. CONYERS. Thank you very much.

Our next witness is counsel for O'Melveny and Myers, Mr. Timothy Muris, esquire. He has had a lot of experience here defending these companies, and he is a former chairman of the Federal Trade Commission. And he served also on the Advisory Panel on Federal Tax Reform.

So we welcome you to our Committee hearing and invite you to proceed, sir.

TESTIMONY OF TIMOTHY J. MURIS, OF COUNSEL, O'MELVENY & MYERS

Mr. MURIS. Thank you much, Mr. Chairman.

May I submit for the record my written testimony and a law review article I recently wrote?

Mr. CONYERS. Yes, all the testimony is incorporated in the record, including your law review article.

Mr. MURIS. Thank you, sir.

I personally advise Visa on antitrust and consumer protection, but the views that I express today are my own. Let me make four points: First, payment cards benefit both consumers and merchants. Cards rank with the cell phone, microchip, and personal computer as one of the last century's great inventions. The simplicity of pulling a card from your wallet or purse, however, belies an extraordinarily complex technological infrastructure that supports these transactions. It cost billions of dollars to create and allow the transactions to occur securely, reliably and efficiently.

Second, payment cards are an example of a two-sided product connecting two groups of consumers. The challenge for any two-sided product is bringing both groups on board. Newspapers illustrate how most two-sided products set prices. This is today's Washington Post. Now, in a business sense, this is a vehicle to connect readers and advertisers. The readers, in fact, pay very little. The publishers get their money from the advertisers. If newspapers charged readers the direct cost of supply, they would lose many of them. Without enough readers, there wouldn't be enough advertisers. Without both sides of the market working, not as many consumers would enjoy their newspaper, and advertisers would lose benefits of this medium.

The economics of attracting the two distinct groups drives the pricing. The value of the two-sided product to one group is determined by its attractiveness to the other. The group with the low-cost substitutes—in this case, its readers, who can go a lot of other places for their news and information—gets the better deal. For payment cards—this is my Visa card—the consumer is king.

To compete with the two historically dominant forms of payment, cash and check, the payment cards are priced to provide value to the cardholders. The industry has followed this model from its inception. Originally, the merchant discount, the amount that the merchants paid, was 7 percent; today, the average discount on American Express is about 2.5 percent, while Visa and MasterCard, larger companies, charge about 2.1 percent. Discover charges about 1.5 percent.

Consumers and merchants clearly benefit. Walk into a McDonald's, and you can now swipe your card to purchase a meal. Nobody

made McDonald's take the payment cards, but instead it found that the cards offered value for a price it was willing to pay.

My third point is that merchants are wrong to analogize interchange to cartel price-fixing. Unlike a cartel, a four-party payment card system cannot exist without interchange. A default rate reduces the cost of negotiating separate fees between the thousands of acquirers and issuers. Moreover, for MasterCard and Visa to succeed, merchants need to honor cards from each of the thousands of issuers. Knowing that all cards must be honored, an individual issuer could then insist on very high fees. Merchants would then be subject to higher costs and would be less willing to accept the network. A default interchange rate, which the payment networks set, avoids this problem.

The difference between the payment card systems in a cartel is stark. With cartel pricing, an end to the cartel lowers prices, raises output, and increased innovation. The end of interchange produces the opposite results and would lead to chaos. The merchants understand this. They don't want interchange to end; instead, they just want to pay less. While they argue against the card systems setting their respective interchange rates, this is exactly what they want the Federal Government to do.

This is not an antitrust remedy. One of the fundamental maxims of antitrust is that the market, not the Government, should set prices. Indeed, reasonableness is never a defense to price-fixing. Interchange began with Visa decades ago. Bank of America started a three-party payment system in California. Because banks could then not cross State lines, the bank tried to franchise its system outside of California with no takers. It spun off the system, renamed it Visa, and Visa then began interchange long before Visa had any significant market share.

My final point is that we are here primarily because merchants want to cap the rates they pay for payment cards. Such caps would inevitably increase card prices to consumers, just as if you reduced the amount advertisers paid for newspapers. The merchants' effort to regulate prices, therefore, poses a direct threat.

Despite what you have heard, most consumers know that merchants pay when consumers use their cards. If consumers understood the threats that the merchants' campaign poses to their wallets, the cards in their wallets, I suspect that we would see nothing less than a consumer revolt.

I understand the full fury of the aroused American consumer. While chairman of the FTC, we created the National Do-Not-Call Registry. I suspect that many Americans feel as strongly about their plastic as they do about their dinner hour.

Thank you very much, and I would be happy to respond to questions.

[The prepared statement of Mr. Muris follows:]

PREPARED STATEMENT OF TIMOTHY J. MURIS

TESTIMONY OF

TIMOTHY J. MURIS

FOUNDATION PROFESSOR OF LAW,
GEORGE MASON UNIVERSITY SCHOOL OF LAW,
AND OF COUNSEL,
O'MELVENY & MYERS LLP

Before the United States House of Representatives
Committee on the Judiciary
Antitrust Task Force

HEARING ON

"CREDIT CARD INTERCHANGE FEES"

Thursday, July 19, 2007

2:00 p.m.

2141 Rayburn House Office Building

INTRODUCTION

Chairman Conyers, Ranking Member Chabot, and Members of the Task Force, thank you for allowing me to discuss the subject of electronic payments. For the last forty years, innovation in the payment industry has delivered substantial benefits to more than 100 million U.S. consumers, nearly 7 million merchants, thousands of financial institutions, and the U.S. economy as a whole, and I am pleased to be here today to discuss these issues with you.

My name is Timothy J. Muris. I am George Mason University Foundation Professor of Law and was Chairman of the Federal Trade Commission from 2001-2004. Although I advise Visa on antitrust law, including issues relating to the setting of interchange fees, the views that I express today are my own.

In testifying here today about interchange, I do not anticipate breaking new ground. This is the third Congressional hearing devoted to the subject in the last few years. In that time, three regional Federal Reserve banks, two law schools, and the AEI/Brookings Joint Center for Regulatory Studies have hosted conferences on interchange. Reflecting the prominence of electronic payment systems in our economy, numerous academics and scholars also have examined the issues we are discussing today.[1]

I want to make one overarching point. The electronic payment system in the United States links more merchants and more cardholders than any other payment system in the world. Proof that the system delivers value to both merchants and cardholders can be found in the fact that a large number of new merchants and new cardholders join the system each year. Last year,

[1] There is a voluminous literature on payment cards and the underlying economics, to which I've contributed. *See* Timothy J. Muris, *Payment Card Regulation and the (Mis)Application of the Economics of Two-Sided Markets*, 2005 COLUM. BUS. L. REV. 515 (2005).

Visa and MasterCard reported 600,000 new merchant outlets on their networks. Discover added more than 1 million new merchant locations in 2004. Meanwhile, cards in force grew by approximately 28 million on the Visa network and 34 million on the MasterCard network.[2] In addition, emerging players such as Pay-by-Touch, Tempo Payments, and OboPay, and new platforms such as mobile payments, demonstrate a healthy marketplace with new entry and competition.

The debate over interchange poses a real threat to these systems and the many consumers, merchants, and financial systems that value them. Critics, including the merchants pursuing class action litigation over interchange in federal court in Brooklyn, want the federal government to impose price controls. I have been through this exercise before, and I strongly suspect that the merchant representatives testifying here today will disclaim any desire for price controls. Nevertheless, the protracted struggle over interchange is simply a fight about whether the federal government should set the rates that merchants pay to accept electronic payments.

With that said, I would like to make five points:

1. Electronic payments deliver extraordinary value to consumers, merchants, and society as a whole.
2. Visa and MasterCard use interchange to deliver an attractive product to cardholders and merchants.
3. Interchange drives innovation in the system.
4. Interchange does not violate the antitrust laws.
5. If the federal government caps interchange, consumers will be hurt.

[2] Nilson Report, *General Purpose Cards—2006* 8 (Feb. 2007).

I. EXTRAORDINARY VALUE OF ELECTRONIC PAYMENTS

The plastic payment cards that we carry in our wallets reflect a global electronic payment system. In 2006 in the United States alone, the four major payment card networks—Visa, MasterCard, American Express, and Discover—processed more than 38 billion transactions. All general purpose-type credit, debit, and stored value cards issued in the United States generated $2.733 trillion in spending. This payment system was one of the great innovations of the 20th century, and it continues to evolve in tandem with other innovations such as the Internet and wireless technology. Although we take it for granted now, it has changed people's lives as profoundly as cell phones, personal computers, and microprocessors.

A. CONSUMERS BENEFIT FROM ELECTRONIC PAYMENTS

As consumers, we are all quite familiar with the benefits that payment cards and electronic payments provide. Payment cards enable us to get instant access to deposit accounts and bank-supplied credit virtually anywhere in the world at any time. Using payment cards, we can buy from merchants we have never met, located in places we have never visited. Payment cards offer consumers reduced risk of theft, better management of expenses, improved recordkeeping, float for those who do not revolve balances, and reward programs. Payment cards provide consumers with flexibility in how to pay for purchases. Using a payment card, a consumer can draw on a line of credit, access ready funds in a demand deposit account, or pay with funds set aside in advance of a particular transaction.

This last category of cards is known as "stored value cards." They constitute one of the fastest growing products in the entire financial services industry, and reflect the continued innovation of the industry. Stored value cards give lower-income households, which generally do not have access to traditional banking products, a more efficient and safer way to pay for

purchases. Employers such as Sears have begun to give employees the option of receiving their paychecks through stored value cards. Such cards enable employees to access their funds without paying the high fees charged by check cashing stores. Federal, state, and local governments also have begun to study stored value cards as an alternative way to distribute government benefits.

Payment cards frequently offer consumers access to better credit terms than they can get elsewhere. Those who scoff at this use of plastic frequently do not need credit or are wealthier individuals with better credit options than many Americans. But for consumers who do not own a home or have sufficient equity in their home, credit cards typically offer the best credit terms available. Credit cards are clearly superior to and less expensive than traditional forms of credit such as pawnshops, payday lenders, and borrowing money from family and friends. In the first quarter of 2007, the average annual percentage rate on a credit card account was 13.41 percent.[3] Personal-finance company loans typically have higher rates and larger up-front fees than the credit lines associated with payment cards.

The argument that credit-card debt is overused is simply misplaced. The use of revolving credit reflects almost entirely an offsetting decline in installment credit, such as from personal-finance companies and retail stores. From 1970-1995, installment credit fell steadily, offsetting the rise in revolving credit. Since 1995, revolving credit as a percentage of disposable personal income has been largely constant.

[3] U.S. Federal Reserve, *Consumer Credit* (July 2007) (available at http://www.federalreserve.gov/releases/g19/current/default.htm) (last accessed July 12, 2007).

B. Merchants, Businesses, Governments, and Financial Institutions Also Benefit from Electronic Payments

The benefits of electronic payments are not limited to consumers. Although their protestations might indicate otherwise, merchants benefit as well. Electronic payment systems move funds more quickly, reliably, and efficiently than paper-based systems. By accepting Visa, MasterCard, American Express, and/or Discover, a boutique clothing store in downtown Dearborn can offer its customers access to the same payment terms available when they shop at a Target or a Wal-Mart. Payment cards speed checkout lines and offer record keeping features for merchants that paper-based systems like cash and checks simply cannot match. New merchants are added to the system almost daily, and the networks are constantly innovating to address the needs of entire merchant segments. Walk into a McDonald's or Subway now and you can swipe your payment card to purchase a meal. Just a few years ago, few if any quick service restaurants accepted cards. They were not coerced into accepting, and they clearly were having no difficulty accepting just cash. They began accepting cards because the payment systems offered a valuable service, efficiency and convenience, for a price they were willing to pay.

Payment cards and the electronic payment system that they represent have made it possible for whole new forms of commerce to emerge. The symbiotic relationship between the Internet and electronic payments is the most obvious example. According to the Census Bureau, Internet sales topped $108 billion in 2006.[4] Payment cards accounted for more than 90 percent of those purchases. Automatic fuel dispensers and self-check out lines at grocery stores provide still other examples of the growing benefits we receive from payment cards.

Commercial enterprises and governments also benefit from the use of electronic payment cards in place of paper-based payment alternatives. Companies and government agencies, of

course, accept payment cards and enjoy the substantial benefits associated with card acceptance. They have also begun to use payment cards to reduce the costs of managing purchases and other expenses. Such programs are known as commercial card programs. These programs offer companies and government agencies tools to monitor and control purchases and expenses. They facilitate compliance with audit requirements, enable more efficient transmission of transaction data, and can be integrated into electronic accounting systems.

The U.S. General Services Administration runs the largest government commercial card program. GSA has contracted with five financial institutions to provide corporate card services to 350 agencies in the federal government. In 2004, GSA-sponsored corporate cards generated 26.5 million transactions. GSA estimates that each commercial card transaction saved the government $53.77 in administrative expenses. According to GSA, its commercial card program saved U.S. taxpayers $1.4 billion in 2004 alone.[5]

Financial institutions benefit from electronic payment systems as well. Electronic payment systems allow small banks to compete with larger, more established banks. Every retail financial institution in the United States, from local credit unions to community banks to Citibank, has access to the major payment systems. Literally thousands of financial institutions depend on payment cards to provide their customers' access to ATMs, checking accounts, and lines of credit. By signing on to systems such as Visa and MasterCard, a credit union or community bank can provide its customers access to services just as sophisticated as those offered by the most sophisticated financial institutions in the country.

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[4] U.S. Census Bureau, *Quarterly Retail E-Commerce Sales 4th Quarter 2006* (February 2007) (available at http://www.census.gov/mrts/www/data/html/06Q4.html) (last accessed July 3, 2007).

[5] U.S. Government Services Administration, *Executive Summary for GSA SmartPay Program* (available at http://www.gsa.gov/Portal/gsa/ep/programView.do?pageTypeId=8199&ooid=11490&programPage=%2Fep%2Fprogram%2FgsaDocument.jsp&programId=10137&channelId=-13503) (last accessed July 12, 2007).

These benefits are not mere conveniences. The advantages of electronic payment systems relative to cash and check may seem small if assessed for one transaction, but they quickly add up when multiplied by the billions and billions of transactions that make up the national economy. The enormous societal benefits of payment cards are built on an extremely sophisticated and complex technological infrastructure that ensures rapid, secure, and reliable processing of electronic transactions worldwide. This efficient system of settling transactions is possible only because of the investment of billions of dollars made by electronic payment providers such as Visa, MasterCard, American Express, Discover, First Data, and Metavante in developing and improving electronic payment offerings.

II. PAYMENT SYSTEMS MUST APPEAL TO CONSUMERS AND MERCHANTS

While no one seriously disputes the many advantages to society of electronic payments, some merchants believe that they pay too much to accept electronic transactions. They focus their criticism on the mechanism known as interchange. They claim that interchange is a "price fix," and they want the federal government to assume responsibility for setting interchange rates. This criticism is fundamentally flawed and completely mischaracterizes the role that electronic payment systems play in facilitating transactions between merchants and cardholders.

Payment card systems are a leading example of what economists and antitrust lawyers call two-sided products. A basic understanding of the economics of two-sided products illustrates why the attack on the setting of interchange is flawed, not just as a matter of antitrust law and policy, but of broader public policy as well. The challenge for the operator of any two-sided product is bringing both sides on board. As an article in the Harvard Business Review

observed last fall,[6] many of the products and services that define modern life face this same problem. PC Operating Systems, Yellow Pages, advertiser sponsored media (*e.g.*, newspapers, magazines, broadcast radio), shopping malls, financial exchanges, and payment cards are all examples of two-sided products.

The pricing strategy employed by many newspapers illustrates how two-sided products actually set their respective prices. Newspapers and other advertiser-sponsored media bring together two distinct groups of customers, readers and advertisers. Readers of newspapers pay little or nothing to enjoy the benefits. Instead, publishers collect the vast bulk of their revenue from advertisers. If a newspaper charged readers a price based solely on the direct marginal costs of supplying readers with each edition, it would likely lose readers who, after all, have many other options. Without enough readers, there will not be enough advertisers. The two sides need to be managed in balance, and enterprises who do so effectively will attract more customers on both sides.

For payment card systems, the two groups of customers are cardholders, who want access to the financial resources to make purchases anywhere at any time, and merchants, who want to supply those cardholders with goods and services. A successful payment card system needs to attract enough cardholders to make the system appealing to merchants and, simultaneously, attract enough merchants to make the system appealing to cardholders.

As it turns out, bringing both merchants and consumers on board is no easy feat. The first payment card system, a three-party system operated by Diner's Club, solved this problem by giving cards to consumers and by persuading restaurants to accept guaranteed transactions from its cardholder base in exchange for a small fee on the transactions. Today, American Express

[6] Thomas Eisenmann, Geoffrey Parker, & Marshall Van Alstyne, *Strategies for Two-Sided Markets*, HARV. BUS. REV. (Oct. 2006).

and Discover continue to follow this model. These networks offer considerable benefits to cardholders at low or even negative prices when considering the benefits of float and reward programs, and they charge merchants a fee on each transaction.

Although the effect on consumers is identical, Visa and MasterCard's interchange mechanism operates somewhat differently. The differences are a direct legacy of Visa's very different origins as a payment system. Bank of America launched the predecessor to the Visa system in Fresno, California in 1958. At the time, federal law prohibited Bank of America from operating across state lines. To create a national system to rival American Express and Diner's Club, Bank of America needed other financial institutions to participate. When a cardholder of one financial institution—called an issuer—uses a card at a merchant signed by another financial institution—called an acquirer—matters are more complicated than in the three-party systems like American Express. The issuer has the right to collect from the cardholder but has no relationship with the merchant. The acquirer has the obligation to pay the merchant but no right to collect from the cardholder. For a four-party payment card system to work, the issuer needs to pay the acquirer for the obligation incurred by the issuer's cardholder.

Originally, Bank of America mimicked the mechanism used by American Express and Diner's Club. Bank of America promised the financial institution that issued the card the entire amount of the discount fee collected from the merchant on the other side of that transaction. In the mid-1970s, the newly formed Visa replaced Bank of America's rule with a fee paid by the merchant bank to the card issuing bank. This fee was known as the Interchange Reimbursement Fee or just "interchange." The fee was designed to compensate both issuers and merchant banks for their role in making the system work. Merchant banks kept the discount fee that they charged their customers, less the new interchange fee they paid to issuers.

As a practical matter, the Visa and MasterCard systems would not work without some kind of interchange mechanism. Each of the two systems has approximately 6,000 card issuers and several hundred merchant banks. To replicate the existing interchange systems through individual contracts, participants in the two systems would need to negotiate more than 1 million contracts. With a standardized set of default interchange rates, Visa and MasterCard can eliminate the transaction costs of negotiating separate interchange fees between acquirers and issuers.

Moreover, for Visa and MasterCard to succeed as "brands," merchants need to honor cards from each of the thousands of issuers. Otherwise, consumers would not be guaranteed their "Visa" or "MasterCard" would be accepted widely. Knowing that all cards must be honored, individual issuers could insist on very high fees for their payment cards. Merchants would then be subject to those high fees and would be less willing to accept the cards. A default interchange avoids this problem. Without this interchange fee, issuers and acquirers would have no practical way to exchange transactions.

For payment card systems, at least at present, the consumer is king. Although merchants decide which payment forms to accept, consumers typically decide the payment form to use on a particular transaction. Payment card systems continue to face competition from two historically dominant forms of payment, cash and check, that the federal government subsidizes and that generally carry a low marginal cost to use. To compete, payment card systems have settled on a pricing strategy that directs substantial value to cardholders (e.g., cash-back, rewards, a grace period, and low revolving rates) at no explicit price per transaction. Merchants are charged on all sales transactions.

The role of interchange in providing benefits to consumers is crucial to understand. When interchange increases, cardholders benefit. Because of intense competition between the many banks that issue payment cards to consumers, "higher" interchange revenues to issuing banks result in increased benefits for users of payment cards, such as increased rewards and lower fees. These benefits come not only in the form of airline miles on high-end credit cards. They include the rebates that the federal government enjoys on the purchasing cards used by the GSA, as well as the rebates that corporations receive from corporate card usage, the low or no fee demand deposit accounts offered by many financial institutions, and the relatively favorable terms on which card issuers currently extend credit to millions of consumers.

Visa and MasterCard set interchange mindful of the need to attract merchants as well as cardholders. If interchange fees move too high relative to the value provided to merchants, merchants will stop accepting the cards or otherwise discourage consumers from using them. If merchants reject the cards or discourage their use, consumers will experience fewer payment options. Likewise, if interchange fees fall too low, financial institutions will turn to other payment systems that provide more revenue per transaction, and consumers will pay more for the cards, receive fewer benefits, and suffer from decreased card availability. As the number and attractiveness of these payment cards fall, merchants will stop accepting the cards. Either way, volume drops, and consumers would lose.

The industry has followed this pricing model from its very inception, before ***anyone*** could credibly argue that ***any*** payment card system had ***any*** conceivable market power. When Frank McNamara kicked off the payment card revolution in 1948 with the introduction of the Diner's Club card, he set the merchant discount on that three-party system at 7% of each transaction. The evolution of the industry from a travel-and-entertainment card carried by

businessmen and accepted at exclusive restaurants and hotels has pushed fees ever lower. Today, the average merchant discount fee on the American Express system is approximately 2.5%, while the system-wide merchant discount on the Visa and MasterCard systems is about 2.1%. Discover has the lowest discount, about 1.5%. The fact that the larger system, Visa, as measured by everything from merchants to cardholders to volume, has a lower discount than American Express also should cast grave doubt on whether so-called market power explains the pricing in this industry.

III. INTERCHANGE DRIVES INNOVATION IN ELECTRONIC PAYMENTS

Visa and MasterCard use interchange to make their systems more attractive than other forms of payment to consumers and merchants. Two recent initiatives related to security and acceptance show how useful interchange can be in driving innovation:

- **Security**—Payment cards have long used interchange to reduce the risk of fraud on the systems. In the 1970s, Visa created a new interchange rate to encourage merchants to install electronic payment equipment at the point of sale. Those first electronic terminals sped up the authorization process, captured more information at the point of sale, and ultimately reduced fraud. Continuing in this tradition, last fall Visa announced that merchants eligible for lower, tiered interchange would need to comply with the standards set by the PCI Security Standards Council, to continue to enjoy the best available rates on their tiered volume. Among other things, the PCI standards preclude merchants from storing unencrypted data read from the back of payment cards. Adherence to this PCI standard would reduce security breaches.
- **Acceptance**—Electronic payment systems did not achieve nearly ubiquitous acceptance overnight. American Express and Diner's Club started by attracting restaurants, hotels,

and airlines. Visa and MasterCard appealed to boutique retailers and other local stores. Over time, their systems grew to include department stores, pharmacies, and grocery stores. Both companies often use rates specific to particular types of retailers to make the system more attractive. This effort began in earnest with department stores in the late 1970s and continued with supermarkets and drug stores in the 1980s and 1990s. Of late, the systems have worked with high-volume, low-ticket size merchants such as fast food restaurants to make their cards attractive to such merchants. They have structured rates and adapted rules for these merchants, and as a result, payment card acceptance in quick-service restaurants has started to climb, and has grown to include other venues such as mass transit, vending machines, and contactless technologies. Increasing use of payment cards at McDonald's, Taco Bell, and In-and-Out Burger is a testament to the value that payment cards provide cardholders and merchants alike.

IV. INTERCHANGE FEES DO NOT VIOLATE THE ANTITRUST LAWS

Interchange is at the heart of what is now the largest antitrust litigation in the hundred-plus year history of the Sherman Act. Various merchants have filed fifty or so cases challenging the interchange fees of the Visa and MasterCard payment systems. They claim that the practice of setting interchange fees on their respective systems violates Section One of the Sherman Act.

Section One concerns itself with agreements that restrain competition to the detriment of consumers. Since the enactment of the Sherman Act in 1890, the price fixing cartel has provided the paradigmatic case for Section One enforcement. Although merchants attempt to analogize interchange to a cartel fixing prices, they are wrong.

After decades of antitrust enforcement, cartel pricing has become relatively easy to spot. A group of otherwise competing firms simply agrees to fix a price for their otherwise competing

products. Basic economic theory explains why such agreements are pernicious. When firms collude to fix the price of a particular product, they deprive consumers of the benefits of competition. Assuming a sufficient number of firms participate, a price fix allows them to raise the price of the product above the level that would otherwise prevail. If a price fix sticks, it may deprive some consumers of the product altogether, which results in a net loss to society as a whole, and transfers wealth from those consumers who still purchase the product to the cartel members.

The setting of interchange in a four-party payment card system shares nothing with this cartel behavior. As discussed above, payment card systems are organized differently. Although American Express, Discover, MasterCard, and Visa are essentially equivalents for consumers, the systems operate differently. American Express and Discover are three-party systems.[7] As discussed above, a single corporate entity issues cards to cardholders, signs merchants to accept those cards, and receives payment for its services. Consequently, when a three-party payment card is used, the rights and responsibilities all stay within a single corporate family. The entity that issued the card pays the merchants the face value of the transaction, less whatever fee the system charges the merchants—known as the merchant discount. That same corporate entity then collects from the cardholder according to whatever agreement has been struck.

In contrast, as previously noted Visa and MasterCard are four-party systems. Here, the payment system itself does not issue cards or sign merchants to accept those cards—the job of issuing cards and signing merchants falls to participating banks, credit unions, and thrifts. Thousands of issuing and acquiring financial institutions collect from their respective cardholders and pay the merchants with whom they have relationships.

It should now be clear why setting interchange rates in a four-party payment card system does not raise the cartel issues the merchants claim. Unlike the cartel described above, the end of the four-party systems clearly would significantly harm consumers. As discussed above, a four-party payment card system simply cannot exist without interchange. Thus, the difference between a cartel and Visa or MasterCard is stark. With cartel pricing, an end to the cartel leads to lower prices, higher output, and greater innovation. The end of interchange instead would lead to chaos, a decrease in available credit, a decline in the number of outlets that accept payment cards, and less innovation.

The merchants understand the facts. They do not want an end to interchange. They simply want interchange rates to be lowered. But this is not an antitrust remedy. If he were to follow antitrust principles, a federal judge could not mandate a new price fix (albeit at a lower level) as a remedy to a price fixing claim. One of the fundamental maxims of antitrust law is that the market, not the government, should set prices. Indeed, "reasonableness" is *never* a defense to a price fixing claim. To set interchange at a reduced rate, however it was ultimately justified, would run directly counter to these core principles of antitrust.

The merchants may also argue that I have omitted a critical fact—that Visa and MasterCard are actually cartels of member financial institutions. Visa and MasterCard are indeed four-party systems. But all payment card systems use merchant discounts in an identical fashion to balance the needs of merchants and card holders. The three party systems, American Express and Discover, are organized differently than the four party systems.

Profound changes to the ownership and governance structures of companies in the payments industry are underway. In May 2006, MasterCard ceased to be a membership

[7] Within the last couple of years, some third party banks have begun issuing American Express and, to a lesser extent, Discover cards; in addition, both American Express and Discover have allowed other merchant banks to sign

association and became a publicly traded company. The financial institutions that had owned MasterCard sold a controlling interest to public investors. Visa will soon be public as well, having recently announced a two-stage reorganization. It will first convert from a non-stock membership corporation into a shareholder owned company. After the merger of Visa Canada, Visa USA, and Visa International, Visa Incorporated will go public, simultaneously divesting its current members of a majority of the stock in the company and corporate control.

V. INTERCHANGE REGULATION (*I.E.*, PRICE CONTROLS) WILL HURT CONSUMERS

To date, the United States has allowed the marketplace to operate and has refused the invitation extended by some merchants to dictate the price of electronic transactions. Although the federal government has facilitated discussion of the topic, it has not intervened. Other nations have not exercised similar restraint, and the consequences are instructive.

Australia reveals what happens when a government assumes responsibility for setting interchange rates. In October 2003, the Reserve Bank of Australia capped interchange rates for Visa and MasterCard at 55 basis points. The effects of the RBA's intervention in the payment card markets will play out for many years, but the regulatory intervention has had one unambiguous effect: consumers have been hurt.[8]

Since the imposition of the rate caps, credit card fees have increased substantially. In a recent study of Australia's rate regulation, economists estimated that Australian cardholders had seen their annual fees and finance charges increase by between AU$148 million and AU$197 million.[9] The value of rewards to cardholders on credit cards has fallen by nearly 20 percent.[10]

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merchants for acceptance. As a result, these networks now also deal with "interchange," or its economic equivalent.

[8] Howard H. Chang, et. al., *An Assessment of the Reserve Bank of Australia's Interchange Fee Regulation*, The Federal Reserve Bank of New York Conference: Antitrust Activity in Card-Based Payment Systems: Causes and Consequences (Sept. 15-16, 2005).

[9] *Id.*

This takes me to my final point. The attack that some merchants are waging against Visa and MasterCard poses a direct threat to the American consumer. The current system of interchange fees is a necessary part of an industry that provides enormous benefits to consumers. I have witnessed the full fury of the aroused American consumer. While Chairman of the FTC, I led the agency in riding the wave of public resentment to create the National Do Not Call Registry. I suspect that many Americans feel as strongly about their plastic as they do about their dinner hour.

If the current interchange cases are actually litigated on the merits, the plaintiffs should lose. Nevertheless, the plaintiffs' lawyers and their merchant clients probably assume that they will never have to litigate these cases on the merits. Instead, they probably assume that they will be able to extort a settlement because, by the time of trial, the plaintiffs' stated damage theory could approach $1 trillion after trebling. They will argue for a "pragmatic" solution to the problem, and they are betting that some arm of the federal government will provide the help that they need to succeed. Because the American consumer will be the primary victim of any such solution, I continue to hope that this Task Force and the rest of the federal government has the courage and conviction to continue to reject the merchants' requests for price controls.

If merchants in the United States ultimately persuade Congress, state legislatures or a federal court to do here what was done in Australia, we can expect a similar outcome. The price of access to electronic payments likely will increase. Interest rates and fees on payment cards of all types—*i.e.*, debit cards, stored value cards and credit cards—will rise. Benefits to consumers will drop.

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[10] Reserve Bank of Australia. *Annual Report 2006 of Payment Systems Board* 12 (2006).

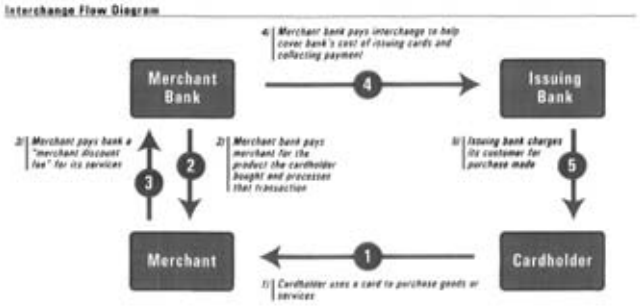
CONCLUSION

Payment systems have helped change the way that people live their lives, benefiting millions of consumers and merchants. Even Visa and MasterCard's critics do not dispute the indisputable. They concede the value of electronic payments. They do not, at the end of the day, even object to interchange. They recognize that without some way of setting interchange, the electronic payment system would not work. The merchants that have encouraged this Task Force to hold this hearing and that are driving the class action litigation in Brooklyn have a more transparent motive. They want the federal government to lower the price that they pay for electronic transactions. I understand the objective, but it is not a legitimate basis for government intervention.

Mr. Chairman, thank you again for the opportunity to share my thoughts on this subject. I would be glad to answer any questions that you might have.

ATTACHMENT

What is Interchange?



Mr. CONYERS. Very interesting.

Our last witness is Senior Vice President and General Counsel for the National Retail Federation, Mr. Mallory Duncan. His job is to coordinate strategic, legislative and regulatory initiatives involving customer data, privacy, bankruptcy, fair credit reporting, and truth in lending.

Well, you have got a big job there, my friend. He has been on a lot of boards of nonprofit organizations throughout his legal career, including the National Hospice Foundation. And we welcome you to this hearing.

TESTIMONY OF MALLORY DUNCAN, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, NATIONAL RETAIL FEDERATION

Mr. DUNCAN. Thank you very much. Thank you very much, Mr. Chairman. Thank you very much.

I am General Counsel of the National Retail Federation, and I am also Chairman of the Merchants Payment Coalition. I want to thank the Chairman and the Ranking Member for inviting me here today to speak on behalf of those two organizations.

The MPC represents virtually every type of retail operation, from corner stores to the Nation's largest retail chains. We want the Committee to appreciate what is going on here. This market is broken, and it needs to be fixed.

The card industry has told you the market is functioning fine and that this is so complicated, four-sided markets, that it would be best if you just ignored it and moved on. But in truth, this is a very simple scheme, privately regulated, not by the market, but by a set of card company rules that they won't make available to this or to any other Committee.

The banks that are members of Visa and MasterCard will tell you that the card business is competitive. On one side, that is true: The banks compete for customers. Each tries to get consumers to carry their brand of card, and the piles of credit card offers in your mailbox is a test of that.

But on the merchant's side, the opposite is true. For example, Visa and its banks get together and decide how much they are going to charge to process card payments. All issuing banks agree to charge the same fees, regardless of which bank's name is on the card. These otherwise competing banks, under Visa and MasterCard's banner, insist that merchants accept their cards, fees and rules on a take-it-or-leave-it basis, with no opportunity to negotiate. And even though the fees are outrageous and the rules harsh, no merchant can stand up against that kind of power.

We believe the two card associations each operate as an illegal price-fixing cartel in clear violation of Federal antitrust laws. Who are the banks among these cartels? Well, they are Citi, Chase and B of A, to name three. Their card divisions are each nearly the size of American Express. What business do these three banks have being in a price-fixing arrangement with each other, not to mention with thousands of other banks? If Kroger, Safeway and Publix agreed with every other grocer to set the price of milk at $10 a gallon, would anyone here believe that this to be a fine, functioning market, delivering value to consumers?

The banks also fix the rules, rules designed to support the cartel and hide its operations from the consumers who ultimately pay for these fees. Let me give you just one example. Retailers are very competitive. The average net profit after wages, taxes, rent and goods is about 2 percent. For grocery stores, it is just about 1 percent. The card company rules say that the regular price we offer to the public must be the credit card price, but a 1 percent or 2 percent profit margin isn't large enough to absorb 2 percent in interchange fees.

So a shopping cart of back-to-school clothes that we would willingly sell for $99 cash has to be priced at $101 because of their rules. But look what has happened: $101 has become the regular price for $99 worth of cash merchandise. And regardless of whether you pay with cash, check or food stamps, we all end up paying the credit card company price.

Now, by the way, merchants are not allowed to show the interchange fee on the receipts the way we would show a sales tax, for example, which essentially is what interchange is. Now, as you can see here, interchange fees are growing at about 17 percent a year, and we expect them to hit $40 billion in 2007. That is more than annual fees, cash advance fees, late fees, and over limit fees combined. It amounts to more than $300 in hidden fees per household each year.

Now, what does interchange pay for? Last year, Diamond Consulting independently studied interchange and discovered that only 13 percent goes to pay for processing transactions. Most of the remainder taxes consumer prices to provide profits for the cartel and rewards for a relative few.

Now, although we may disagree on the benefits, in his written testimony Mr. Buhrmaster accurately describes what is happening here. He essentially said the big banks set the rules, and they set them high, so high that even small or inefficient banks can make a profit, while the big banks make a killing. This is not the workings of a competitive market.

Now, if you look at this chart, you will see that the blue line is the rise in the retail sales over the last several years, and the red line is the rise in interchange. These rising fees have other consequences on other businesses. At Balliets, a highly regarded $7 million-a-year women's clothing store in Oklahoma, interchange fees rose to more than $80,000 last year, topping the $60,000 the owner spent on health insurance for his employees. In order to pay the card companies this year, he was forced to reduce the company health insurance contribution from 70 percent to 50 percent minimum required by his carrier. He tells us that next year, Balliets may actually be forced to stop offering health coverage to its employees if interchange fees continue to rise.

In conclusion, the collective setting of interchange fees represents an ongoing antitrust violation and is costing merchants and their consumers tens of billions of dollars annually. Competition authorities in the rest of the world has realized this and begun to address it, and the rates in those countries are lower. The U.S. rates are on the far right side of this chart; the other industrialized countries are to the left.

The credit card system is an important component of our economy, potentially benefiting consumers, merchants and banks alike, but it has become dramatically tilted in favor of the two cartels that control the market. There are several pending lawsuits, but the courts' remedies are limited. Courts can deliver damages, prohibit specific conduct, or become regulatory czars. Congress has much more nuance and flexible tools at its disposal.

We urge you to study this problem and work with all of the parties on a solution to this anti-competitive market. Thank you.

[The prepared statement of Mr. Duncan follows:]

STATEMENT OF MALLORY DUNCAN

ON BEHALF OF

THE NATIONAL RETAIL FEDERATION

BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON THE JUDICIARY ANTITRUST TASK FORCE

HEARING ON

CREDIT CARD INTERCHANGE RATES

JULY 19, 2007

Chairman Conyers and Members of the Task Force, I am honored to appear before you today. My name is Mallory Duncan and I am Senior Vice President and General Counsel of the National Retail Federation (NRF). The National Retail Federation is the world's largest retail trade association, with membership that comprises all retail formats and channels of distribution including department, specialty, discount, catalog, Internet, independent stores, chain restaurants, drug stores and grocery stores as well as the industry's key trading partners of retail goods and services. NRF represents an industry with more than 1.6 million U.S. retail establishments, more than 24 million employees - about one in five American workers - and 2006 sales of $4.7 trillion. As the industry umbrella group, NRF also represents more than 100 state, national and international retail associations.

NRF is also a member of the Merchants Payments Coalition (the MPC). The MPC is a group of 22 national and more than 70 state trade associations representing retailers, restaurants, supermarkets, drug stores, convenience stores, gasoline stations, theater owners, on-line merchants and other businesses that accept debit and credit cards. MPC is fighting for a more 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. NRF and the MPC are very pleased that the Task Force is holding this hearing to explore one of the most significant issues ever to face the merchant community.

The collective setting of interchange fees by Visa and MasterCard represents an on-going antitrust violation and it costs merchants and their customers—that is, America's consumers—tens of billions of dollars annually. These fees, hidden from consumers, are in addition to the late fees, over-the-limit fees, and other card fees with which consumers are only too familiar. This Task Force has an important perspective on this issue. The problems with interchange fees stem from basic antitrust law and competition policy issues with which this Committee is familiar. We hope that this hearing will be the first step in a thorough exploration of these issues by the Task Force.

I would like to do a couple of things in my testimony today. First, I will describe interchange fees and some of the major problems with them. Second, I will discuss the antitrust law violations raised by the Visa and MasterCard interchange fee system. My comments will reflect the mission of the Merchants Payments Coalition, which is to bring about a more competitive and transparent card system that benefits all of us. We look forward to working with the Task Force to help achieve this objective.

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

Interchange fees are collectively set by Visa and MasterCard member banks. And each of those supposedly competing banks charges those same rates.

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

All of the incentives for the banks agreeing on the interchange fee are geared toward raising the fee higher and higher. The higher the fee, the more money card-issuing banks make. And banks that have merchant accounts and receive the transaction from the merchants (known as acquiring banks) do not lose a cent because they all charge the merchant for the entire cost of the interchange fee. These fees are so high that merchants simply cannot absorb the costs. They must pass along much of these fees to consumers.

Visa and MasterCard are able to get away with this, however, because they have market power – both individually and jointly according to the courts. By a very conservative estimate, Visa and MasterCard together control more than eighty percent of the credit card market. The vast majority of merchants therefore have no choice but to accept their cards. In fact, a recent study by the Kansas City Federal Reserve Bank concludes that merchants realistically cannot refuse to accept Visa and MasterCard payment cards, regardless of interchange fee costs.

The result is that interchange fees continue to increase. Consequently, the perverse effects of the current interchange fee system are growing, and are of growing concern, because electronic payments, especially card payments, are an increasing percentage of consumer transactions, replacing checks and cash. In 2003, in fact, the number of electronic payments exceeded the number of check payments for the first time in U. S. history. This event is significant, because checks are cleared at "par" (paid by banks at their face value) and the cost of the checking system is borne by the banking system, with Federal Reserve pricing rules limiting check clearing costs to the cost of processing checks. On the other hand, because card-based payments are credited to a merchant's account only at a discount, merchants, and ultimately consumers, not only must pay for costs of the card transaction processing system—but also make a significant contribution to the cost of marketing and issuing cards, themselves. Indeed, the funds Visa and MasterCard banks collect through these fees goes toward marketing efforts such as the more than 6 billion credit card solicitations sent to consumers in 2005.

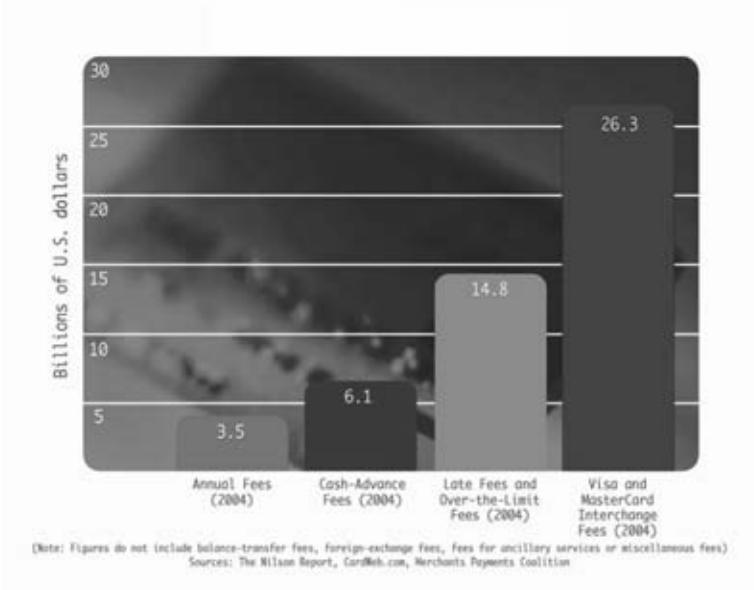
Because these collectively-set interchange fees are passed on to merchants by banks that process the merchants' card transactions, the merchants inevitably must take this cost into account when

pricing the goods or services they sell. As a result, even consumers who pay by cash or check subsidize card-issuing banks' marketing efforts.

The result is an inflationary sales tax on all Americans. Individual consumers and consumer advocates have raised issues for years regarding unfair consumer practices by the card companies. But a primary source of funding of the marketing that lures consumers into these problematic situations is the interchange fee. These fees dwarf the more visible card fees, as set out in Figure 1. Cure the problems associated with the vastly inflated interchange fees and the volume of abusive marketing by card companies will be reduced.

Figure 1

Total Card Fees By Type (2004)



Tellingly, in other nations that have put an end to this price-fixing scheme by Visa and MasterCard, merchants and consumers have benefited. These fees should be lower in the United States than in other countries because we have the largest transaction volume (which should create economies of scale) and we have the best technology and very low fraud rates. Unfortunately, however, U.S. merchants and consumers are being fleeced.

These huge fees are even more pernicious because they are hidden. The card associations make every effort to ensure that card holders remain unaware of the interchange fee costs their usage of cards imposes. First, card association rules require merchants to advertise the price that a card user would pay as the primary advertised price. Second, card association rules prevent merchants from using different prices to reflect the different levels of interchange fees associated with different types or brands of payment cards.

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

Those rewards are a key part of the problem and it bears noting that the rewards consumers receive are worth far less than the interchange fees they pay. The result is that these fees impose a large but hidden burden on merchants and all of their customers.

In sum, the combination of interchange fees and card system rules limiting hiding the fees and limiting retailers' ability to deal with them distorts the price signals regarding the use of cards and thus the nature of competition between payment systems. The higher cost to merchants for customer use of payment cards flows through into higher prices for all consumers – whether they use cards or not.

II. PRICE-FIXING BY CARD ASSOCIATION MEMBERS (OR THEIR AGENTS) IS UNLAWFUL.

Visa and MasterCard both were formed as consortiums of competitors. Those competitors, banks, compete to get consumers to sign-up for and use their cards. Visa and MasterCard, then, are cartels whose members set the fees they will charge and all agree to charge the same fees.

This price-fixing by cartels is illegal and has long been a central element of the antitrust prohibitions of the Sherman Act. The recent initial public offering by MasterCard does not change the essential nature of the price-fixing arrangement. MasterCard still engages in price-fixing on behalf of its members. While MasterCard itself is now a separate entity and not simply an association of banks, competing banks cannot escape liability by simply allowing a third party to fix prices on their behalf.

That is just what happens now. MasterCard member banks agreed as part of the IPO that the interchange fee system would continue to operate in the same way – with MasterCard setting the fees and all member banks charging the same rates. The price-fixing agreement, then, is largely unchanged and member banks have collectively kept a significant ownership interest in MasterCard. Member banks also appoint members to the board and they remain MasterCard's only customers.

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

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

Indeed, in recent years, a number of other countries have found interchange fees to be antitrust violations. These findings of illegality include:
• Australia, 2000 (by the Australian Competition and Consumer Commission);
• European Commission, 2002 (cross-border transaction by Visa);
• Spain, April 2005 (interchange fees of major card associations) Competition Court of Spain;
• European Commission, June 23, 2006 (Statement of Objections to MasterCard based on the preliminary view that its credit and debit card interchange fee mechanisms are unlawful); and
• Poland, January 2007 (ordering abolition of Visa and MasterCard interchange fees).

Antitrust authorities in the U.S., however, have not yet taken action against the collective setting of interchange fees. While this may be based in part on the existence of the Eleventh Circuit's 1986 decision in the NaBANCO case, that case is no longer supportable.

The NaBANCO decision was based on a very different payment cards market. More than twenty years ago, Visa and MasterCard did not have the stranglehold on the payments market that they have today. The decision that Visa did not have market power has since been decided differently by Second Circuit Court of Appeals and the idea that centrally fixed interchange was necessary to get the fledgling system off the ground is clearly outdated.

Over time, some of the rules that Visa and MasterCard have claimed were essential to their systems (such as denying banks the ability to issue Discover and American Express cards and tying the acceptance of debit cards to the acceptance of credit cards) have fallen by the wayside after antitrust challenges. These cases have gradually shown a variety of problems with the structure of Visa and MasterCard's systems.

Other nations that have examined interchange have found decided problems with Visa and MasterCard's attempts to justify the legal and economic basis for the size of their interchange

fees. In fact, the European Commission's Directorates for Competition and Financial Services jointly conduct a comprehensive study into the European payment card industry in general, and Visa and MasterCard in particular. The final report of this study was released in January. 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 issues have responded to lower merchant fees by offering consumers a choice: Low cost cards with low interest rates and fees and no rewards, and rewards cards with higher interest rates and annual fees.

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

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

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

III. CONCLUSION: CONGRESS SHOULD ACT

In my view, this hearing is not yet about solutions. It is the first opportunity for the Task Force to explore the issue. Visa and MasterCard consistently want to skip over anyone analyzing the actual problem and simply want to criticize potential solutions or regulatory schemes in other parts of the world. This is a convenient way for Visa and MasterCard to continue to keep their illegal behavior out of the spotlight and, they hope, cut-off discussion before Congress learns too much about what they have been doing.

Suffice it to say that there are a broad range of legislative solutions – both within and outside this Committee's jurisdiction – that could improve on the current system. The antitrust problems and lack of a competitive interchange fee market cry out for solutions and there are many that do not constitute the government price control bogeyman that the credit card companies claim we want.

Simply the act of holding this hearing and investigating the problem are large steps forward in the effort to inform people about these practices and find the right solution. We sincerely appreciate the Task Force's interest and stand willing and able to work with all of you on this important public policy issue.

Mr. CONYERS. Thank you, Attorney Duncan.

And I thank all the witnesses.

Mr. DUNCAN. Mr. Chairman, I also have comments from other members of the MPC I would like to submit for the record, if I may.

Mr. CONYERS. I would be happy to receive them.

Mr. DUNCAN. Thank you.

Mr. CONYERS. Well, men, we heard the preliminary opening statements in this case. And without rushing to any judgment, it doesn't look so good for the credit card companies. So let's see if we can find out a little bit more.

Now, Mr. Buhrmaster, with all respect to your aunt's winery business, she has not been found guilty of committing fraud in the Federal court system and holding back information like the credit card companies, so I would distinguish her conduct and her activities very much from the credit card companies.

Mr. BUHRMASTER. Not to my knowledge, she hasn't.

Mr. CONYERS. Well, that is good enough for me, and we will check the kind of quality of her products, too, while we are at it.

Mr. BUHRMASTER. It is very good, I assure you.

Mr. CONYERS. Okay.

Mr. BUHRMASTER. Would you like me to respond?

Mr. CONYERS. No. [Laughter.]

With regard to—this is a statement that could be the subject of another hearing that is quite separate. "The market, not the Government, should set prices." That always grabs me by the collar, coming from a former Chairman of the Trade Commission.

First of all, we find out the market isn't setting the prices here. But even if it were, it wouldn't make me feel better. I mean, markets sometimes go really crazy, and we have to bring in the Government. That is what all these agencies are trying to do is bring down prices. Following the market can get you into very big trouble. But we are not even using the market, as it turns out.

So let me get to the main point of all this. What are we to do? Congressman Johnson, a Member of this Judiciary Committee, has introduced a bill which is supposed to—he has got some legislation that would—it is called the Arbitration Fairness Act, with respect to unfair use of mandatory arbitration, which is another little problem, where you can't go in and sue on your own, but you are caught. And, of course, that is always in the fine print in many instances.

So let's get to the solution part of it. Mr. Mierzwinski, after we investigate thoroughly, complained to the high heavens, tons of mail, constituents raising sin, so what do we do?

Mr. MIERZWINSKI. Well, Mr. Chairman, first, I want to thank you for bringing up Congressman Johnson's bill, which all the consumer groups support. Arbitration, of course, is a separate issue, but it is related to the problem consumers face with their credit card companies. All their unfair issuer practices, you can't do anything about them, and the Arbitration Fairness Act would solve that problem.

By the way, the only people the Congress has ever protected from arbitration are car dealers. They said, "We are very small compared to car manufacturers," and so Congress did exempt them

from mandatory arbitration. We think consumers deserve the same.

But on this particular issue, I think you are doing the exact right thing. The first step should be—sunlight is the best disinfectant, and the Committee is conducting its oversight role. I think there are some real questions about all of the mergers that have gone on in the issuer marketplace that have been just simply rubberstamped over at Justice.

And the issue here is being litigated with all the retailer lawsuits, but I think it is important that Congress takes a look at it. That would be the first step to solve this problem of unfair interchange fees and try to dig into further some of these problems with non-transparency that the card issuer—I am sorry, that the associations have, where nobody knows what their rules are, nobody can look at their rules unless they sign an NDA, et cetera, et cetera.

Mr. CONYERS. Well, the credit card companies are being sued all over the place, but they have settled one antitrust suit case for $336 million, where they were accused of fixing credit card foreign currency and exchange rates, but there are other lawsuits going on, and that is why they declined to come here today, to be present at the hearings.

Steve Chabot?

Mr. CHABOT. Thank you, Mr. Chairman.

My first question—and it is kind of a series of questions. I would invite perhaps one representative from the credit card companies and one representative from the retailer folks or consumer folks to respond. And we have only got 5 minutes, so it is kind of hard to do this.

But the first question would be this. If I am a business owner or retailer, and I want to be successful, how important is it to accept payments electronically? And what are my options for payment within the credit card industry? And would I negotiate these options with my bank or with the individual credit card companies? And what are my options if I choose to accept payments only in some form other than credit cards, like cash or check? And does acceptance of credit or debit cards impact my chances of success?

And whichever one wants to take it, either side is fine with me.

Mr. BUHRMASTER. I would be happy to answer that question. I am an acquirer, and I have merchant customers. We have about 160 merchant customers, and these customers have made a choice to accept electronic payment cards. They don't have to, but they have made a business decision, because it makes sense for what they do.

When they make that decision, they will come to us—and they will probably go to another bank and maybe another payment processing company and ask us how much it is going to cost. They want to know what it is going to involve. What are the risks? What are the costs? And so forth.

We can sit down, if they can tell us what their average volume is and how many customers that they expect, the average ticket size—that is the average charge that is made—and we can come pretty close to giving them an estimate of what it is going to cost

them to run this operation for themselves and what it will mean to their bottom line.

Those businesses that come to me and ask for payment services, they understand this is a cost of operating your business. They want to attract those customers that want to pay by card. In today's society, people want things now. Everybody wants it now, and the best way to have that is through electronic payments. In other words, that is how they can get things now, either on credits or using their debit card.

Mr. CHABOT. Okay, thank you. And have you decided which one of the other three would like to—Mr. Smith?

Mr. SMITH. Let me just address the first part. There is no negotiating with the credit card companies. It is a take-it-or-leave-it proposition. You don't negotiate your fees. If you choose not to take credit cards, which we are free to do, we are turning our back on about 60-plus percent of transactions. And, again, that is not something that is very inviting for the retailers to tell their consumers, "No."

I don't think any of us in the retail industry mind taking a credit card. What we want is a fair fee to be able to be charged to our retailers. We want them to compete for our business just as we compete for our consumers.

Mr. Muris made the analogy to cell phones and computers and credit cards being some of the greatest inventions. Look at what the cost of cell phones has done as volume has gone up. Look at the cost of computers as volume has gone up. But look at the analogy of credit cards: As volume has gone up, the fees have gone up, as well, when, in our opinion, they should be going down because of the additional usage.

So it is just not a free market enterprise system, and that is what we would like for it to be.

Mr. CHABOT. Mr. Buhrmaster, did you want to follow up? And I would invite either one of the folks if you would like to——

Mr. MURIS. Can I?

Mr. BUHRMASTER. Please.

Mr. MURIS. Merchants can do lots of things. Believe it or not, there are prominent merchants that don't accept certain kinds of credit cards. Costco is one of the most successful merchants in the world in Mr. Smith's line of business, and I can't use my Visa or MasterCard or Discover card there. I can't use Visa at Sam's Club. On the other end, if you go to Neiman Marcus, you can use only American Express. Lots of small restaurants I go to don't take cards.

Merchants can offer cash discounts. We heard a lot of things—and if someone gives me the chance, I would correct them for the record later—about restrictions on merchants. Merchants are allowed to discount for cash. They can advertise that fact. They can post big signs in the stores that they discount for cash. Merchants can steer customers—and many of them do, especially in the grocery business—to debit, which is cheaper. Discover is significantly cheaper.

There are thus lots of options for merchants. And, in fact, the contracts are not take-it-or-leave-it. Supermarkets have negotiated

a better deal, in terms of interchange fees, than almost any other major group of merchants.

Mr. CHABOT. I am just about out of time, so let me go back to the retailers. Mr. Duncan?

Mr. DUNCAN. Thank you. Just a couple of points. First of all, in terms of supermarkets negotiating a better deal, what happened there, actually, was they gave the supermarket industry—this is monopolist. What does a monopolist do? They segment the market. They went to supermarkets and said, "We will give you 1 percent," and cards came in at 1 percent, and then they began introducing new cards with extra high rates, but they weren't part of the deal. So suddenly supermarkets are paying 2 percent for some of their transactions.

This is not fair dealing. They changed the terms on merchants the same way they change the terms on consumers.

Mr. CHABOT. Thank you very much, Mr. Chairman. I see I am out of time. I yield back my time.

Mr. CONYERS. Okay.

Mr. Howard Berman? No questions.

May I gain the attention of my friends at the other end? Do either of you have any questions that you would like to pose to the witnesses? Okay, you can think of some.

That is the way Bill Delahunt works. He is a very extemporaneous guy.

Mr. DELAHUNT. Spontaneous is the word, Mr. Chairman. And I thought Mr. Berman would, but if you care. He is listening.

Mr. BERMAN. I am meditating.

Mr. DELAHUNT. What would be the problem, for the sake of transparency, on some document—the sales slip, et cetera—list the exchange fee? What is the problem with that?

Mr. MURIS. There is nothing now that prevents merchants from doing that. Consumers aren't interested, but if merchants want to go ahead and do that, they can. Merchants know what they pay, which is the merchant discount——

Mr. DELAHUNT. I am talking about the credit card——

Mr. MURIS. No, that is what I am saying.

Mr. DELAHUNT. I am talking about—oh, the issuer you are talking about?

Mr. MURIS. The issuer?

Mr. DELAHUNT. Yes.

Mr. MURIS. I am sorry, the issuer——

Mr. DELAHUNT. I am talking about the credit card companies.

Mr. MURIS. Yes, the issuer has a relationship with the consumer and discloses the fees that it pays to the consumer, if that is——

Mr. DELAHUNT. But would the issuer have a problem, given the dimensions of the customer base—and having the wherewithal, in terms of the software, just for sake of transparency, put down what the exchange fee was in that particular transaction?

Mr. MURIS. But the issuer—the transaction is between the consumer and the merchant, not the issuer.

Mr. DELAHUNT. I understand that, sir. But for the issuer——

Mr. MURIS. I am sorry, the issuer can't do what you are asking.

Mr. DELAHUNT. Can he, Mr. Duncan?

Mr. DUNCAN. Sure, certainly they could. I mean, look, they are the ones who have these prices, and they are the ones who develop these prices. If they wanted to disclose it, it would be a very simple thing for them to do. Frankly, it would be a lot easier for them to disclose it than for us to disclose it, because we don't know how much a transaction is going to cost us until after you——

Mr. DELAHUNT. That was the rationale opposing it. What is the problem?

Mr. MURIS. Well, in fact, the interchange fees are disclosed, and they are available on the Visa and the MasterCard Web site, if that is your question.

Mr. DELAHUNT. Please, please, Mr. Muris, you know, on the Web site? I mean, some of us don't know how to access a Web site, let alone asking the consumer to do that—I mean, in the real world, people get a slip. It would be very convenient for them, for the consumer, to understand what the exchange fee was. And what is the problem for the issuer to do that?

Mr. MURIS. There is nothing that prevents when consumers engage in a transaction the merchant from disclosing that. I believe consumers aren't interested in that information. Consumers are interested in the prices that they pay.

Mr. DELAHUNT. But the consumer, I dare say, would like to know, you know, if they are paying 1 percent or 2 percent or 3 percent more what it was. Why not, just for the sake of——

Mr. MURIS. But consumers know what they pay to the credit card company. They know what they pay to the merchant. If the merchant, for whatever reason, wants to break it down——

Mr. DELAHUNT. They don't know what—please.

Mr. MURIS. Sure, they know.

Mr. DELAHUNT. They know? They don't know what the figures are.

Mr. BERMAN. Would the gentleman yield?

Mr. DELAHUNT. Of course I yield.

Mr. BERMAN. I thought I heard one of you—I don't know if it was Mr. Duncan or Mr. Mierzwinski—say that, under the contract between the merchant and the issuer, that the merchant wasn't allowed——

Mr. DUNCAN. We have to advertise everything as the credit card price. There is——

Mr. BERMAN. Right.

Mr. DUNCAN. So the price to the consumer—we have to tell the consumer is the credit card price.

Mr. MURIS. Mr. Duncan said that the companies, Visa and MasterCard, prevent the disclosure that you are asking for, and they don't. And, second, if the merchants want, they can offer a discount for cash and they can advertise it. There is nothing that prevents them from doing that. In fact, some merchants do.

Mr. DUNCAN. May I mention this discount for cash? I mean, that is thrown around as if it were a panacea. In fact, they have a series of rules that they disclose to us through the merchant banks as to how you can offer a discount for cash. Most merchants understand those rules to say that you can offer a discount for cash as long as the credit card price is the most prominent price and the discount

for cash is the smaller price, and it has to be separately listed in each instance.

So that means, where do you see it? You won't see it in the Sears, with 100,000 different items. They are not going to put 200,000 prices on the merchandise. You will see it at a gas station, because they only have three products, regular, mid-level and premium. And so there it is conceivable you could put a lower price.

But even when you have that option, they are trying to stop us from doing it in gas stations. Just this last couple of months, Visa went to a gas station in San Francisco, no less, that was offering a 10-cent-a-gallon discount for cash. They had a sign up that said, "Credit price, cash price," and Visa said, "No way. No can do, because it looks like the credit price is not the regular price. You have got to call that"——

Mr. DELAHUNT. Reclaiming that time, I think that is easy to corroborate. I mean, and you are saying—or it has been said that, you know, we are trying to—that the retail industry wants Government to do what the marketplace should be doing.

I mean, clearly, there is an appropriate role for Government in certain circumstances. We have usury laws, you know? I mean, the reality is, we have got, you know, in some States, there are caps in terms of interest rates. Otherwise, you know, we could follow the rule, you know, let it go. I mean, the mafia would be in good shape. It wouldn't be interest; it would be called the vig under those circumstances. But maybe we are talking about the vig.

And I yield back.

Mr. CANNON. Mr. Chairman, I ask unanimous consent that the gentleman be granted an additional 2 minutes, because I am actually interested in hearing from Mr. Muris how it is obvious to the consumer, because it doesn't seem to me to be obvious——

Mr. DELAHUNT. I yield to the gentleman, if I get an extra 2 minutes.

Mr. CANNON. Then, Mr. Muris, you were insisting that it is obvious to the consumer. How is it obvious to the consumer?

Mr. MURIS. I am saying what is obvious to the consumer is what the consumer cares about, which is the price that they pay. If Sears wanted to, however, Sears could post a gigantic sign that says, "Minus X percent"—pick 2 percent—"Minus 2 percent for cash." They don't have to post it on every individual item.

Most Americans, sir, most Americans know that merchants have to pay for credit cards. There have been surveys that show that, consumers understand that. Consumers also understand that they get a good deal from the payment card companies. There is enormous competition, despite what we have heard today.

Mr. CANNON. Pardon me, but have there been any studies where you have asked consumers what they think they are paying for their credit card fees?

Mr. MURIS. Yes. Credit card fees are disclosed. Okay, we are talking about two different things here. Consumers visit a merchant——

Mr. CANNON. Well, we only want to talk about one thing, and that is, what percentage of the final price that a consumer pays in a store does he think he is paying for the store and what does he think he is paying for you? Have there been any studies where you

have asked consumers what they think the appropriate interchange fee that the merchant pays should be?

Mr. MURIS. Yes. When consumers are asked, do they know about that the merchant is paying? They say, "Yes." And when they are asked, are they okay with the arrangement, at various price arrangements——

Mr. CANNON. Are they ever asked how much they think they are paying?

Mr. MURIS [continuing]. Most Americans are okay with that.

Mr. CANNON. Have you ever asked what Americans think they are paying when you ask those other questions? In other words, do we have any studies that indicate that Americans know what the fee actually is?

Mr. MURIS. The fees that Americans pay for credit cards are disclosed. The prices that they pay in stores are disclosed. If the stores wanted to—as I have said——

Mr. CANNON. Pardon me. Pardon me. I guess it is my time, having had it yielded, I am asking a really simple question. I think most people know they pay a fee, but I don't think they know that it is anywhere near what it actually is. I am just wondering if you have done any studies that you can show us where you have asked people what they think an appropriate fee to pay for a credit card transaction would be?

Mr. MURIS. There are studies that address that issue. I would be glad to submit them for the record. But there is a more important point here, which is—if Mr. Smith or Mr. Duncan, who worked with me at the FTC years ago—if they feel that consumers want to pay cash, they can tell consumers that, "You will get a discount," and they can say it is 2 percent or whatever it is they want, paying for cash. Why isn't that a solution to the problem?

Mr. CANNON. You are here telling me what you think the most important issue is and not really answering the question. I am looking forward to the report to see what people think they are paying. I was actually quite startled.

Mr. SMITH. Mr. Chairman?

Mr. CANNON. And yielding back—let me yield back to the gentleman from Massachusetts.

Mr. CONYERS. The Chair is conflicted, because Mr. Smith was very agitated about trying to get in the conversation. So if we grant 1 minute more to Mr. Delahunt's time, maybe he can get in his two cents.

Mr. DELAHUNT. I yield to——

Mr. CONYERS. Smith?

Mr. DELAHUNT [continuing]. Smith.

Mr. SMITH. Well, Mr. Chairman, it won't take that long. We as a retailer do focus groups with our consumers on a periodic basis. And one of the questions we have asked our consumers, "Do you know what you pay or what we pay in credit card fees or debit card fees?" And I cannot—we have never hit double digits with people that even have an idea of what they pay. Most people think it is free. They think they get their credit card, they pay fees for the credit card, in a lot of cases, and they don't have an idea that the retailer pays a fee.

Now, some will say, "Yes, I am sure you pay some fee." The vast majority of customers, when we do our focus groups, have not a clue that they are paying extra for their product because of credit card fees.

Mr. CONYERS. Thank you very much.

The Chair recognizes the very patient gentleman from Florida, Mr. Ric Keller.

Mr. KELLER. Well, thank you, Mr. Chairman.

And I have 23, 24 questions, and no way we are going to be able to get to it in my 5 minutes or before votes, so let me just give a brief opening statement to kind of lay out what my concerns are and try to get to as many questions as I can.

I remain very open-minded about this issue. On the one hand, I think the electronic payment system, dominated by Visa, MasterCard, and their participating banks, has provided a very positive convenience to consumers and merchants over the past 10 years.

On the other hand, I am quite concerned that, despite the dramatic increase of the volume of interchange fee business, we have seen that interchange fee rates have not fallen, as we might expect, but instead have increased, along with the volume of business. And these costs have been passed onto consumers.

Now, earlier today, I went down to the congressional liquor store on Capitol Hill to check out something. [Laughter.]

I feel I could use it now, but I saw that a six-pack of Coke is only $3.65, and that is the exact same price of a six-pack of Pepsi. I saw that a six-pack of Bud Light is only $5.29. It is the same price as Miller Lite, exactly. Pepsi keeps Coke honest. Miller Lite keeps Bud Light honest.

Why the heck isn't MasterCard keeping Visa honest? Why doesn't MasterCard say to the retailers and merchants, "Hey, they may charge you 2 percent fees, but we are going to have 1 percent"? Why don't we see that competition? Is there collusion going on between MasterCard, Visa and their participating banks? Or could it just be that the cost of business for these organizations has gone up and they have to incur costs associated with fraud and other expenses?

The $64,000 question for me is: Can we find a way to hold down the increase in interchange fees without resorting to price controls? And I haven't heard the answer to that yet.

And I am just going to be honest with you. Both sides have very strong points and very weak points, and let me just tell you what I think they are, as I see it as a neutral observer.

In terms of the banks and the credit cards, they have made a strong point in saying that they have provided a valuable service with the electronic payment system offering convenience and a strong point in pointing out we shouldn't have price controls. That is not our way. On the other hand, they have no good explanation that I have heard for why we have seen these dramatic increases in interchange fees.

On the other hand, I look at the merchants and retailers, and they have a very good explanation of the problem and the unfairness of having these fees jacked up dramatically over the past 10 years. And in light of the fact that 60 percent of their customers

are using MasterCard and Visa, they have you by the shirt. And on the other hand, the weakness here, you have not given us any good solutions at all. And so I would love to hear what the solutions are, outside of price controls.

Let me begin with you, Mr. Smith, and make sure I am walking through this process property, at least Food City. I go to your store, and I buy $100 worth of groceries at Food City with a Visa card issued by my bank. It is my understanding that Food City, in terms of the allocation money, would pay approximately $2.10 to its bank, called the merchant discount rate. Its bank would then keep a processing fee of about 35 cents, and then Food City's bank would pay an interchange fee of approximately $1.75 to my bank, the issuing bank. And then my bank would pay approximately 9.5 cents to Visa or MasterCard, so for a grand total of about $2.10.

Is that roughly how it works?

Mr. SMITH. Mr. Keller, I am not sure I can tell you exactly how the transactions work. I can tell you that my bill is going to be over 2 percent of my transaction.

Mr. KELLER. Two percent. All right, and I know you are concerned about that, because it used to be 1 percent about a decade ago, right?

Mr. SMITH. Yes, sir.

Mr. KELLER. Now, let me ask you this. If you take that same $100 grocery example, and your customer instead uses of the credit card, uses a debit card, and he puts in PIN number, isn't it true that Food City would only have to pay about 25 cents, rather than the two dollars in fees associated with the credit card?

Mr. SMITH. That is correct. It would be much, much less than the credit card.

Mr. KELLER. Why don't you just put up a sign encouraging customers, "Please use your Visa debit card, and put in your PIN number, instead of using your Visa credit card"?

Mr. SMITH. We do encourage customers to use a PIN-based debit card, and a lot of our customers choose to do so. But by the same token, a lot of our customers choose to use a credit card for many different reasons. Maybe they don't have the money in the bank at that particular time. Maybe it is rewards or points that they have been enticed with to be able to use that credit card.

Mr. KELLER. Do you offer a discount to those customers who use their Visa debit card with PIN numbers or who pay in cash?

Mr. SMITH. We do not.

Mr. KELLER. Are you legally allowed to if you wanted to?

Mr. SMITH. It is my understanding that we are not allowed to do that. Now, I heard Mr. Muris say that we are allowed to. Maybe we will look into that. I stopped by—and I know nobody can see this—but I stopped by my local commissioner of revenue. I live in the commonwealth of Virginia. And this is a property tax payment form that is put out by the county. And they surcharge. If you use a Visa or a MasterCard to pay your property taxes—which I didn't realize people did, but they do—they actually allow them to surcharge. And it surcharges up to 3 percent.

But we can't surcharge. We cannot surcharge. If we can discount, that is news to me, but other entities, such as governments—I

think the IRS does the same thing—surcharge consumers for using those credit cards.

Mr. KELLER. Well, thank you. I have a ton more questions, but, Mr. Chairman, my time has expired.

Mr. CONYERS. All right, you can put them in the record or send them to the witnesses to submit their responses if you would like, Mr. Keller.

The very distinguished gentlelady from California, Maxine Waters.

Ms. WATERS. Thank you very much, Mr. Chairman.

Before I move forward with my questions, I think we should make sure the record reflects that the Congress of the United States does not own a liquor store. [Laughter.]

I can just see us bombarded with our citizens saying, "Aha, there you go, you have got a gym and a liquor store." So the record reflect that that is some retail store that has adopted the name "Congressional Liquor Store."

Mr. CONYERS. So reflected.

Ms. WATERS. Thank you.

Secondly, for the study that Mr. Muris referred to, he wasn't very exact about the time of the study, what the study entailed. He said he would submit it to us, and I would like the Chair to ask that that be submitted by a time certain, within the next 10 days or so.

Mr. CONYERS. Is that all right with you?

Mr. MURIS. Yes, sir.

Ms. WATERS. All right, thank you very much.

Now, to Mr. Duncan. I would like to explore with you this business about the interchange fees, and how they have increased, and how they do this. As a consumer, I know that credit card companies have the teaser rates that they get you in with and then they increase over a period of time. I also know that, once you become a customer, if you are late paying, they have a way of increasing your interest rates. They have a way of generating fees.

And then I discovered that fee generation is a whole business, that there are companies who do nothing but teach banks and financial institutions how to create more fees. And I think something I read some time ago indicated that some of our businesses are getting more money, more profit in fees than they are on the actual services.

So we know, as consumers and customers, how we have gotten caught up in the fee game and the fees that we have—explain to me, why do you think these fees have increased over a period of time, when everybody concedes that they should have been reduced? And what other ways and what other techniques are being used in order to get more money out of the merchants?

Mr. DUNCAN. Congresswoman, there is a number of answers to that question. I guess the simplest one is to say that a monopolist will do what a monopolist does. And Visa and MasterCard are essentially a duopoly, and so they will try to find ways of profit maximizing.

And not surprisingly, many of the same techniques they will use with consumers, such as teaser rates, they will also use with the merchant community. As someone mentioned a moment ago, they

introduced a new category at a low rate and then flood the market with higher rate cards, which essentially drives that up.

They also have rules, and we haven't really focused on the rules today. But there are rules which the executive vice president of Visa says are the size of the New York City phonebook. That is 1,900 pages, roughly. They will only disclose a fraction of that, and yet we are expected to abide by them. And the fraction they expose, in the case of one company, you have to sign a gag order. NRF could go on the line and look at those rules, but then I couldn't talk to you about them and we couldn't solve this problem.

So they have a number of techniques, such as rate increases, that are governed by those rules, that cause prices to go up. I think, talking about the number of options, it is beyond the scope of the time we have here, but needless to say it is a profit-maximizing endeavor.

If I may, may I just respond to one thing that Mr. Keller raised, in terms of the pricing? You saw similar pricing between Visa and MasterCard. This market is broken; it needs transparency and genuine competition. But currently, Visa and MasterCard don't battle for merchants. They battle to get banks to issue their brand of cards. So this is the only market in which the competitors compete, by raising prices rather than lowering them.

Ms. WATERS. Wow. I had another question, and I am so taken away—oh, I want to ask this. This Congress and most public policymakers wax eloquently about support for small business. As a matter of fact, if you polled the Members of Congress about their feelings and support for small business, that would rank very high in those public policy considerations that they work with, they deal with.

I want to know the impact of these interchange fees on small businesses. Are our small businesses being hurt? Are they being ripped off? Are they being caused to go out of business, not to be able to have the inventory that they need because they are being gouged?

Yes, sir?

Mr. BUHRMASTER. Yes, thank you. I would like to respond to that.

I deal with small businesses every day. My bank was the number-one small business lender in New York state for a bank our size. Small businesses have a variety of costs of doing business. They have insurance; they have lawyers; they have accountants; they have waste removal.

When I look at a financial statement for a typical small business, you know, that accepts credit cards, what I am finding is, on average, insurance is more, it costs more for insurance, waste removal is fairly equivalent to the cost of your interchange fees, and legal and accounting is less. So it is a cost of doing business. It is built into their pricing structure overall.

I don't believe they are being gouged. I think they are getting a good service for it. You know, these are people that have to—these are merchants that have to reach the people. And right now, the most popular means of making payments is through credit cards.

And if you take a look at the national savings rate, it was negative the first time, it is because people are getting used to putting

thing on their credit cards. And I don't think it is anything that is on Visa or MasterCard's advertisements that is doing it; I think it is people's desire for now.

Ms. WATERS. Aside from the convenience for the customer and the merchant, what else does the merchant get for this fee?

Mr. BUHRMASTER. For its fee?

Ms. WATERS. For this interchange fee that they pay.

Mr. BUHRMASTER. Well, first of all, the merchant has the fraud protection system, which is built into the system, that if someone comes in with a fraudulent card, if they don't have that system there, they might accept that for payment and end up taking the loss later. However, by running it through the system properly, if they do everything properly, they are covered, and that is a valuable thing. You can't have that with the check.

With cash, of course, cash is king, but not everybody carries cash anymore. I mean, if you poll everyone in this room, how many people really have a lot of cash in their wallets? Most of us rely on those cards that are in our wallet to go to McDonald's or to the beverage store.

Ms. WATERS. Well, that is why the merchants are at the mercy of the issuers, because most people do rely on credit cards. I wish we did not have to, but you can't travel in this country, you can't get lodging in this country, you can't do anything without a credit card, so we are at the mercy of the credit card companies.

Yes, sir?

Mr. SMITH. Congresswoman, if you assume this is the cost of doing business—which I wouldn't disagree with—it is an uncontrollable cost of doing business. It is one we can't negotiate. I can negotiate with the folks that are going to pick up my trash, and I can find the one that gives the best service and the best price. I can negotiate with a bank, if he is going to take my checks. I can negotiate prices on check processing. I can negotiate every one of my costs of doing business, but I cannot negotiate that cost of taking credit cards.

Ms. WATERS. How would you recommend we could help you?

Mr. SMITH. I wish I had a simple solution, because it is somewhat of a complex thing. I think that, when people compete, just as we compete in the retail grocery business, the consumer benefits. And that is what I hope that this group, along with Food Marketing Institute and some other participants in the Merchants Payment Coalition, can get together and come up with some very good solutions.

Ms. WATERS. Yes, sir?

Mr. MIERZWINSKI. Representative, if I could just add one quick point, the market power of the two card associations forces merchants to accept their product on the terms that are offered. And the terms that are offered are very, very complex, as you have heard.

And I spoke to one small business woman—a doctor, actually, a solo practitioner—and she cannot find out until she gets her bills back from her third-party processor that some of the cards that she has accepted are these rewards cards with the much higher fees that she pays. They look like Visa cards to her, and they go through her machine just like Visa cards. They are all the same,

but these new types of cards that are being offered are these rewards cards, these signature cards.

And I would submit that the fraud detection and everything else is a cost of the companies—are doing for any of the cards and that you are not getting better fraud detection. You are simply paying for more rewards, but you don't have any idea what you are paying. You have no choice in the matter, because of the market power of the company.

Ms. WATERS. Yes, sir?

Mr. MURIS. Ma'am, could I just make two points in response? One, I would like to submit for the record a letter from the Small Business and Entrepreneurship Council, which opposes what the merchants want to do, if I could submit that for the record.

Mr. CONYERS. Without objection.

Ms. WATERS. Before you—are you going to accept that for the record?

Mr. CONYERS. I did. You don't want to?

Ms. WATERS. Well, I wish I had been able to object to that.

Mr. CONYERS. You didn't want to——

Ms. WATERS. Because I want to see it. Because I can't imagine merchants sending a letter up here saying, "Don't help us."

Mr. CONYERS. Well, we have accepted it for the record so you can examine it now.

Ms. WATERS. All right.

Mr. MURIS. And my second point is, in terms of small merchants, Visa and MasterCard are two of the greatest things that ever happened for the small merchants in America.

Ms. WATERS. My time is up. Thank you.

Mr. MURIS. If you don't want to hear the answer, that is fine.

Ms. WATERS. No, no, no, I don't.

Mr. CONYERS. I was afraid to tell her, her time was up. [Laughter.]

So now that she acknowledges it herself, I mean—the Chair is pleased to recognize the Ranking Member of the full Committee from Texas, Lamar Smith.

Mr. SMITH OF TEXAS. Thank you, Mr. Chairman. Mr. Chairman, I assume that the gentlewoman from California has, in fact, set the precedent and the standard for time allotted for questions?

Mr. CONYERS. You may not make that assumption. [Laughter.]

Mr. SMITH OF TEXAS. Mr. Chairman, first of all, I would like to ask unanimous consent to have an opening statement made a part of the record.

Mr. CONYERS. Without objection.

Mr. SMITH OF TEXAS. And I would like to also that I apologize to our witnesses for being slightly late today. I was over participating in a Conference Committee over on the Senate side on the 9/11 bill, and that was the first meeting and somewhat mandatory. And, unfortunately, I have got to return as soon as I finish my questions to that Conference Committee.

Mr. Muris, let me address my first couple of questions to you. And some of these questions are really follow-ups to questions related that you have been asked already. But how does Visa and Master Charge actually set their interchange rates? What factors go into those specific rates?

Mr. MURIS. Well, they recognize that this is a two-sided market, and it is a two-sided market where the consumer is king. The consumers get tremendous value. They get the rewards cards.

Mr. SMITH OF TEXAS. How are the actual rates set? Say it is roughly 2 percent.

Mr. MURIS. The rates have been set in part by competition. In fact, we have heard a lot of talk about rates going up. The merchant discount rates haven't gone up since the late 1990's, and they did go up. And one of the reasons—Mr. Keller asked what happened—one of the reasons was——

Mr. SMITH OF TEXAS. Actually, let me go back to my question. What factors do you consider in setting those rates?

Mr. MURIS. That is what I am saying. Competition between Visa and MasterCard to get banks to dedicate themselves to them was one of the factors that caused the increase in rates in the late 1990's.

Mr. SMITH OF TEXAS. Is there an overhead factor? Is there an expense factor? Is there a cost factor?

Mr. MURIS. But in a two-sided market it is frequent that one side gets subsidized. If I go on eBay, the seller pays it all and the buyer pays nothing. I mentioned newspapers when you weren't here. In newspapers, the readers are subsidized by the advertisers.

In payment cards, the cardholder gets a very good deal, and the merchants bear most of the costs. And that happens throughout in these so-called two-sided markets.

Mr. SMITH OF TEXAS. Okay. You have gotten some criticism today about anti-competitive behavior. How do you—if the fees are so similar, if you talk about an individual going into a store and buying the same merchandise with the Visa and the Master Charge, the fees are going to be pretty similar, why isn't that anti-competitive behavior?

Mr. MURIS. Well, as Mr. Keller mentioned, in competitive markets, it is quite frequent that the prices are similar or even identical. But here prices, in fact, are different. American Express, which is a smaller company, has a higher merchant discount of 2.5 percent. Discover has a lower merchant discount.

The size of the merchant discounts, is related to the type of the card and with what happened—of the need to attract merchants, as compared to consumers. There are antitrust cases going on. Those cases do not involve American Express and Discover because they are single entities.

Through historical accident, because Bank of America could not have multi-state banking, we ended up with the system that we have now. MasterCard and Visa have, in fact, moved to a system that now will look much more like American Express and Discover.

Mr. SMITH OF TEXAS. Mr. Duncan, why do you think the interchange fees are too high? And you have been asked several times today about a solution, and I heard one about arbitration and that a bill has been introduced to, I gather, compel arbitration. I assume you are opposed to price controls, but what other answers are there out there if, in fact, you can show that the fees are too high?

Mr. DUNCAN. Sure, let me start with just suggesting to you how fees are fixed. As Mr. Buhrmaster said in his testimony, and I think I referenced in my testimony, what happens is a group of big

banks with Visa get together and they set the fee. They then take it back to the Visa, and Visa blesses it, and all of the banks then charge that fee.

Mr. SMITH OF TEXAS. Just because they have gotten together doesn't necessarily prove the fee is too high. Why is the fee too high?

Mr. DUNCAN. The fee is too high because it is set the way a fee would be set by a monopolist. In any other market, as we see growth, as we see computerization, as we see improvements, prices go down. After all, this was originally a fee for processing a transaction, and now we see that only 13 percent of it goes to processing.

Mr. SMITH OF TEXAS. And what would you propose as an alternative?

Mr. DUNCAN. There is a couple of parts to that. First of all, because this system is governed by a privately regulated set of rules, the first thing we have to have is some transparency. We have to be able to see the rules of the game to know how you are going to fix this thing.

Look back. A few years ago, we had Ma Bell, and you could get any phone you wanted as long as it was black, white or ivory, and you paid two dollars a minute for long-distance calls. The courts got involved, and there was tumult. Finally, Congress came around and said, "You know, this is a problem that we have to fix. We have to look at it, study it, and come up with a solution."

We have an analogous situation here. The courts are involved, but only Congress can come up with a nuanced response to make this work. It may be as simple, for example, as looking at the "honor all cards" rule, the rule that says, "If I sign it to take this 1 percent traditional card, I have got to take this 3 percent business rewards card," and allowing a merchant to say, "No, I don't want to take these business rewards cards or these high-flying extra cards."

Mr. SMITH OF TEXAS. Okay.

Mr. Chairman, I would like to have an additional minute. And if granted, I am going to yield it to the gentleman from Florida, Mr. Keller.

Mr. CONYERS. Very good.

Mr. SMITH OF TEXAS. Thank you.

Mr. KELLER. Thank you.

Mr. Duncan, what is to keep Visa and MasterCard, since they have an 80 percent market share, for determining, "You know, instead of having 2 percent interchange fees, we are going to have 3 percent or 4 percent"?

Mr. DUNCAN. Frankly, the only thing I think that stops that from happening is because they are monopolists, and monopolists will price maximize. It has been a number of years since economics, but there is a market-clearing competitive price, and there is a much higher price that monopolists charge if they can profit maximize.

Mr. KELLER. Mr. Muris, would that be a good thing, if the interchange fees went up to 3 percent?

Mr. MURIS. Well, if they had the power that Mr. Duncan says they have, obviously the fees wouldn't be where they are now. But it is important to understand that——

Mr. KELLER. But isn't your position "when interchange fees increase, cardholders benefit"?

Mr. MURIS. Yes, but interchange fees are set in this process, this balancing process. It is clear that one of things——

Mr. KELLER. So if the ATM fees go up, that is good for me?

Mr. MURIS [continuing]. What happens with interchange is that cardholders received better cards. Most of us have four or five cards in our wallets, believe it or not. If interchange went down, like has happened in Australia, what happens is, annual fees become an issue. With annual fees, people would carry far fewer cards.

You might believe that people are wrong to carry four or five cards. I personally don't, but there is a direct relation between the size of the interchange fees and the quality of the cards.

Mr. KELLER. Thank you. I think my time has expired. I yield back.

Mr. MIERZWINSKI. Mr. Chairman, could I just add one quick comment on the Australia? I mean, the consumer groups would be happy to submit for the record that we disagree with the card associations' interpretation of the Australia experience, and we think that actually, overall, consumers are paying lower fees, and there are more entrance in the market, and it is a much more competitive system.

Mr. CONYERS. We would be pleased to accept any information in that regard.

The Chair recognizes Chris Cannon.

Mr. CANNON. Thank you, Mr. Chairman. I appreciate that.

And let me pick up from where I was with Mr. Smith. You were talking about some focus groups you had done. Do you have anything that you can share with us, any written reports on those focus groups or anything that would indicate something we could look at as a Committee?

Mr. SMITH. No, no, sir, I don't here with me today. I could provide that with you in the future.

Mr. CANNON. If something is done already, I would appreciate that. That would be interesting.

Mr. SMITH. Yes, sir.

Mr. CANNON. In that process, did you ask people what they thought fees currently are?

Mr. SMITH. And I don't recall exactly the exact line of questioning, because obviously I wasn't doing the questioning, but the questions had to do with payment methods. Which payment methods do you prefer? Is it debit, credit, check, et cetera? And it kind of weaved back around to the question, you know, what fees do you think are associated? Do you think any fees are associated with these cards? And that is where we ascertained the information that most consumers do not think there are fees associated with cards.

Mr. CANNON. Did you then take it beyond that to say globally how much profit is built into those transaction fees for banks?

Mr. SMITH. No, sir, because we were very careful not to disclose things we are not supposed to, according to the rules.

Mr. CANNON. Can you tell me about the rate you pay or the rates—for instance, does one size fit all or are there multiple rates that you end up paying as a merchant?

Mr. SMITH. Well, actually, I have a rate sheet right in front of me here. We pay 64 different rates to credit card companies. I would be happy to share this. At this point, I am probably not allowed to.

Mr. CANNON. Well, I ask unanimous consent that that be included in the record.

Mr. CONYERS. Without objection.

Mr. CANNON. Thank you.

Mr. SMITH. I am not sure that I can do that in accordance and not be in violation of my Visa and MasterCard——

Mr. MURIS. It is public information.

Mr. SMITH. I would be happy to supply you with that. But there are 64 different rates that are on this sheet. And if you look at MasterCard's rate sheet, as I understand it—now, this is not just for our industry; this is for our stores—but theirs was 106 pages long for all of the industries that they do business with.

Mr. CANNON. But this sheet reflects your fees?

Mr. SMITH. Sixty-four different rates.

Mr. CANNON. And they are different rates, and therefore, presumably, some ability to push people to use rates that are higher? Do you find that banks are—in other words, we have talked a lot about different kinds of cards. And some cards have extra fees because they are specialty cards, and a merchant ends up paying more, but do you find that there is pressure by banks in the system to encourage people to use cards that result in higher fees for you?

Mr. SMITH. There is no question to that, sir, yes.

Mr. CANNON. Do you push back on that at all?

Mr. SMITH. There is no way we have the ability to push back. We have to take all cards. We can't discriminate on any type of cards. And even if we could, with 64 different payment structures, I don't know how that would be possible in a retail environment.

Mr. CANNON. Given this policy, I appreciate that.

There is one other—I have many questions, but one I want to direct to Mr. Muris. You talked about the benefit of the system and some of the robustness of it and how merchants have a choice—I think you mentioned Costco doesn't take some cards. Costco, I think, is a little unique.

But however you consider the market for merchants today, how do you deal with the online environment? What does the merchant do who is online, where a customer has a different set of choices? Is it not more important for someone online to have the ability to process a credit card than it is, say, a store down the street?

Mr. MURIS. Absolutely. And I would submit that, without payment cards, we wouldn't have the vibrant online economy that we have. And the key to the functioning of payment cards has been their ability to balance these two sides of the market.

Interchange rates could be higher online, because the fraud possibilities are higher, but I think the Internet makes the case for payment cards, not the opposite.

Mr. CANNON. Well, so my point here is not that it is enhanced—I mean, I believe that it has. And Mr. Duncan earlier talked about profit, and I think actually profit is a wonderful motive. It gets people to do things they might never have thought of doing, like getting out and working. So there is nothing critical in this question.

But the question more that I am asking is, is there a disproportionate bargaining position on the part of the credit card companies when they are dealing with people online?

Mr. MURIS. In many ways, I don't think so. PayPal and other people are trying to come up with different kinds of payment systems. Again, we have a variety of—we have four credit card payment systems. It is quite frequent. I don't know how you much you purchase online, but when I purchase online, most of them seem to take all the major systems.

Although there has been a tremendous benefit, there is competition in this business, and I think that competition acts like it acts otherwise, to protect the consumer.

Mr. CANNON. I only buy things online in D.C., where I don't think I have to pay sales tax on them. You have to remember everything you buy in Utah and declare that on your sales tax, another issue for one of the Subcommittees of this full Committee to deal with at another point in time.

Mr. Chairman, I recognize my time is expired, and thank you, and yield back.

Mr. CONYERS. Thank you very much.

Mr. Darrell Issa?

Mr. ISSA. Boy, it is hard to know where to begin. We are not the courts, and, Mr. Chairman, I respect the fact that we have certain limited jurisdiction. So let's assume for the moment that it is the courts' job to decide if you are a trust, if, in fact, Visa and MasterCard are operating as monopolies.

But, Mr. Muris, I guess since you are the apologist for the credit card companies here today, to use a technical term I think we use from time to time here at the dais, why in the world within our powers shouldn't we have a piece of legislation that says that, from a contractual standpoint, since it is very clear that credit cards have monopolistic power as a group, then why is it that it wouldn't be appropriate for us to sponsor legislation, on a bipartisan basis, that would simply allow those taxes to be added, 64 different—and, by the way, Mr. Smith, I am assuming you will answer affirmatively that your stores could have a computer that would add the exact amount of those 64 different rates so that whatever card I chose, I got the effective tax rate back to me, as a pass-through, no profit, just a pass-through—why in the world shouldn't we sponsor legislation that says that?

And then, secondly, and probably even more importantly, why in the world should this Committee allow a gag rule to be in place that prevents the public from knowing what is being added to the cost of the product, particularly when a gallon of gasoline has more profit in it for your companies than it has for any of the people they are buying from?

Mr. MURIS. Well, I am speaking—although I have done work for Visa, I am speaking, as I always do in front of Congress, for myself. I decided 40 years ago that I wanted to be active in public policy issues and speak my mind, and that is what I am doing today.

Mr. ISSA. Oh, okay. So when your firm advertises that as a lobbyist organization, that you are the premiere one in Washington, that it has nothing to do with that? You are doing this on your own dime for free, not for a client?

Mr. MURIS. No, what I am saying is that this is not my full-time job. I am a college professor, as well, and I am doing other things. I only speak in public and I only represent people in whose cases I believe. In fact, Discover came to me in 1990 in a case against Visa and wanted to hire me to work for them, and I said Visa was right.

Mr. ISSA. Okay, well, in that case, I think I will switch to Mr. Buhrmaster. As a small banker—I will ask you the question—why in the world do you believe that you only have essentially two people you can deal with and both of them, Visa and MasterCard, guarantee you a profit, even though your various banks are on the back end, the smaller end, but they set the price high enough that the smallest of banks still make a profit on it? Why do you think that occurs?

Mr. BUHRMASTER. Well, I don't believe they set the price. I do believe that the price is set by the marketplace. When a merchant comes and sits down at my desk and says, "I am interested in this product," chances are they spoke to someone else. And I disagree with Mr. Smith when he says there is no competition here, there is no negotiation.

Mr. ISSA. Well, let me switch. I will switch, but I want you—just double check—I want you to have your banker's hat on, okay?

Mr. BUHRMASTER. Certainly.

Mr. ISSA. If I came to you tomorrow with a product that cost 25 cents per $100, 0.25 percent as a transaction fee, and that is all you had to pay, and then you could price your amount on top of that for a merchant, let's say another 0.25 percent or another 0.5 percent, so that for 0.75 percent, instead of 2 percent or 2.5 percent, you could provide a merchant with this transaction, no frills, would you for a minute not take that 0.25 percent, add your 0.25 percent or 0.50 percent, and undercut the existing competitors of Visa and MasterCard? If that was available today, is there any reason you wouldn't take that?

Mr. BUHRMASTER. When I look at a product I am buying—and that is one of my jobs at the bank; I examine new products—I want to know the same thing my customers ask when they walks in here: Where am I going to get the best service and the best price?

If I made my decision solely based on the best price, I would probably not be in business, because I have gotten some great deals thrown in front of me that turn out pretty bad. Now, that said——

Mr. ISSA. Okay, well, let me rephrase that.

Mr. BUHRMASTER. But, no, I know what you are saying.

Mr. ISSA. Let me re-ask the question one more time, because the time is limited, and I think we have to get the basic question of: Is there an absence of an a-la-carte for a reason? If Visa or MasterCard offered you the transaction separate from all the other things that go in it, the 0.25 percent rate, which would be about what I guess is the 13 percent of the fees that are going on, just my arithmetic, if they offered that, would there be any reason in the world that you would not use that, at least with merchants who wanted it as a competitive advantage?

Mr. BUHRMASTER. I want the best deal I can get for my bank and my customers, so if someone is offering me a better rate and I am used to their service, and I can verify their service, and I can make

sure I am getting the value for my price, I would take it. Now, that said——

Mr. ISSA. I am assuming that, if that were offered by Mr. Buhrmaster, that you would take that rate of about half what you are paying and put the rest of it either into savings or, perhaps, eking out a profit. Is that roughly correct?

Mr. SMITH. I think that would be fair to say. We would enjoy having a lower rate and competition to get there.

Mr. ISSA. So it is the absence of competition and the absence of disclosure that we are dealing with here today within our jurisdiction?

Mr. BUHRMASTER. I have to disagree with that. That is been said a number of times here, and we are talking about an absence of competition. There is not an absence of competition. As a merchant acquirer, there is not.

I have people coming into my office—out of my 160 merchants, we have people that come in and say—I had a guy come in, and he showed me his business card. On the back of it, it says, "I can give you this rate." Well, I say, "All right, what services are they offering?" There is competition. Every day, there are people in my merchant shops trying to offer them a better rate.

I price the way I feel I can make a profit and I can deliver good service. I don't want to do both. I don't make a big profit on this. I deliver good service.

Mr. ISSA. But Mr. Buhrmaster—and my time is up, and I don't want to take too much of the indulgence of the Chairman, but since I am, oddly enough, the only member of a public company's board, and my company does about $40 million of transactions a year, and I am the former CEO, with all due respect, I have been at the negotiation table on behalf of my company with the various banks. And it simply isn't true.

Yes, you can negotiate over 0.02 percent or so. You cannot negotiate beyond that. We are dealing here today, with the Chairman's leadership, on the portion that is, in fact, the price-fixing portion. And I would hope that, in the future, that the kinds of hearings we have continue to expose the fact that there is an absence of competition and a gag rule in place in America today.

And, Mr. Smith, thank you for your leadership and the rest of you that helped flesh this out.

Thank you, Mr. Chairman, for your leadership. I yield back.

Mr. CONYERS. I thank you so much.

Mr. Chabot?

Mr. CHABOT. Thank you, Mr. Chairman.

I just have one final question that I would like to put to both sides. To the banks-credit card folks, obviously you have been on the receiving end of the more probing questions. And my question to you is: Are there any misimpressions that you have heard here, that the Committee may have received? Is there anything that you would like to clear up? Is there any other criticism that you have heard that you think is unwarranted? I would like to give you both a last shot to make your best case to us.

And then, to the retailers, if you could comment as to why—oftentimes, a lot of us believe that you don't necessarily want Congress getting involved in something that marketplaces can kind of

take care of things, but that is not always the case, and sometimes we do need to step in and regulation is appropriate. Would you tell us why this is an area that ought to be probed further and that we ought to look into and how we could be involved to the extent that we can be helpful and not screw up the marketplace out there, as Government is sometimes apt to do?

And I don't care who goes first. We can just go down the line, however you want to do it. Why don't we go, Mr. Smith, if you would like to? And we will just go right down the line. And if you could keep your comment to perhaps a minute or so, because I have only got 5 minutes.

Mr. SMITH. Well, thank you, Mr. Chabot.

I think that the thing that we look at in our business is we are the purchasing agent for our consumers. It is our responsibility to make sure that we can bring food to the table of our consumers as inexpensively as we can with quality merchandise. The problem we have got, when you see a 2 percent fee for credit cards and a 1 percent profit margin, you must understand that there is a pass-through to the consumer.

Our concern is, as it has gone up 117 percent, we don't know where the end is. We have credit card fees that are going up faster than our health care, faster than any other expense that we have in our business.

I don't know that I have a solution for you here today. I wish I did. But I what I do think works and what I have experience with is being in a free market enterprise system, one where competition is readily available, and folks vie for your business each and every day. And I hope that is what we can work with this Committee to come up with.

Mr. CHABOT. Thank you.

Mr. Buhrmaster?

Mr. BUHRMASTER. Well, I enjoyed the probing questions, and I wish you would have asked me more. I came here, and I enjoy asking the questions for you folks.

I feel that we have missed something here. There is competition in this business. From where I sit, I sit at a desk, in a small bank, in a small town, in a small community, and I have my merchant customers bombarded with people coming in and offering them better deals. There is competition out there.

The base price may be set, but that is what allows a bank like ourselves to be in the business. You know, we can compete with the Bank of Americas. We may add on what our cost is so that we can be competitive. But it is so important to note: There is competition out there. And I do lose customers, and I gain customers.

Second is just don't forget the small banks in this equation. You can't forget that we are driving the economy of this country and that this is an important part of our driving the economy. We have to have these payment options for our people, for our consumers, and for our merchants and our small businesses. It is important.

And if legislation is put forth that restricts our ability to compete with the large banks, you will lose the small banks in the payment acceptance arena, and it will be dominated by large players that traditionally have not looked out for the consumers the way small banks do.

Mr. CHABOT. Thank you.

Mr. Mierzwinski?

Mr. MIERZWINSKI. Thank you, Mr. Chabot.

The first thing I would like to say is simply that the consumer groups care about all consumers, not only cardholders. And if cardholders represent 50 percent of the business of a store and the cost is 2 percent added on across all 100 percent of the store's customers because of unfair interchange rates, well, then everybody is paying 1 percent more, regardless of how we pay, with a card or without a card. So that is the first issue out there.

Second, in terms of the unfair practices, one thing that we haven't pointed out is that the cheapest form of interchange is actually PIN debit. There are statistics out there and there are facts out there that show that many banks are now starting to impose a PIN debit fee on consumers to drive them to signature debit, which is the higher cost debit. And that is why you have all these rewards programs. They put the rewards programs on the signature debit only, just like on credit cards, because they want to drive you to that, because they make more money from the merchants.

Rewards, by the way, we think are overrated, particularly on credit cards. Most people don't redeem them. And if this is what we are paying for, it is a ridiculous system.

Then, finally, you asked, what else should you be looking into? The final point of my testimony was that, in addition to this system of interchange being broken, we believe that the issuer system is an oligopoly and that there are bad practices that companies engage in, because of those anti-competitive practices at the issuer level, and we would encourage a second hearing just on issuer competition.

Mr. CHABOT. Thank you.

Mr. Muris?

Mr. MURIS. Thank you very much. And let me submit for the record that I have heard a lot of facts—many more than I could talk about now—that I thought were wrong. Just let me make a few points.

First of all, regarding rewards cards, I like my rewards. I don't think it is the job of Government to tell people what kind of products they should take.

Second, fees are not out of control. And let me submit for the record data I obtained from Visa involving supermarkets, which show that the increase in volume explains, virtually percentage point for percentage point, the increase in interchange that supermarkets have paid to Visa in the last 7 years.

Next is, despite what we have heard, merchants can discount for cash. They can disclose all this information. They can steer. They can have people use debit. They can have people use Discover. There are lots of things they can do.

Next, what we heard from both Mr. Smith and Mr. Duncan when they were asked for remedies shows that, if this were really an antitrust case, they wouldn't be here. An antitrust case would simply end the price fix. By asking for a complicated AT&T break-up kind of remedy, that is clearly an implicit admission this is not the cartel case they claim.

Finally, consumers do know that merchants pay. In fact, two-thirds of them know that merchants pay to use the cards.

Thank you.

Mr. CHABOT. Thank you. If we could get some follow-up on that, because there have been some discrepancy this afternoon from both sides. We would like to get—I think, I am sure we all would—just to verify it one way or the other.

Mr. MURIS. Yes, sir.

Mr. CHABOT. Thank you.

Mr. Duncan?

Mr. DUNCAN. Yes, first, I guess what I would like to say is that what we have here is a market failure. We don't have a market. We have prices that are regulated privately and supported by a secret set of rules. So that is not a functioning market; that is not the definition of a market.

Now, the courts—as Tim points out—the courts are very good at deciding liability, and they can determine damages. But if we are talking about fixing this, we are talking about prospective remedy, that is not something a court is very good at. So it is really the prerogative of Congress to come up with the kind of nuanced solutions we need to help correct an anti-competitive market. I would suggest that one of the first places we look is at these rules.

Mr. CHABOT. Okay, thank you very much.

Mr. Chairman, I want to thank you for having this hearing and just say that I think both the witnesses on both sides here were very, very good. And I think they had great presentations, handled the questions very well on both sides, so thank you to the panel.

Mr. CONYERS. But there is a lot of conflicting testimony here, sir. Somebody is less correct than somebody else, which is our job to determine.

Ric Keller?

Mr. KELLER. Thank you, Mr. Chairman.

And I want both sides to know that I have read everything you have had to say, I have listened to every word you have had to say, taken notes on everything you have had to say, and really hope we have given you a fair shake, both sides, and will continue to do that.

Following up on what Chairman Conyers said, I am going to try to create order out of chaos just a little bit. I have found six factual inconsistencies between you—one side said one thing; one said the other—and one area of agreement. And I will go through that and see if we can at least get the agreement.

The retailers say, "We just want to be able to see these Visa and MasterCard operating rules, and they are kept secret from us and the public." Mr. Muris, on behalf of the credit card companies, banks, "No, we don't keep them secret. They are right there on the Web site. Anybody can see it."

Retailers said, "We can't advertise or offer cash discounts or debit card discounts; in fact, Visa threatened some California gas station for offering lower cash prices." Mr. Muris said, "Not true. You can offer lower prices, cash discounts, offer debit card discounts, advertise it if you want."

The retailers said, "We don't have the bargaining power to deal with these credit card companies. It is take-it-or-leave-it, and we

have to take it, since they have got 80 percent market share, companies like MasterCard and Visa." Mr. Muris says, "Not so. Costco cut a deal with American Express, using their bargaining power, and American Express typically had a higher merchant rate, 2.5 percent, more than MasterCard and Visa, so just cut your deal."

Retailers say that, "When interchange fees increase, it hurts consumers and cardholders." Mr. Muris says, "When interchange fee increase, cardholders benefit. Higher interchange fee revenues to issuing banks result in increased benefits to users of payment cards, such as increased rewards and lower fees. These benefits come not only in the form of air miles, but also include rebates."

Retailers say, "We don't want price controls. We want competition." Mr. Muris says, "Critics, including the merchants, want the Federal Government to impose price controls."

Mr. Smith, on behalf of the retailers, is the CEO of Food City and the president of food marketing, says the supermarkets are hurting. Mr. Muris pulls out a letter and says supermarkets are doing great. They are not hurting.

Well, here is my one area of agreement that I have seen: It seems that people at least agree, pursuant to these operating agreements that Visa and MasterCard issue, if there is a company such as Mr. Smith's company, Food City, and they agree to accept Visa, and someone comes along with one of these Visa premium cards, with lots of bells and whistles, like airline miles and rewards and rebates, and it has a much higher interchange rate, you have got to take it, just like the more basic one. And Mr. Muris hasn't disputed that.

And one of the solutions—in fact, the only solution I have heard today that Mr. Duncan has offered is maybe that should be changed, maybe you should have the freedom to turn down some of these big-ticket premium reward cards that are charging you very high interest rates. Is that essentially your idea, Mr. Duncan?

Mr. DUNCAN. That would be a first step.

Mr. KELLER. Mr. Muris, have I accurately laid this out, or am I mistaken?

Mr. MURIS. Yes, what you have done is destroyed the value of Visa and MasterCard as a brand, because what that means——

Mr. KELLER. I didn't know I was that powerful. [Laughter.]

Mr. MURIS. Well, that is what your remedy would do, because what that means is—the value to me is I can take my Visa card and it will be honored anywhere. And what you are saying is, no, the merchant can pick and choose. So you really would hurt the value of the brand.

Mr. KELLER. But you would agree with the statement—and I don't want to quarrel with you; I just want to make sure I am getting my facts right—that, if someone enters into a Visa agreement, such as Food City, and you agree to take the Visa cards, you have got to take all the Visa cards, the premium ones and the basics? Is that right?

Mr. MURIS. Absolutely. I think you are doing a superb job of summarizing. I was just saying the implications of what you want would have disastrous consequences.

Mr. KELLER. Thank you, Mr. Chairman. I will yield back the balance of my time.

Mr. CONYERS. My commendations to you, because that is precisely what we are going to have to do after this hearing, is what you have already initiated. I thank you very much, Ric.

Steve Cohen, were you just passing through the Rayburn building, wandered in here, or do you have a purpose?

Mr. COHEN. Mr. Chairman, I was going through the payphone return coin places to try to get some money to pay my credit card bill, and I hadn't come up with enough yet, but I did stop by. Thank you, Mr. Chairman.

I am interested in this issue, and I have had an interest in consumer issues for some long time. And I am afraid I am not as maybe up to speed as Mr. Keller and some of the others, having listened to the testimony.

But one of the things that—and it is just shocking to see that these rates have continually gone up, and the United States is appearing to be the only country in which credit card interchange fees are increasing, and has far higher fees than almost any other industrialized country. And I guess that is—whose testimony is that from, or is that just the gospel?

Mr. DUNCAN. That is the gospel.

Mr. MURIS. Well, it is not true. You know, it is another fact I will dispute, but we could——

Mr. COHEN. Is it the gospel according to Ed?

Mr. MIERZWINSKI. The statistics we have seen, Representative Cohen, are that the U.S. has the highest rates. The retailers and the consumer groups agree on that.

Mr. COHEN. And, Mr. Muris, which countries have higher rates?

Mr. MURIS. Well, I will submit for the record two pieces of evidence, one from Aité, which shows that what merchants pay is lower in the United States than most places; another from the European Union that shows what merchants pay in the United States for Visa is right in the middle of other countries.

Mr. COHEN. But Visa is different. We may be talking about MasterCard.

Mr. MURIS. Well, no, I believe Visa and MasterCard are very similar.

Mr. COHEN. They are very similar.

Mr. Chairman, may I ask a question? I may be confused. Wasn't this about antitrust?

Mr. CONYERS. Well, this is the Antitrust Task Force of the Judiciary Committee, yes.

Mr. COHEN. So is this an admission that Visa and MasterCard are kind of doing something together?

Mr. CONYERS. Well, no, wait a minute. We haven't gone that far yet.

Mr. COHEN. Okay, I am sorry.

Mr. CHABOT. Would the gentleman yield?

Mr. COHEN. Yes, sir.

Mr. CHABOT. I thank the gentleman for yielding.

Mr. Muris, if you have evidence to the contrary or there are studies out there, I would like to have that material. I think we all would, again. You know, otherwise, if there isn't something, then I would tend to accept that. You know, if there is something that is inconsistent, then I would like to see it.

Mr. MURIS. No, I will submit the information for the record, but the truth is, in competitive markets, firms tend to—and I believe it was Mr. Keller who pointed that out—when you walk into stores, close competitors have similar prices. That is what often happens in competition.

Mr. CONYERS. Well, that is also possible price-fixing, too.

Mr. MURIS. Sure, it is a possibility of price-fixing, monopoly, or competition.

Mr. CHABOT. And I am talking specifically about whether the United States has the highest rates.

Mr. MURIS. Oh, yes.

Mr. CHABOT. That is what I was talking about.

Mr. MURIS. Yes, and I have—and I will submit two different pieces of data for the record.

Mr. CHABOT. Yes, I mean, I would be very interested in seeing it, but I haven't seen it, other than what Mr. Cohen has referred to, so I am assuming that that is the case, unless I see something different. Then I would look at the source of that.

Thank you.

Mr. COHEN. Sure, that is on page three here of the consumer group testimony on credit card—let me ask this question. Mr. Muris, are you with a credit card company?

Mr. MURIS. I am testifying today, as I always do—we had a little exchange about that—I am——

Mr. COHEN. I think I heard that one. You are a citizen, and you only come out for folks you like? I heard that. Between telephone booth places, I did hear a little bit of that.

Mr. MURIS. I have spent 40 years doing this. I have had six jobs in the Federal Government. I have had a lot of other policy jobs. I only speak and work for people in whose cause I believe, and I am proud of that, sir.

Mr. COHEN. Do you have any reason to know why the credit card companies continually send out all these requests for people to get credit cards? I live in a house for 19 years, and there is still soliciting the people who died before I moved in and saying, because of their good credit rating, they are entitled to get this card. They have been dead for a long time.

Mr. MURIS. Sure, and it is one of the——

Mr. COHEN. They are debt-free.

Mr. MURIS. It is one of the ways that people get credit cards. One of the things that I suspect you helped us with, when I was chairman of the Federal Trade Commission, we made it easier for people to opt out of those solicitations. It was not like—we did the National Do-Not-Call Registry when I was chairman, and Americans overwhelmingly signed up for that. Americas overwhelmingly don't——

Mr. COHEN. But these people are dead. They can't opt out.

Mr. MURIS. But I am saying that, if you wanted to, sir, you can opt out. But like me, you probably don't, because most people—it is very easy to sift through their mail. And, in fact, I have accepted credit cards based on the mail solicitations. But if I wanted to, I could opt out.

And thanks to you and the other Members of Congress, a few years ago, you made it easier for people to opt out, and I thought that was a good thing.

Mr. COHEN. But the cost of sending that letter to make you opt out and then to make you opt out cost all this money that we then charge in fees. And then to make money, we have to charge more money even.

Mr. MURIS. Sure, advertising and marketing——

Mr. COHEN. So why you can't be more selective in who you pick, who really is somebody that deserves and has good credit? Isn't there some way to—because it bothers me as a consumer, and it bothers me as somebody who invests, that is such wasteful spending.

Mr. MURIS. Again, I would be glad to help you exercise your right to opt out.

Mr. COHEN. I think we have a volunteer here. End of my 5 minutes, please.

Yes, sir?

Mr. BUHRMASTER. As a credit card issuer, everybody has a different way they do business. And I am speaking as a small bank, but there are other large banks that their way of doing business and getting credit cards into the hands of consumers is the mass mail. To my grandmother who passed away several years ago, we still get mailings for her, but that is the way they choose to pick their customers.

Other banks, other issuers choose other ways. It is just in the business model. It has nothing to do with the interchange debate. It probably has more to do with the shrinking margins that the banks are experiencing because of the rate environment. They are looking for ways to find more ways to lend to people.

The money they are making off of people with bad credit come from these interest rates that are high. So——

Mr. COHEN. Right. And, apparently, according to this information, there are nine billion unsolicited credit card offers sent just this last year, nine billion. Even in China, that is a lot of people.

Mr. BUHRMASTER. But I get more requests for charitable donations than I do for credit cards.

Mr. COHEN. That is different.

Mr. BUHRMASTER. It is different. It is different. But it is what comes——

Mr. COHEN. And you are apparently quite wealthy and probably——

Mr. BUHRMASTER. I wish I were.

Mr. COHEN. Thank you, sir.

Mr. BUHRMASTER. Thank you.

Mr. COHEN. Thank you, Mr. Chairman.

Mr. CONYERS. Well, this has been a very conflicted set of testimonies we have received, but then that is what we are here for, isn't it?

I thank all of the witnesses. I know you will be submitting—if you keep your promises, we will be getting more statements to build up into this record than we usually normally receive. And we have 5 days—you may get questions from us, and we will get an-

swers back from you. And then we will have concluded the first hearing.

What is important is, what are we going to do in the second hearing, or maybe even the third? It has not escaped my notice, Mr. Keller, that solutions to this problem are pretty few and far between, so it is going to test the skills and competency of this Judiciary Committee a great deal.

But you have got to start it, and you have opened up this testimony in a very fine way. We thank you very much.

And the hearing is now adjourned.

[Whereupon, at 4:16 p.m., the Task Force was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

PREPARED STATEMENT OF THE HONORABLE LAMAR SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS, AND MEMBER, ANTITRUST TASK FORCE

Mr. Chairman, today we consider an issue that is vital to the American economy.

America has gone through a radical transformation in the way it pays for its goods and services. Ten years ago, almost 80% of all financial transactions were made with checks or cash. Today, less than half of purchases are conducted this way. And three years from now, consumers will use credit and debit cards for over 70% of all their purchases.

Properly used, credit cards offer many benefits for consumers and businesses alike. For consumers, they offer fraud protection, payment flexibility, the ability to track purchases and airline miles. For merchants, they offer guaranteed, faster payment and the opportunity to expand businesses through Internet and phone sales.

Some studies have shown that consumers who use credit or debit cards at the time of purchase are likely to spend more than they would otherwise.

Of course, this growth has not come without its costs. Consumer groups have complained for years about credit card practices that they think are unfair or illegal. Merchants, too, have had their complaints. In 2005, the Second Circuit affirmed a settlement in which VISA and MasterCard paid $3 billion. The settlement arose from a case brought by a group of retailers who claimed that VISA and MasterCard had illegally tied the acceptance of their credit cards to their debit card offerings.

This resulted, among other things, in the imposition of fees on the banks that issue credit cards that were higher than they would have been in a competitive market.

Today, retailers continue to claim that VISA and MasterCard are charging these higher fees for the acceptance of their cards, and that these fees are ultimately passed on to consumers. A group of retailers has brought a series of federal antitrust suits challenging the way that VISA and MasterCard set these interchange fees and they are pending in the Eastern District of New York.

At the same time, retailers complain that VISA and MasterCard do not make available to them all of the rules that govern their transactions. They cite examples of merchants that have been assessed fines by the credit cards for rules that they did not know existed.

For their part, the credit card companies insist that they have provided all the relevant information to merchants. They also maintain that the setting of credit card interchange fees is a necessary part of their business that maximizes the number of consumers who are willing to carry their cards and the number of merchants who are willing to accept them.

Retailers have raised some serious questions. For example, who sets the interchange fee, and how it is set? How much of the interchange fee is passed on to merchants and, ultimately, the American consumer?

What are interchange fees used to finance? Who makes the rules the merchants must abide by, and who enforces those rules? Which of these rules have been made available to the merchants and which have not? And if those rules have not been made available, why have they not?

As for the retailers, I would like to know what is the remedy that they would really like out of these hearings? What is the information that they feel that they are not getting from the credit card companies and why is that actually important to them? What are the benefits that they receive from the credit card payment system? Are those benefits outweighed by what they have to pay in interchange fees?

PREPARED STATEMENT OF THE HONORABLE SHEILA JACKSON LEE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS, AND MEMBER, ANTITRUST TASK FORCE

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CONGRESSWOMAN SHEILA JACKSON LEE, OF TEXAS

STATEMENT BEFORE THE

COMMITTEE ON THE JUDICIARY
ANTITRUST TASK FORCE

OVERSIGHT HEARING:
"CREDIT CARD INTERCHANGE FEES"

JULY 19, 2007

Thank you, Mr. Chairman for holding this oversight hearing. Let me also thank the Ranking Member and all the members of the Task Force for volunteering to serve on the Antitrust Task Force. The continued vitality of our nation's economic system depends upon fair and vigorous competition. This has proven to be the best and most effective way of ensuring innovation, improving quality, reducing prices, widely distributing goods

and services throughout the population, and turning the diversity of the nation into its greatest strength and asset. I am therefore very pleased to be a member of this Task Force. I strongly believe that working together; we can achieve great things for the American people.

The purpose of the hearing is to examine credit card interchange fees – which are fees charged when a consumer uses any payment card at a retailer. The fees cover the cost of processing the transaction, fraud protection, billing statements, payment system innovations and other expenses. Groups representing merchant interests have raised concerns about the interchange fees, namely the lack of awareness of these among consumers, inconsistent charging practices, increased costs of goods and services, as well as the possibility that Visa and MasterCard -- the dominant payment card companies -- are setting the interchange fees collectively and thus precluding outside competition. The payment card industry defends the fees, explaining that Visa and MasterCard do not prohibit disclosure of interchange fees to consumers, the fees are the result of healthy competition, and they are necessary to the entire system of payment cards.

Mr. Chairman, electronic transaction fees are increasingly important to Americans. More and more people are using credit cards to make daily purchases and as a result, the rate of ATM usage has skyrocketed. American

citizens unlike before are buying more homes, investing in higher education and planning for early retirement. As a result of this economic phenomenon, the usages of credit cards have increased tremendously and more Americans hope to improve and maintain good credit history to preserve an abundant lifestyle.

Today, we shall hear from representatives of two important actors in this important sector of the economy: merchants, on the one hand, and card issuers and payers on the other. I welcome and look forward to our distinguished panel of witnesses for clarity in resolving this issue.

Mr. Chairman, 10,000 electronic transactions are processed every second. These transactions generate more than $2.5 trillion in sales per year and nearly two- thirds of Americans families use electronic payments routinely. Nearly one billion cards are in use in the United States and it is expected that consumer spending using electronic payments will exceed $5 trillion by 2009. Payments made electronically in the United States have grown from 25% in 1995 to over 50 % in 2002 and are still on the rise. An increasing number of Americans make payments electronically due to its convenience and reliability.

Mr. Chairman, merchants complain that they are charged excessive fees in exchange for electronic payment methods. They argue that unlike

other credit card fees, interchange fees are hidden and thus it impossible for merchants to tell consumers how much the fees are costing them. In addition, interchange fees are non-negotiable. Merchants constantly work to lower interchange cost so that they can run their businesses more efficiently and offer greater value to their customers.

It is reported that only 13 percent of the interchange fee is actually used for processing. Retailers are claiming that the fixed interchange rates make it practically impossible for merchants to tell customers how much they are really paying. Merchants claim that interchange fees add to the price of everything we buy. Americans paid more than $36 billion in credit interchange fees in 2006 alone, and the average American family is now paying more than $300 a year in interchange fees.

Nearly 30 associations, representing 2.7 million stores composing of retailers, supermarkets, drug stores, convenience stores, fuel stations, on-line merchants that accept credit cards are fighting for a more competitive and transparent card system that works better for consumers and merchants alike. Because the cost of the hidden credit card interchange fee is built into the price of everything a merchant sells, the average American household pays hundreds of dollars in interchange fees each year. Unlike other costs, the credit card interchange fee is not negotiable. Merchants

PREPARED STATEMENT OF THE HONORABLE STEVE COHEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE, AND MEMBER, ANTITRUST TASK FORCE

Credit card interchange fees represent a hidden cost to consumers because merchants will pass on these fees to consumers. These fees may be all the more harmful to consumers because the major credit card companies may be colluding to fix the fees charged to merchants, thereby imposing higher costs on consumers than the market might otherwise. Such conduct, if in fact it were occurring, would constitute anticompetitive behavior in my view. I look forward to learning more about the issue from today's witnesses.

LETTER FROM TIMOTHY J. MURIS, OF COUNSEL, O'MELVENY & MYERS LLP TO THE HONORABLE JOHN CONYERS, JR., ENCLOSED WITH ATTACHMENTS

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VIA HAND DELIVERY

The Honorable John Conyers, Jr.
Chairman, Antitrust Task Force
Committee on the Judiciary
U.S. House of Representatives
2426 Rayburn Building
Washington, DC 20515

Re: ***July 19, 2007 Hearing on "Credit Card Interchange Fees," Antitrust Task Force, U.S. House of Representatives Committee on the Judiciary***

Dear Chairman Conyers:

I write to submit for the record materials that supplement my testimony for the Antitrust Task Force "Credit Card Interchange Fees" hearing on July 19, 2007. I thank you again for the opportunity to testify, and appreciate your consideration of these additional materials. I have briefly summarized responses to the questions and data requested by the Task Force, and enclose the noted items for additional information.

1. **Consumer Awareness of Merchant Discounts**

   During the hearing, I mentioned that consumers in the United States appeared to be aware that merchants pay a fee when consumers choose to use a payment card to complete a transaction. My response was based on a study from April 2007 done by Javelin Research. The relevant part of the Javelin Research report is attached as Enclosure A. Javelin reported that 66 percent of surveyed consumers were aware that merchants pay a percentage of the overall sale for each debit and credit card transaction as a fee to process their card.

2. **Comparison of the Cost of Payment Card Acceptance in the United States and Elsewhere**

   In public discussions of interchange, representatives of merchants often suggest that merchants in the United States pay more to accept payment cards than merchants pay anywhere else in the world. Although I do not know of a comprehensive global survey of payment card acceptance costs, the available information on the subject appears to refute this claim.

The most extensive survey on the cost of payment card acceptance outside of the United States of which I am aware is contained in a recent report by the European Union on the payment card industry. That report contains a chart, attached to this letter as Enclosure B, that purports to show how much European merchants paid in 2004 to accept payment cards. The chart presents the data in percentage terms, identifying selected European countries by letter. The chart does not identify the countries by name. (The entire report can be found on the internet at http://ec.europa.eu/comm/competition/antitrust/others/sector_inquiries/financial_services/interim_report_1.pdf (last visited July 27, 2007).)

I submit an additional chart based on the data in the European report. At a conference hosted by the Federal Reserve Bank of Kansas City, Bill Sheedy of Visa presented some information about merchant discount rates on Visa transactions from 1995 to 2004. *See* KCFRB, *Interchange Fees In Credit And Debit Card Industries: What Role for Public Authorities?* 180 (2005) (available at http://www.kansascityfed.org/PUBLICAT/PSR/Proceedings/2005/Industry%20panel.pdf) (last visited July 30, 2007). Information on the American Express merchant discount rate in 2004 is available at page 36 of the 2006 American Express Annual Report (which is at http://library.corporate-ir.net/library/64/644/64467/items/235025/ Amex_06AR_03_8_07.pdf (last visited July 27, 2007)). Enclosure C compiles this information into a new chart. This chart shows that merchant discount rates in various European countries exceed the rates paid by U.S. merchants in 2004 to accept either American Express or Visa payment cards.

This analysis also is largely consistent with the analysis done by the AITE Group. AITE reported in 2005 that U.S. merchants paid lower discount rates for Visa and MasterCard credit card transactions than merchants paid in all but three of fourteen European countries. The relevant part of the AITE report is attached as Enclosure D.

3. Supermarket and Regular Retail Interchange Rates

During the hearing a question was raised about interchange rates on transactions at supermarkets as compared with interchange rates on all transactions. MasterCard and Visa post information about the interchange rates that apply to transactions at supermarkets and other retailers. The MasterCard rate table can be found at http://www.mastercard.com/us/wce/PDF/14992_MasterCard_Interchange_Rates_and_Criteria_-_October_2006.pdf (last visited July 30, 2007). The Visa rate table can be found at http://usa.visa.com/ download/merchants/Interchange_Rate_Sheets.pdf (last visited July 30, 2007).

4. Visa's Rules on Offering and Advertising Cash Discounts

During the hearing, we discussed the subject of discounts for cash transactions. As I mentioned, nothing in Visa's rules prevents merchants from offering and advertising cash discounts to consumers.

Visa Rule 5.2.D.2.a states:

> A merchant may offer a discount as an inducement for a Cardholder to use a means of payment that the merchant prefers, provided that the discount is clearly disclosed as a discount from the standard price and non-discriminatory as between a Cardholder who pays with a Visa card and a cardholder who pays with a comparable card (*i.e.* MasterCard, Discover and American Express).

To offer a cash discount, a merchant need only post a sign or advertise the cash discount as a percent or amount. A merchants does not have to post two prices for each individual item offered for sale, as representatives for some merchants claim.

A fellow panelist suggested that Visa required a San Francisco gas station to stop advertising a cash discount. I understand that the station in question, however, was imposing a surcharge, not a cash discount. California law, like the law in several other states, prevents retailers from imposing a surcharge on a cardholder who elects to use a credit card in lieu of payment by cash, check, or similar means, while allowing for a retailer to offer a cash discount so long as it is offered to all prospective buyers (Calif. Civil Code Section 1748.1). The gas station in question had presented a credit price surcharge, rather than a cash discount. It was asked to discontinue using a surcharge.

Again, thank you for inviting me to share my thoughts and perspective on interchange with the Subcommittee.

Sincerely,

Timothy J. Muris

Enclosures.

Payments Interchange: The Tenuous Balance
Merchant, Issuer, and Network Uncertainty Calls for Policy Changes and the Elimination of Rhetoric

JAVELIN STRATEGY & RESEARCH

Overview

Interchange as an institution within card acceptance has worked under the premise that credit and debit cards provide sufficient merchant value vis-à-vis the price of interchange. But it has become a tenuous balance based on various practices and actions—by networks and issuers on one side, and merchants and merchant advocates on the other—that threaten to change the face of interchange and card transactions as a whole. Javelin used surveys of consumers, merchants and interviews with industry leaders to uncover the forces that could most readily upset that balance, and to determine the most profitable actions that issuers, networks, and merchants should consider now.

Primary Questions

- How are consumers' payment choices affected by their attitudes toward interchange?
- How well do merchant efforts to align consumers against interchange work?
- What is the value versus the cost to merchants in accepting credit and debit cards?
- What are the primary threats to traditional interchange models and payments providers?
- Which solutions or actions may best serve all parties in restoring the cost/value balance?

Findings and Analysis

Consumers are allied with neither merchants nor issuers in the battle over interchange, and efforts by either party to enlist them are counterproductive. Consumers are aware of the existence of interchange, and even believe that it affects the price they pay for goods and services, but will not change their choice of payment—particularly with large chain merchants—simply to lower merchant costs. Furthermore, consumers do not trust merchants to share any gains received through interchange reduction with them. Contrary to much rhetoric, many merchants see the benefits and value of credit card acceptance. Among the two highest choices for the payment method that best helps them meet revenue and business goals, cash and credit cards, 35% of merchants select credit cards, while a nearly identical 36% cite cash. It is specific issuer and network practices that most threaten the overall institution of interchange, driving merchants to push alternative payments. Allowing the selective surcharging of transactions may be the least disruptive concession that restores the balance between cost and value for merchants and avoids regulation or legislation of interchange rates.

Audience: Merchants, Issuers, Payment Networks, Alternative Payments Vendors.

Author: Bruce Cundiff, Senior Analyst

Contributors: James Van Dyke, President and Founder

Editor: Mary T. Monahan, Editor and Analyst

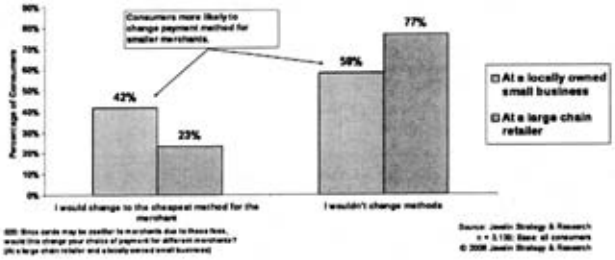
Publication date: April 2007

Subscribers to Javelin's syndicated research service are invited to submit inquiries related to this or any other topic. Please contact us via inquiry@javelinstrategy.com with such requests.

Enclosure A

Only Small Merchants are Positioned to Make Interchange a Consumer Issue

Figure 1: Interchange Knowledge Effect on Consumer Payment Choice



Large merchants looking for sympathy from consumers regarding interchange will not receive it, and efforts to make interchange a consumer issue using *large* merchants are fruitless. The fight for the hearts and minds of consumers rests with portraying smaller, locally owned businesses as victims. Large merchants and merchant organizations who represent them are attempting to politicize the issue by indicating that interchange is a "hidden tax" that consumers actually pay. As long as large merchants lead this fight, it is an ineffective strategy.

Two-thirds of consumers state that they know that there are fees charged to merchants for each card transaction, and an overwhelming 84% believe it affects the prices that merchants charge for goods and services. But few consumers are willing to change their choice of payment method at large chain retailers because of this issue. Only 23% would use "the cheapest method for the merchant" at a large chain retailer. Large electronics retailers, department stores, and even grocery store chains (often the most vocal) will not succeed in eliciting the sympathy and backing of consumers in their fight against interchange.

However, the percentage of consumers willing to change payment methods rises to 42% for transactions at "locally owned small businesses." This is an astounding difference simply based on the type of merchant, and could be a decisive factor in making interchange a consumer issue. Whereas large merchants are seen as indifferent or even adversarial to consumers, small merchants may be more likely to be viewed as a personal ally within the system. Thus, traditional large merchants have few options for attracting consumer sympathy at the expense of issuers or the overall networks themselves.

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FIVE MISCONCEPTIONS ABOUT INTERCHANGE IN AMERICA

In 2004, card issuers generated about US$25 billion dollars in revenue from card interchange in the U.S., an amount equivalent to the total revenues of Fortune 500 companies such as American Express or Wachovia. Always a contentious issue in the U.S. since the 70s, the interchange has attracted renewed attention as interchange rates have continued to increase and regulators in other countries have become more interventionist (e.g., Australia, U.K., European Union). While the case for capping the interchange grows around the world, Aite Group believes the U.S. should refrain from regulating the interchange. In this Impact Note, Aite Group critiques some of the classic misconceptions around interchange. We argue that:

- The bankcard industry in the U.S. could live without the interchange;
- But capping the interchange would likely benefit merchants at the expense of consumers;
- There are other options left to merchants than regulatory intervention to advance their cause, including building their own debit network (e.g., Debitman).

DEFINITION

The interchange is the fee paid by the issuer or the acquirer to each other. The interchange is designed to compensate the issuer or the acquirer for the services provided to the other party at the time of a transaction, but it is also made to encourage the recipient to expand its services. In the U.S., as in most countries around the world, the interchange flows from the acquirer to the issuer for a debit or credit card transaction. Whereas it flows from the issuer to the acquirer for an ATM transaction. The interchange is said to be *positive* when it flows from the acquirer to the issuer, and *negative* when it flows from the issuer to the acquirer.

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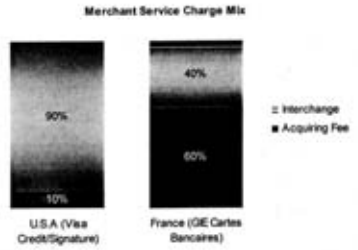
MISCONCEPTION #1: THE U.S. HAS HIGH INTERCHANGE RATES

A classic misconception is that the U.S. has high interchange rates with credit card and signature debit, compared to other countries. The problem with such a comparison is that the interchange is only a component of the total fees charged by banks and processors to merchants. While in the U.S. the interchange is an important component of the Merchant Service Charge (MSC), in many other developed countries around the world, the acquiring component of the merchant fee is actually greater than it is in the U.S.

France, for instance, has an interchange of 0.4% for debit card transactions. Its U.S. equivalent, a signature-debit card transaction (transactions are offline in France), carries an average interchange of 0.92% + 15 cents, more than twice the French interchange. Yet, the interchange represents only 40% of the MSC in France, versus 90% in the U.S., so French and American merchants end up paying roughly the same MSC (Figure 1).

FIGURE 1: INTERCHANGE AS A COMPONENT OF THE MERCHANT SERVICE CHARGE



Source: Industry sources, Aite Group

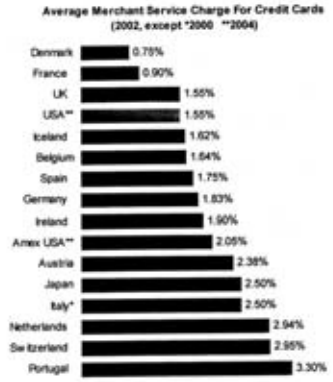
A probe of merchant costs needs to focus on merchant service charges, not merely on the interchange. In a number of countries, issuers have been able to offer low interchange primarily because they tightly control merchant acquiring. In the U.S., the largest acquirer enjoys less than 20% market share, versus about 45% in the UK, for instance. A review of MSCs across countries is more of an apple-to-apple comparison than a comparison of interchange fees.

The U.S. MSC for credit cards fares very well compared to other developed countries. As indicated by Figure 2 on page 3, the average MSC for credit cards,

although higher than in the United Kingdom and France, is one of the lowest offered to merchants across developed nations.

Where the U.S. fares less well is with debit cards. Average MSCs for signature debit and PIN debit transactions are among the highest compared to MSCs for signature debit and PIN debit transactions in other developed countries. Yet, merchants in France, Spain, and Japan pay more to process a debit transaction than their counterparts in the U.S (Figure 3 on page 4).

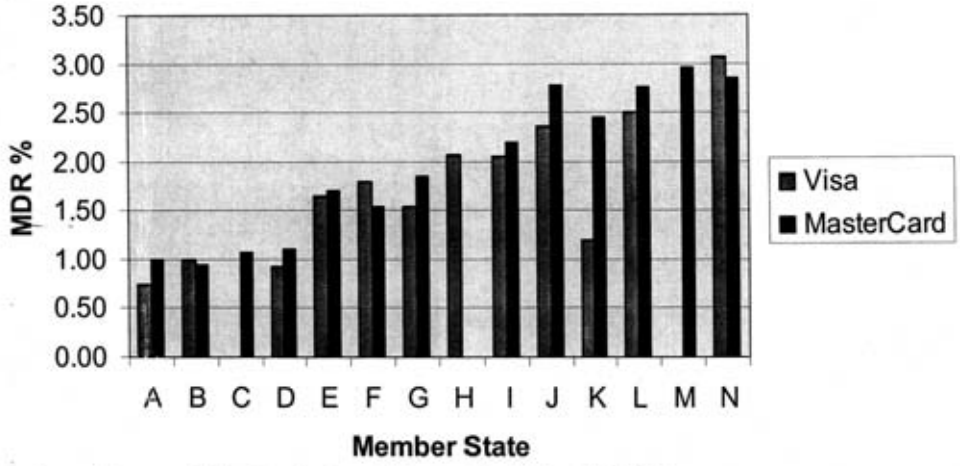
FIGURE 2: CREDIT CARD MERCHANT SERVICE CHARGES



Source: Payment Systems Europe Ltd., Alix Group Analysis

Merchant Discount Rates In Europe

Weighted Average Merchant Discount Rates
Per European Country
MasterCard and Visa Cards 2004

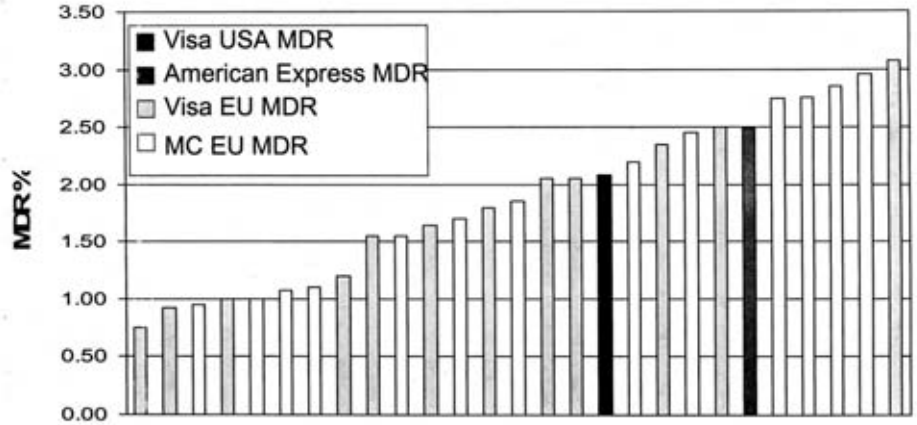


Source: European Union, *Interim Report I:Payment Cards* Chart 22 (2006)

Enclosure C

American Express, MasterCard and Visa Discount Rates

Europe and U.S. 2004



Sources: European Union, American Express, Visa

Enclosure D

VISA

Visa U.S.A. Interchange Reimbursement Fees

The following tables set forth the interchange reimbursement fees applied on Visa financial transactions completed within the 50 United States and the District of Columbia.

Visa uses interchange reimbursement fees as transfer fees between financial institutions to balance and grow the payment system for the benefit of all participants. Merchants do not pay interchange reimbursement fees; merchants pay "merchant discount" to their financial institution. This is an important distinction, because merchants buy a variety of processing services from financial institutions; all these services may be included in their merchant discount rate, which is typically a percentage rate per transaction.

Visa U.S.A. Consumer Debit
Interchange Reimbursement Fees*
Rates Effective April 2007

VISA

Fee Program	Visa Check Card
CPS/Supermarket Debit—Performance Threshold I	0.62% + $0.13 ($0.35 Cap)
CPS/Supermarket Debit—Performance Threshold II	0.81% + $0.13 ($0.35 Cap)
CPS/Supermarket Debit—Performance Threshold III	0.92% + $0.15 ($0.35 Cap)
CPS/Supermarket Debit—All Other	1.03% + $0.15 ($0.35 Cap)
Check Card II Supermarket	$0.25
CPS/Retail Debit—Performance Threshold I	0.62% + $0.13
CPS/Retail Debit—Performance Threshold II	0.81% + $0.13
CPS/Retail Debit—Performance Threshold III	0.92% + $0.15
CPS/Retail Debit—All Other	1.03% + $0.15
CPS/Automated Fuel Dispenser, Debit	0.70% + $0.17
CPS/Service Station, Debit	0.70% + $0.17
CPS/Small Ticket, Debit	1.55% + $0.04
CPS/Retail 2, Debit	0.80% + $0.25
Utility Program	$0.75
CPS/Retail Key Entry, Debit	1.60% + $0.15
CPS/Card Not Present, Debit	1.60% + $0.15
CPS/e-Commerce Basic, Debit	1.60% + $0.15
CPS/e-Commerce Preferred Retail, Debit	1.55% + $0.15
CPS/e-Commerce Preferred Hotel and Car Rental, Debit	1.36% + $0.15
CPS/e-Commerce Preferred Passenger Transport, Debit	1.60% + $0.15
CPS/Hotel and Car Rental Card Present, Debit	1.36% + $0.15
CPS/Hotel and Car Rental Card Not Present, Debit	1.36% + $0.15
CPS/Passenger Transport, Debit	1.60% + $0.15
CPS/Restaurant, Debit	1.19% + $0.10
CPS/Account Funding, Debit	1.75% + $0.20
Check Card II	0.55% + $0.10
Electronic Interchange Reimbursement Fee, Debit	1.75% + $0.20
Standard Interchange Reimbursement Fee, Debit	1.90% + $0.25

* Fees paid to cardholder financial institution.

Visa U.S.A. Consumer Credit
Interchange Reimbursement Fees*
Rates Effective April 2007

VISA

<table>
<tr><th>Fee Program</th><th>Visa Signature Preferred</th><th>Visa Signature</th><th>Traditional Rewards</th><th>All Other Products</th></tr>
<tr><td>CPS/Supermarket Credit—Performance Threshold I</td><td rowspan="13">2.20% + $0.10 (except for Business-to-Business which receives 2.10% + $0.10)</td><td rowspan="3">CPS/Rewards 1 1.65% + $0.10</td><td colspan="2">1.15% + $0.05</td></tr>
<tr><td>CPS/Supermarket Credit—Performance Threshold II</td><td colspan="2">1.20% + $0.05</td></tr>
<tr><td>CPS/Supermarket Credit—Performance Threshold III</td><td colspan="2">1.22% + $0.05</td></tr>
<tr><td>CPS/Supermarket Credit—All Other</td><td colspan="2">CPS/Rewards 1 1.65% + $0.10</td><td>1.24% + $0.05</td></tr>
<tr><td>CPS/Retail Credit—Performance Threshold I</td><td rowspan="3">CPS/Rewards 1 1.65% + $0.10</td><td colspan="2">1.43% + $0.10</td></tr>
<tr><td>CPS/Retail Credit—Performance Threshold II</td><td colspan="2">1.47% + $0.10</td></tr>
<tr><td>CPS/Retail Credit—Performance Threshold III</td><td colspan="2">1.51% + $0.10</td></tr>
<tr><td>CPS/Retail—All Other</td><td colspan="2" rowspan="3">CPS/Rewards 1 1.65% + $0.10</td><td>1.54% + $0.10</td></tr>
<tr><td>CPS/Automated Fuel Dispenser</td><td>1.50% + $0.05</td></tr>
<tr><td>CPS/Service Station</td><td>1.43% + $0.10</td></tr>
<tr><td>CPS/Small Ticket</td><td colspan="3">1.65% + $0.04</td></tr>
<tr><td>CPS/Retail 2</td><td colspan="3">1.43% + $0.05</td></tr>
<tr><td>Utility Program</td><td colspan="4">$0.75</td></tr>
<tr><td>CPS/Retail Key Entry</td><td rowspan="13">2.20% + $0.10 (except for Business-to-Business which receives 2.10% + $0.10)</td><td colspan="2" rowspan="3">CPS/Rewards 2 1.90% + $0.10</td><td>1.85% + $0.10</td></tr>
<tr><td>CPS/Card Not Present</td><td>1.85% + $0.10</td></tr>
<tr><td>CPS/e-Commerce Basic</td><td>1.85% + $0.10</td></tr>
<tr><td>CPS/e-Commerce Preferred Retail</td><td colspan="3">1.80% + $0.10</td></tr>
<tr><td>CPS/e-Commerce Preferred Hotel and Car Rental</td><td rowspan="7">EIRF 2.30% + $0.10</td><td rowspan="7">CPS/Rewards 2 1.90% + $0.10</td><td>1.58% + $0.10</td></tr>
<tr><td>CPS/e-Commerce Preferred Passenger Transport</td><td>1.75% + $0.10</td></tr>
<tr><td>CPS/Hotel and Car Rental Card Present</td><td>1.58% + $0.10</td></tr>
<tr><td>CPS/Hotel and Car Rental Card Not Present</td><td>1.58% + $0.10</td></tr>
<tr><td>CPS/Passenger Transport</td><td>1.75% + $0.10</td></tr>
<tr><td>CPS/Restaurant</td><td>1.54% + $0.10</td></tr>
<tr><td>CPS/Account Funding</td><td colspan="3">2.14% + $0.10</td></tr>
<tr><td>Electronic Interchange Reimbursement Fee (EIRF)</td><td colspan="3">2.30% + $0.10</td></tr>
<tr><td>Standard Interchange Reimbursement Fee</td><td colspan="4">2.70% + $0.10</td></tr>
</table>

* Fees paid to cardholder financial institution.

Visa U.S.A. Commercial Interchange Reimbursement Fees*

Rates Effective April 2007

VISA

Fee Program	Purchasing	Business	Corporate T&E
Commercial Level III	1.80% + $0.10	na	na
Commercial Level II	2.00% + $0.10	2.00% + $0.10	2.00% + $0.10
Commercial Business-to-Business	2.10% + $0.10	2.10% + $0.10	2.10% + $0.10
Commercial Retail	2.20% + $0.10	2.20% + $0.10	2.20% + $0.10
Commercial Card Not Present	2.40% + $0.10	2.25% + $0.10	2.20% + $0.10
Commercial Electronic Interchange Reimbursement Fee	2.45% + $0.10	2.40% + $0.10	2.20% + $0.10
Commercial Standard Interchange Reimbursement Fee	2.70% + $0.10	2.70% + $0.10	2.70% + $0.10
GSA Large Ticket	0.95% + $35.00 (1.35% minimum)	na	na
Visa Purchasing Large Ticket	0.95% + $35.00	na	na

* Fees paid to cardholder financial institution.

Visa U.S.A.
Other Transactions
Interchange Reimbursement Fees*
Rates Effective April 2007

VISA

Fee Program	Credit Voucher Transactions
Passenger Transport Service Category, All Card Types	2.06%
Non-Passenger Transport—Consumer Visa Credit Card	1.73%
Non-Passenger Transport—Consumer Visa Debit Card	1.31%
Non-Passenger Transport—Commercial Visa Product	2.24%
Mail/Phone Order and Electronic Commerce Merchants—Consumer Credit	2.04%
Mail/Phone Order and Electronic Commerce Merchants—Consumer Debit	1.87%
Fee Program	**Visa Prepaid Load Service Network**
Visa Prepaid Load Network Interchange Reimbursement Fee	$0.75
Fee Program	**Manual and Emergency Cash Disbursements**
Cash Disbursement Reimbursement Fee	$1.50 + 0.18%
Fee Program	**ATM Cash Disbursements**
ATM Cash Disbursement Reimbursement Fee—Tier 1	$0.50
ATM Cash Disbursement Reimbursement Fee—Tier 2	$0.40

* Fees paid to merchant financial institution.

Interchange Fees: Network, Issuer, Acquirer, and Merchant Perspectives:

Panel Remarks

Chair: Avivah Litan

Ms. Litan: We are finally here. We are able to hear the perspectives of the issuers and the acquirers, and we do have merchant representation in the form of a couple associations, and of course the issuers and associations. So we will hear all sides of the issue today.

As an analyst who follows different areas of payments, I see this as the one market in the United States where volume will go up, risk will go down, but prices will go up. On the other hand, as an analyst who follows fraud and identity theft, I also see the cards as the best mechanism for consumers to use, especially credit cards.

As an analyst who follows the retail payment community, I know the average retailer really does find credit cards as a very preferable payment mechanism because of the guaranteed payment the next day, etc. It is a complex issue and hopefully we will hear today from the different sides of the equation on their perspectives.

We are going to start with an introduction from each of the panelists and a discussion on their companies and perspectives, and then we will get into the general discussion.

Let's start with Xavier Duries.

Mr. Duries: During the last 40 years, Europe has focused its efforts on building an internal market between its now-25 member states. This single market has been achieved in many areas, notably for our single currency. But for decades, all European retailers, whatever their size, have been facing the same issues as their American, Australia, Mexican, and other counterparts in the payments systems field: dominant position of two card schemes (networks), collective price fixing, lack of transparency, and abusive consequences of the four-party systems. In addition, even if banks claim it is possible, cross-border acquiring is still not possible in practice in Europe, preventing retailers from fully benefiting from the internal market.

The current situation in the credit card market is highly anticompetitive, not transparent, inefficient, and unfair. The schemes, in dominant position, impose unilaterally their condition to the whole market; 80 percent of the discount fee paid by the retailer is not negotiable; and once they have signed a contract for one type of card, retailers are forced to accept all other products—even the most expensive—delivered by the scheme, the so-called honor-all-cards rule (HACR). We are convinced that it is in the interest of society as a whole to prevent these behaviors.

The fact that the interchange fee represents 80 percent of the merchant discount leaves little room for competition on the acquiring side, whatever the number of acquirers in a specific state. This absence of competition and transparency keeps the retailers from purchasing services they would like to offer to consumers at the best prices.

It is even sadder to realize, though, that even an increase of competition in the acquiring market would not solve the issue, as the system is built as such that more competition on the issuing side implies more free gifts and loyalty benefits being offered by issuers to cardholders, leading to fee increases for the merchants. The case of Spain, which has several acquirers but higher merchant interchange fees (MIF) than Luxembourg with only one acquirer, illustrates this.

Today, there is a total distortion in the price signals sent to the consumers. Consumers see credit cards as free—or even as a way to get some air miles—while this instrument is much more expensive for the retailers than other means of payments. This nonrespect of the "user pays" principle leads to cross-subsidization between payment means, which is inefficient and costly for the society as a whole.

The situation in the debit card market is not much brighter. Some card schemes, influenced by industry associations like the European Payment Council, are replacing efficient, well-functioning, PIN-based national debit card schemes with their own, more-expensive network debit cards. In the United Kingdom, the replacement of the national Switch system by Maestro led to a 60 percent increase of the prices.

The situation in the payments system in Europe has somewhat evolved in the previous years, in particular thanks to the efforts of the European Commission and several national competition bodies. However, it still has to go great lengths to be a fair deal for the society as a whole and for consumers and retailers in particular.

The commerce sector welcomes the initiative from the European Commission to introduce more competition and more transparency in the payments services market with its directive for a New Legal Framework.[1] The Single European Payment Area, a project of the banking industry, is a good initiative, but its commitments are still vague and its scope seems not to include cards.

The literature and the recent cases at the national level confirm that the current situation is absurd and not tenable. The Australians gave a shock to the system and demolished some of the banks' arguments when they discovered that decreasing the MIF by half did not change the banks' income. Even some Visa consultants have come to the conclusion that the MIF is not necessary to the system.[2]

Retailers are not asking for a free lunch, but rather for a fair price. Society calls for more competition, more transparency, and, above all, a fairer distribution of costs between the stakeholders. Regulators have to intervene in the four-party payment systems in order to obtain transparency and ensure an optimal outcome in terms of public benefit. The ultimate beneficiary will be the consumer, as in any democratic system.

Mr. Gabeiras: I will start by telling you that Spain is *not* a mature market as far as payments systems are concerned. The point of sales (POS) volume represents only 15 percent of private consumer expenditures, while in more mature markets, such as France or the United Kingdom, this figure covers approximately 24 and 30 percent, respectively. There is always still a span to reach these levels. We have about 50,000 ATMs for a population of 43 million people, 900,000 POS terminals deployed in the field, and roughly 45 million bank cards issued.

I am, of course, totally in favor of interchange rates. We have read, at least within my organization, everything that has been written concerning interchange rates, both from the academic side as well as from the industry realm, and, as a result of that, I personally share the models of Jean-Charles Rochet, Tirole, and Schmalensee. In fact, the procedure we have devised in the past is a mixing of both, trying to estimate demand with a log linear function as well as to calculate the interchange rate in a two-step model, postulating that the aggregate demand is a function of the average price applied to the customer and the average price applied to the cardholder. This interchange rate drives us to a formula that can be easily

calculated, as a linear function of acquiring and issuing prices and costs, mainly the average price to the customer, cardholder, and retailer; the average cost of the issuing side; and the average cost of the acquiring side, in a such a way that, for us, the interchange rate has to grow if the price to the merchant and the cost of the issuer grows. It has to decrease if the cost of the acquirer grows and the price applied by the issuer grows. But this model, which had been defended before the Spanish competition authorities, was recently rejected and, as a result of that, we are obliged to apply a totally new procedure starting on July 5, 2005, and take into account the following principles.

First, the debit interchange rate has to be a flat value. This flat value has to be calculated exclusively taking into account the processing of authorization and clearing costs—no other cost component allowed, including the fraud-based cost. For the Spanish authority, there is no counterfeit fraud on the debit side. Second, on the credit side, our authority allows two components. The first is the same one as in the debit card interchange rate, a flat value reflecting processing costs. The second is a variable component per transaction, a percentage of the value of the transaction reflecting the fraud but not the float.

We are in the middle of the process of deciding what to do. Possibly, we will appeal the resolution before the normal justice system. But in any case, in the short run, we are obliged to apply a new procedure, taking into account these components of cost that have been defined by the competition authorities. Alternatively, we are also studying the possibility of applying the international interchange rates authorized by the European Commission for intra-European Visa transactions.

Mr. Geve: TransAction Resources works for merchants around the world. So what I am going to provide is a merchant perspective that is going to be very light on economic theory and is going to be focusing much more on the practicalities and the pragmatic issues that we approach. I would also like to say that while the focus of this whole session and my remarks is on interchange, we must remember those other issues that are associated—the other scheme rules, the honor-all-cards rule, access to card schemes, and others—when considering things in the wider environment beyond here.

I will talk a little bit about the Australian experience, talk a little bit about cost-based interchange, and then wrap it up by talking about regulatory oversight and where that stands. In 2001, the Reserve Bank of Australia (RBA) designated the credit card payments system, which allows it to mandate standards for the payments system. It implemented those reforms in 2003.

Chart 1:

There were three key parts of that. The first was that a cost-based interchange was introduced. The second was that they allowed merchant surcharging for credit cards. The third was it opened up access to card association membership, so that nonfinancial institutions and, indeed, merchants themselves could become acquirers subject to prudential regulation.

As a result of that, the credit card interchange rate reduced from an average of around 0.95 percent to around 0.5 percent currently, excluding tax. The card-present electronic rate (the lowest rate) is about 0.44 percent, excluding tax, for Visa and about 0.46 percent for MasterCard.

Despite the doom and gloom predictions by the card associations and by the banks, the Australian system hasn't fallen. MasterCard's famous death spiral, resulting in a collapse of the system, just hasn't happened. We are going to have a look at that in a moment.

From a merchant perspective, we believe it demonstrates that interchange is not a delicate balancing act. It hasn't all fallen apart. Chart 1 shows what has happened prior to and since the introduction of interchange.

Credit card spending has continued to increase. It hasn't dramatically stopped that. What it really has done is realigned the issuing banks' income. Their income overall hasn't particularly changed, just the source of it. So they are now getting more income from the cardholders and less

from the merchants. That was part of the RBA's objective. They didn't want incentives for cardholders to use a more expensive, less efficient payment system, so they have taken out the loyalty component from the cost-based interchange formula.

We have seen an increase in annual cardholder fees. We have seen fees introduced for belonging to the loyalty programs and/or a reduction in the benefits in those loyalty programs. In fact, some of the card divisions of the banks are making better-than-ever profits. The ANZ Bank had a profit growth of 58 percent in its card-issuing and merchant services division. Westpac indicated the regulations have had no negative impact on their results. Commonwealth Bank also has said similar things. These are the three largest card issuers in Australia.

So that brings us to the issue of cost-based interchange. From a merchant perspective, what to look for is an equitable distribution of the costs and the benefits. Acquirers and processors provide a service to issuers. And that shouldn't be overlooked. Without acquirers, and in some cases the larger merchants, making considerable investment in infrastructure, then issuers don't actually have a product to offer. Unless there is a network out there so that the card can be used at any merchant, then there is no point in the issuer issuing that card.

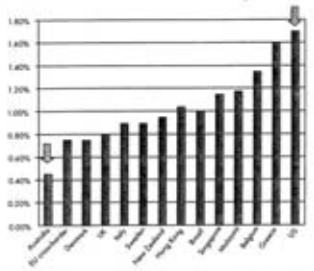
So these acquirers and merchants that make this investment need a return on their investment for providing that infrastructure and that service. I think it is interesting that regulators in Australia, in the European Union, in the United Kingdom (certainly the preliminary decision), and now, we've heard, in Spain have all considered the economic arguments we've heard about two-sided markets, about network externalities, and about the delicate balancing acts. In all cases, they have mandated a cost-based structure.

If that were applied in the U.S. market, a move to cost-based interchange here could reduce the value of interchange effectively paid by merchants by more than $10 billion per annum. So it is a significant amount of money.

Just looking at the U.S. environment, there are international precedents which should be persuasive in this market. In fact, the costs in the U.S. market should be less than those in other markets because of the economies of scale. We have seen a lot of the costs coming down here. The cost of fraud has come down, the cost of charge-backs, borrowings, processing are all reducing. But interchange rates are increasing. At the end of the day, cost-based interchange here could be lower than in other countries because of those economies of scale and because of those reductions.

Chart 2:

International Credit Card Interchange Fees



In Chart 2, I've tried to take some countries at random and show where the United States fits with Australia in terms of interchange fees for credit cards.

You'll see at the left-hand end you have the Australian and European cross-border. The United Kingdom winds up that end as well, and the bar representing its interchange fees is likely to become a bit lower when the decision is finalized there. At the other extreme, we have the United States, with its lower costs and economies of scale. It doesn't seem to make sense that a country where you have significant card usage and significant economies of scale would have the highest interchange fee.

Finally, why is regulatory oversight increasing around the world in recent years? In the United States and in other countries, we are seeing control of currency moving from public authorities to private organizations. As we move from cash and check payment to card payment, we are seeing private organizations taking control. These organizations have market power. They also determine who plays (who are members), what the costs are (interchange fees, association fees, etc.), and what the rules are, such as the honor-all-cards rule and the nondiscriminate rule.

We are moving from currencies with no interchange fees, such as cash and check, to one with interchange. Cash payers, who are often from lower-income groups, are subsidizing card payers, who are often from higher-income groups.

In summary, I would like to quote the Office of Fair Trading in the United Kingdom, which said, "In effect, these fees act like a tax on retail transactions that is paid by all consumers in shops that accept credit cards."

Mr. Haandijk: When Interpay started, back in the early 1990s, it was cumbersome. Large investments were involved. We had a number of loss-making years, until such point in time when a very big retail chain in Holland committed itself to a certain number of transactions. Then it really started hitting off and has been growing ever since. That is also maybe illustrated by the fact that since we began, in nominal terms, we have reduced the charge to the merchants by 50 percent, which in real terms makes for a much higher reduction in price over the years. And it has been established—not by ourselves, but by the Dutch central bank, as well as KPMG and CapGemini—that our fees are the lowest in Europe if not in the world.

In Holland, there is no interchange fee. It was set at zero by Interpay. That is true and, at the same time, not entirely true. Let me explain what I mean by that.

The issuing banks in Holland are also our shareholders. If we pay an authorization fee or an interchange fee for authorization to our banks, we would have sustained a period in which we would have losses for that much longer. So we agreed to pay dividends as long as we had profits, and we would pay dividends comparable with Dankort, the domestic debit card profit. After many, many years, that came into being and those profits were distributed, not on the basis of the shareholding percentages in Interpay, but on the basis of the debit transactions. So the issuers, in a roundabout way, as long as our results allowed it, were reimbursed for the authorization costs they incurred.

In looking at the developments in Europe and looking at the developments in Holland as well, a commission was launched by the governor of the Dutch central bank at the request of the Minister of Finance. They came up with a number of suggestions to improve the transparency in the Netherlands. As a consequence of this, we stepped back as an acquirer; we are no longer the acquirer in the Netherlands for the debit card transactions. The acquiring was taken over by the banks, and we render the processing.

We also separated. You have to bear in mind we just started launching an activity like that. You bring everything together. You consider yourselves about rules and regulations. You consider yourselves about technical standards that need to be adhered to in terms of POS and what-have-you. At

the beginning of last year, we separated the rules and regulation part of the Dutch domestic debit card system out of Interpay. It is now a separately operating company.

Having said all that, we were scrutinized by the Dutch anticompetition authority, NMa for short. They came to the conclusion that we have charged excessive prices during the periods under scrutiny—1998 through 2001—and we were subsequently fined.

At the same time, the banks—our shareholders—were fined because they are accused of having used Interpay as what we call a "central sales office," which makes for a bit of a bigger thing. Either we have made decisions to use excessive pricing and therefore Interpay should be fined, or the shareholders have used Interpay as a sales office and they should be fined. But the two don't seem to go together that well.

Apart from that, we are totally convinced that the way the NMa went about arriving at the conclusion with regard to our excessive pricing is not valid for that reason and for the reason that retail organizations in Holland have said, "You have charged excessive pricing. You have been fined for that. We have suffered damages (*despite the lowest rates in the world*), so we'll sue you for those damages."

We recently have received about 12,000 letters from retailers through the main retail organization, and those letters are obviously of the same wording and go along the lines of, "You have been fined. We have suffered damages. We are not in a position to compute our own damages, so please would you be so kind as to calculate the damages we have suffered, and will you then subsequently transfer the amount over to us!"

That is the situation we are in. I can tell you it is a very challenging one.

Mr. Sheedy: We will spend some time here in a few minutes talking about balance and the successes we've had in the U.S. market. It is a different market. I agree with a number of the economic perspectives this morning. We need to appreciate the unique dynamics of each domestic market before you can weigh in and discuss interchange.

Lloyd Constantine talked about Visa debit roughly being analogous to an electronic check. I think first and foremost, it is not. The value that is being provided by electronic payments systems in the United States, and check card in particular, far exceeds that of check. This includes the efficiency on the back end, certainly, but also the value that is being provided consumers. This morning, a number of the economists mentioned that absolutely has to be appreciated in the discussion.

Lloyd would suggest that the consumer's judgment should be substituted with his own. We ought to go to zero interchange. We have a debit market in the United States that, again countering his perspective, evolved, quite frankly, not from the government setting up a PIN debit scheme, as has happened in some markets internationally, but with the check card market kick-started by Visa in the early 1990s. The merchants responded by deploying PIN pads, and the free market raged on. And consumers and merchants have ultimately benefited.

The 20 percent of check card customers that use their check card in a signature-based environment 25 times a month would take exception with the perception that it is equal to a check. It is not.

Lastly, Lloyd had suggested that Dick Schmalensee was an employee of Visa U.S.A. Dick, I've been a Visa employee for 12 years. I am a member of the senior management team. I have never met you, so, "Welcome aboard!"

Again, interchange in the United States is a challenging matter. We believe it is central, as we will discuss, to trying to position the electronic payments market in the United States to drive value to consumers and merchants, ultimately to the economic benefit of all participants. We have heard quite a number of different perspectives today. I am going to use the time certainly to lay out the way we look at the matter and continue to, hopefully, foster a healthy debate, but also to set the facts straight on some inaccuracies that have been heard and will continue to be heard in the press.

The number one challenge from my perspective is the merchant one. Merchants perceive interchange as a cost. Last night Tom Hoenig referred to, as Lloyd also pointed out, interchange as a pricing mechanism. Perception being reality, I can acknowledge that. But interchange is more than a pricing mechanism. To us, it is a basic tenet of our business, right along with product, brand, systems, and the relationships we have with our member financial institutions and merchants. It is how we drive value. And ultimately the continued growth of this industry, we believe, is best served if pricing continues to be a function of the competitive market.

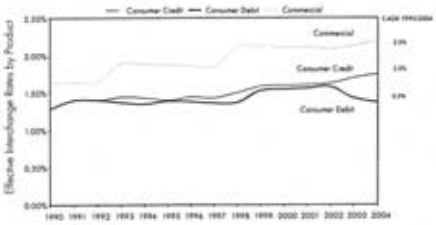
That being said, we are all for greater transparency and greater dialogue. Stu and I have talked, and we are very open to providing any and all information at data points. Ultimately we think that is healthy.

As my responsibilities are on the U.S. market for Visa U.S.A. and interchange strategy, I am going to focus my comments on three areas in particular. First, for those of you paying attention to the press in the United States, there have been very political, very well-organized merchant interest groups that have been, in our opinion, misleading the market and providing misinformation on interchange. We are going to be more vocal in

Chart 3:

Interchange Fees: Rate versus Usage

Systemwide, interchange rates have increased 1.86% annually since 1990



Source: Visa USA

trying to set the facts straight, not with conjecture but with data.

Second, interchange has been absolutely key to Visa driving value to merchants and consumers. We are going to talk about how we've done that and how we plan to continue doing that going forward.

The third point is the Visa payment system is by no means static, and we will continue to drive innovation. We will continue to drive data security. Ultimately, interchange is a very important part of enabling Visa and the member financial institutions to be able to do that.

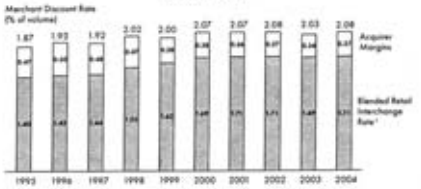
In my interchange strategy responsibilities with Visa U.S.A., I spent a considerable amount of my time and company resources trying to understand the merchant point of view, the member point of view, and the consumer. I have personal relationships with most, if not all, of the merchants represented in the audience today. It is a very challenging balance, looking at interchange and trying to represent all constituencies in order to optimize the growth of the venture. I think we have done it pretty well. I think there are absolutely opportunities to improve. And the free market ultimately will determine how best that is accomplished.

Merchants want to lower their costs. I get that. Every vendor and in every relationship that merchants have that drives their costs, they want to manage those costs down. The data on Chart 3 shows that some of the rhetoric you are hearing from the merchant constituencies in the United States misleads the picture.

Chart 4:

Rate Increase Effect is Overstated

Over the past six years, merchants' Visa discount rate has been relatively flat (<0.5% CAAGR)



[1] Blended credit and offline debit interchange rates
Source: Visa Profit Analysis Reports and internal analysis

They talk about escalating rates. They talk about rates going up, as being out of control. And it is just not borne by the facts.

Systemwide in the United States since 1990, rates have increased by 1.86 percent per year. That data point is a bit challenging to understand, because it is a rate on a rate. The fact remains: We continue to be a much cheaper alternative versus American Express.

By and large, when you look at total costs from a merchant point of view, costs as characterized by the expenses that they get from their acquirer, these costs have been relatively flat over the last six years, as you can see on Chart 4.

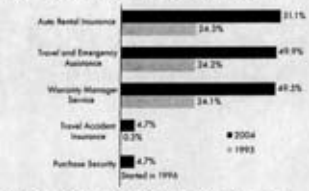
Merchants in the United States benefit tremendously from the thousands of Visa acquirers that are competing every day for their business. Merchants of all types and sizes have significant negotiating leverage, and they benefit from that competition. That competition is fostered within the Visa association. Furthermore, and a bit unique to the U.S. market, Visa U.S.A. has partnered with many merchants directly in structuring customized interchange agreements designed to shift share away from their more expensive cost payments. We have customized marketing arrangements with each individual merchant. We have co-branding agreements with a number of various successful merchant partners. Ultimately, we believe it is these business levers that are going to be a much more successful mechanism by which merchants manage their costs, as opposed to hiring lobbyists and partnering with class-action attorneys.

Chart 5:

Delivering Consumers More Value

Significantly more cards enjoy enhancements in 2004 than in 1995, as annual account fees have declined

Visa Credit Card Enhancements, 1995 and 2004, % of Cards in Force



Purchase Security with Extended Protection replaced by Warranty Manager Service by most issuers. Warranty Manager Service started in 1999.
Source: Visa Enhancement Management

Total dollar interchange has absolutely increased in the U.S. system. This is where the pressure is coming from. But, as we have just observed from the data that I have shared, the total dollar of interchange in the U.S. system has grown, not because rates are out of control, but because there has been usage. And the usage has been driven by consumer-merchant participation in the payments system.

Why? Chart 5 touches on the considerable benefits to one side of this equation, which is the consumer.

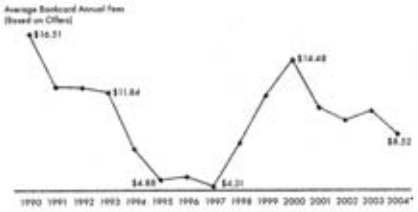
Over time, the consumer experience in the payments system hasn't been static. They continue to drive and realize considerable benefits from the payments system. I am very concerned, as are a number of the folks who spoke earlier, that the consumers' perspective often gets lost in this debate. In fact, in the title of this panel discussion, "Interchange Fees: Network, Issuer, Acquirer, and Merchant Perspectives," where is the consumer? We want to make sure that the consumer doesn't get lost in this debate. Ultimately, they are the point of reference that everyone can share—merchants, regulators, and Visa and our banks included.

But merchants have benefited tremendously as well. There are fantastic examples of ticket lift, faster throughput at the point of sale, more payment guarantees, and the ability for merchants to deploy more effective product delivery channels—such as automated fuel dispensers, electronic com-

Chart 6:

Falling Cardholder Annual Fees

The average annual fee accross all cards[1] has fallen by 50% since 1990



[1]Includes cards without annual fees-defined as Total Fees on all offers/# of Total Offers
*YTD 2004
Source: Mail Monitor®

merce, self-checkout, and the like. Some of these benefits can be quantified; some of them show up in the form of a more convenient experience for the consumer.

Reinforcing the need to focus on competition and benefits to the consumer, Chart 6 shows that over the last 14 years, annual fees in the U.S. market have been cut in half.

If the merchant lobby had its way with reduced interchange or even zero interchange, those costs don't go away. They get shifted, as we've seen in Australia in the higher annual fees to consumers. Even our critics on this case would have a difficult time characterizing the Australia experience as being pro-consumer. I refer you the the Julian Wright-Stuart Weiner paper on this point.

As for annual fees, Chart 7 shows how the association model, where there are thousands of Visa member financial institutions that compete vigorously for consumer business, has driven down cost of borrowing to revolvers.

This chart shows stated APRs and cost-of-funds trending over the last 14 years. And you can see that net borrowing cost, adjusted for cost of funds changes, has been nearly cut in half over this period. This is an example of how competition and innovation have benefited the consumer.

Chart 7:

Driving Consumer Prices Down

The spread between average APRs and prevailing Treasury rates has fallen by 4% per year since 1990

Ultimately, revolvers will bear the brunt, in our opinion, of any regulatory action on interchange—price caps, rate controls, etc. These costs would ultimately shift back and find their way to higher APRs and hit those consumers that are least likely to be able to foot the bill and benefit the merchants.

Alternatively, our member financial institutions, our issuers, could decide they don't want to participate in the Visa association with lower interchange rates. They could issue American Express; higher costs to merchants; and, ultimately, lower levels of utilities to consumers.

One of the questions observed earlier, and a question I often hear from merchant partners, is, Where are the scale benefits? There has been extraordinary growth in the payments system. Shouldn't there be cost benefits, and how come those haven't found their way into the interchange structure? The cost benefits are absolutely there. There have been enormous scale efficiencies, but what you see—and to my earlier point—is the product hasn't been static. The product has innovated. The product provides greater levels of security, greater functionality, and greater utility to consumers and merchants than ever before. We have been successful, we believe, versus our card competition, debit competition, and the Automated Clearing House (all due respect to the Federal Reserve). And

Chart 8:

Increasing System Security

Fraud rates have decreased by 7% per year from 1990 to 2004, even as Visa volume has increased 16% annually

Source: Visa USA

we have been successful versus cash and check because of this innovation. We are not a utility. We are an innovative, competitive payments system, and interchange makes sure we stay that way.

I would like to shift my focus to a place where consumers and merchants can absolutely agree. It is the security of the payments system. Chart 8 shows trends in fraud over the last 14 years.

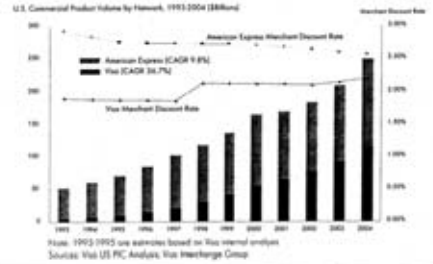
You can see that as the payments system has grown 16 percent annually in the United States, fraud rates have dropped 7 percent annually. Fraud rates in the United States are the lowest in the industrialized world. Interchange has been absolutely key to facilitating the investments, incentives for merchants to submit clean transactions in the system, and investments on the part of Visa and our member banks to manage and maintain that risk dynamic.

One of the more challenging aspects, and Avivah Litan hit this up front, of the industry is that in recent years competition has manifested itself in the form of raising rates. How could that be? For the economists who studied two-sided markets, I think they understand it conceptually. I am going to show you a real-life example of where this has happened and how it has been good for all constituencies.

Chart 9:

Driving Product Innovation

Visa commercial interchange fees increased competition and product innovation for commercial customers



Note: 1993-1995 are estimates based on Visa internal analysis
Sources: Visa US PIC Analysis, Visa Interchange Group

Higher interchange has absolutely been a source of product innovation and competition in the commercial card market. As shown on Chart 9, back to the mid-1990s, American Express dominated this market.

They owned the vast majority of the small-business purchasing and corporate travel and entertainment (T&E) business. We already had higher interchange rates in the Visa system for commercial products, but we could not get the banks attracted to invest in this market. There wasn't a return on investment.

With an increase that we took to market in 1997, we then crossed that threshold, created a positive business case for the banks to enter that market, and now in 2005, Visa issuers are the largest provider of business purchasing and corporate T&E products in the United States, supplanting American Express.

We have brought down rates for consumers. We have increased the level of competition and innovation in the marketplace. And we did it with rising rates.

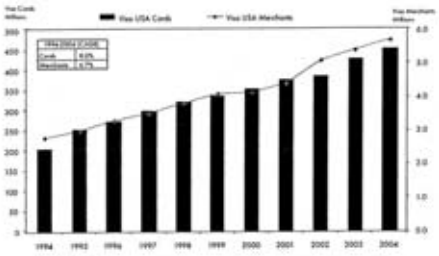
In conclusion, in our opinion, it is hard to see what is broken here. Our success is based on maximizing the value proposition to consumers and merchants. In absence of a balanced value proposition, it just doesn't work.

The question being posed at this conference is, What role is there for

Chart 10:

Visa Payment System

Success is primarily based on balanced merchant and cardholder participation



Source: Visa USA

public authorities? From a Visa perspective, we welcome free and open dialogue. We look forward to helping anyone understand our business and sharing whatever data are possible. But with consideration to U.S. rate controls, we don't see a role. Chart 10 shows that beginning in 1994, merchant participation in the payments system has grown from 2.8 million merchants to north of 5.5 million today. Cardholder participation in the payments system has grown almost lockstep with that merchant participation—extraordinary growth, and evidence of value being provided on both the merchant and the consumer side. The assertions being made by the trial bar and some of the merchant advocacy groups would suggest that the electronic payments system, as it has been managed, hasn't been good for them. However, I think if you look at the data points and the successes we have had in the U.S. market, you would conclude to the contrary.

Ms. Webb: I suspect you know, but in case you don't, JPMorgan Chase is a quite large issuer of credit cards, debit cards, and stored-value cards, and we are also a substantial player in the merchant acquiring space in this country.

Today, I have four points that I'd like to make with you. One is that we believe interchange is actually a great value. Two, we believe that interchange pricing (I just learned today that I am supposed to call it "equilib-

rium") is quite competitive. Three, merchants do have choice. And four, regulation would be quite detrimental to consumers.

Let me start with point one, which is that interchange represents a terrific value. And unfortunately, like everyone else here today, I will not discuss the consumer, which is a shame. But you are all consumers, and my guess is that every one of you has a couple cards in your wallet and appreciates the value they bring to you. So I will not spend time on that and will move on to the merchant, who is paying the freight here. Let's talk about that.

We think the number one area where merchants get tremendous value out of interchange is in increasing sales. Let me give you a couple of examples. Over the past year, both associations have spent considerable amounts of money investing in radio frequency identification (RFID) terminals at quick-service restaurants in this country, enabling consumers to go into those restaurants and pay for their transactions without having to swipe their cards, requiring issuers, by the way, to have to re-card those consumers as well. This is a considerable investment. But the early results are showing that the average spend of those consumers is $7 versus $5 when they go in with cash.

I'll give you another example: our partnership with Starbucks. In 2003, we issued with them the Duetto card, which is a combination of a stored-value card and a credit card. Since inception until now, when you look at the Starbucks stores that accept the card, their sales lift has been 13 percent versus 5 percent without the card. Unequivocally, cards drive increased revenues for merchants.

What we also see is that cards are making new markets available to merchants. Ninety-two percent of the transactions that are completed on the Internet are paid for with plastic. The stored-value market today is $70 billion. These are enormous markets enabled by this payments system. We bring these benefits to merchants, and we do it by attracting consumers, acquiring consumers, and then incenting consumers to use those cards. Interchange is the means by which we are compensated for doing that.

The economic system, or the monetary system, as a whole realizes a benefit from the card-based payment system. We have replaced 26 percent of consumer checks with cards. That has not only resulted in the Fed being able to close a number of check processing centers, but it has also provided a wealth of data that didn't exist previously for anything from macroeconomic trends to increasingly focusing on money laundering.

My second point is that interchange pricing is actually quite competitive. Look at the cost of a cash transaction—we saw it this morning with a back-of-the-envelope, and we also have a McKinsey study that looks at the aver-

age cash transaction, factoring in fraud, float, and theft. When you factor it all in, you are looking at 165 basis points. A debit transaction, which is the competitor, on average on a blended rate is 42 basis points for a PIN and 112 basis points for a signature.

We've seen lots of charts look at only interchange in the credit market and credit cards globally, and those charts are missing a big part of the equation. The acquiring business is incredibly competitive in this country. However, in many other developed countries, the acquiring business is quite different and adds a substantial amount of cost to the merchant. So when you look at all-in merchant acceptance costs across 16 developed countries that were surveyed by the EDA Group, what you find is that the United States actually is among the lowest, with only three being lower—France, Denmark, and the United Kingdom.

We think this is a very competitive market that is actually becoming more competitive. DebitMan is attempting to enter the market with great merchant support, although they are finding that it is quite difficult to get these cards into consumers' wallets and have them use the cards.

Also, let's look at what GE is doing, quite interestingly, to leverage its private-label network and partner in a different way with the likes of Discover and Wal-Mart.

That brings me to my third point, which is merchants not only have choice, they have more choice now than ever before. They have more choice from these new competitors. They have more choice because of some laws that have been passed recently or some judicial proceedings. Also, they have more choice about which network they will work with and why. They can leverage that and, frankly, should be leveraging that.

They can also look at with whom they want to co-brand. We have 900 different credit cards, many of which are co-brand cards, where the merchant enjoys tremendous benefit from the cards being used. It is not just the big merchants, such as Walgreens and the like, that we've heard about that have in fact negotiated better interchange rates, demonstrating their market power. It is also smaller merchants. Gas stations, for example, do have the choice to accept cash at a discounted rate. They don't choose to do so and, in fact, have spent money to equip their pumps with terminals to enhance consumer convenience and presumably to get greater throughput and probably greater ticket sizes. And then there is the dry cleaner, who has a clear sign posted saying that only cash or ?IN debit are accepted. That is it. Merchants have choices and more choices as time goes on.

My fourth point: When we look at regulation—to Bill's point earlier—

we see no evidence that when interchange goes down due to regulation, due to negotiated bilateral deals, or due to anything, that benefit is passed on to the consumer. We haven't seen any evidence of that. The consumers continue to pay the same prices and actually do receive less value on their cards. So in summary, consumers pay. We don't think that is a good thing.

We also think this is an incredibly innovative market. I wouldn't call it just a dynamic market; I'd say it is a frothy market. That is why we are all here, right? This is really a frothy market. That is a terrific thing. There are new competitors. There are new products. There are new markets for us to attack. There are new customers for us to acquire. Regulation is static, and regulation would make this a stagnant market.

In closing, what I'd like to say to you is that *we believe* that the best way to optimize the efficiency and safety and soundness of the payments system in this country is to minimize the use of paper with all of its attendant cost, risks, and leakage in the monetary system. We believe this would enable merchants to get rid of not only their variable but also their fixed costs of processing paper payments and continue to realize the spend lift from accepting plastic. We very much look forward to collaborating with any and all toward that objective.

ENDNOTES

[1] The complete name is New Legal Framework for Payments in the Internal Market.

[2] "If the courts had mandated a zero interchange fee and forced issuers to take receivables at par, Visa probably would have survived." David S. Evans and Richard Schmalensee, "Paying with Plastic" (MIT, 1999).

PREPARED STATEMENT OF THE NATIONAL ASSOCIATION OF CONVENIENCE STORES (NACS)

Chairman Conyers and Members of the Antitrust Task Force, I am Hank Armour, the President and Chief Executive Officer of the National Association of Convenience Stores ("NACS"). Prior to taking my current job, I owned and operated fifty-nine retail facilities in Washington, California and Oregon. I am pleased to submit for the record this testimony on behalf of the NACS.

Founded in 1961, NACS is an international trade association representing more than 2,200 retail and 1,800 supplier company members in the United States and abroad. NACS is the pre-eminent representative of the interests of convenience store operators. The convenience store industry in the United States, with over 145,000 stores across the country,[1] posted $569.4 billion in total sales in 2006, with $405.8 billion in motor fuel sales. Overall, eighty-two percent (82%) of the motor fuels (gasoline and diesel fuel) sold in the United States is purchased at the more than 114,000 convenience stores that sell fuel. And, to give some perspective on the issues being discussed today, the industry posted $4.8 billion in profits last year—which includes both profits at the pump and inside the store—but paid $6.6 billion in credit and debit card fees on its transactions. The next time you stop for a fill-up, keep in mind that more of the money you are paying goes to the card companies than the retailer selling you gasoline will get to keep.

Last year was the first in which card fees exceeded profits industry-wide, and they did so by a large margin. These changes have made interchange fees the top issue for our industry. The rapid increase in fees is unjustifiable and unsustainable. We cannot thank the Task Force enough for agreeing to look into this issue and we look forward to working with you throughout your review.

To raise awareness of the many problems caused by interchange fees and their impact on everyday consumers, NACS has worked with many in the retail industry to establish a broad collection of voices known the Merchants Payments Coalition ("MPC" or the "Coalition"). 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 MPC includes 22 trade associations representing many of the retailers in your districts—the very grocery stores, drug stores, restaurants and shops that you and your constituents frequent daily. The MPC represents a diverse group of interests who often disagree on many issues, but who have banded together to challenge the unfair and unjustifiable practices of Visa and MasterCard. The MPC is fighting for a more competitive and transparent card system that works better for consumers and merchants alike.

There has not been nearly enough information and discussion about interchange fees in the past and we applaud the Task Force for its willingness to examine them. These fees have escalated to the point that they are now the third highest operating cost to my industry—behind only payroll and rent. Of the many types of fees charged by credit card companies, interchange fees are the most pernicious because they are arbitrary, excessive, are not disclosed to retailers or consumers, and ultimately, they drive up the cost of all products. This is a burden that is borne by both credit card users and non-users alike. And retailers have virtually no choice but to accept them, as Visa and MasterCard leverage their dominant market power to force them upon an unwitting public.

The collective setting of interchange fees represents an ongoing antitrust violation by the two leading payment card associations, Visa and MasterCard. These antitrust violations cost merchants and their customers tens of billions of dollars annually. This system is anticompetitive in several ways. First, these fees have been fixed by banks that compete to issue payment cards to consumers or to sign up merchants to accept Visa and MasterCard cards. No matter which Visa or MasterCard member bank issued the card that is used to make a purchase or which Visa or MasterCard member bank signed up the merchant making the sale, the same uniform fixed interchange rates apply. This system also cements Visa's and MasterCard's substantial individual and joint market power. The higher the interchange fees charged by Visa or MasterCard, the more attractive that card system becomes to banks compared to other card systems. Thus, the member banks have every incentive collectively to ensure that the card system sets high interchange fees.

[1] More than 70,000 stores are operated by NACS members. NACS members include forty-nine (49) of the fifty (50) largest companies in the industry, but seventy-three percent (73%) of members operate ten (10) or fewer stores.

We hope that the following discussion provides the Committee with some insight into the opaque and costly world of interchange fees, so that it may better understand the challenges thrust upon our small businesses by Visa and MasterCard and the need for greater disclosure of interchange fees.

INTRODUCTION TO INTERCHANGE FEES AND THEIR CURRENT USE

Interchange fees are the fees credit card companies and banks charge merchants every time a credit or debit card is used to pay for a purchase. The fee is a percentage of each transaction that typically varies with type of card, size of merchant and other factors—but it averages approximately 2 percent for credit card and signature debit transactions. Interchange fees are set by the collective action of MasterCard and Visa member banks (which include most banks in the United States) and are imposed on merchants by the banks to which merchants submit credit card transactions for payment. Merchants must then treat the interchange fee expense as a higher cost-of-doing-business.

When a consumer buys an item with a Visa or MasterCard credit or debit card, the merchant does not receive full face value from the bank to which it submits the charge. The difference between the face value of the customer's purchase and the amount the merchant actually receives is called the "merchant discount," the vast majority of which is the interchange that is paid to the bank that issued the customer's card. As these interchange fees increase and card use expands, merchants are naturally forced to pass these costs along to consumers in the form of higher prices for all products.

The average consumer has no idea that this fee is imposed every time he or she makes a purchase with a Visa or MasterCard card. In this way, interchange acts as a hidden sales tax on U.S. commerce, raising both merchant costs and ultimately the price of goods and services sold to consumers.

To make matters worse, interchange fees are not tailored to Visa's and/or MasterCard's cost of processing the transaction. While there may have been some reasonable basis for the size of these fees decades ago, the proliferation of card transactions has driven down per transaction costs. In fact, a bank consulting firm reported last year that the cost of processing transactions was only 13 percent of the interchange fees charged. As described in greater detail below, interchange fees are now an arbitrary revenue source on top of already significant interest fees, late fees, over-the-limit charges and other fees charged by Visa and MasterCard. How can Visa and MasterCard get away with this practice? To put it bluntly, it is because they have market power and exercise that power in ways that violate the antitrust laws.

Interchange fees are set in secret by Visa and its member banks. MasterCard and its banks do the same. Visa member banks all agree to charge the same fees and this collusion (as well as the separate collusion engaged in by MasterCard member banks) is a massive antitrust violation. Not only that, Visa and MasterCard rules make it virtually impossible for merchants to disclose the fees to the public. The rules run more than a thousand pages, governing every detail of electronic transactions. Retailers must contractually agree to abide by all of these rules in order to accept Visa and MasterCard, but retailers do not get to see those rules. Visa and MasterCard make excerpts available, but that is not good enough as retailers often have problems with rules that are not covered by these excerpts. Visa now allows retailers to view the full set of rules only if they sign a non-disclosure agreement and only after they sign a contract agreeing to abide by the rules.

PROBLEMS WITH INTERCHANGE FEES

1. Interchange fees are a product of dominant market power and retailers have no choice but to accept them

Credit and debit card transactions are a large and growing part of retailers' business. In the convenience store industry, approximately 65 percent of motor fuel sales are paid for with credit or debit cards, and when prices rise, retailers tell us this rate can reach 80 percent in many markets. In fact, across all industries in the United States, the number of electronic payments—most of which are credit and debit card payments—now exceeds the number of payments by check. The average U.S. consumer carries a limited amount of cash at any given time, and experience shows that when consumers want to buy something that costs more than about $20, the transaction is likely to go on a credit or debit card. In this environment, NACS members simply must accept credit and debit cards—if they do not, these merchants would quickly lose customers to nearby competitors that accept all forms of payment.

Visa and MasterCard dominate the card market. Accordingly, most of the buying public holds Visa- and/or MasterCard-branded cards, and the two companies enjoy greater than 80 percent market share in the electronic payment industry. Our judicial system has acknowledged the vast market power enjoyed, and scrupulously maintained, by Visa and MasterCard. In 2003, the Second Circuit Court of Appeals held in the U.S. Department of Justice's case against Visa and MasterCard that the two card associations, both jointly and separately, had market power.[2] This is consistent with other cases and with retailers' experiences.

Perhaps the ubiquity of Visa- and MasterCard-branded cards has something to do with the fact that U.S. consumers receive well over 5 billion mail solicitations for credit cards each year. That is more than 20 solicitations for every man, woman and child of all ages every year. And, frankly, exorbitant interchange fees are fueling the over-saturation of consumers by these direct solicitations. Regardless of the reason for the boom in cards and card usage, it is clear that cards, especially those issued by Visa and MasterCard, are so commonplace that retailers are effectively forced to accept them.

Visa and MasterCard protect their market share with the complex web of rules alluded to above. Retailers are often prohibited by these rules from presenting pro-consumer pricing solutions such as offering cash discounts to customers, even though they cannot prohibit cash discounts under the Truth in Lending Act. Recently in California, some retailers began to offer cash discounts for gasoline purchases. If a customer chose to purchase using cash, he would receive several cents off each gallon purchased. This discount was to incentivize consumers to pay with cash so that the retailers would save on the interchange fees and the savings could be passed along to consumers. Unfortunately for consumers, Visa unilaterally determined that such practices violated their rules and threatened to fine some retailers $5,000 per day for such "infractions." Because Visa could not simply prohibit the discounts, it argued that these retailers could not call the higher price offered the "credit" price. Visa suddenly decided that doing so turned these cash discounts into credit surcharges which Visa does not allow—even though this method had been used by gasoline retailers to describe cash discounts for decades. Instead, Visa directed retailers to call the higher price the "full" or "regular" price. Visa pushed these terms even though the state of California determined that the use of those terms for gasoline purchases would confuse consumers and break California law because full serve and regular fuel are often used to describe other aspects of gasoline pricing. Visa thereby presented retailers with a Catch-22 situation: either break Visa's rules and face stiff fines or break California law and face its penalties. Of course, what Visa really wanted was for retailers to abandon the discounts so no one noticed the huge costs associated with credit cards.

2. Interchange fees lead directly to higher costs for merchants and, ultimately, for consumers

As discussed above, interchange fees act as a tax on the American consumer. When merchants incur fee after fee, ultimately they are forced to pass some of the cost to the consumer in the form of higher prices for goods and services. In fact, the average American family pays $331 in interchange and related fees every year. And that is true whether or not that family uses a single credit or debit card. Because these fees are hidden in the cost of virtually everything we buy, even cash-paying consumers ultimately pay for them.

In the aggregate, retailers and their customers paid $36 billion in interchange fees last year. When all of the other fees on credit and debit transactions are included, the tab increases to over $40 billion. And this figure does not include the many other fees collected directly from consumers such as annual fees, late fees, interest, etc. According to a report by the Government Accountability Office, for every $100 in credit card purchases, credit card companies collect $2.50 in interchange and processing fees.

Last year, in fact, convenience stores paid more fees for accepting cards than they made in profits. Card fees paid by the industry rose 22 percent last year so that the industry paid $6.6 billion while making $4.8 billion in profits. Think about that the next time you fill-up. Card fees are the second largest operating expense in our industry—behind only labor costs. If you are concerned about gas prices, these out-of-control fees are the place to start.

The statistics regarding the growth of interchange fees are astounding. In 2001, Visa, MasterCard and their issuing banks collected $16.6 billion in credit card interchange fees. They have now ballooned by 117 percent to $36 billion—more than all the late, over-the-limit and other fees we all know about combined.

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

The United States enjoys the highest volume of credit card transactions in the world (see Figure 1). Theoretically, this should lead to significant economies of scale and lower interchange rates. We also have the best technology for processing these transactions and we have very low, and decreasing, rates of fraud. Yet, somehow, U.S. rates are higher than corresponding rates in other countries. In the United Kingdom, interchange fees average 0.7 percent, and in Australia, they stand at 0.45 percent—well below the 2 percent charged in America. Even more troubling, our rates are rising, while most other countries' rates are flat or declining. Visa and MasterCard are putting the weight on their worldwide business on the backs of American consumers. About sixty percent of all of the interchange in the world is paid by American consumers and that is wrong.

Not only have interchange fees been historically exorbitant, but there is little hope that the fees that are drowning America's small businesses will recede any time soon. Visa and MasterCard compete by raising, not lowering, their interchange rates. When they raise their rates, Visa and MasterCard induce their bank members to issue more of their cards. Higher interchange rates mean those banks, in turn, get more money from transactions put on those cards. These practices create perverse incentives that actually reward fee increases, as normal competitive market dynamics are inverted and consumers are left footing the bill.

For example, in May 1998, Visa announced that it would increase a debit card interchange fee by about 20 percent. The increase was to take effect in April 1999. In November 1998, however, MasterCard announced a 9 percent increase (also to take effect in April 1999) that was enough to keep its fee higher than Visa's. In most competitive markets, Visa's price increase would have presented an opportunity for MasterCard to hold or lower prices to gain market share—but apparently not when both card brands enjoy merchant acceptance of over 98 percent. In fact, those increases were just the start. In January 1999, Visa announced it would increase its fee by an additional 6 percent. Then MasterCard announced another increase five days later. All of these increases were made before the first rate increase even took effect. When the dust finally settled, Visa's rates went up 26 percent and MasterCard's went up 17 percent. Overall, these increases alone cost U.S. consumers an additional $300 million per year.

Unfortunately, without healthy and competitive market forces, we lack the necessary checks and balances to prevent rates from rising to stratospheric levels. The shear market power of the credit card companies combined with the straitjacket of anti-competitive rules they maintain inhibits retailers from refusing to take cards in general or declining to take a card with higher interchange rates. And in a non-transparent market, these practices go unchallenged.

3. Interchange fees and their impact are not disclosed to consumers

It is not surprising, given the nature and cost of interchange fees, that Visa and MasterCard go to great lengths to ensure that consumers remain in the dark about these fees. The efforts of credit card companies to keep interchange hidden drives up costs. Without any price cues, it appears that credit card use is costless and consumers are deprived of the opportunity to choose lower cost options. It is in this shroud of darkness that Visa, MasterCard and their member banks collect literally billions of dollars from unwitting consumers.

Furthermore, it is not just consumers who are left in the dark; Visa and MasterCard refuse to fully disclose their operating rules to retailers as well. The card associations have a complex matrix of interchange rates ranging from about 5 cents plus 1.15% for each transaction to 15 cents plus 2.95% of the transaction. But it is hard for retailers, particularly small mom-and-pop stores, to figure out why they fall into a particular rate category. Plus, retailersare charged different rates within the course of the same business day. Corporate cards, rewards cards, fleet cards and others carry very high rates while basic cards can have lower rates. Other factors can change the rates as well. For example, if a card swipe doesn't work and the retailer needs to call to get authorization, the transaction then falls into a different risk category and a different interchange rate is charged. And if the phone call doesn't go through, then again, a higher rate is charged.

MasterCard has put its rates on its website—and the document is 100 pages long. These rates are 100 pages long. Visa's rates are also very confusing. Retailers simply are not given the clear, understandable and timely information they would need to accurately inform consumers about the rates being charged. And Visa and MasterCard make no effort to inform consumers—instead, as I noted, they actively try to keep the fees hidden in the overall prices of goods.

As this Congress moves forward on this issue, it is imperative that transparency of interchange fees be improved. Without adequate disclosure, true competition is impossible and interchange fees and consumer prices will continue to climb upward.

4. Interchange fees are without justification and priced without regard to the cost of transactions

The volume of electronic transactions has increased dramatically in recent years. Since 2001, debit card use has surged by more than 20 percent a year. Economies of scale, competition, plummeting computer costs, low interest rates and low inflation, however, are not driving down payment fees. In fact, the fees are up 117 percent just since 2001.

Banks and card companies acknowledge the fees are not based solely on processing costs. In fact, the fees help subsidize marketing efforts to entice consumers to use more cards, to use them more frequently and to purchase goods and services in greater amounts. In fact, many of these marketing efforts are specifically designed to drive consumers to higher fee transactions. Solicitations for corporate and rewards cards are becoming more common and Visa in particular has aggressively promoted consumers signing for debit transactions. Using a signature rather than a PIN code on a debit transaction not only results in far higher interchange fees, but also is a far less secure method of transacting. Just last year, a bank industry consulting firm estimated that only 13 percent of the interchange fee covers processing costs, while 44 percent pays for rewards programs and the balance goes to marketing, advertising, services, profits and other items (see Figure 2).[3]

It is troubling that interchange fees continue to increase while they should be declining due to decreased costs. When evaluated in the context of their market power, these rates are nothing less than outrageous.

CONCLUSION: ACTION IS NEEDED

Congress, the executive branch, and the courts have, at times, looked into the interchange pricing system. Meanwhile, interchange rates increased again in April of this year. Some of the new rates are now more than 3 percent when the percentage rate and fixed fee are both calculated. In addition to increasing rates, Visa and MasterCard are pushing more consumers into the higher-rate premium cards and away from lower-rate standard cards.

When Visa and MasterCard act with the false imprimatur bestowed by duopolistic market power, we can expect that these activities will continue unabated. In other words, without immediate intervention, their exploitative pricing and policies will surely persist. NACS is pleased that this Task Force is taking an active role in examining an industry long in need of reform and increased disclosure. Hopefully, this hearing will be the first critical step toward leveling the playing field for the small business owners and consumers of America.

[3] *A New Business Model for Card Payments,* Diamond Management & Technology Consultants, 2006.

FIGURE 1.

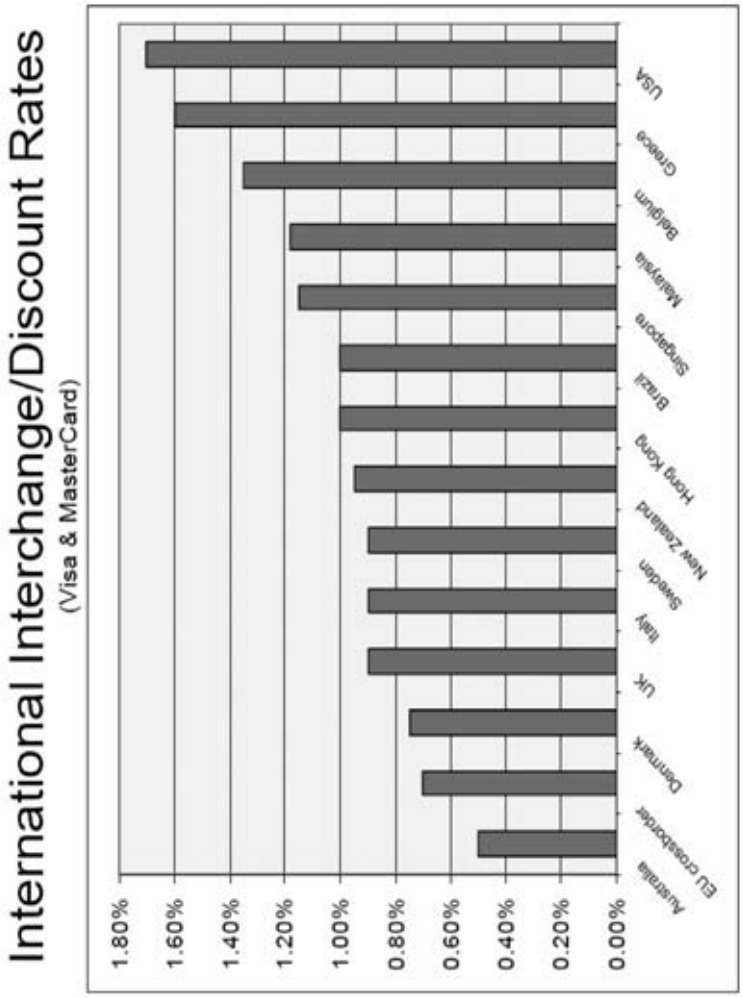
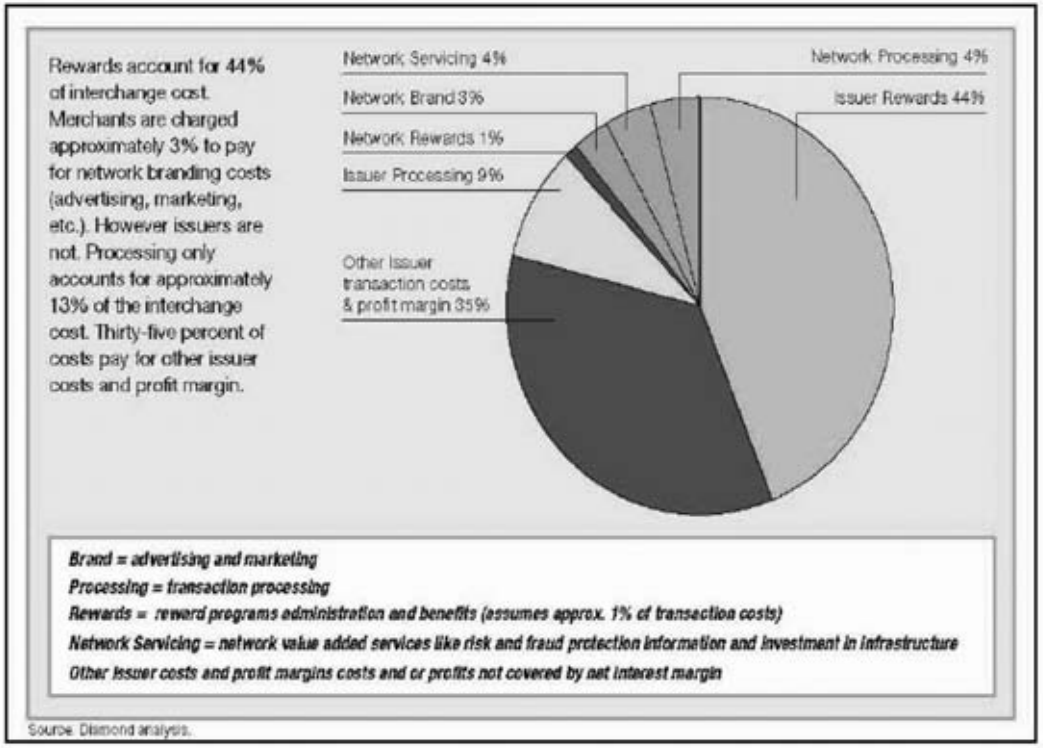

International Interchange/Discount Rates
(Visa & MasterCard)
1.80%
1.60%
1.40%
1.20%
1.00%
0.80%
0.60%
0.40%
0.20%
0.00%
Australia
EU crossborder
Denmark
UK
Italy
Sweden
New Zealand
Hong Kong
Brazil
Singapore
Malaysia
Belgium
Greece
USA

FIGURE 2. Estimated Components of Interchange



Source: Diamond analysis.

PREPARED STATEMENT OF THE NATIONAL GROCERS ASSOCIATION (NGA)

The National Grocers Association (N.G.A.) greatly appreciates the opportunity to submit this statement for the record of this important hearing before the U.S. House of Representatives Committee on the Judiciary Antitrust Task Force. N.G.A. thanks Chairman Conyers and the Task Force for holding today's hearing on interchange, a matter of great antitrust importance to consumers and the retail community.

N.G.A. is the national trade association that represents exclusively the interests of independent, community-focused grocery retailers and wholesalers. An independent, community-focused retailer is a privately owned or controlled food retail company operating in a variety of formats. Most independent operators are serviced by wholesale distributors, while others may be partially or fully self-distributing. A few are publicly traded, but with controlling shares held by the family and others are employee owned. Independents are the true entrepreneurs of the grocery industry and are dedicated to their customers, associates, and communities. N.G.A. retail and wholesale members accounted for over $200 billion of U.S. grocery sales last year. N.G.A. is a founding member of the Merchants Payment Coalition that is made up of trade associations representing supermarkets, retailers, convenience stores, restaurants, drug stores, gas stations and other businesses that are concerned about increasing and unfair interchange fees charged by credit card companies and banks.

An interchange fee, usually in the form of a percentage of the transaction, is charged to the merchant by the card issuing bank and the card association. N.G.A. believes that there are major antitrust problems with the current interchange fee system, causing profound harm to consumers and merchants. For the benefit of the American consumer, federal governmental agencies and members of Congress must exercise oversight of debit and credit card interchange fees and the lack of a competitive market.

I. INTERCHANGE: A MARKET FAILURE THAT HARMS CONSUMERS AND MERCHANTS

Interchange fees charged by MasterCard and Visa, and the rules under which they are levied, are nothing more than a hidden tax on retail grocers and the consumers they serve, including customers using other payment methods who indirectly subsidize cardholders. Interchange fees are hidden from consumers by credit card companies, but consumers ultimately pay them because costs are passed along in the form of higher consumer prices. Visa and MasterCard rules require that the fees be collected from the merchants, not directly from the card users. These card-based fees are the single most profitable source of income for banks. These fees now exceed $36 billion annually (up over $10 billion from 2006 reports) with contracts that actually prohibit merchants from disclosing the cost of interchange fees to their customers who use the cards.

In a competitive marketplace when costs go down, rates should fall. Interchange fees have increased precipitously even though fraud is down and transaction volume is up significantly. This is because debit and credit card systems and their interchange rates are a private, unregulated money system that has exceeded cash and checks as the favored means of paying for goods and services since 2004. The debit and credit card interchange rates of Visa, MasterCard and their member banks are established collusively by the competing banks that constitute the boards of directors of Visa and MasterCard. This is a clear violation of federal antitrust laws. As a result, interchange rates can be increased at will; they bear no relation to any legitimate charges that arguably should be imposed on merchants and consumers.

The interchange system is a clear example of a market failure. No competitive forces exist to pressure the card associations to lower rates. Rather, competition raises interchange fees, as Visa and MasterCard compete for bank issuers by offering them higher and higher payouts from interchange fees.

Few issues have received the attention of retail and wholesale grocers, as well as all other retail merchants, as that being given to the high and increasing cost of interchange that retailers must pay to Visa and MasterCard for accepting their debit and credit cards. The United States has the highest credit card interchange fees of any industrialized country, and interchange rates have continued to increase in the United States even while costs of processing and fraud have declined. In contrast, interchange rates internationally continue to decline dramatically. The international precedents for antitrust investigation and government intervention are persuasive and demand serious review and appropriate action by this Committee.

A recent Morgan Stanley report found that the weighted average for Visa and MasterCard interchange had increased from 1.58 percent in 1998 to 1.75 percent in 2004 (an increase of 10.8 percent) and is forecast to grow to 1.86 percent in 2010 (an additional increase of 6.3 percent over 2004 and 17.7 percent since 1998).

The recent "Diamond Study" of interchange examined, among other issues, the costs presently being borne by consumers and merchants under the present interchange system. The study found that the largest single use of interchange paid directly by merchants and indirectly by consumers is cardholder rewards—a 45% slice of the interchange pie. There is no justification for this charge, but there is an explanation—the exercise of unbridled market power by VISA, MasterCard and their banks. On two levels, the charge is also unfair, first, because merchants cannot negotiate their rates, and they are forced to pay these rates to the issuing banks, without viable alternative options. The rewards programs are arrangements between the issuing banks and the cardholders. Second, the cardholders who receive the benefits are not the only ones who pay for them in the form of higher prices. **All customers pay the same prices, regardless of how they pay, and those prices include the cost of interchange. So everyone pays for the rewards. This burden falls heaviest on the poorest consumers, who are least able to absorb the higher prices.** Consumer rewards must no longer be part of the interchange rate.

The next largest slice of the interchange pie is "other issuer costs" and profit, set at 35% by the Diamond Study. One estimate places more than half of this amount—20%—on the cost of direct mail solicitation of new cardholders—more than six billion pieces of mail in 2005! All that was said about cardholder rewards can be repeated about direct mail solicitations as well as another 3% slice of the pie that Diamond refers to as "network branding expenses," also known as advertising. So, bank solicitations and Visa and MasterCard advertising are roughly 23% of the pie. Add the 45% represented by cardholder rewards, and by any rational approach, 68% of today's interchange fees should disappear. While not separately identified in the Diamond Study, part of the remaining 15% of other issuer costs is likely to include fraud and interest revenue foregone due to the cardholders' interest free period. The interest is merely another cardholder benefit, which is not a proper charge to merchants and all consumers. Fraud losses have been disallowed in most of the countries that have acted on the interchange issue. In addition, the system in which the fraud is perpetrated is the system that Visa, MasterCard and the banks designed and created, a system that is ripe for picking, and they want merchants and consumers to bear the cost of their mistakes.

The vast majority of grocers do not have the ability to overcome the market power of Visa and MasterCard in order to negotiate lower rates. The results of the recent settlement in 2003 of the Wal-Mart lawsuit against the credit card companies clearly illustrate the anticompetitive nature of the interchange system. Visa and MasterCard agreed to pay the plaintiff retailers more than $3 billion, but immediately increased credit card interchange rates to cover the cost of the settlement—and then some.

Except for the very largest merchants, efforts to negotiate lower interchange rates have been rejected, even when retailers have attempted to aggregate. The vast majority of merchants, therefore, have no control over this discriminatory cost of doing business, because it is set by a cartel.

The issue here is about the need for competition, and when it does not exist, then solutions must be pursued to correct the unfairness and level the playing field. In November 2005 N.G.A., together with some of its members, Affiliated Foods Midwest, Coborn's Inc., and D'Agostino's Supermarkets, filed a class action suit against Visa, MasterCard and a number of banks, alleging the named defendants conspired to fix the interchange fees that are charged to retail grocers and ultimately consumers in violation of the Sherman Act. This action was consolidated in the U.S. District Court for the Eastern District of New York with over 47 other actions filed.

One must ask why the United States lags behind other countries in addressing this

important issue. Australia in 1998 passed its Payment Systems (Regulation) Act 1998 after an investigation by the Australian Competition and Consumer Commission found against the collective fixing of interchange fees. Consequently, on August 27, 2002, the Reserve Bank of Australia adopted a new cost-based approach to interchange fees and eliminated the no surcharge rule, which prevents retailers from directly charging consumers the cost of interchange when they pay by card. The purpose is to ensure that the setting of interchange fees in designated credit card systems is transparent and promotes efficiency and competition. In the Bank's view, interchange fees in the credit card systems were not subject to the normal forces of competition which pushed fees up, not down. The Reserve Bank of Australia reported in August 2005 that, "Prior to the reforms, this fee averaged 0.95 percent of the amount spent; it now averages around 0.54 per cent." The Reserve Bank of Australia also found, **"In total, as a result of the Bank's reforms, merchants' costs of accepting credit and charge card payments were around $580 million lower than they would otherwise have been. Given the competitive na-**

ture of Australian business, these cost savings are finding their way into lower prices for goods and services, or smaller price increases than would have otherwise have taken place." On November 25, 2005, the Reserve Bank of Australia announced further amendments that became effective on July 1, 2006. Some observers predict rates will drop to .35 per cent.

On September 6, 2005, the United Kingdom Office of Fair Trading (OFT) found that a collective agreement between members of MasterCard UK Members Forum (MMF), including most banks, setting the multi-lateral interchange fee paid on virtually all purchases using UK-issued MasterCard credit and debit cards between March 1, 2000, and November 18, 2004, restricted competition and infringed Article 81 of the EC Treaty and the Chapter 1 prohibition of the Competition Act. It gave rise to a collective agreement on the level of the multilateral interchange fee and resulted in unjustified recovery of certain costs.

The OFT found the inclusion of extraneous costs provided a large flow of revenue to card issuers and the incentive to induce customers to hold and use MasterCard cards, for example, through loyalty schemes, advertising and funding the interest-free period. The fee was passed on to the retailers by the merchant acquirers through higher merchant service charges. The OFT stated, **"Consumers, including those who do not use MasterCard cards, ultimately picked up the cost for the higher interchange fee through higher retail prices."** Sir John Vickers, OFT Chairman, said, **"This unduly high interchange fee was like a tax on UK consumers."**

Although the OFT consented to the Competition Appeal Tribunal's setting aside of the OFT's September 2005 decision, the investigation will continue and will include Visa. OFT chief executive John Fingleton stated in June 2006: "We still believe that the interchange fee arrangements that are now in place could infringe competition law and are harmful to consumers, who pay higher prices as a result of these fees. Continuing to defend appeals against the original decision before the Competition Appeal Tribunal diverts us from dealing most effectively with the overall problem of interchange fees. Our resources are better spent in reaching decisions on MasterCard's and Visa's current interchange fee arrangements rather than continuing with these appeals that concern only MasterCard's historic arrangements."

In September 2000, the European Commission challenged Visa's anticompetitive multilateral interchange fee, and Visa agreed in 2002 to lower the weighted average fees in stages to 0.7 per cent in 2007. Numerous other countries, such as Sweden, Italy, Netherlands, Switzerland, Spain, Israel and Mexico have addressed the anticompetitive nature of interchange.

Other countries have addressed and reduced anticompetitive interchange fees, and now it is time for Congress and federal agencies to do the same.

The current interchange system is inherently flawed and presents gross inequities for both retailers and consumers. Transparency is a must. All parties involved, especially consumers and merchants, should be made aware of the interchange fees charged to merchants, and ultimately consumers. The consumer has a right to know how interchange fees affect the prices of goods and services from merchants. Retailers are charged increased interchange fees to cover the incentives given to consumers to use the cards carrying the highest interchange rates. Those incentives by any objective standard should not be part of every consumer's grocery bill; they should be absorbed by Visa, MasterCard and their card-issuing banks, which reap the majority of the huge financial benefits. It is time to end this "hidden tax" on merchants and consumers, including customers who pay by cash or check and thereby subsidize cardholders.

The present system has another major antitrust flaw in addition to interchange rates: anticompetitive card association rules and procedures. For example, imagine yourself as a retailer who wishes to accept Visa and MasterCard as a means of payment by your customers. You sign merchant agreements in which you agree to abide by all of these associations' rules, but a wall of secrecy and nondisclosure hides them from retailers. Those rules must end.

II. COLLUSIVE SETTING OF INTERCHANGE FEES AND OPERATING RULES VIOLATE ANTITRUST LAWS

In the Department of Justice case against Visa and MasterCard, the U.S. Court of Appeals for the Second Circuit found that when Visa and MasterCard pass rules, that it is the collective action of a cartel of banks that compete to issue cards or sign up merchants to accept Visa and MasterCard *U.S. v. Visa U.S.A., Inc.,* 2003 WL 22138519 (2d Cir. Sept. 17, 2003). It follows that the setting of interchange rates by those same Visa and MasterCard banks also work as a cartel in the setting of interchange fees and violates Section 1 of the Sherman Act. The existing system

eliminates any incentive for card issuing banks to lower interchange fees in response to the demands of the merchant community, consumers and other participants in the marketplace.

Visa's and MasterCard's complex system of rules amplify the power of this cartel to maintain supra-competitive pricing by restricting merchants' ability to disclose fees to consumers or charge cardholders a different price based on differences in interchange fees for various cards. For example one rule requires merchants to accept all Visa and MasterCard credit cards despite the fact that interchange rates vary by as much as 100% based on the type of card (Platinum Plus(r), Visa Signature(r), corporate, small business etc.). The sad consequence of this system is that all consumers, regardless of form of payment, end up subsidizing the rewards of select cardholders. This type of cartel rate setting and rule making are clearly in violations of the Sherman Act.

III. CONCLUSION

N.G.A. strongly believes that action by Congress and federal agencies is needed to end the anticompetitive and illegal price fixing and discriminatory establishment of interchange rates and card association rules. Interchange fees should be set by competitive forces, not by collusion. In addition, anticompetitive rules which harm merchants and consumers and maintain the market power of card associations must be ended, and retailers must be informed in advance of the rules to which they will be subjected.

N.G.A. applauds the Committee for holding this important hearing and urges Congress to continue to investigate and correct the unfairness of the current interchange system.

LETTER FROM JOHN GAY, SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS & PUBLIC POLICY, NATIONAL RESTAURANT ASSOCIATION, TO CHAIRMAN CONYERS AND RANKING MEMBER CHABOT

REPRESENTING THE RESTAURANT INDUSTRY

The Cornerstone of the Economy, Career Opportunities and Community Involvement

July 17, 2007

Chairman John Conyers
Ranking Member Steve Chabot
Committee on the Judiciary, Antitrust Task Force
2138 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Conyers and Ranking Member Chabot:

On behalf of the National Restaurant Association and its 935,000 restaurant and food-service locations nationwide, thank you for holding this important hearing to examine credit card interchange fees.

Interchange, a fee that is collectively set by Visa® and MasterCard's® member banks, is a percentage of each transaction, sometimes accompanied by a flat fee, that banks collect from retailers every time a credit or debit card is used to pay for a purchase, adding up to billions of dollars each year. This high cost poses a difficult burden to small businesses and restaurants across the country.

Interchange fees are meant to cover the cost of processing a credit card transaction and the potential risk taken by the issuing bank of a default on payment. The cost of processing a debit or credit card transaction is the same whether you are buying a cup of coffee or a meal at a fine dining restaurant, yet because this charge is levied as a percentage, the higher your bill, the more money goes to VISA and MasterCard member banks. Thanks to technology, the cost of processing these electronic transactions continues to decrease and yet the charges continue to rise and are among the highest in the world. The result is an increase in revenue for the card issuer, and a drain on a restaurant's bottom line.

In the United States, interchange impacts not only the merchants, but has the largest impact on American consumers. This "hidden tax" was estimated to cost the average American household approximately $232 in 2004. This year, the restaurant industry will spend over $3 billion on interchange fees. It is critical that we find a way to slow the out-of-control interchange increases that place undue financial burdens on American restaurants, other merchants and their consumers.

Thank you again for holding a hearing on this important matter.
Sincerely,

John Gay
Senior Vice President
Government Affairs & Public Policy

1200 SEVENTEENTH STREET, NW • WASHINGTON, DC 20036-3097
TEL: 202.331.5900 • FAX: 202.331.2429 • WWW.RESTAURANT.ORG

LETTER FROM G. KENDRICK MACDOWELL, GENERAL COUNSEL AND DIRECTOR OF GOVERNMENT AFFAIRS, NATIONAL ASSOCIATION OF THEATRE OWNERS (NATO), TO CHAIRMAN CONYERS AND RANKING MEMBER CHABOT

THE NATIONAL ASSOCIATION
OF THEATRE OWNERS

Chairman John Conyers
Ranking Member Steve Chabot
Committee on the Judiciary, Antitrust Task Force
2138 Rayburn House Office Building
Washington, D.C. 20515

July 19, 2007

Re: Hearing on Credit Card Interchange Fees

Dear Chairman Conyers and Ranking Member Chabot,

I write on behalf of the National Association of Theatre Owners (NATO) to commend your decision to hold a hearing on credit card interchange fees. This hidden charge — imposed on merchants through complex and obscure rules with no relation to any actual cost of services — exacts approximately $65 million a year from our industry and our patrons.

NATO is the national trade association of the motion picture theatre industry. Its members operate more than 29,000 motion picture screens located in all 50 states. NATO's membership includes the largest cinema chains in the world, as well as hundreds of independent theatre owners. Historically, our industry has been cash-based, but the percentage of credit card transactions, for both tickets and concessions, steadily rises. As a result, movie patrons must pay ever-increasing interchange fees when buying tickets and are often hit a second time in a single trip when they purchase concessions.

Visa and MasterCard are not subject to any meaningful competitive pressures beyond the stark capacity of merchants and consumers to bear the added cost. Visa and MasterCard member banks raise jarring antitrust concerns by collectively setting supracompetitive interchange rates. Indeed, the exorbitant rates in the United States are among the highest in the world, despite greater volume and a lower cost of service here. Specifically, Visa and MasterCard collected more than $36 billion in interchange fees in 2006, up 17 percent from 2005 and 117 percent since 2001. These increases have occurred even though the actual cost of transaction processing continues to go down.

Merchants have long operated virtually in the dark about how the interchange rates are determined and applied, along with the myriad additional restrictions applicable to use of various credit and debit cards—including a brazenly anticompetitive requirement that interchange fees never be itemized for customers to see. In short, we've been unable

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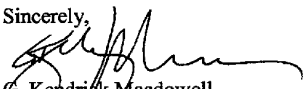
even to examine the onerous rules that exact tens of millions of dollars from our industry. The fees are hidden and merchants are blinded — because Visa and MasterCard can.

Last year, under pressure from Congress and merchants, Visa and MasterCard posted excerpts of the rules on their websites. Visa now allows merchants to view the full set of rules — subject to a rigorous nondisclosure agreement, and excepting information of a "competitive" nature, and excluding details such as "interchange rates." It is a testament to the arrogant market power of these banking institutions that such a caricature of transparency could be imagined "progress."

We applaud your resolve to examine this financial pathology that drains away so many billions of dollars.

Sincerely,



G. Kendrick Macdowell
General Counsel and Director of Government Affairs
National Association of Theatre Owners

LETTER FROM RANDY SCHENAUER, CHAIRMAN, GOVERNMENT RELATIONS COMMITTEE, SOCIETY OF AMERICAN FLORISTS (SAF), TO CHAIRMAN CONYERS AND RANKING MEMBER CHABOT

SAF
SOCIETY of AMERICAN FLORISTS

Your Growth is Our Business

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ALEXANDRIA, VA 22314 USA
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www.safnow.org
www.shoutflowers.com

July 18, 2007

Chairman John Conyers
Ranking Member Steve Chabot
Committee on the Judiciary, Antitrust Task Force
2138 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Conyers and Ranking Member Steve Chabot:

On behalf of the Society of American Florists (SAF), thank you for holding the hearing this Thursday, July 20 on Credit Card Interchange Fees. The floral industry supports the efforts of the Antitrust Task Force to closely examine the practices of credit card companies imposing random hidden charges on merchants who accept their credit and debit cards for payment. SAF is a member of the Merchants Payments Coalition, an organization representing the nation's retailers in payment and transaction issues. The goal of the coalition is to arrive at more competitive and transparent credit card fee system that serves consumers and merchants fairly.

The Society of American Florists (SAF) represents the entire floriculture industry in the U.S. – growers, wholesalers, retailers, importers, suppliers, educators and related organizations. Floriculture is a $19 billion component of the U.S. economy. SAF's membership includes nearly 11,000 small businesses nationwide.

Banks and credit card companies collected more than $36 billion in interchange fees in 2006 alone, up 17 percent from 2005 and 117 percent since 2001. Floral business owners, whether retailers, wholesalers or growers, have no choice but to pass those fees on to consumers in the form of higher prices. The increase in fees is puzzling because only 13 percent of what is collected in interchange by the credit card companies is spent on processing.

Many retailers in the floral industry enjoy a very small profit margin. Our members are dealing with a perishable product and a discretionary purchase. In the modern economy of electronic commerce, most retail flower shops cannot depend on walk-in business and all have now developed websites. Flowers can be purchased online using a credit card or debit card. Retail florists have seen a tremendous increase in the use of debit/credit cards in the last five years. This alone has contributed to either higher prices to the consumer or a decreased profit margin.

We hope this hearing will lead to more disclosure of credit card company fees, policies and practices. We hope also that the hearing will lead to greater competition in this market. Thank you again for taking the lead on this important issue.

Sincerely,

Randy Schenauer
Chairman, Society of American Florists Government Relations Committee

LETTER FROM BRIAN E. CARTIER, CAE, CHIEF EXECUTIVE, NATIONAL ASSOCIATION OF COLLEGE STORES (NACS), TO CHAIRMAN CONYERS AND RANKING MEMBER CHABOT

National Association of College Stores

500 E. Lorain Street **Oberlin, Ohio 44074**

July 19, 2007

Chairman John Conyers
Ranking Member Steve Chabot
Committee on the Judiciary, Antitrust Task Force
2138 Rayburn House Office Building
Washington, D.C. 20515

Dear Congressmen Conyers and Chabot,

On behalf of the National Association of College Stores (NACS), I write to thank you for holding a hearing today on "Credit Card Interchange Fees."

Headquartered in Oberlin, Ohio, NACS is the professional trade association representing the collegiate retailing industry. We represent more than 3,100 collegiate retail stores and 1,100 vendor companies. NACS member stores serve nearly 95% of America's 15.5 million college students while supporting the academic missions of higher education institutions.

As you know, college costs have been increasing significantly undermining access and affordability for millions of students and their families. One area contributing to higher education costs for students and their parents are inflated interchange fees.

Cash strapped college students, parents, and alumni pay a hidden fee on virtually every transaction they make, costing all U.S. consumers more then $36 billion dollars a year. This fee, called interchange, is a percentage of each transaction that Visa and MasterCard banks collect from institutions of higher education and merchants every time a consumer uses a credit or debit card to pay for a purchase or service. The fee varies with type of card and other factors, but averages close to 2 percent for credit card and signature debit transactions. These fees drive up the cost of higher education for all students, parents, and alumni whether they pay with plastic, cash or check.

Students who shop at college bookstores are increasingly using plastic payment forms. More then 70% of students have debit and credit cards. Credit and debit purchases accounted for 54.6% of student purchases in college stores in 2003-2004, resulting in an estimated $85 million in interchange fees paid by college bookstores and their student and parent customers. These costs continue to climb.

A 2003 study by the National Association of College and University Business Officers found that credit and debit card fees "represents a significant expense for many institutions." The total costs to higher education institutions and students for interchange fees is much higher then found in just tuition and fee payments and college bookstores. Everything a student and parent buys on or off campus such as textbooks and supplies, clothing, food, gas, airplane tickets, and computers have higher prices due to inflated interchange fees.

At a time when students and parents are struggling to pay for college costs and institutions of higher education are being saddled with higher operating costs, credit card interchange fees are unreasonably and inexplicably high. Additional study is needed on how these fees impact escalating costs for higher education institutions and their student and parent customers.

Thank you for exploring this critically important issue.

Sincerely,

Brian E. Cartier

Brian E. Cartier, CAE
Chief Executive

LETTER FROM LISA J. MULLINGS, PRESIDENT AND C.E.O., NATSO, INC., TO CHAIRMAN CONYERS AND RANKING MEMBER CHABOT

July 18, 2007

Chairman John Conyers
Ranking Member Steve Chabot
Committee on the Judiciary, Antitrust Task Force
2138 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Conyers and Ranking Member Chabot:

As the trade association that represents the interests of America's travel plazas and truckstops, NATSO writes to express the industry's support for the House Judiciary Committee's Antitrust Task Force hearing on credit card interchange fees scheduled for Thursday, July 19, 2007. The U.S. travel plaza and truckstop industry employs over 144,700 individuals and sells 75-80 percent of diesel fuel sold in the United States. A typical travel plaza or truckstop sells gasoline and diesel fuel, operates fast food and/or full-service restaurants, sells convenience items, offers free extended stay parking, and might offer truck repair and a host of other services. Most, if not all, of these services are paid for by credit/fleet cards used by professional truck drivers and the traveling public.

The use of credit/fleet cards to purchase items continues to increase. Ten years ago, approximately 35 percent of diesel fuel purchases were made with credit/fleet cards, while today approximately 80 percent of these same purchases are made via card payment and thus subject to interchange fees. The credit/fleet card usage rate for independent marketers is closer to 90 percent of their total diesel fuel sales.

Increased fuel prices have resulted in even higher interchange fees because the fees are percentage based, even though the transactions themselves cost no more for the banks to process. Consumers complain about gas prices now, but what

they don't know is that the credit card issuers are making more money on a gallon of gas than the gasoline merchant. They are truly profiting off of higher prices, since interchange fees are percentage based. The average fuel marketer makes a profit of two or three cents per gallon sold, but pays three times that in interchange fees. The public's calls for investigations into price gouging at the pump fail to recognize that the biggest profiteers are the credit/fleet card companies. While businesses and the public are suffering under high fuel prices, credit/fleet card companies are raking in the profits.

It is clear that this hearing before the Antitrust Task Force is timely and critical. Thank you for holding this hearing. Please feel free to contact NATSO for further explanation about how interchange fees impact the travel plaza and truckstop industry.

Respectfully,

Lisa J. Mullings
President and CEO

LETTER FROM DARRELL K. SMITH, PRESIDENT, NATIONAL ASSOCIATION OF SHELL MARKETERS (NASM), TO CHAIRMAN CONYERS AND RANKING MEMBER CHABOT

National Association of Shell Marketers
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July 18, 2007

Chairman John Conyers
Ranking Member Steve Chabot
Committee on the Judiciary, Antitrust Task Force
2138 Rayburn House Office Building
Washington, D.C. 20515

Dear Congressmen Conyers and Chabot:

The National Association of Shell Marketers extends our gratitude for your decision to hold a hearing on credit card interchange fees. NASM represents nearly 300 wholesale marketers with nearly 7,500 retail locations in virtually every state in the U.S., and over 100 suppliers of goods and services to the industry. The small, community-based, often family-owned businesses represented by NASM are engaged in fair and honest business practices that are respectful of their neighbors, friends and customers whom they serve in their communities.

Credit card interchange fees have become extraordinarily detrimental to our members, and have been a significant contributor to increased gasoline prices for consumers. Our members are proud to be a part of the American free market, but they do not understand why Visa and MasterCard seem to be exempt from the American free market principles of fair competition. Those companies operate in secret while controlling 80 percent of the credit card purchase volume.

The gasoline business is highly competitive and price sensitive. It is a "cents per gallon" business, and an inordinate amount of those "cents" now go to credit card companies and their banks. As much as eight cents per gallon can be collected by such companies and banks on sales of gasoline at the pump. Indeed, those companies and banks often make more than our members or their service station dealers on those transactions. Yet, interchange fees are hidden from the consumer. And service station owners and dealers, on the frontline, are the ones who must absorb the wrath of angry consumers and the media.

Congress is currently attempting to tackle high gasoline prices with such strategies as anti-price gouging legislation. However, previous attempts at price controls actually increased prices for consumers. If Congress wishes to enact legislation that will have a real impact on the price of gasoline, and thereby provide needed relief to American consumers and small businesses, it should address the problem of excessive credit card interchange fees.

We appreciate your interest in this critical subject for our industry, and we trust that the good work being done by your Committee will provide a meaningful solution.

Please do not hesitate to contact me if you have any questions or would like any further information from NASM.

Sincerely,

Darrell K. Smith

Darrell K. Smith
President

LETTER FROM HEIDI M. DAVIDSON, VICE PRESIDENT, GLOBAL PUBLIC POLICY, MASTERCARD WORLDWIDE, TO CHAIRMAN CONYERS, WITH ENCLOSED NEWS RELEASES

Heidi Davidson
Vice President
Global Public Policy

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MasterCard
Worldwide

July 18, 2007

The Honorable John Conyers, Jr.
Chairman
House Committee on the Judiciary
2138 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Conyers:

In connection with your preparation for tomorrow's hearing on interchange and antitrust issues, MasterCard would like to provide you with some information and materials you may find helpful.

It is our experience that there have been questions as to whether merchants who accept MasterCard-branded payment cards have access to the rules governing merchant participation in the MasterCard system. Merchants are an important part of our system and we ensure that all merchants can easily obtain those rules pertaining to their business from our website. Any merchant or other member of the public can access the merchant operating rules at any time by visiting our website, www.mastercard.com, and entering the "For Merchants" portion of the site. Attached is our press release from August 12, 2004 announcing the posting of the rules to the site.

There have also been questions as to whether merchants have access to the specific interchange rates paid by merchant acquiring banks to card issuing banks. Although merchants do not pay interchange rates—they pay merchant discount fees to their respective banks, the price of which is included in their contracts with those banks—MasterCard makes sure that merchants can, at any time, have full access to the default interchange rates set by MasterCard management. Like the merchant rules, the MasterCard interchange rates can be found in the "For Merchants" portion of our website. The website also includes comprehensive explanatory information merchants may need to understand the rates and how they apply. Please find attached a press release from October 30, 2006 announcing the decision to post these materials on our website.

I hope you find this information helpful. Please do not hesitate to contact me if you have any questions or if MasterCard can be of further assistance.

Sincerely,

Heidi M. Davidson

MasterCard Worldwide

News Release

MasterCard Announces Initiatives Aimed at Giving Merchants New Tools to Enhance Benefits and Efficiency of Card Acceptance

Includes Enhanced Website, Publication of Rules Manual and New Merchant Advertising Campaign

Purchase, NY, August 12, 2004 - MasterCard International has implemented a range of new initiatives that are aimed at providing merchants with new tools that will help them maximize the benefits and value of accepting MasterCard payment cards.

"Merchants are a critical part of the vibrant payments system," said Fred Gore, MasterCard senior vice president of Acceptance. "The goal of all of our work with merchants is to ensure that they have the tools they need to engage in the payments system in the most efficient and beneficial manner possible. This array of initiatives – the enhanced website, publication of our rules, and the recently announced merchant advertising campaign – are a demonstration of our commitment to this important constituency."

MasterCardmerchant.com, a website for the merchant community, provides information to merchants and acquirers about MasterCard acceptance programs. The site provides information to help merchants leverage card acceptance for their businesses. Topics include industry-specific programs across most merchant categories; co-branding; preventing fraud; new technologies; and brand standards. To help merchants who don't yet accept cards, basic information is provided on the benefits of card acceptance, how transactions work, and automated referrals to acquirers.

MasterCard has also published a new manual to provide merchants with MasterCard rules and procedures that apply when a merchant accepts MasterCard cards and Maestro cards for payment. The manual can be downloaded free of charge from the MasterCard merchant website.
MasterCard members in the acquiring community are obligated to assure that merchants comply with MasterCard's rules and procedures, and may also choose to require a merchant to adhere to additional or more stringent standards than MasterCard rules require.

"In the past, we directed our members, who provide MasterCard acceptance to merchants, to inform merchants about our rules and procedures," Gore said. "We recognize the growing voice the merchant community has in the payments industry today, and believe that both merchants and consumers will benefit if we can provide merchants with a better understanding of the rules and procedures, as well as the benefits and efficiencies related to MasterCard acceptance."

The new MasterCard Merchant Rules Manual includes rules covering a wide range of topics relevant to merchants, such as the steps that a merchant must follow to complete a sale, how MasterCard transactions are processed, and programs that MasterCard has put in place to reduce fraud. Regional variations of these rules are also included in the manual.

In addition, MasterCard's credit and debit interchange program rates for the U.S. are now being established solely by MasterCard management, with no Board participation. MasterCard will continue to establish interchange program rates that are aimed at balancing the needs of merchants and issuers, in order to encourage both acceptance and issuance of MasterCard cards.

New Advertising Campaign
MasterCard recently launched a new "Priceless" ad campaign in the U.S. that, for the first time, features large national merchants as part of the brand's positioning, as well as a dynamic new layout and style. The

new ads will help MasterCard accomplish its goals of continuing the effectiveness of the "Priceless" campaign, connecting with consumers and building the MasterCard brand, as well as providing value to MasterCard's merchant partners.

The ads, developed by McCann Erickson/New York, will debut with a number of high-profile national merchants, including Banana Republic, The Gap, Kmart, Pier 1, Travelocity, RadioShack, Shell and Williams-Sonoma, in publications such as Conde Nast Traveler, Golf Digest, Gourmet, Money, Sports Illustrated, Blender, and Real Simple.

"This new format promises to position our Priceless print advertising in a context which is all the more relevant to today's consumer," said Amy Fuller, vice president, Brand Building, Americas, MasterCard International. "In addition to creating heightened brand relevance among consumers, this new approach will more closely align MasterCard with leading merchant brand names."

MasterCard included merchants as part of the campaign for a number of reasons, including positive brand association and alignment with top merchant brands in their respective categories.

About MasterCard International
MasterCard International is a leading global payments solutions company that provides a broad variety of innovative services in support of our global members' credit, deposit access, electronic cash, business-to-business and related payment programs. MasterCard International manages a family of well-known, widely accepted payment cards brands including MasterCard®, Maestro® and Cirrus® and serves financial institutions, consumers and businesses in over 210 countries and territories. The MasterCard award-winning Priceless® advertising campaign is now seen in 96 countries and in 47 languages, giving the MasterCard brand a truly global reach and scope. For more information go to www.mastercardinternational.com.

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MasterCard Worldwide

News Release

MasterCard Interchange Rate Schedule for US Merchants Posted On Mastercardmerchant.com

Purchase, NY, October 30, 2006 - MasterCard said today that its interchange rates that apply to US merchants are now posted on its website, along with the comprehensive information merchants need to understand the rates and how they apply. MasterCard announced on September 5, 2006 that this information would be posted on the company website by November 1.

The rate schedule can be accessed at http://www.mastercardmerchant.com, where merchants have been able to access the MasterCard merchant rules manual since August 2005. The comprehensive document includes the interchange rates, as well as key qualifying criteria associated with each rate.

Walt Macnee, president, Americas, MasterCard, said "Although MasterCard's US interchange rates have generally been available to merchants both through requests to merchant acquirers and independent sales organizations, and on the Internet, the merchant community has asked us for greater transparency, and we are pleased to accommodate their request.

"Just publishing rates alone could lead to confusion among merchants who may be seeing this information for the first time," Macnee noted. "We are confident that we are providing merchants with the information they need to understand the interchange rates and structure and determine which rates may apply to their transactions. We want to have an ongoing dialogue with merchants, acquirers and other interested parties about the format and content of our rate disclosure, as we plan to update this document regularly."

MasterCard typically updates interchange rates semi-annually, and going forward will update these rates on the website after each interchange rate announcement to issuers and acquirers.

"MasterCard has been a leader in providing greater transparency in the payments industry," said Joshua Peirez, Group Executive, Global Public Policy for MasterCard. "We were the first in the industry to publish our merchant rules and procedures on our website, making them available to all interested parties without restriction, and now we are pleased to address this important issue by also making our interchange rates that apply to US merchants available on our website."

About MasterCard Worldwide
MasterCard Worldwide advances global commerce by providing a critical economic link among financial institutions, businesses, cardholders and merchants worldwide. As a franchisor, processor and advisor, MasterCard develops and markets payment solutions, processes close to 14 billion payments each year, and provides industry-leading analysis and consulting services to financial institution customers and merchants. Through its family of brands, including MasterCard, Maestro and Cirrus, MasterCard Worldwide serves consumers and businesses in more than 210 countries and territories. For more information go to www.mastercardworldwide.com.

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LETTER FROM THE PETROLEUM MARKETERS ASSOCIATION OF AMERICA (PMAA) TO CHAIRMAN CONYERS AND RANKING MEMBER CHABOT

PMAA PETROLEUM MARKETERS ASSOCIATION OF AMERICA

1901 N. FORT MYER DRIVE • SUITE 500 • ARLINGTON, VA 22209-1604 • 703-351-8000 • FAX 703-351-9160

July 16, 2007

Chairman John Conyers
Ranking Member Steve Chabot
Committee on the Judiciary, Antitrust Task Force
2138 Rayburn House Office Building
Washington, D.C. 20515

Dear Congressmen Conyers and Chabot:

On behalf of the Petroleum Marketers Association of America (PMAA) members, we thank you for holding a hearing on credit card interchange fees. The issue of credit card interchange is one of the highest priorities of the members of PMAA. PMAA is a national federation of 45 state and regional trade associations who collectively represent over 8,000 petroleum marketing companies. These companies are independent small businesses and market a wide variety of products to include gasoline, diesel, heating oil, lubricants, jet fuel, kerosene and propane. Our members own over 60,000 gas station/convenience stores and supply motor fuels to an additional 40,000 retail locations. PMAA members also market over 80 percent of the heating oil in the US.

As you are very much aware, the issue of gas prices is a very sensitive one to consumers. However, very few consumers know that they pay a hidden fee on virtually every gas station transaction they make, whether they use a credit card or not. For the typical gas station/convenience store operation, the cost of interchange and processing fees can be as high as three percent, a cost to consumers of an additional nine cents per gallon with prices at three dollars per gallon.

Our heating oil dealer members are struggling with interchange fees as well. Visa has classified heating oil dealer transactions to the mail order category, which is one of the highest interchange rates. PMAA recently inquired with Visa as to their rationale for charging their highest fees to heating oil dealers and consumers. There are over 42 million consumers in the US that rely on heating oil or propane to heat their homes. All of these consumers' transactions are recurring and are low risk. Our members have strong relationships with their customers that span many years, unlike a typical mail order retailer that shares this interchange classification. It does not make any sense that heating oil dealers should have their transactions classified as higher risk. We believe that these

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