H.R. 2382, THE CREDIT CARD INTERCHANGE FEES ACT OF 2009; AND H.R. 3639, THE EXPEDITED CARD REFORM FOR CONSUMERS ACT OF 2009

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

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H.R. 2382, THE CREDIT CARD INTERCHANGE FEES ACT OF 2009; AND H.R. 3639, THE EXPEDITED CARD REFORM FOR CONSUMERS ACT OF 2009

Thursday, October 8, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:03 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Waters, Gutierrez, Velazquez, Watt, Sherman, Meeks, Moore of Kansas, Baca, Miller of North Carolina, Scott, Green, Cleaver, Klein, Wilson, Perlmutter, Carson, Speier, Minnick, Adler, Kosmas; Bachus, Castle, Royce, Capito, Hensarling, Barrett, Marchant, Posey, Jenkins, Lee, Paulsen, and Lance.

The CHAIRMAN. The hearing will come to order. Before we make our opening statements, if there is no objection, we have two colleagues here. We all know what the schedule is like, so if there is no objection, I will go right to our two colleagues. And after they made their statements, we will get to our opening statements.

We have before us two pieces of legislation. One is a bill to move up the effective date of the credit card bill that the House passed. The other is a new subject for us dealing with the question of interchange fees. The first of these is somewhat familiar; the second is not.

We have before us two of our colleagues who are sponsors of the interchange bill. We will later today hear from one of the sponsors of the credit card bill.

But let me now go to the gentleman from Pennsylvania, Mr. Shuster, I will go by seniority, and recognize him to talk about his legislation.

STATEMENT OF THE HONORABLE BILL SHUSTER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. SHUSTER. Thank you, Mr. Chairman.

I appreciate the opportunity to be here today, and thank—well, it is Ranking Member Bachus—but Ranking Member Hensarling for having us here today, and the members of the committee for allowing us to share some information on what I believe is an important topic, an important issue, and that is interchange fees in H.R. 2382.

I would also like to thank Congressman Welch for his leadership on this issue and for working together with me on H.R. 2382. I believe action is needed to help level the playing field between consumers, small business, and credit card companies by requiring greater transparency and prohibiting unfair and abusive practices when it comes to interchange fees. Last summer's dramatic rise in gas prices was a prime example of the inflexibility of credit card companies towards merchants and consumers over the interchange fee.

As most of us know, fuel prices doubled, and the interchange fee basically doubled with the fuel prices while the credit cards did nothing to add value but were able to collect windfall profits because of that. Also, as fuel prices rose above authorized transaction limits, major credit card companies reserved the right to repay gasoline merchants a lower price than was actually purchased, particularly on smaller transactions. I joined with Congressman Welch to introduce H.R. 2382 to curb this type of practice. This legislation focuses heavily on transparency in the hopes of determining whether credit card companies are pursuing anticompetitive practices.

And again, it doesn't prohibit interchange fees. We just want to have some transparency and fairness injected into the process. It makes interchange fees subject to full disclosure in terms and conditions set by credit card companies, especially accessible by consumers. And we have here today, this is the interchange fee agreement, 1,000 pages. I am confident that few in this room could figure out what is going on in the agreement here. And many small businesses have that same problem in trying to understand what is happening in here.

This H.R. 2382 would also prohibit profits from interchange fees being used to subsidize credit card rewards programs. Small businesses and ultimately consumers should not be financing the perks of luxury card holders.

To put the impact of interchange fees into perspective of a business, I want you to consider a convenience store chain in my district, Sheetz; it is a real-life example. The Sheetz Corporation, which has 363 stores in six States, as I said, is headquartered in my district. Last year, Sheetz paid twice as much in interchange fees as they took in, in net income after taxes. Their second largest expense after payroll is the interchange fee, which is incredible to me. This means that, for Sheetz, the interchange fee eclipses the company's cost of rent for 363 stores. The interchange fee is also 1½ times the cost of providing health care to their nearly 13,000 employees. And Sheetz is not alone.

Sadly, it is joined by thousands of businesses across the country who are being unfairly penalized through interchange fees. Something must be done, and I believe H.R. 2382 is the right vehicle for that change.

Mr. Chairman and members of the committee, I hope you will consider the merits of this bill as well as the serious struggles of small businesses across this country that need transparency, simplicity, and fairness when it comes to the issue of interchange fees.

Again, thank you very much for giving me the opportunity.

[The prepared statement of Representative Shuster can be found on page 57 of the appendix.]

The CHAIRMAN. And another Member who has been very active in urging us to take this up, the gentleman from Vermont, Mr. Welch.

STATEMENT OF THE HONORABLE PETER WELCH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VERMONT

Mr. WELCH. Thank you, Mr. Chairman.

Thank you, members of the committee, for allowing me and Mr. Shuster to testify today.

Credit cards are necessary in today's economy. They do provide a service to merchants in the form of secure payment. They provide a great service to consumers in terms of convenience. And it is reasonable to expect that merchants pay a fair fee for this service, just as consumers should pay a reasonable interest rate on credit.

But just as with credit cards issued to consumers, the near monopoly of big banks and credit card companies has led to abuse. The amount of interchange fees collected by big banks tripled from 2001 to 2008, from $16 billion to $48 billion; 80 percent of that money goes to 10 banks; not to 10 percent of our banks, but to 10 banks. Now, part of that is due to the increase in volume. But part is also due to the market power of credit card companies and big banks and to the fact that the interchange fees continue to rise so that now in the United States, they are the highest in the world.

Credit card companies and big banks are also finding more ways to squeeze merchants, for whom the profit on an individual sale, as Mr. Shuster pointed out, can be completely canceled out by the cost of the interchange fee.

The Welch-Shuster bill addresses these anticompetitive and abusive interchange practices. It raises four fundamental policy questions for this committee to consider:

First, should credit card companies and banks have to disclose information about interchange rates? Our view is yes. And our bill would require that disclosure.

Should merchants be able to freely advertise cash discounts without credit card company intervention? Our view is yes. This bill would ensure that merchants have that freedom.

Third, should merchants have to subsidize rewards or premium credit cards from which they receive no benefit? Our view is no. And our bill would prohibit this practice. That would be an arrangement between the card issuer and the card user. If banks or credit card companies want to offer me airline miles, for example, my corner store should not have to pay. I should pay for that.

Fourth, should the government be able to set rules of the road and require the banks and credit card companies to play fair? Our view is yes. And that is why our bill empowers the Federal Trade Commission to prohibit unfair or anticompetitive practices.

Mr. Chairman, what is at issue here is a question of fairness and reasonable regulations. Credit card companies have near monopoly power. Individual merchants, one of whom, Kathy Miller from the Elmore General Store in Vermont, doesn't.

And we welcome your consideration of these four policy questions that are presented by our bill. Thank you.

[The prepared statement of Representative Welch can be found on page 58 of the appendix.]

The CHAIRMAN. I thank our colleagues.

Do any of the members here have questions for our colleagues?

If not, we will thank them, and we will be in touch with them.

Let me at this point, because we often have the most members here when we just start out, we have a third colleague who was interested in the credit card bill, the gentlewoman from New York, Ms. Lowey. I didn't inform her in time for us to do the formal clearing process. Would there be any objection if she were to speak on the next panel? Hearing no objection then, Ms. Lowey can be notified that she can come if she would like to and is able to; I know that is always a problem. Our two witnesses are excused.

Mr. WELCH. Can we stay for a few minutes?

The CHAIRMAN. Yes. You won't be able to ask questions.

But is there any objection to the gentlemen sitting with us?

No?

That kind of undercuts my argument that you were in a hurry, but go ahead.

We will allow the Members to join us, but the size of this committee prohibits us from giving questioning privileges because we never have enough time for our members.

We will now begin our opening statements. We can start my 5 minutes, please.

There are two bills before us today. One, as I said, is something we are familiar with. That is the bill that would move up the date of the credit cards. I thought that we could have done it more quickly. We accommodated people in the industry who said, well, we need time to prepare. We said at the time, many of us, that if this time were used instead to take advantage, we thought, of the time lag to move things up, that would be very problematic for us.

In my judgment, some of that has happened. Recently, Bank of America announced that it would in effect be abiding by the main portions of the bill right away. That is welcome both for the customers of Bank of America, but also because it is an indication that one of the large credit card companies—and they have a massive operation here—is able to comply, that the timeframe is not as bad. This is not brand new to them. They have known about it for a while. I think the case is very clear that this is the kind of protection that shouldn't wait, and we should move forward.

The interchange bill is different. It is new for us. It is a complex one. I will say, let me give a little history, I was on the committee—I am not sure any other members were at the time—early in the 1980's, when Congress, and I know some of the credit card companies tell us we should not interfere and we should leave this to the free market, but that wasn't their posture in the early 1980's when they lobbied Congress successfully to pass a bill interfering with the right of merchants to do certain things with regard to credit cards.

I thought that was a violation of free market principles and voted against it. I was outvoted. In fact, I was so heavily outvoted that it passed on suspension and was signed by President Reagan. And I thought it was a lapse from free market principles.

Those who argue that we shouldn't be dealing with the interchange issue because it is interfering with the free market, my response has been, well, the best way to do that is simply to remove any legislation that regulates what merchants can do with regard to the credit card industry.

But the credit card industry has supported and maintained support for legislation in which the Federal Government restricts merchants' choices. And once you have done that, it is kind of hard to go back to being for the free market. The notion, having imposed that set of restrictions on merchants, it makes it harder to give discounts for cash; having imposed or to charge more for the card, having imposed that restriction on the merchants by Federal legislation, it seems to me very hard for the credit card industry to now go back and argue that they want to stick with the free market.

It reminds me of the comment that had been made, I believe, by Harry Warner or Jack Warner in the motion picture industry about one of the motion picture stars, that he knew her before she had become a virgin. There are some things which, once lost, are not easily recovered, in my judgment.

So that I think is what we have before us today. But it is a complex subject. It is a three-sided operation, because you have customers, the merchants, and the credit card companies. It is a subject that is an important one. Our colleagues on the Judiciary Committee had looked at it some from the antitrust standpoint, and they may still go ahead and do that. That is their jurisdiction.

But we have jurisdiction as well. And this is the beginning of a serious look at this issue.

With that, I will recognize the gentleman from Texas for 5 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman.

Indeed, we do have two bills before us. Before I discuss them, I would at least like to acknowledge the absence of the author of one of them, the gentlelady from New York. Clearly, she is dealing with a great personal tragedy in her life. And although I have debated her frequently on the subject, she has certainly been a great professional in bringing this credit card legislation to the House. And even though I disagree with 80 percent of the legislation, to get something that is of this import passed through this House has spoken well of her.

I am somewhat sensitive of debating the issue in her absence, but knowing that we have debated it frequently, I know that there are plenty of people on her side of the aisle who will be able to—

The CHAIRMAN. If the gentleman would yield, I thank him for that gracious statement.

Let me say on behalf of our colleague, Ms. Maloney, she is fully understanding of this. And I am sure she will be appreciative of the sentiment and, of course, has no objection to the gentleman going forward.

Mr. HENSARLING. Thank you.

I think before considering the implications of either of the two pieces of legislation, we need to take a very careful look at where we are in this economy.

Since we have passed the President's economic stimulus program, unfortunately, another 3 million of our fellow citizens have lost their jobs. We now have the highest unemployment rate we have had in a quarter of a century at 9.8 percent. Most professional economists believe that will soon tick up to 10 percent.

I need not tell you where we stand with respect to the debt and the deficit. The Federal Reserve released information yesterday that I believe showed that total consumer credit outstanding, which includes everything from credit card debt to loans for recreational vehicles, fell $12 billion in August, or 5.8 percent in a seasonally-adjusted annual rate—the 7th straight month of declines—longest stretch since 1991.

Other Federal Reserve data has indicated that credit card lines have now been cut, I believe, by 25 percent in the last year. In the last 2 years, credit card lines have been cut by $1.25 trillion. I am very concerned about the impact that this has on small businesses.

We have had testimony in this committee room, and I have had lots of testimony in the Fifth Congressional District of Texas which I have the honor of representing, that tells me that small businesses that rely upon credit cards are having trouble accessing credit lines to preserve and create jobs. And I think job one of this committee and this Congress ought to be getting this economy moving again, getting people jobs. And so I am concerned about the potential unintended consequences that either of these pieces of legislation would have.

Now, speaking first to what we have known as the Credit Cardholders' Bill of Rights, I would just say, and now we have a new piece of legislation that would essentially move up the timetable for this legislation. I do not believe there is a good time to enact a bad bill. This is a bad bill. I believe in 20 percent of it. I do believe that consumers have been misled on disclosures. I do believe there are deceptive practices out there. But unfortunately, this bill goes way beyond that. And I am afraid that both bills may have the potential to simply exacerbate a credit crunch at a time when small businesses are having trouble accessing credit, again, to create and preserve jobs.

Ultimately, the so-called Credit Cardholders' Bill of Rights, which I still view as a "credit cardholders' bill of wrong," erodes risk-based pricing. And it is risk-based pricing that has allowed millions of people to access credit who haven't been able to access it before, including, again, small businesses. I believe in many respects, it represents another bit of bailout legislation, because it tells the people who do it right, ultimately they are going to pay higher fees and higher interest rates to help subsidize those who do it wrong.

And I hate to say that I told you so, but when we debated this bill, I predicted what would happen. And indeed, we see it happening. Now, credit card companies, in anticipation of this legislation, are cutting back the lines even further. And I am afraid we could exacerbate the situation.

With respect to the interchange, I am still very curious ultimately what this bill is going to do to help consumers. I am not unsympathetic to those who complain about it, but I am wondering, how is this any different from the costs that one pays for payroll, one pays for real estate, or their advertising. It is a cost of doing business. If there are legal restraints of trade here, I would like to hear about them. If there are legitimate antitrust issues, I would like to hear about them. Otherwise, I see my time is up, so I will have to hear about them later.

Mr. GUTIERREZ. [presiding] I gave you a little extra time there because we are friends.

I yield myself the remainder of the time. On April 30th of this year, I stood next to Chairman Frank and other members of this committee after we passed the CARD Act on the House Floor and listened as the chairman issued a warning to the credit card-issuing banks. Chairman Frank told the banks that if they began to speed up rate increases or continue the practices that we had just prohibited, then we would move up the implementation date on the CARD Act. He cautioned them in no uncertain terms that this committee would not hesitate to stop them if they continued to take advantage of and abuse consumers.

With that warning, the House passed an amendment to allow the banks sufficient time to implement substantial strict and admittedly complicated changes to the way they do business. But I never anticipated how uncomplicated it would be for the banks to continue with the very practices that we had just banned. We were reasonable. We were fair. The banks were not. We can't turn back the clock, but we can make sure that the banks' unreasonable practices do not continue to affect more American households.

Today, we must begin the process of accelerating the implementation date of the Credit Cardholders' Bill of Rights. When I got home that day from the signing ceremony for the legislation at the White House, I had a notice in the mail. It said that my bank was increasing my rate, decreasing my available credit, and increasing fees across-the-board. This was the very day President Obama signed the bill into law.

What I hope to find out during the third panel of this hearing is why it is so easy for credit card companies to nickel and dime their customers as quickly as they do, while at the same time it takes so long to end unfair and deceptive practices that this Congress has banned?

I listened to my colleague, Mr. Hensarling, talk about risk-based pricing. And I will just end with this, not to take any more time, what changed? What changed between the day we passed the bill and the day I arrived home to get my changes from my credit card company? I have the most secure job that exists in this economy, a government job. I can't think of a more secure job. I still have—I have been a nine-term Member. I don't know, did they make some evaluation that I had an opponent in the next primary who was going to knock me out? I wish they would let me know. I haven't had an opponent in the last 3 elections in the Democratic primary, and I have a 90 percent Democratic district.

So I tell you all that to say, I don't understand what the new risk was. I have an 800-point credit score. We pay our bills on time. Maybe we do it too well. So I was a risk? No, what they decided to do was change the terms of our contract as they did to advance and to accelerate it. We told them, don't do it. We gave them an amendment. We were fair to the banks, and the banks were not fair to the consumers.

We will now proceed—oh, we have Mr. Castle for 2 minutes.

Mr. CASTLE. Thank you, Mr. Chairman. I have concerns about both pieces of legislation here.

First, with respect to the CARD Act and moving up the date, let's recall that date was already moved up from what the Federal Reserve was doing to what we did in legislation. The net result of that has been, as Mr. Hensarling has indicated to us, that we see fewer people getting credit at this time. We do see people getting cut back on the credit which exists. And we are seeing many jobs in the credit card industry in this country being already reduced, and probably many more to be reduced when all this goes into effect. So it has had some negative economic effect, particularly for people who can't now get credit and cannot now go out and spend in our economy. We need to at least consider this. I am not suggesting we should just oppose the bill arbitrarily, but we need to consider all the consequences of what we are doing.

And the same thing applies with respect to the interchange legislation. I listened to our two distinguished colleagues who spoke about that. And as has been indicated here, I heard no mention of reduction of costs as far as consumers are concerned. Apparently, the concern is strictly with those who are handling the cards in their business and what they are doing. And I would agree completely with the concepts that were put forward. We do need to have greater transparency, the full disclosure. This is not something that necessarily seems to affect consumers, because nobody has indicated they would reduce costs if indeed legislation like this would pass.

But I think among the merchants and those people who are issuing the cards, there indeed needs to be an openness and a responsibility. So we can approach this legislation, but we need to approach it very carefully. I don't think in this time of our economy, that we can afford to just pass legislation which is going to be too vindictive in terms of reduction of interchange fees or even elimination of the same. The same thing applies to the credit card legislation. We just need to be very cautious about the downside consequences.

I appreciate the opportunity and I yield back, Mr. Chairman.

Mr. GUTIERREZ. The gentleman yields back.

Congressman Scott, you are recognized for 2 minutes.

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

I want to thank the chairman for holding this important hearing on credit card issues. I want to focus mainly on the simmering battle between the banks and retailers regarding credit card interchange fees. I have constituents in both camps who have vigorously pleaded that their case is very important on this issue.

At the center of the debate is the question of whether or not banks are overcharging merchants for processing credit cards and other products at the point of sale. The retailers claim that interchange fees have unfairly increased annually, despite better technology and more efficient processing systems. The banks claim that the system is more complex than the retailers describe. And they also are carrying the risk of data protection and credit losses. Both industries are in the unfortunate situation of operating on thin margins of profits.

So I hope this hearing will focus on what the consumer wants, since they are stuck in the middle. In this economy, the consumers want easy access to their credit. They want no hassle at points of sale. They want use of multiple types of payment products. And they most definitely want protections against fraud and low prices.

This is a very, very important hearing this morning, Mr. Chairman. I thank you for yielding me time on this important issue.

Mr. GUTIERREZ. Mr. Hensarling, any other time?

Then, we will go to our second panel.

Ms. Kathy Miller, board member of the Vermont Grocers Association, you are recognized for 5 minutes.

STATEMENT OF KATHY MILLER, OWNER/OPERATOR, THE ELMORE STORE, ELMORE, VERMONT; BOARD MEMBER, VERMONT GROCERS' ASSOCIATION

Ms. MILLER. Good morning, Mr. Chairman, Congressman Welch, and members of the House Financial Services Committee.

I would like to thank you for allowing me to testify today. My name is Kathy Miller. And I—along with my husband Warren and daughter Kelly—am the owner of the Elmore Store in Elmore, Vermont.

I am also here today as past Chair of the Vermont Grocers Association, and on behalf of the Food Marketing Institute and National Grocers Association, which represents our Nation's supermarkets and grocery stores.

We appreciate you holding this hearing and for the opportunity to provide testimony on credit card interchange fees, also known as swipe fees to merchants who have to pay the fee each time a card is swiped.

Thank you to my Congressman, Peter Welch, for inviting me here today to testify.

It has been 3 years since I testified before the Senate Judiciary Committee at the invitation of Senator Leahy on the anticompetitive and anticonsumer practices of the credit card companies.

Unfortunately, many of the same problems still exist today, and interchange fee costs have continued to rise at the expense of small businesses like ours. This is a store that we have owned and operated now for 26 years. I am a fifth generation Vermonter, with deep roots in Elmore. I am the "mom" part of the operation. My husband Warren, "pop," is minding the store, so I can be with you today. Warren has recently served 2 terms in our State legislature in Montpelier.

We are not only committed to our store, but to our community and to the State of Vermont as well. You may wonder why we do what we do 7 days a week, 96 hours a week, 364 days a year. To be honest, sometimes we ask ourselves that same question. But we believe that we can and do make a difference to the people in the community who depend upon us. My concerns as a small independent store may seem small to you, but they are a huge burden to us and very real.

Congressman Welch listened to these concerns from Vermont storekeepers like me, and he wrote legislation to try to address several of them. Warren and I commend Congressman Welch for introducing this important legislation to protect small businesses like our store in Vermont. And we look forward to consideration of the Credit Card Interchange Fees Act by this committee.

Since I told my customers I was coming to Washington, D.C., to testify on this issue, I can't even tell you how many of my customers were unaware of the hidden fees. They swipe their cards and think all is free because there is no charge to them at all. Obviously, we lose money on many small transactions, and too much on others. So we have to raise prices because we can't absorb it all. In the grocery business, we compete by lowering prices, not by raising them.

I am not a lawyer, but I know this is a huge problem that retailers across the United States, large and small, are facing. So I ask you to look at this matter seriously.

I have customers who apologize to me for using their cards. I keep telling them, please, keep coming in the store and shopping. We need and appreciate your business. We have streamlined our business to reduce costs as best we can. Maintenance doesn't get done as it should. Less money goes out in payroll. But we just can't keep absorbing these fees in these tough economic times.

If the interchange swipe fees were fair and reasonable, Warren and I would have more money to invest back into our business. An example is, we only have one phone line to save money. I can't take a deli order. I can't do grocery orders with my line tied up to swipe credit cards. What happens in a small country store is when a customer swipes their card for a pack of 35-cent gum, it is pre-priced, and it costs us 21 cents. The swipe fee on that sale costs us 21 cents, so I just lost money. I might as well just let them take the gum. A 99-cent bag of chips is prepriced, again, and it costs us 74 cents. The credit card fees are 23 cents. I can only make 2 cents on that sale. What is wrong with this picture?

Congressman Welch's bill would allow us to set reasonable minimum purchase requirements. Visa and MasterCard require us to accept all their cards if we take any. And they market a whole host of affinity cards with so-called free features. I rode in on a plane. I haven't been on a plane in, I can't tell you how long. And I have lost it now, but there was a napkin in front of me, "get free airplane rides." Nothing is free.

Oh, here it is. Thanks.

So what they can't tell you is they charge merchants higher interchange rates for accepting these cards. Warren and I haven't gone on a vacation in 10 years; yet every day we are paying for our customers' trips when we take their credit cards.

The Visa and MasterCard contract rules are not law, so why do we comply with them? This hasn't happened to us yet, but we have heard stories of other small businesses being threatened with excessive fines for breaking the rules, even for something as minor as requiring a $5 minimum to use a credit card. A $5,000 a day fine, which I hear is Visa and MasterCard's going rate these days, would simply put us out of business. I had a store owner call me to say, "We are going to get fined $25,000. What should we do?" I said, "Take your signs down. We can't set minimums."

The average supermarket industry profit margin last year was 1.43 percent. That means a profit of $1.43 on a $100 transaction. The interchange paid to the bank to issue that card on the same transaction is more than that. I would like to ask you on your next ride home to take a look and see how many vacant storefronts there are in your small downtowns. Just this last winter alone, 6 stores closed within a 50-mile radius of us.

Some days I feel like I should just turn my keys in, but too many people count on us. Elmore is a town with 850 people. We are the hub. We are mom and pop. We are just trying to keep our doors open.

Thank you very much, and I would be pleased to answer questions.

[The prepared statement of Ms. Miller can be found on page 215 of the appendix.]

Mr. GUTIERREZ. Thank you very much.

Mr. David Evans, a lecturer at the University of Chicago Law School.

Welcome.

STATEMENT OF DAVID S. EVANS, LECTURER, UNIVERSITY OF CHICAGO LAW SCHOOL

Mr. EVANS. Good morning. Thank you very much.

I would like to thank Chairman Frank and Ranking Member Bachus for inviting me to testify.

Members of the committee, my name is David S. Evans, and I am a lecturer at the University of Chicago Law School and also a visiting professor at University College London.

Despite the law school affiliations, I am actually an economist. I have written on the payment industry from both the business and policy perspective, including “Paying with Plastic,” which has become the standard reference work on the industry.

I represent solely myself at the hearing today. But in the interests of transparency, I just want to note that Visa funded my research on the payment card industry for many years. In recent times, though, I have been a business adviser to many of the innovative entrants into the payments business. And that includes several companies that compete with the incumbent networks and issuers in part by offering lower merchant fees.

Economists have been studying the subject of interchange fees and related practices since the early 1980’s. There has been a flurry of research in the last decade. Much of the research is based on the new field of economics known as two-sided markets. Businesses that create value by bringing different kinds of customers together are said to be two-sided. So a stock exchange like NASDAQ brings liquidity providers and liquidity takers together, while a matchmaking service like eHarmony brings men and women together.

Payment cards help merchants and individuals to transact with each other. So cardholders and merchants are in effect the two sides of the business.

I have appended to my statement today an article that I co-authored with Dick Schmalensee that provides some of the key references that back up some of the things I am going to say.

So this research provides several insights. First, it turns out that it is very difficult to say in practice that the interchange fee charged by a payment network is too high, too low, or just right from the standpoint of public welfare. And it is even more difficult for a regulator to have any confidence that it could establish a better interchange fee. This argues for caution in price regulation of interchange fees.

Government regulation is appropriate when it is possible to both identify a market failure and fix that failure without creating significant unintended consequences. That is not possible with the current economic state of knowledge on interchange fees.

H.R. 2382 wisely stays away from specific price regulation, in my view.

Second, and very importantly, any change that is made to the pricing for one side of a two-sided business will tend to have an opposite effect on the other side. Two-sided businesses recover their costs and they earn profits from both sides. So if a two-sided business earns less on one side, it usually has to earn more on the other side. Many daily newspapers, for example, are charging people more because they are making less money from advertisers.

In evaluating the bill before you, it would be prudent in my view to anticipate how the changes to merchant pricing and other changes will ultimately affect cardholders. There probably is not a free lunch here.

Third, the customers of two-sided businesses interact a lot, and the platform makes money by promoting valuable interactions. But the platform also has an interest in policing bad behavior. So eBay, for example, is a two-sided business. It tries to get buyers and sellers to swap a lot of stuff. But it also has rules that buyers and sellers have to follow; eBay protects buyers by kicking sellers that repeatedly fail to meet their end of the bargain off of eBay.

I mention this in the context of H.R. 2382 because many of the policies that the bill seeks to restrict at least arguably benefit one side of the market, namely individuals who carry cards and want to use them freely and easily. A card brand can provide benefits to individuals by assuring them that their card will be accepted everywhere and that these individuals won't be surcharged.

One could also argue that the network policies that are the subject of H.R. 2382 are anticompetitive or contrary to the public interest, but I believe it would be prudent to consider the procompetitive explanations as well as any anticompetitive ones that you want to think about.

Most likely, again, there is no free lunch here either. Prohibiting the networks from imposing various restrictions will likely impose some collateral costs on end consumers.

And if I have one more minute to continue, there are many elements to this bill, and I have not done a careful study of it. I would like to suggest, however, that payment cards is one of the most complex industries that economists study. There are many moving parts and interdependency between merchants, cardholders, processors, acquirers, networks, and other players. And as a result, there is a greater risk in this industry than in many others for government intervention to have unintended consequences.

Finally, I am not aware as an economist of any systematic evidence that would support the position that the payment card network practices targeted by H.R. 2382 cause public harm overall once we take into account the interests of consumers, or that the types of restrictions on payment card networks suggested in the bill would ultimately enure to the public.

I also don't believe that any of the targeted practices are in fact anticompetitive under U.S. law.

Thank you, again, for the opportunity to appear before this committee. And of course, I would be very happy to respond to your questions. Thank you.

[The prepared statement of Mr. Evans can be found on page 191 of the appendix.]

Mr. GUTIERREZ. Thank you.

Mr. Mark Caverly, executive vice president of the Local Government Federal Credit Union, on behalf of CUNA and the Electronic Payments Coalition, you are welcome. You have 5 minutes.

Mr. CAVERLY. Thank you. Good morning.

Mr. GUTIERREZ. Good morning, sir.

STATEMENT OF MARK CAVERLY, EXECUTIVE VICE PRESIDENT, LOCAL GOVERNMENT FEDERAL CREDIT UNION, ON BEHALF OF THE CREDIT UNION NATIONAL ASSOCIATION (CUNA) AND THE ELECTRONIC PAYMENTS COALITION (EPC)

Mr. CAVERLY. Mr. Chairman, members of the committee, thank you for the opportunity to testify today in opposition to H.R. 2382, the Credit Union Interchange Fees Act of 2009.

My name is Mark Caverly, and I am speaking today on behalf of the Credit Union National Association and the Electronic Payments Coalition. My credit union is a member of CUNA, the largest advocacy organization for America's 92 million credit union members.

And CUNA is a member of the EPC. The EPC includes credit unions, banks, and payment card networks that move electronic payments quickly and securely between millions of merchants and millions of consumers across the globe. The goal of the EPC, and the reason I am before you today, is to speak for the consumer and to protect the value, innovation, convenience, and competition in today's electronic payments system.

I serve as executive vice president for the Local Government Federal Credit Union in Raleigh, North Carolina. We serve the financial needs of local government employees, elected officials, volunteers, and their families. My credit union has 178,000 members, and we are the issuers of 173,000 debit cards and 16,000 credit cards for our membership.

To begin, allow me to cover the who, what, and why of interchange. Who is responsible for interchange? Interchange is the responsibility of the merchant and the merchant's bank. Card issuers such as my credit union who assume the risks of fraud, nonpayment, and the administration of the card program receive interchange.

What is interchange? First of all, interchange is not a fee on consumers. To the contrary, interchange represents the merchants assuming their fair share of the financial responsibility for the card payment system. Merchants receive many benefits and tremendous value from accepting cards. The merchant discount fee, which includes the interchange amount, is the merchants' cost of doing business for accepting this valuable form of payment. The credit union's cost of doing business includes funding costs, credit losses, billing and collections, customer service, data processing, and compliance. The value merchants receive when we administer these programs and assume significant risks for their benefit far exceeds the interchange fee.

Why is interchange important to credit union members? As an issuer, my credit union receives interchange when our members use their debit and credit cards. Interchange helps us support the card programs for the benefit of our members or the consumers. In fact, interchange for my credit union's card program represents 14.4 percent of my credit union's total income year-to-date.

Our concerns regarding this legislation come down to a simple point: If my credit union's interchange decreases, consumer costs increase. Reducing the merchants' interchange responsibility would result in costs shifting from merchants to consumers, and increased fees for consumers to obtain debit and credit cards.

While the bill simply references credit card interchange fees in its title, the bill would also address debit card interchange, and would create significant changes to the foundation of the electronic payments system. The bill reduces consumer choice and increases consumer costs and confusion in many ways.

But allow me to share a few examples with you. First, the merchants are seeking to abolish the honor-all-cards rule or practice that merchants must follow. As a consumer, you may choose to carry only one credit card and one debit card with you. Now, imagine your favorite chain restaurant has either decided not to honor cards issued by credit unions or has entered into an agreement with a large financial institution. The restaurant tells you that they won't accept the card of your choice or will only offer more favorable prices to the cards issued by the large financial institution. Consumers want honor-all-cards because it gives them the choice as to what card to carry.

Second, gas stations are seeking to abolish the current system regarding charge-backs. Essentially, it would absolve them from the financial responsibility when they allow card transactions to be processed in violation of the preauthorized amount for the sale. If this were enacted, my credit union will assume even more of the risk of fraud and an increase in the risk of nonpayment. And as a nonprofit financial cooperative, when our costs increase, so do the costs to our consumer members.

Finally, by not mentioning data security, this bill allows merchants to continue to walk away from their data security responsibilities. Cleaning up after merchant data security breaches is a significant cost that we as credit unions continue to pick up.

In conclusion, credit unions oppose H.R. 2382 and other legislation designed to decrease the merchants' responsibility for the value they receive from the card payment system. If merchants are successful in reducing their fair share of responsibility for the card payment system, the consumers will pick up the difference.

Thank you for giving credit unions and their consumer members an opportunity to share our position on interchange and the card payment system.

[The prepared statement of Mr. Caverly can be found on page 110 of the appendix.]

Mr. GUTIERREZ. Next, we have Mr. Ed Mierzwinski, consumer program director, U.S. PIRG.

Please, you are recognized for 5 minutes.

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

Mr. MIERZWINSKI. Thank you, Chairman Gutierrez, Mr. Hensarling, and members of the committee.

I am Ed Mierzwinski, of the U.S. Public Interest Research Group.

This is a very fascinating consumer issue. And we have supported the Welch-Shuster bill, H.R. 2382, to give merchants a fairer shake against the credit card companies and the credit card networks. We believe that the proposed bill addresses a number of flaws and problems in the system.

Let me describe just briefly how it works. First of all, approximately 2 percent of every dollar that you spend goes to a fee called the merchant discount, but the bulk of it is this interchange part that is essentially nonnegotiable. Recently, debit and credit combined passed all cash transactions.

If you presume for the purpose of discussion that 50 percent of transactions cost the merchant 2 percent more than its other transactions, then he or she has to raise his or her costs to all consumers, including those who don't pay with credit or debit, by 1 percent; 50 percent raises your costs 2 percent, so 100 percent pay 1 percent more. So all consumers pay more at the store and more at the pump because of interchange that is nonnegotiable, nontransparent to the merchant.

Second, it is a really kooky system in a lot of ways. One of the ways is that merchants are forced under this honor-all-cards provision to accept a Visa card that looks exactly like another Visa card, except that it costs the merchant 3 percent or more instead of 1 or 2 percent. Why does this Visa card cost more than that Visa card? Well, it is because of rewards programs. Interchange doesn't just pay for fraud. Interchange doesn't just pay for the system. It pays for solicitations, the 5 billion trees that cry every year because of all the—well, maybe it is not 5 billion trees, but it is 5 billion letters from credit card companies, the solicitations, and the rewards.

So who benefits from rewards? I submit that only convenience credit card users benefit primarily from rewards. The purpose of rewards debit is to drive people to debit transactions so that merchants can earn more money. But revolving credit card users don't make money on rewards. If it costs you 25 percent APR to carry a balance and you are getting a 1 percent reward, you are not benefiting from rewards. So it is not all credit card customers; it is only some. And it is not all consumers; it is only those who use cards.

There are other problems with the system. Merchants are prevented by these thousands of pages of contractual gibberish from providing their customers with a choice of a lower cost discount for cash. They may not be prohibited explicitly, but the merchants tell me that it is a serious problem that the banks force on them. They make it very difficult for them to offer their customers discounts for cash.

So I think there are some serious problems in the interchange system that will be addressed by the Welch-Shuster bill and that will benefit all consumers.

Again, I am concerned with all consumers. I am not simply concerned with credit card customers. Today we have an increase in the use of debit, but not all of that debit is associated with bank cards.

I want to make one point unrelated to the bill. I would encourage the committee to also look at increasing the consumer protections that apply to all prepaid cards. As we use more payroll cards, as we use more prepaid debit cards not associated with bank accounts, as lower-middle-income working families accept their social welfare benefits through EBT, they are all paying interchange, but the merchants—I am sorry, the banks and the interchange networks are not providing those consumers with the same consumer protections as consumers have with the gold standard of a credit card or the less than gold standard of Regulation E, which provides consumers of bank-issued debit cards with consumer protections. We need a whole revamp of the payment system to protect consumers.

In the couple of seconds that I have left, I also want to strongly support the bill to accelerate enactment of the final provisions of the Credit Cardholders' Bill of Rights. The banks have been behaving badly.

And then I want to say, how did we get into this mess in the first place with the credit card companies? Well, the reason is we didn't have a regulator whose job was to protect consumers. And that is why this committee needs to pass a strong consumer financial protection act that restores Federal law as a floor, not a ceiling. Keeping preemption is a big mistake. I urge you to stick with the bill and not support any amendments to add preemption to the bill. Thank you.

[The prepared statement of Mr. Mierzwinski can be found on page 200 of the appendix.]

Mr. GUTIERREZ. The Honorable Ann D. Duplessis, Liberty Bank senior vice president of retail banking and marketing and sales, on behalf of the Independent Community Bankers of America.

You are recognized for 5 minutes.

STATEMENT OF THE HONORABLE ANN D. DUPLESSIS, SENIOR VICE PRESIDENT, LIBERTY BANK AND TRUST, NEW ORLEANS, LOUISIANA; STATE SENATOR, DISTRICT 2, LOUISIANA STATE SENATE, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA (ICBA)

Ms. DUPLESSIS. Thank you, Mr. Chairman, and members of the committee. Again, my name is Ann Duplessis, and I am a senior vice president of retail banking with Liberty Bank and Trust, a $400 million community bank headquartered in New Orleans.

I am also a proud Louisiana State Senator, representing areas in New Orleans, in and around New Orleans' Lower Ninth Ward, eastern New Orleans. I am also the chairman of the Commerce, Consumer Protection, and International Affairs Committee, and am pleased to be here today on behalf of the Independent Community Bankers of America to discuss this very important issue of interchange.

I also asked that you be given a separate ICBA statement on the credit card bill, and hopefully that can be included in the records.

Just a little bit about Liberty Bank. We started in a trailer in New Orleans about 37 years ago, and we have grown to more than 13 locations across 5 States. We are one of the five largest African-American-owned financial institutions in the country. In addition to my current role at Liberty Bank, I was also a small business owner, operating a hair salon and day spa and a business consulting practice.

On behalf of ICBA's nearly 5,000 member banks, I want to thank you for the opportunity to testify on the important role credit and debit card interchange fees play in supporting community banks and our customers. The payment card system provides tremendous benefits to consumers and merchants, but it is not cost-free. Liberty Bank is both an acquiring bank for merchants and a card issuer. Our customers are both individual consumers and local merchants who have decided, after shopping around, that we can provide them with the best acquiring services.

Even a relatively small acquirer like Liberty Bank can provide merchants full access to the global electronic payment systems. As a community banker serving local merchants, and as a former small business owner, I strongly believe the key points in this entire debate over interchange fees is being masked behind misleading rhetoric from the large merchants that stand to benefit by congressional action.

The most important concern for any small retailer, their banker, and ultimately the customers who pay for the goods and services is merely the cost of handling money. Money is given and received in many forms, all of which have costs. Cash and checks have given way to plastic, not only due to consumer preference but also because accepting electronic payments is a more efficient and less costly way for merchants to provide these services. I know because I have seen this firsthand as a business owner and as a banker who every day works to improve the bottom line of my local retailers.

Credit cards are the only loan or credit product that generally allows the consumer to control how much he or she will owe and whether he or she will pay a finance charge or just be a convenience user. Our credit card programs are not huge profit centers, but they have real value and give me the basic ability to offer products to consumers and merchants coupled with superior customer service that community bankers can provide.

Distorting the network rules in favor of large retailers and away from consumers would jeopardize the ability of community banks to continue to offer these services. If more small banks stop offering interchange-supported products and services, it is likely that the industry would consolidate into just a few very large issuers and acquirers.

In the Credit Card Interchange Fee Act, large merchants simply want Congress to intervene so they can pay less and follow fewer rules for the benefits they receive from the card accepters.

This bill would also create a burden for consumers by reducing their flexibility. Today, Liberty Bank cardholders know that their payment card will be honored at any merchant accepting electronic payments. This bill would allow a merchant to now dictate to consumers the terms of use and which cards that consumer must carry. If a Liberty Bank card is no longer accepted universally, my customers may be forced to apply for multiple cards that they don't want or need, thus decreasing credit scores and making it more difficult to get credit. It would create an incredibly inefficient and uncertain shopping experience if customers no longer control their own payment choices.

Mr. GUTIERREZ. The time of the gentlelady has expired.

Ms. DUPLESSIS. Thank you.

[The prepared statement of Ms. Duplessis can be found on page 180 of the appendix.]

Mr. GUTIERREZ. You are very welcome.

And now, we have Mr. Mallory Duncan, senior vice president and general counsel, National Retail Federation, on behalf of the Merchants Payments Coalition.

You are recognized for 5 minutes, sir.

STATEMENT OF MALLORY DUNCAN, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, NATIONAL RETAIL FEDERATION, ON BEHALF OF THE MERCHANTS PAYMENTS COALITION

Mr. DUNCAN. Thank you, Mr. Chairman. I want to thank the ranking member and members of the committee. I would like to thank you and the members of the committee for allowing me to appear.

Let me state the obvious. We are retailers. No one believes in free markets more than we do. We know that free markets work when there is transparency, few fetters on competition, and ideally, an absence of concentrated market power. That is the world we face with most of our suppliers, and it is what we as an industry deliver to our customers.

Retail competition is fierce. It is reflected in very thin profit margins, typically around 2 percent. With margins that narrow, when costs go up, so do prices. When costs go down, competition pushes prices down as well. You can buy great electronics for a fraction of the price you would have paid a few years ago. That is the beauty of the competitive market.

We want to provide value to our customers, and that is why we are so concerned by what the credit card companies are doing to us and to the American consumer; they are doing it with hidden fees, arcane rules, and overwhelming market power.

The credit card market is broken and needs to be fixed. The card industry has told you that the market is functioning fine, that it is so complicated and two-sided that you had best just ignore it. That sounds like what they said about subprime loans. But in truth, it is a very simple scheme; they don't want oversight because what they have is a privately regulated cartel.

The banks and the members of Visa and MasterCard will tell you the market is competitive. As appendix A at the back of my testimony indicates, in part that is true, they do compete for customers, but on the merchant side, the opposite is true. Since its inception Visa and its big banks have gotten together and decided how much they are going to charge to process payments. Once the decision is blessed, all issuing banks charge the same fee regardless of the bank's name that is on the card. These otherwise competing banks huddle under the Visa and MasterCard rules as one, and insist that merchants accept their cards, fees, and rules on a take-it-or-leave-it basis, with no opportunity to negotiate. No merchant can stand up to that.

Now, both firms have changed recently their structures, but the net result is the same. We have here cartels operating in violation of the antitrust laws. But there is more. They also fix the rules, rules designed to support the cartel and to hide its operation from consumers who ultimately pay most of these fees. It is this lack of transparency and these confining rules that the Welch-Shuster bill addresses. Let me give you a couple of examples.

The card companies have what they call a nondiscrimination rule. It prohibits merchants from giving customers a discount if the customer uses the card with lower fees. This is a remarkably anti-competitive rule. It is like Coca-Cola telling grocery stores that they could be fined or their right to sell Coke products revoked if they charge people less for Pepsi than for Coke. Its effect, of course, is to discourage the market from moving towards cheaper forms of payment. Welch-Shuster would open the market up to competition.

Or take pricing generally. The card companies' rules say that the regular price we offer the public must be the credit card price, but a 2 percent profit margin isn't large enough to absorb a 2 percent interchange fee. So a shopping cart of back-to-school clothes that we would willingly sell for $99 cash has to be priced somewhere around $101 because of their rules. But look at what is happening, $101 becomes the regular price for $99 worth of cash merchandise. And regardless of whether one uses cash, check, or food stamps, we all end up paying the credit card company price. In effect, interchange acts as a privately imposed hidden sales tax on U.S. commerce.

As to transparency, most consumers don't realize that rewards cards cost far more to use than does a regular card. Do consumers know that swiping rewards cards drives up the price of everything they buy even higher?

Now, if I may, I would like to raise one issue that NRF is very concerned about that does not apply to the Welch bill, and that is debit cards. Cash and check pass at par, that is face value. The Federal Reserve says that in return for a $100 check, a bank must give you $100 in exchange, yet $100 on a debit card is subject to interchange fees. But what is a debit card other than a plastic check? There is no loan; they are even called "check cards." It is time for Congress to demand that Fed do for plastic checks what they have long insisted on for paper checks. Otherwise, again, we will end up eating up the value.

In conclusion, you should know that the bulk of interchange goes to a handful of banks. There are roughly 10,000 banks in each of the card networks, yet more than 80 percent of the interchange goes to just 10 big banks. But they don't show up here to defend it. Apparently they are not only "too-big-to-fail," they are "too-big-to care."

[The prepared statement of Mr. Duncan can be found on page 144 of the appendix.]

Mr. GUTIERREZ. We are now going to go to the question portion of this hearing.

This is quite an educational process. And I think that of everyone who has testified, I want to figure out a way that we help out Mrs. Miller from Vermont and her store and her family business. She seems to have made—not that the rest of you didn't make compelling arguments, but the most compekking argument.

Is there anything else you would like to add, something that you didn't have time for in your 5 minutes?

Ms. MILLER. Not really, just maybe a few things. I know they keep talking about cash discounts and credit and that kind of stuff. Maybe in a bigger store where you scan, that wouldn't be an issue. Well, mom and pop stores, as long as I own the store—I have been there for 26 years—I never going to have a scanning system. It is all manual. That would be an absolute nightmare as far as the storekeeper and employees. I was given a copy of what the rules were as far as discount and point of sale, and I don't understand them. I would be more than glad to share it with you. It talks about setting a standard price, and it is just kind of gibberish to me.

Mr. GUTIERREZ. We want to see what we can do to make sure we keep businesses such as yours—

Ms. MILLER. Keep it simple.

Mr. GUTIERREZ. Right, keep it simple and keep it understandable and keep it in business.

Ms. MILLER. And the big thing with Congressman Welch's bill is—I haven't been out of Vermont very often, but a lot of our stores do have minimum setup, $5, $10, whatever. And I guess that is what I am looking for is the flexibility to be able to do that. I am not discriminating against a sale, I am not saying you can use this card, you can use that card, but that definitely would help us.

My examples with the potato chips and the gum, that is real. It happens every day of the week.

Mr. GUTIERREZ. I will never walk into a mom and pop grocery store in my neighborhood—

Ms. MILLER. But we want them to walk into our store. Don't drive by and get your big pack of gum at Wal-Mart.

Mr. GUTIERREZ. I will go hungry before I use a credit card after your example today. I mean that sincerely. It is outrageous what happens.

Ms. MILLER. I am on Route 12, and we are 23 miles from Montpelier, our State capital, and we are near Stowe, the ski capital of the East. So people are on their bicycles, and they have a piece of plastic in their back pocket. And I want them to come into my store, so that would definitely help me. They might walk out with an Elmore Store T-shirt on, and they won't have to carry it, they can do that.

Mr. GUTIERREZ. I get it.

Ms. MILLER. Other things I know, like when I testified in front of Senator Leahy's committee, they talk about litigation. And I am not part of the litigation, I don't understand the whole situation, but that has been going on for years. Small retailers can't wait years and years and years for more change.

And they talk about the monthly fees. I don't know what my monthly fees are until I get my bill. Number one, I still get one in the mail because I am an old-fashioned girl. I like paper and pencil, and I use my computer because my bookkeeper makes me do it, but I still do all my own stuff. But I don't know until the end of the month what is getting taken out of my checking account.

Mr. GUTIERREZ. So there is the end of the month, and there is this—

Ms. MILLER. It is like, whoa. July and August is a busy time, and $600 a month is a lot out of a small store. So you have to have that in your checkbook, and it is just like—it is huge, and you don't know what it is, but you have to be prepared.

Mr. GUTIERREZ. What we will probably do is, we will probably be in touch with you just to get more examples from you and others like you.

Ms. MILLER. And one more small example, and I don't mean to interrupt you.

Mr. GUTIERREZ. Absolutely.

Ms. MILLER. Two months ago, all of a sudden, I got a three-page letter saying I had to either say yea or nay to an $8.95 a month fee for breach of security insurance. And I figured that was covered by my home or my store insurance policy. So I called my local insurance company in Montpelier and they were like, gee, that is a really good question. It took her probably a week to get back to me and she said, you are not covered. So there is another $8.95 a month. So you never know what is going to come from where.

Mr. GUTIERREZ. Well, what we will do is we will make sure that we have a conversation. We have your testimony, but we will have a further conversation. I know Congressman Welch will work on making sure that happens because there is a lot of eye opening information here at this hearing.

I know that in my neighborhood, I guess you pay one price for gasoline if it is cash and another price if it is a credit card, except it doesn't happen in every neighborhood in Chicago. It is only in certain neighborhoods in Chicago this happens, where there is a duality of prices for gasoline.

And the other thing, the big retailers. I went to a big retailer, and they have a sign that says, "Use your debit card, we will give you 3 percent back." Guess what I did? I used my debit card because I have cash in my debit account, and they gave me 3 percent back and I was happy to get it. You can't do that.

Ms. MILLER. No.

Mr. GUTIERREZ. It is unfair.

Ms. MILLER. And when somebody walks in my store, I don't want to treat people differently. Everybody should be on a level playing field and be treated the same.

Mr. GUTIERREZ. We are going to try to do that, Ms. Miller. That is going to be our intent.

Ms. MILLER. Thank you, I appreciate your time.

Mr. GUTIERREZ. You have Congressman Welch on the committee. We will be talking to him some more.

Thank you so much.

Mr. GUTIERREZ. Congressman Hensarling, you are recognized for 5 minutes.

Mr. HENSARLING. Before I get into my line of questioning, I have a statement here from the Financial Services Roundtable in opposition to both bills. I would ask unanimous consent that it be entered into the record.

Mr. GUTIERREZ. Hearing no objection, it is so ordered.

Mr. HENSARLING. Thank you, Mr. Chairman.

Indeed, Ms. Miller, you give very compelling testimony. I have heard from a number of very small retailers in my district in Texas, but I am still trying to figure out exactly who is "David" and who is "Goliath" in trying to figure out the public relations battle. Is it a battle between your little grocery store versus Visa? Or is this Wal-Mart versus Liberty Bank, a community bank that I assume serves a lot of low-income and minority people in the Ninth Ward of New Orleans. I am not so certain that it is easy to discern who is "David" and who is "Goliath" here, nor do I necessarily think that is a good way to legislate.

I guess the question I have here—and Mr. Duncan, I don't have all of your written testimony here in front of me, but did I hear you make a declarative statement that the payment systems of Visa and MasterCard violate our antitrust laws?

Mr. DUNCAN. Yes, you did.

Mr. HENSARLING. If so, why are we here? Why haven't the courts already acted?

Mr. DUNCAN. Well, the courts actually, Congressman, have acted in some instances. The Justice Department brought a case against Visa and MasterCard for another set of rules, which was the exclusionary rules.

Mr. HENSARLING. There again, we have antitrust laws on the books. If these companies have violated them, I would assume that the practices of which you complain about today, would have already been fined and received cease and desist orders. So are you saying in some cases yes, in some cases no?

Mr. DUNCAN. I am saying litigation takes years, antitrust litigation takes years, and, unfortunately, antitrust legislation is backward looking. So a decision the court makes today covers what happened—

Mr. HENSARLING. Well, I am anxious to see the rulings of the courts, but my guess is that reasonable minds may end up disagreeing.

Mr. Duncan, my guess is there are very practical impediments, barriers to entry, in this market, but are there legal barriers to entry for people setting up a new payment card system? Listen, I know it is a capital-intensive business, but so is the airline business. New airlines have been created in the last few years. So why don't you all get together and create your own credit card network?

Mr. DUNCAN. Well, there are, as you have mentioned, practical barriers to entry in this market. The two cards, Visa and MasterCard, have 85 percent of the market.

Mr. HENSARLING. I understand the practical barriers. Are there legal barriers? If so, I would like to work on them; I believe in more competition as opposed to less. Are there legal barriers of entry that you would like to make this committee aware of?

Mr. DUNCAN. I am not sure that there are legal barriers to entry that are necessarily within the jurisdiction of this committee.

Mr. HENSARLING. Well, let me ask you this: I assume that your members believe they do receive some value in these payment systems. For example, the ease of the payment, you don't have to worry about the bounced checks. I assume you have a fairly sophisticated antifraud network.

What we are discussing now is the price that I think I heard either you or Ms. Miller describe as either abusive or unfair. So you do acknowledge you get some benefits, we are now debating whether or not the price is fair. Is that—

Mr. DUNCAN. There are benefits to cards in some instances, yes.

Mr. HENSARLING. And so, again, the complaint here is the price. But how does this differ from if your rent goes up, your utilities go up, your payroll goes up, your insurance premiums go up? All of that comes into the base price of your item. Sooner or later, it gets pushed off onto the consumer and you ostensibly are trying to make a profit. So how is interchange somewhat unique from every other cost that your membership deals with?

Mr. DUNCAN. Actually, that goes to the very first point you raised as to who is the "David" and who is the "Goliath" here. The difference is, it is not a question between the Elmore Store and a large bank; the debate is between open competition and privately regulated markets. Visa and MasterCard—

Mr. HENSARLING. Well, it sounds like it could be open competition if we don't have legal barriers to entry.

I see that my time is starting to wind down. I am also curious about—I guess I will ask this as a rhetorical question—the ability of retailers to deal in cash only. I can tell you right now, I just had a son turn 6 years old, and his birthday cake was purchased from Casa Linda Bakery in Dallas, Texas. They only take cash, and they have been successful for decades and decades.

Mr. DUNCAN. I guess the last point would be that all these other items you mentioned—the rent, the utilities—we can either negotiate or control them. We cannot control interchange.

Mr. GUTIERREZ. Ms. Miller, I see you are over there trying to get in a word edgewise. I ask unanimous consent that Mrs. Miller has 30 seconds.

Ms. MILLER. Thank you.

Do we have any control? No. When I take somebody's card, I have that equipment in front of me, and I swipe the card. It is through my local bank—I choose to use my local bank because of the technical support. Does it cost me a little bit more? Yes. But I am in a rural area. If I have an issue, I can make a phone call 24–7. I have a real person who can help me out.

As far as your payroll, payroll is something you can control. That is why it is Cathy and Warren at the Elmore Store. I have two part-time employees and I employ three high school students.

Rent, utilities. You bring in the natural cooler systems. We were actually the first one—

Mr. GUTIERREZ. Your 30 seconds is up, Ms. Miller. I am sorry. Senator Duplessis?

Ms. DUPLESSIS. Thank you, Mr. Chairman.

I would like to just make a few comments to clarify some of the issues that Ms. Miller suggested.

First, I would like to also invite her to be a customer of Liberty Bank, because obviously, the bank that you are dealing with is not giving you the best deal.

At the end of the day, every merchant has a depository account. That is where the money flows. And so the relationship that a merchant has with its banker is what causes the negotiation. Every day, when I look at my merchant accounts, we look at total relationships and we negotiate their fees.

Mr. GUTIERREZ. Thank you.

Congresswoman Waters, you are recognized for 5 minutes.

Ms. WATERS. Thank you very much. Let me welcome all of our panelists here today, and thank you for coming.

You are here at the Congress of the United States at a very interesting time.

What I am gleaning from the testimony is that two of the organizations that I have fought very hard for, the credit unions and minority banks, are kind of caught in an unusual and difficult situation. First of all, many of us are just at this time very unhappy with the major banks in this country. We have bailed them out. They have tightened the credit on everybody, individual consumers. And I am particularly concerned about these exchange fees or interchange fee—what do you call them? Interchange. I remember testimony that came from one of the panelists here—Mr. Mallory Duncan, weren't you before the Judiciary Committee?

Mr. DUNCAN. I was.

Ms. WATERS. And at that time, I thought there should be some real concerns about antitrust and collusion based on your testimony. I don't know what is happening over in that committee, but I am going to direct my staff to pay attention to that aspect of this.

Let me just say particularly to our credit unions and minority bank panelists, there has to be some changes made in the way that these fees operate now. I understand the problems that you are presenting to us today, but the overall problems and the abuses just trump the problems that the minority banks and the other companies are having.

So what I am going to do is work with the authors of this legislation to see if I can address some of your concerns as we make the changes that need to be made, but it cannot stay the same.

I just don't understand, merchants are forbidden to impose a surcharge for the use of payment, credit or debit cards, under the no surcharge rule. Merchants are required to take all credit cards bearing the card association brand on our all cards rule. They are required to accept these cards at all outlets. Merchants are prohibited from offering discounts to particular types of cards. The nondifferentiation rule. Who made these rules? Where did these rules come from?

Mr. MILLER. Isn't it Visa and MasterCard?

Ms. DUPLESSIS. No. May I make a response to that?

Ms. WATERS. Sure. Yes, please.

Ms. DUPLESSIS. I think some of the issues that you brought up are inaccurate. First, that there is no charge or difference that Visa or MasterCard requires for cash or credit. The second thing is, imagine you are shopping or you are going to make a purchase. This bill would allow credit merchants to change at their will who and what type of credit card they will accept. So today, you walk in Target or Wal-Mart or Saks, and you have a credit card that you typically use. Tomorrow, Saks may say they don't accept that.

Ms. WATERS. But excuse me, if I may. That has always been the way that credit cards worked in this country. I have credit cards that cannot be used. It didn't just start yesterday. And it still goes on all over the country. So what is different?

Ms. DUPLESSIS. It is the networks. Your merchant can decide whether it will accept Visa, MasterCard, Discover, American Express, or any of the other credit card companies. They can decide which one of those companies they will accept. But if they decide to accept the Visa, MasterCard, Discover, American Express, then they have to accept all cards using that logo, that network. The difference here is, they can say I accept Visa, MasterCard, but I only accept this type of card that Visa, MasterCard uses.

Ms. WATERS. But this is a rule that was basically developed by the big credit card people.

Ms. DUPLESSIS. No, this is what his bill would do to us. It would change the ability for that consumer—if I have a Visa card and I decide—and "X" merchant accepts Visa, then I can use any type of Visa card that I have, whether it is a rewards card, an affinity card, or any type of card at that store to make a purchase. If this legislation passes, that store may say, we accept Visa or MasterCard, but not that particular issuer. That is the dangerous part. And that is the part that would create a very uncertain, very inconsistent—

Mr. GUTIERREZ. Your time has expired.

I ask unanimous consent that the National Association of Convenience Stores and the Society of Independent Gasoline Marketers of America; the Electronic Transactions Association; the Independent Community Bankers of America; the National Black Chamber of Commerce; the Blackhawk Network; the Honorable Betsy Markey; and the American Bankers Association all have unanimous consent for their statements to be included in the record.

Hearing no objection, it is so ordered.

And next we have the ranking member, Mr. Bachus. You are recognized for 5 minutes, sir.

Mr. BACHUS. This interchange fee is a serious issue. I think most of the members are trying to study it and make a judgment. But my remarks are going to be on something else.

Mr. Mierzwinski, you made the remark—and I think it was in connection with implementation of the new credit card bill—that you believe the banks are behaving badly?

Mr. MIERZWINSKI. That is correct, sir.

Mr. BACHUS. I know Congresswoman Waters says that she and her colleagues are very upset with most of the big banks. I think you would admit that is a broad generalization of all banks.

Mr. MIERZWINSKI. Well, I think that in the credit card market, as you know, Mr. Bachus, the credit card market is extremely concentrated, there are just a few banks. According to studies that will be discussed in the second panel by some of my consumer colleagues, all of the big banks are either raising interest rates dramatically, raising minimum payments, jumping on consumers with massive changes to their cards. And so if the credit unions aren't doing it, that is great, but they have such a small part of the market.

Mr. BACHUS. Well, let me say this; we passed credit card legislation that increased their cost—I think we all would accept that—and it exposed them to risks that they didn't have before. And I think at the time we debated it, there were pretty broad statements by both the industry and by Members of Congress that this was going to result in—that they were going to have to raise the rates in many cases, that they were going to have to restrict credit in many cases. In fact, I read studies at the time that said they may have as many as 25 percent of the folks who were extended credit probably may be denied credit cards going forward depending on how it was implemented.

So I don't think it should come as a shock to any of us, including consumer groups, that they are raising rates and they are limiting their exposure. In fact, I would submit, if they made any mistakes—and they did over the past several years—it was overextension of credit, giving credit cards to people who probably should not have had them, giving them too much credit. And they have taken tremendous losses on it. And their costs are going up. They don't escape a bad economy.

I am just saying that I think of everything we do here, that we don't approach this from the banks are behaving badly. I understand your frustration, but I can say that it could have been predicted that people were going to be getting notices that their rates were going up because—yes, and some of the changes I think were good, but it was also very predictable that it was going to cost more because somebody has to pay for it.

Mr. Evans, let me shift gears and ask you a question. You did a recent University of Chicago study on the Consumer Financial Protection Agency, as it is so called?

Mr. EVANS. Yes, that is correct.

Mr. BACHUS. You state that under conservative assumptions, that legislation would increase interest rates consumers pay by at least 160 basis points, reduce consumer borrowing by at least 2.1 percent, and reduce net new jobs created in the economy by 4.3 percent?

Mr. EVANS. Those are the findings, yes, sir.

Mr. BACHUS. And that is conservative, right?

Mr. EVANS. Certainly, the first two are.

Mr. BACHUS. Okay. 160 basis points? You said what now?

Mr. EVANS. The first two statements you said, the 160 basis points, that is conservative.

Mr. BACHUS. Conservative. That it would raise interest rates by that amount and reduce consumer borrowing by at least 2 percent?

Mr. EVANS. That is correct.

Mr. BACHUS. What effects would that have on our economy?

Mr. EVANS. In the long run, it would have a terrible effect on the economy. And remember, the CFPA is a very onerous and very intrusive form of regulation. So in the long run, my belief and the result of the study is it would have a serious effect in terms of the access that consumers and, very importantly, small businesses will have to credit.

In the short term, I think it is particularly problematic, the CFPA, and the reason it is particularly problematic is it creates an enormous amount of uncertainty for lenders, imposes a lot of potentially very high costs on them, and I think in the short term the result of the passage of the CFP Act in its current form would have a very serious effect on access to credit and a negative effect on the economy.

Mr. BACHUS. And those were conservative assumptions. I can't imagine if—

Mr. GUTIERREZ. The time of the gentleman has expired. We are going to recess. We have some votes, and we will be back right after the votes.

[recess]

Mr. WATT. [presiding] The Chair has asked me to continue the process. I was the next in line to ask questions anyway, so we will consider the hearing reconvened and I will yield myself 5 minutes as soon as we find somebody who can operate the clock for us.

Let me just make a couple of comments in my 5 minutes of time. I am one of those people who has the luxury—or the curse—of serving on both the Judiciary Committee and the Financial Services Committee. And I think I got some appreciation during the last term of Congress of how complicated a subject this whole interchange fee issue is over in the Judiciary Committee when there was an effort made to solve the retailers' problem by allowing them to band together and disregard the antitrust laws as a counterweight to the power of the industry on the other side. I didn't think that was a reasonable solution, not because I didn't think probably that there were some problems that needed to be addressed, but I just didn't think that was the appropriate solution. It was the only solution that the Judiciary Committee could really fashion within its jurisdiction since it has jurisdiction over the antitrust laws, but that didn't necessarily make it an appropriate solution to the problem.

There are multiple players here. The one thing I found out is that there are retailers, there are banks, there are credit card companies, there are credit unions who, despite the fact that they issue credit cards, have a slightly different position sometimes than the banks, and of course there are consumers. So I identified at least five different interests that have to be taken into account during my evaluation of this in the Judiciary Committee.

I think today's hearing actually is a very productive thing because one of the concerns I had about what we were doing in Judiciary was that I didn't think we had enough hearings for people to understand the relative interest of those five and potentially other parties to this discussion. And while we don't ever understand completely the totality of nuances and facts and different circumstances in any area that we legislate in, I think we do better legislation the more we understand about the various interests that people have in it, and we have at least then the capacity to try to balance those interests from a public policy perspective. So that is kind of the way I am approaching this. I think this is a valuable hearing because it adds to the level of knowledge that we as members of the committee have to try to fashion a solution.

Now, having said that, the question I would raise I guess is this; we did a credit card bill on the consumer side that constrained certain kinds of conduct vis-a-vis consumers. Is there anybody who thinks that some kind of legislation on the other side that has the potential to impact consumers through interchange fees is not an appropriate exercise? Is there anybody on this panel who believes we should be doing nothing? Just raise your hand if you believe we should be doing nothing.

Ms. DUPLESSIS. I do.

Mr. WATT. Tell me why you think we ought to be doing nothing.

Ms. DUPLESSIS. I am not going to say that I believe that we should be doing nothing—

Mr. WATT. Okay. Well, then you are not going to be responsive to the question I asked. I didn't ask what we ought to be doing, I just asked is there anybody who believes we ought to be doing nothing.

Is there anybody who believes—and my time is running out—who believes that we shouldn't at least be taking a look at the interchange fee side of this equation in the interest of consumers and all of the parties as we did on the other side when we addressed—maybe not the same way, but some kind of framework on the interchange side of this equation? Does anybody think we shouldn't be at least exploring that possibility?

Mr. CAVERLY. I just want to make a comment.

Mr. WATT. Mr. Caverly is getting ready to make a comment. I am not sure it is in response to my question, but go ahead.

Mr. CAVERLY. I think there is a danger in getting involved in regulating interchange fees.

Mr. WATT. There is always a danger in everything we do, I understand that. But my impression, to be honest with you, is that there is so much inconsistency out there, and that this is an area that at least we need to be looking carefully at. I am not sure that I have decided what the solutions ought to be. I am not sure I even understand all of the problems that exist; I am just trying to get a basic understanding.

But my time has expired. I used most of it making my opening statement. So I am going to go on to Mr. Sherman from California for 5 minutes.

Mr. SHERMAN. Thank you, Mr. Chairman.

We have dealt with this same issue in Judiciary where the proposed solution was to deal with antitrust law to allow retailers to get together and bargain. Over there, what I suggested was, what if we limited to retailers with 500 or fewer employees. And my concern then was that the proponents of dealing with the interchange fee paint this picture, and I don't have to describe the picture that well, it is actually the same picture that is on Cathy Miller's report, and that is a picture of a small store. And they say we have to help the small store. And then I proposed an amendment that would limit it all the way up to 500 employees, and the proponents of the bill beat the amendment.

Why, Mr. Duncan, do we not simply address the picture that is being painted, which is that the small stores aren't being treated well? Why do we need to help WalMart?

Mr. DUNCAN. Well, it is not a matter of helping WalMart or the small stores solely. The problem is we have a market that is not working, as we discussed in Judiciary. And if we believe that competition is good for all merchants, all banks, and all consumers, then we need to remove fetters on competition for everyone.

Mr. SHERMAN. I understand the theory. But if WalMart's costs go down, does that mean they charge me lower prices or make higher profits? And if the interchange fee is less, does that mean that I don't get my miles? The point here is that the credit card companies are competing. They are competing to try to get as many cards in people's hands as possible. Sometimes, that is a problem in that they extend credit that people can't afford to pay. They have been jolted out of doing that. They may be going too much in the other direction.

But right now, the stores have to pay a lot. And the cards compete for business by giving me free miles. Why should I lose my free miles so that WalMart's costs go down? How certain am I that WalMart is going to pass that savings on to me?

Mr. DUNCAN. Well, let me try to explain how the savings works. Obviously, every merchant, if this were to pass, would pass the savings on in a different way. Let me explain how that works. Merchants compete for market share. And if you are in a market that favors low-cost products, you want to grow that. So what you will do—

Mr. SHERMAN. Sir, I am in a market that favors high profits and big dividends. So I will shop at the stores in my area. I am not going to get lower prices. I am not going to get a cleaner store. I am just going to see that WalMart's dividends per share go up. How does that help me?

Mr. DUNCAN. If in fact—let's take two stores competing, if they are in the cost-sensitive market. If one of them is returning the costs and the other isn't, as I said in my oral testimony, the one that is returning the costs grows their market share.

But you could have a different scenario. You could have a high-end store which says—I will use Nordstrom as an example, and they don't compete on price, they compete on service. And so they will provide more of what their customers want in terms of more service because that is how they—

Mr. SHERMAN. You are assuming that retailing is such a competitive market that every savings is passed forward to consumers. And I am telling you about a different area, where in fact it isn't so competitive, and the lower costs translate into higher dividends for shareholders. If the image you are trying to paint in favor of this bill is a small store, I would think we would want to limit it to small stores.

But I want to ask one other question. Why not simply solve this problem by giving me a 1 percent discount for paying cash? Why won't your members do that for me?

Mr. DUNCAN. There are two questions there. One of them is, do the card companies put up barriers to us providing discounts for cash? And they have put enough barriers in place that most retailers can't do it. A few can. That is the quick answer to that.

Mr. SHERMAN. What are these barriers and why can some retailers jump over them in a single bound and others are constrained by gravity? I have been told by the other side that all your members are just free to give me a cash discount. They don't, for their own marketing reasons.

Mr. DUNCAN. No, that is not accurate.

Mr. SHERMAN. What if we simply prohibited all barriers to giving a discount for paying cash?

Mr. DUNCAN. That is an excellent idea, and in fact that idea was proposed in the other body by Senators Durbin and Bond, and the banks screamed bloody murder that we might pass the savings on to consumers, so they tried to block it.

Mr. SHERMAN. I will for the record ask Mr. Caverly to respond to that and see if he screams bloody murder about that. I yield back.

Mr. CAVERLY. As a follow-up to that statement, I believe the merchants already have the ability. Irrespective of any new legislation, merchants can provide a cash discount under the current rules. And back to the question, there has been a lot of discussion about consumers and how the consumers are going to benefit.

Mr. SHERMAN. My time has expired.

Mr. WATT. [presiding] The gentleman's time has expired. The gentleman from New York, Mr. Meeks, is recognized.

Mr. MEEKS. Thank you, Mr. Chairman. And I have been listening to the hearing in my office, and I am not sure—I heard Mr. Scott's opening statement. And I kind of agree with him, because I have constituents on both sides. And so that is why I have been listening with a lot of intent.

But let me just ask a question, I think that Mr. Sherman was asking to Mr. Duncan, and just say, what if we included in this bill language that said all savings from this bill had to be passed through to customers, and they had to be posted transparently so that they could ensure you are not simply extracting margin from credit card companies to pass through to individual retail companies? Would you have any objection to that?

Mr. DUNCAN. Sure. Absolutely.

Mr. MEEKS. You would have an objection?

Mr. DUNCAN. I would have an objection because you would simply be substituting one restraint, the restraints they put on us now as to how and when we can offer discounts, for a different set of restraints as to how we would have to accord—

Mr. MEEKS. Let me go on that because it seems on the one hand, someone is saying this is going to save the consumers some money. And if it is going to save the consumers—that is the reason—then it seems to me it should not be a problem in posting, well, this is how we are saving you some money. And as a result, the money is not going back into our pockets, this money is going to consumers.

Mr. DUNCAN. I see what you are saying. Let me say it a different way. As I was just saying to Mr. Sherman, different stores will respond depending upon their particular market. So one store might decide, for example, that we are going to give you free gift wrapping if you use a cheaper form of payment. You use a debit card, you use cash, we will give you free gift wrapping. That is a savings to the consumer, but it is not in the same way as a dollars savings that you would see.

Mr. MEEKS. I want to ask you that in a second, but I want to go just about another concern because we only have these 5-minute interviews here. But Ms.—I hope I am pronouncing your name correctly—"Duplessis?"

Ms. DUPLESSIS. "Duplessis."

Mr. MEEKS. "Duplessis." Senator Duplessis. I was listening to you also. Here is one of the concerns that I have about unintended consequences. And I think this is what you were getting at, I just want to make sure, about reducing access to credit. And especially it is important at this time when our economy is in the most need, and generally I think people utilize their credit cards more as they spend more money.

And I think what your testimony—based upon your testimony this morning, I am concerned that it will further have a disproportionate impact on access to credit, especially for minorities and people of color and others who are already—basically, those people who are already on the margin of being able to have access to credit. Can you share your thoughts on that?

Ms. DUPLESSIS. Yes. You are right on target with what we are talking about when we say that there could be some unintended consequences. But in addition, on the merchants' side, when we talked about unintended consequences that they are not factoring into this equation, we are talking about the issue that cash is not a cheaper form of payment. Cash is perhaps a more expensive form because that merchant, by using electronic payments, that merchant now does not have to pay for the transportation of that cash. That merchant, while that cash is sitting in their cash register, it is not earning interest for them. When they are using an electronic form of payment, that cash is deposited in their accounts immediately. So that merchant has immediate availability to reinvest those dollars.

We have not even talked about the money that they are making as a result of being able to have immediate availability of cash. In addition, they do not have courier expenses, which goes to the bottom line. That is a cost savings for being able to accept electronic payment.

Mr. MEEKS. Let me ask Mr. Duncan. I am sorry I am cutting you off, because I see my time is about up. But I heard in his testimony or read in his written testimony that he said debit cards are plastic checks. Who is responsible for collecting the payment in the case of a bounced check? And I thought that is the retailer. As opposed to, in the case of a credit card or a debit card, isn't it the bank or the credit card company that is behind it? Is that not correct? And so therefore, I am wondering, are there good estimates of the cost burden that collections on bounced checks imposed on retailers before credit and debit cards became the predominant form of payment?

Mr. DUNCAN. There have been a number of companies who have looked into that. And I hate to disagree with the senator, but in fact the cost of accepting cash is a fraction of the cost of accepting credit cards or debit cards, a small fraction. Checks, we have found, cost us virtually nothing in comparison with the cost of taking debit cards or credit cards.

Let me just put it a simple way: It doesn't cost any more to carry a $10 bill to the bank than it does to carry $1,000 in bills to the bank.

Ms. DUPLESSIS. Yes it does, sir. As a banker, there are things called analysis charges. And every bill that you deposit into a bank, there is a charge for handling that money.

Mr. DUNCAN. Let me say that a $1 bill versus a $100 bill.

Ms. DUPLESSIS. Okay.

Mr. GREEN. [presiding] Excuse me, friends. While we are enjoying the debate, the chairman expects us to move along. We have another hearing that will take place here at 2:00 today.

Mr. Scott of Georgia is now recognized for 5 minutes.

Mr. SCOTT. Thank you, Mr. Chairman. Could you all tell me why the interchange fees have been rising so? Particularly with some of the technological changes that are being made, why have they been rising so fast?

Mr. CAVERLY. The fee itself as a percent of the transaction has not risen. That fee as a percentage has stayed relatively flat over the last decade. What you are seeing, though, is an increased use of plastic cards as a form of payment, an increase in sales volume associated with the use of debit and credit cards. But the fee itself as a percentage has remained relatively flat.

Mr. MIERZWINSKI. Mr. Scott, if I could just respond. It is a time when it should be declining; because of the cost of providing the product, it should be declining, not staying flat.

Ms. DUPLESSIS. Actually, the costs of providing the product has escalated, because we now have other issues to contend with, fraud and those types of issues, breaches in card security that sometimes the merchant doesn't have the necessary infrastructure to stop card breaches. And so those costs are borne by the bank and the issuing card carrier, holder, because we now have to try and handle those issues that the merchant doesn't bear.

Mr. SCOTT. But isn't fraud going down?

Ms. DUPLESSIS. No, not at all. It is getting worse.

Mr. CAVERLY. We also have to contend on an ongoing basis with data breaches. And in late 2008, early 2009, there was a data breach at a merchant processing company, and that caused our credit union to reissue about 50,000 new cards at a cost of $150,000. So there are ongoing costs.

Yes, I understand the theory is the payment system is in place, but there are ongoing costs, and they are escalating.

Ms. MILLER. Sir, if I could interrupt whenever you are ready?

Mr. SCOTT. Yes.

Ms. MILLER. In my small store, in my situation I go to the bank. We do daily deposits. I deposit cash. It doesn't cost me money to deposit cash. It doesn't matter if I put in $1 or I put in $1,000. If I deposit a check that I decide to take from a consumer, it costs me 15 cents to deposit their check into my banking account. So if a customer writes me a check for $1.35 for a bottle of water, I pay 15 cents.

If they decide to ask my husband Warren for $200 cash back, I have to go somewhere, it costs me 15 cents. If the person uses their debit card, their credit card in my store, it costs me 20 cents every time I swipe that card, plus my transactions fees, which I find out at the end of the month.

And I beg to differ—maybe in Mr. Caverly's situation, he says fees haven't gone up—but my fees have gone up. And since I testified in 2006, credit card usage has gone up over 50 percent in our store. People are using plastic. I want to be able to take it. I don't want to discriminate against my customers. I don't want to say, okay, you are giving me cash, this is going to be your price.

We are a small operation. We don't scan. And it would just be a major nightmare. And I would suggest if you removed any barriers, give us a chance to give a consumer a discount or a free product for any type of payment.

Ms. DUPLESSIS. Sir, can I read a statement from Visa and the rules with regards to surcharging?

Mr. SCOTT. Sure, go ahead.

Ms. DUPLESSIS. If I may. It says: "Always treat Visa transactions like any other transaction. That is, you may not impose a surcharge on a Visa transaction, but you may, however, offer a discount for cash transactions."

So I don't understand why we keep saying that Visa or MasterCard doesn't allow merchants to charge a discount for using cash. It says it directly in the agreement between the merchant.

Ms. MILLER. I am not saying—okay. Go ahead.

Ms. DUPLESSIS. Would you like this?

Ms. MILLER. I am not saying that is not true. I know I can't add a surcharge to my consumer.

Ms. DUPLESSIS. You have been saying all along that you can't.

Mr. SCOTT. All right.

Ms. MILLER. No, I am saying I can do a cash discount, but I don't want do a cash discount.

Ms. DUPLESSIS. You don't want to do a cash discount. That is different than not being able to.

Mr. GREEN. The member is in control of the time. Mr. Scott.

Mr. SCOTT. I have 5 minutes. And now some of that is gone. But if you do, just allow them to come through me. This is good give-and-take. This is exactly what we need.

Let me ask a couple of questions about our credit unions and smaller banks. How can reasonable rates be established so that some of the smaller community banks and credit unions can continue to offer credit services for their customers?

Ms. DUPLESSIS. It is all about relationships, sir. If I have a merchant who is banking with Liberty Bank, that merchant is based on the number of relationships or the type of relationships they have with me, i.e. their personal accounts, a loan, other types of products, then I can in totality look at those relationships and negotiate their fees and as well as their interchange fees.

So this notion that merchants and retailers can't negotiate interchange fees is just false. We do it all the time. But it is based on a relationship that individual small retailer has with their bank.

Mr. GREEN. The time has expired, Mr. Scott. We will have to get the question for the record. Thank you.

Mr. Moore is recognized for 5 minutes.

Mr. MOORE OF KANSAS. Thank you. Mr. Caverly, while some may be more concerned with large firms like Visa or WalMart in this debate, I wonder how this interchange proposal will affect small businesses who need access to credit: community banks and credit unions, as well as small merchants who are competing against large retailers.

As you know, our financial system remains fragile. And I hear from small businesses in Kansas that have lost access to credit, or they see their credit line slashed, if there is a dramatic change in interchange rules today, what effect would it have on credit unions and community banks?

Mr. CAVERLY. The effect would be significant. Kind of going back to this specific bill with the honor-all-cards rule, I think that would create mass confusion for our consumers, for our members, to not have the confidence that when they walk up to a merchant and see the Visa sticker on the door that their card will be honored or accepted.

But with respect to a reduction in interchange fees, there is a cost, there is an ongoing cost to offering these card programs. And in this discussion—the question of what would happen if interchange fees are reduced is not an academic question or an academic discussion. We can look at what happened in Australia when the government did step in and reduced interchange fees. The merchants received to the tune of about $900 million a year in benefit. That benefit was not passed on to consumers. What did happen, though, is many small issuers, perhaps like a credit union or a small community bank, were forced out of the market. But ultimately, consumers ended up paying more because now to replace that loss in interchange income, the issuers had to begin charging fees, annual fees for cards, higher annual fees for rewards programs.

So I think ultimately that is the impact. Significant impact on the credit union, but more importantly a significant impact on our membership and consumers.

Mr. MOORE OF KANSAS. Senator Duplessis, do you have any additional comments?

Ms. DUPLESSIS. No, I think he basically hit the nail on the head.

Mr. MOORE OF KANSAS. Thank you. In today's economy, Ms. Miller, would sweeping changes to interchange rules help or hurt small retailers? And would you be concerned these small retailers would lose access to credit?

Ms. MILLER. Yes, it would help us. I don't believe that we would lose access to credit or to the use of it. It has just become so predominant in our world today, if the consumer wants it, it is going to happen.

The big thing, when I testified earlier, is just if we could set up a minimum, like Congressmen Welch and Shuster have proposed in this bill, it would be a godsend to small businesses. Because—

like my examples with the gum, my examples with the potato chips, a bottle of water. It is real and it happens every day. So yes, it would help us, sir.

Mr. MOORE OF KANSAS. Okay. Thank you. I am aware the Government Accountability Office, GAO, is working on a report they will release soon on interchange fees. But looking at the report they wrote last year on the impact of interchange fees on the Federal Government, the GAO found that in countries that have rolled back interchange fees to less than 1 percent of transactions, consumers did not necessarily reap the benefits.

I don't know if there is a lot of interest in simply transferring profits from one industry to another, but why not require all savings from interchange fees be automatically transferred to consumers?

Ms. Miller, do you have any views on that? And Mr. Duncan as well?

Ms. MILLER. To be totally honest, I have never thought of it the way that you are talking about it. Would it be passed on to my consumers? Yes, it definitely would. You talk about competition, there is not a lot around us. We are a small store. There are 850 people in town. We have a one-room school house across the road. You have to go 25 miles to Montpelier, you have to go 50 miles to Burlington. I have to take care of my customers. If I don't take care of my customers, the doors are going to close. I need help.

Mr. MOORE OF KANSAS. Mr. Duncan, do you have any thoughts?

Mr. DUNCAN. Sure. Let me start with the GAO report. It is unfortunate in that GAO report that the staff chose to rely on a study that was actually a MasterCard study, rather than going to the Federal Reserve Bank of Australia. Because if they had spoken with the Federal Reserve Bank, they would have found that in fact there had been significant savings to consumers as a result of the changes in Australia.

And in fact, I was at a conference in Chicago just recently, the Chicago Fed, where they talked about $1.1 billion in returns to consumers as a result of the changes that they had made there.

In terms of the other issue, if I may just briefly—

Mr. MOORE OF KANSAS. Sure.

Mr. DUNCAN. In terms of the honor-all-cards rule, I think there has been some mischaracterization of the Shuster-Welch bill. The honor-all-cards rule when it was first enacted was actually an honor-all-banks rule. What it said is if you got a card from Nevada or a card from Colorado or Massachusetts, they all have to be accepted.

What the card companies did was they took that rule and they perverted it and they said it is not just honor all banks; it is honor all products that we put our name on. So if we issue a very expensive product, you have to take that. The Welch-Shuster bill would take it back to the original honor-all-banks rule so cards from all banks and all credit unions would still be accepted.

Mr. MOORE OF KANSAS. Thank you, sir. I yield back.

Mr. GREEN. Thank you. Mr. Cleaver is recognized for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman. Mr. Duncan, you said earlier, and I think several have quoted you that the debit card is a plastic check. And you still stick by what you said earlier?

Mr. DUNCAN. Yes.

Mr. CLEAVER. Okay. Senator, do you agree?

Ms. DUPLESSIS. No. Well, I agree that it could be considered a plastic check, absolutely.

Mr. CLEAVER. Okay. When a check is presented by a merchant, either through the machine—Emanuel Cleaver has just written a check here for $50—they do the machine to check the balance, and they come back and say sorry, you are writing a check for $35, you only have $25 in your account, I am sorry, we can't do business.

Ms. DUPLESSIS. You bring up a really good point. That is called remote deposit capture, in which a merchant can take that check, run it through a scanner, and it talks with the bank to determine if funds are there.

Mr. CLEAVER. Okay.

Ms. DUPLESSIS. But there is a fee for that, too. That merchant pays a fee. You can call it an interchange fee, but there is a fee that merchant pays for that convenience.

Mr. CLEAVER. Right. Good. Now, but then we have a problem. And that is the same thing could be done with a debit card. It is a plastic check. But it is not. And so what the debit card does is create a high-interest loan. And if you are making loans, what is the difference between a loan shark, which is defined as an interest rate of between 10 and 20 percent—the new definition, not the Mafia and the Godfather stuff—but the definition of 10 to 20 percent. So if you can find out that a paper check has insufficient funds, couldn't you also find out that the debit card—

Ms. DUPLESSIS. You do. It is all real-time. It is all the same process.

Mr. CLEAVER. So explain how banks were able to end up with $24 billion, with a "B," billion dollars in overdraft fees.

Ms. DUPLESSIS. That is when you use the old process of depositing a check. And that is an extremely great point. Because for that merchant, they have a couple of options. They can take that paper check, not pay for the service of scanning that check to get real-time dollars, and have those dollars automatically deposited into their account. They don't have the cost of a bounced check.

But if they take that same check and bring it to their bank for processing, then they have some risk there. They have the risk that the check will not be honored. That is a cost to that merchant.

Mr. CLEAVER. So when the debit card is swiped—

Ms. DUPLESSIS. Real-time.

Ms. MILLER. If there is no money there, it says "declined."

Ms. DUPLESSIS. It says "declined." Same with the check. It is the same process, two different machines.

Mr. CLEAVER. Okay. But explain how you end up with a $24 billion balance sheet on overdrafts with both debit cards and paper checks—

Ms. DUPLESSIS. You don't.

Mr. CLEAVER. —which is up 35 percent from last year.

Ms. DUPLESSIS. No, sir, you don't. Let me try and get you there. What is happening, when that transaction comes in, it depends—you have in a person's activity, you have numerous transactions that are posted.

Mr. CLEAVER. Okay. I don't want to learn. What I want you to do is tell me, how did the banks come up with $35 billion more than they did 2 years previous to that in overdraft fees?

Ms. DUPLESSIS. It wasn't based on real time authorization. It was not based on real time authorization, sir. If that bank gives you an authorization that the money is good, whether you do it with a check and it is scanned, or with a debit card, when you get an authorization the money is automatically, immediately—they call it presentment—taken from your account.

So the overdrafts that banks receive, the billion dollars that you say that the industry has received—

Mr. CLEAVER. Twenty-four billion.

Ms. DUPLESSIS. But you are talking an industry, not one bank. The industry, that the industry has received, is not based on credit card or check scanning real-time transactions. Because the money is already accounted for.

Mr. GREEN. The gentleman's time has expired. We will now recognize the ranking member, Mr. Hensarling, for as much of my time as he may consume. And I will have 5 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman. I appreciate your indulgence. I just have a couple more questions. And in the interests of time, I am happy to have the witnesses submit their answers in writing.

The question of the Australian experience has come up. It is the only similar legislation I have seen in a modern economy dealing with interchange. Mr. Duncan, apparently you take issue with the prevalent studies that say that when merchant fees dropped, they did not result in lower prices from consumers. So I would be interested in what studies you have, if you would submit them in writing, since what I have seen shows—

Mr. DUNCAN. I will submit the statements of the Federal Reserve in fact, yes.

Mr. HENSARLING. Fine. Send that, please.

Also, I have seen studies that show that after that legislation was passed, merchants began adding credit card surcharges to goods, increasing costs to consumers. And on the competition side, one of the major bank cards shut down in 2006, lessening competition for consumers.

Again, if you have facts or studies that are to the contrary, if you would submit those in writing.

One question for you, Mr. Mierzwinski. And that is, it is my understanding if this legislation passes, that the usual contract clause that ensures that consumers have universal acceptance of their cards will be thrown out. And as an organization that ostensibly lobbies in favor of consumers, if you would submit an answer in writing how that benefits the consumer, because at the moment, it is beyond me.

Thank you, Mr. Chairman, for your indulgence.

Mr. GREEN. Thank you.

With the remainder of my time, which is a little more than 3 minutes, let's just start with Ms. Miller, and we will give each of you an opportunity to give a closing statement. I do ask that you be as terse as possible so that the rest of your colleagues will have an opportunity to respond.

Ms. Miller, any final words that you would like to share with us?

Ms. MILLER. I wasn't really ready. But I guess my biggest thing is, please support Congressmen Welch and Shuster in this bill. If I can be of any more assistance to anybody, I am only a phone call away, an e-mail away. I want to help.

And another thing, too, I don't know if you really understand this; we can't talk to our customers about this. I can't, according to their rules and regulations, tell my customers what they are paying in fees through my business. So I am going to go back to the store tonight, and tomorrow morning everybody's going to be like wow, what is up? And I can't talk about it. So please support their bill. Thank you.

Mr. GREEN. All right. Sir?

Mr. CAVERLY. To respond to that comment, my understanding is that Visa and MasterCard both allow the merchants to provide that information to their customers in terms of the fee structure. That can be provided by a merchant to their customers.

In closing, or to wrap this up, I think Congressman Scott had mentioned this in his opening comments, that I think the key question is what would happen to the consumer? And again, I am here representing the 92 million—

Mr. GREEN. I am going to have to ask that you wrap it up, because I do want to hear from the other panelists.

Mr. CAVERLY. Okay. I am here representing the 92 million credit union members and the 178,000 members in my credit union. And I think ultimately, whether it is this legislation or other legislation that will reduce interchange fees, it is going to hurt the consumer.

Mr. GREEN. Next, please.

Mr. MIERZWINSKI. Very briefly, first, I will respond in detail to Mr. Hensarling's question. But I don't believe the honor-all-cards rule is actually meant as a consumer protection rule. I refer to Mr. Duncan's comments.

Second, I strongly concur with Mr. Cleaver that we need overdraft protection at point of sale so that consumers can decline and not pay those billions of dollars in overdraft fees since they have the real-time solution.

And third, I would submit the interchange market is broken and needs reform. But the retail market, I need to be convinced the retail market is broken and needs the kinds of reforms the banks claim it needs.

Mr. GREEN. Thank you, sir. You will each have approximately 30 seconds.

Ms. DUPLESSIS. Thank you. What I would like do is just ask that you really consider and truly understand the true unintended consequences that trying to regulate these fees could have not only on the small community banks, but also on the merchants themselves. I don't think they actually realize what those unintended consequences will be.

Mr. GREEN. Sir?

Mr. DUNCAN. I would first of all echo Ms. Miller's comments about the Welch-Shuster bill. And I would add to that just one point. For markets to work so that everyone benefits, we need two things: We need transparency and we need competition. We don't have either of those now. And the bill will help us achieve that.

Mr. GREEN. Thank you very much. This panel is excused. And we will ask that you move away as expeditiously as possible.

We ask that the next panel move forward and be seated. And we thank you for your patience. We did have a number of votes that interceded. So thank you very much for your patience that you have demonstrated.

Thank you. We would like to welcome this, our third and final panel. And we are honored to have with us today the deputy director for national priorities for Consumer Action, Ms. Ruth, and I believe the last name will be "Susswein."

Ms. SUSSWEIN. "Susswein."

Mr. GREEN. "Susswein." Thank you.

We have the senior vice president and general counsel for ABA Card Policy Council with the American Bankers Association. This would be Kenneth J. Clayton.

We have the president of the National Small Business Association, Todd McCracken.

We have the senior compliance counsel with the National Association of Federal Credit Unions, Anthony Demangone.

And finally, we have the manager of the Safe Credit Cards Project, the Pew Charitable Trusts, Mr. Nick Bourke.

We will start with Ms. Susswein, and each of you will have 5 minutes. And when you finish, Ms. Susswein, I will of course announce the next speaker.

You may proceed. You now have 5 minutes to summarize your comments.

STATEMENT OF RUTH SUSSWEIN, DEPUTY DIRECTOR, NATIONAL PRIORITIES, CONSUMER ACTION

Ms. SUSSWEIN. Thank you, Congressman. And thank you to the committee for having me testify today on behalf of Consumer Action. I am Ruth Susswein with the nonprofit education and advocacy group Consumer Action. For more than 2 decades, we have been reporting on credit card rates and fees to track industry trends and assist consumers in comparing cards. We are one of the groups that consumers call when they have a credit card problem.

I would like to express our appreciation today, first of all, for the chairman's leadership on consumer protection issues, and particularly for supporting the Consumer Financial Protection Agency. We are also grateful for the tenacity on this issue. We strongly support H.R. 3639, to establish an earlier effective date for the Credit CARD Act.

We are going to focus our testimony today on the exploitive practices of some card issuers and how some of these practices have taken place since the Act was signed into law.

We have been conducting extensive annual credit card surveys at Consumer Action since the mid-1980's. We survey each of the top credit card issuers, from banks, credit unions, and low rate issuers. In our 2009 survey, we discovered that between March and June, some major credit card issuers had arbitrarily increased rates, spiked fees, and hiked minimum payments. There appeared to be no rational reason for these increases, no jump in the prime, no other reason other than issuers making good on threats that credit would dry up and cardholders would see costs rise with the passage of the Credit CARD Act.

A few examples: Bank of America has a Platinum Plus card that the purchase rate went up to 46 percent. Citi had 3 cards that went up 26 to 42 percent within that March to June period. Within 3 months, some cards went up as much as 3 percentage points. We have also found fees that spiked between March and June.

Consumer Action also assists consumers with all sorts of problems. And we hear from our complaint hotline. I would like to give you just a brief sample of some of the things we have been hearing about this problem. A Chase customer for 19 years saw his minimum payment jump from 2 percent to 5 percent; his amount raised, going up from $250 a month to over $600 a month. He told us, "We have excellent credit. We have done a terrific job managing our money during severe economic conditions." And yet this is a terrible way to treat good customers.

A Maryland cardholder contacted us in desperation when her rate more than doubled. It went from 12.49 percent to a whopping 29.9 percent; her monthly minimum went from an affordable $151 a month to $471 a month. She couldn't pay it. When she contacted the issuer to try to arrange an affordable payment plan, she was turned down. And she acknowledged that she had been late with one payment when her due date was moved back a week from the 4th to the 30th. She understood being hit with a late fee, but not a 140 percent interest rate hike.

We happened to intervene on that cardholder's behalf, and ultimately, the bank was able to help her. But not everyone is that fortunate. Had the Credit CARD Act been in effect already, her late payment would not have allowed her rate to more than double, and that entire ordeal could have been avoided.

We hear from scores of cardholders who have paid on time each month who have seen their rates rise, often double, often for no reason at all. We hear from cardholders who say they have three and four cards where they have seen rates as much as double.

One cardholder I spoke to yesterday said, "I have done nothing wrong. I have lived up to my obligations, and I am being treated like a deadbeat. And when I call the company and complain, what they say is, 'there is nothing we can do about it.'"

Cardholders who have seen their rate go from 7.9 fixed to 17.9 variable complain to the company and are told it is a business decision based upon economic factors. Factors that are beyond a cardholder's control, even though they are told their rates are based on risk-based pricing.

If the credit card law was in effect today, issuers would still have the freedom to raise rates for arbitrary reasons, but they would not be able to apply the increase to the balance in most cases.

We don't accept the notion that card issuers must find ways to replenish their coffers on the backs of cardholders. We think there is a direct link between some of the indefensible practices and today's high default rates.

There is no logic in taking a customer who is responsible, who is meeting his monthly bills and paying interest to boot, and hiking rates, spiking minimum payments, and transforming the healthy customer into an unhealthy one. We think that cardholders have cried out to Congress to add fairness and limits to this lopsided lending system.

Mr. GREEN. Ma'am, we will have to get the rest of your statement in the record. You will be asked some questions, and perhaps you will have an opportunity to expound. But we must move forward. Thank you so much. I am sorry.

[The prepared statement of Ms. Susswein can be found on page 221 of the appendix.]

Mr. GREEN. Mr. Clayton, please, you will have 5 minutes to summarize.

STATEMENT OF KENNETH J. CLAYTON, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, ABA CARD POLICY COUNCIL, AMERICAN BANKERS ASSOCIATION (ABA)

Mr. CLAYTON. Thank you, Mr. Green. Thank you for the opportunity to testify on H.R. 3639, a bill that would move up the effective date of the broad mandates of the CARD Act to December 1st of this year.

Let me say at the outset that all card lenders, whether they are the largest financial institutions in the country or the smallest community banks, are working hard to implement the CARD Act as soon as possible. The Act requires a fundamental change in the credit card marketplace, with consumers provided greater control over the terms and use of their card. Card issuers recognize that Congress has spoken, and that changes must come in how we interact with our customers.

However, while we understand that some members of this committee continue to express concern over actions taken by issuers in the marketplace, we believe that there are both strong practical and policy reasons for not adopting H.R. 3639. In short, we believe that its enactment will actually exacerbate the problems experienced by consumers, small businesses, and the broader economy in accessing reasonably priced credit.

In my testimony today, I would like to make three basic points:

First, full implementation of the provisions of the CARD Act is a practical impossibility. Implementation of that Act is an enormous task, requiring the complete reworking of internal operations, risk management models, funding calculations, employee training, and computer coding necessary to service hundreds of millions of accounts every day. To do this right requires an investment of hundreds of millions of dollars, thousands upon thousands of manpower hours, and perhaps, most importantly, sufficient time. The timeframe provided in H.R. 3639 is inadequate for the task at hand. The Federal Reserve just recently issued an 800-page proposal seeking public comment on provisions of the CARD Act. Comments are due in mid-November. There is not sufficient time for the Fed to review the comments, revise the rule to incorporate appropriate changes, issue a final rule before December 1st, and expect institutions to immediately change their systems to fully comply with the new rules by that December 1st date.

It becomes even more difficult when you consider that in some instances, proposed rules do not yet exist, and that technological solutions to the various challenges posed by the new rules will take time to develop.

Besides the practical hurdles of speeding up compliance, other negative consequences are likely. Thousands of small community banks that issue credit cards would be negatively impacted by the change. Retailers that offer private label cards in concert with major card issuers run the risk of system failures at the peak time of the holiday season. This is due to the inadequate time under the proposed bill to implement and test the systems changes required. This could mean significant lost sales for retailers at a time period where merchants typically receive 25 to 40 percent of their annual sales volume, not to mention the substantial customer confusion, anger, and loss of convenience that would be caused.

My second point is that the industry is very sensitive to the concerns that you, Mr. Chairman, Congresswoman Maloney, and others have raised over increased rates in the marketplace. The CARD Act includes a provision requiring 45-day advance notice for any rate increase, with the right for the consumer to say no. That provision has already been implemented and went into effect on August 20, 2009, nearly 2 months ago. Thus, consumers are already protected in this area.

My third and final point is this: The cumulative impact of six straight quarters of job losses is putting tremendous financial pressures on both individuals and financial institutions. Falling behind on debt payments is an unfortunate side effect of high unemployment and a frozen job market. Simply put, this has made for a very difficult lending environment, and the industry is experiencing significant losses. Lenders must take steps to mitigate risk, which has led to the price increases and credit line reductions that you have seen in the marketplace. To do otherwise would seriously compromise our ability to make loans in the future.

The requirements of the CARD Act that limit prudent risk management merely exacerbates the challenges presented by the economy. Moving up the effective date of that Act would increase the likelihood of systems failures, expensive litigation, and underwriting problems, adding to the pressure to increase rates and cut available credit. We believe that consumers, small businesses, and the U.S. economy will suffer if such a result comes to pass. Thank you for considering our views.

[The prepared statement of Mr. Clayton can be found on page 120 of the appendix.]

Mr. GREEN. Thank you.

Mr. McCracken, you are recognized for 5 minutes, sir.

STATEMENT OF TODD McCRACKEN, PRESIDENT, NATIONAL SMALL BUSINESS ASSOCIATION (NSBA)

Mr. MCCRACKEN. Thank you very much. I appreciate the opportunity to be here today. Again, my name is Todd McCracken. I am the president of the National Small Business Association, America's oldest small business advocacy organization.

When I testified before this committee's Subcommittee on Financial Institutions and Consumer Credit in March, I spoke at some length to the difficulties America's small business owners were encountering in their attempts to access credit. Unfortunately, the situation is little improved.

In its July 2009 quarterly Senior Loan Officer Opinion Survey, the U.S. Federal Reserve reported that over the previous 3 months, domestic banks continued to tighten standards and terms on all major types of loans to businesses and households. Banks also reported that they expected their lending standards across all loan categories to remain tighter than their average levels over the past decade until at least the second half of 2010.

Credit cards are now the most common source of financing for America's small business owners. According to our 2008 nationwide survey of small- and mid-sized businesses, 44 percent of small businesses identified credit cards as a source of financing that their company has used in the previous 12 months, more than any other source of financing, including business earnings.

The results of more recent internal surveys have been even more dramatic. When asked what types of financing their firms have used in the previous 12 months, 59 percent of the small businesses in 2009 identified credit cards. In 1993, only 16 percent of small business owners identified credit cards as a source of funding. And over a third of the respondents in the credit card survey also reported that a quarter or more of their overall debt financing was comprised of credit card debt.

In 2009, small business owners have experienced a litany of abuses and deteriorating credit terms unrelated to their past performances. Nearly 80 percent of the small business respondents to the credit card survey said that the terms of their cards have gotten worse in the last 5 years. Almost half of the respondents reported that they had encountered a credit card due date that seemed to change randomly. And 57 percent reported that they had received a bill too close to the due date to mail their payment in on time.

Furthermore, a quarter of the respondents reported that their interest rates increased between February and April 2009, while a third reported their credit limit had been reduced in the previous 6 months.

According to a recent article in the Wall Street Journal, credit card lines have been cut by over $1.25 trillion in the last 2 years, and 10 percent of all credit card accounts have been canceled. The same article asserts that lenders began reducing available credit by ZIP Code in the fourth quarter of 2007, and have been cutting inactive accounts, whether or not the customer viewed the account as a liquidity vehicle for the past 4 quarters.

While NSBA supports the expedited enactment of the protections contained in the Credit CARD Act, it also urges Congress and this committee to address two additional aspects of the credit card industry that urgently need reform. One is the absence of explicit protections for small business cards; and two is the secretive and uncompetitive interchange system.

The largest loophole, we believe, in the Credit CARD Act was the absence of the explicit protection for small business owners who use their cards for business purposes. Since the legislation amended the Truth in Lending Act, which, except for a few provisions, does not apply to business cards, its protections were limited to consumer credit cards. Although the credit cards of many, if not most, small business owners are based on the individual owner's personal credit history, it is conceivable that issuers could legally consider them exempt from the law's vital protections. Although in the past, issuers appear largely to have kept most of their cards in compliance with TILA, there is no guarantee this convention will continue, especially when one considers that its basis appears to have been practicality and not legal obligation. Since issuers were able to subject consumer cards to the most egregious of practices, there was little incentive to distinguish between consumer and small business cards.

An unintended consequence of the Credit CARD Act is that it could provide just such an incentive. Thankfully, legislation has been introduced that would correct this oversight and extend equal protection to the cards used by small business owners with 50 employees or fewer.

The Small Business Credit CARD Act of 2009 also contains an opt-out provision so that small business owners who do not want their cards protected in such a manner can choose to keep any current agreements.

H.R. 3457, this was the bill, is supported by a range of organizations from consumer groups to small business groups, and I respectfully request this committee consider this bipartisan, commonsense legislation as soon as possible.

I am going to submit my statement on interchange fees for the record—because I think you have dealt with that to a great extent today—and conclude.

If millions of small firms are going to be created during this recession, as they have been in previous recessions and economic downturns, then they are largely going to be financed with credit cards, given the current lending environment. Although credit cards are an inherently expensive and volatile source of financing for many entrepreneurs, they are also indispensable.

Congress can and must ensure, however, that they are not allowed to function simply as a mechanism with which to siphon capital from the backbone of the economy to the top 10 U.S. banks.

[The prepared statement of Mr. McCracken can be found on page 194 of the appendix.]

Mr. GREEN. Thank you, sir.

Mr. Demangone is now recognized for 5 minutes.

STATEMENT OF ANTHONY DEMANGONE, DIRECTOR OF REGULATORY COMPLIANCE/SENIOR COMPLIANCE COUNSEL, THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS (NAFCU)

Mr. DEMANGONE. Good afternoon. My name is Anthony Demangone, and I am the director of regulatory compliance at NAFCU and its senior compliance counsel. As the committee is well aware, there have been many recent changes to the Truth in Lending Act and Regulation Z over the past year-and-a-half. The Federal Reserve Board has taken numerous actions regarding credit card regulations, real estate lending, and student lending, among others.

Most recently, the Federal Reserve Board announced an 841-page proposal to implement provisions of the Credit CARD Act, set to go into effect February 22nd of next year.

In short, America's credit unions have been asked to handle a seemingly endless number of changes to the lending law. I fear these changes are being adopted with only larger commercial banks in mind.

I assure you, however, the resources of the credit union industry and other small institutions are being stretched to the limit. This challenge is further exacerbated by the short compliance deadlines included in the Credit CARD Act, deadlines made even shorter by the legislation this committee is examining today.

It is with this in mind that NAFCU strongly opposes the Expedited CARD Reform for Consumers Act. NAFCU understands that the Credit CARD Act was a response to a legitimate need to rein in unscrupulous credit card practices. Unfortunately, the measures targeting unscrupulous lenders created operational burdens for an entire industry. Simply put, credit unions will not be able to bring their systems into entire compliance by December 1st of this year.

The best argument against a shorter effective date is the unintended consequences of the 21-day provision included in the Credit CARD Act. This provision was intended to require lenders to send out credit card statements 21 days in advance of the payment due date for their credit card account. Unfortunately, the provision was drafted so that it applied to all open-ended consumer plans. This seemingly small issue proved to be a very substantial and costly problem for credit unions. It will likely lead to the end of credit unions issuing consolidated statements, the elimination of the ability to pick due dates, and weekly and biweekly payment dates will cease to exist for open-ended lending.

Simply put, the 21-day issue is the largest single compliance burden the credit union industry has faced in the last decade. More importantly, it is an issue that could have been resolved easily if not for the fact that the effective date followed so quickly after the bill was signed into law.

When Congress passes legislation, it dictates what must be done. Federal agencies and private industry, however, are responsible for determining how it gets done. Simply put, there needs to be sufficient time between when Congress decides what must be done and when industry is required to have their operational systems in place to accomplish that end.

Equally important is the fact that it would be virtually impossible for the Federal Reserve to promulgate regulations to meet the December 1st effective date. Moreover, even if the Fed could act in time, I assure you industry could not. We are currently digesting the 841-page proposal the Fed recently announced, which will implement the provisions set to go into effect February 22nd of next year. Many institutions will have difficulty modifying their operations to meet that date, much less a December 1st deadline. Given that compliance is factually impossible, there seems little reason to move the date forward.

Taken together, the CARD Act and the subsequent changes to Regulation Z will create significant changes in the credit card industry. It is customary, natural, and necessary for lenders to reconsider their own business plan and practices in light of such dramatic changes. Indeed, it would be irresponsible for management to carry on current practices without considering the long-term effect these changes will have on the market. Yet a shorter effective date will force many lenders to ignore or discount long-term planning for the simple reason that they must devote all of their time and energy to compliance.

The bill's provisions regarding increasing interest rates and changing terms makes sense when considered individually. However, they will dramatically change the way institutions conduct their conduct. An artificially short effective date, however, handcuffs senior management, and will make long-term strategic planning more difficult.

While we understand the committee's concerns with the abuses in the credit card industry, a December 1st effective date will do little to alleviate the problem. At the same time, an earlier effective date will exacerbate our operational problems, likely create new problems, and increase the overall cost of compliance for all lenders.

Thank you for the opportunity to provide our views on this important topic, and I am pleased to respond to any questions.

[The prepared statement of Mr. Demangone can be found on page 129 of the appendix.]

Mr. GREEN. Thank you, sir.

Mr. Bourke, 5 minutes.

STATEMENT OF NICK BOURKE, MANAGER, SAFE CREDIT CARDS PROJECT, THE PEW CHARITABLE TRUSTS

Mr. BOURKE. Thank you, Mr. Chairman. My name is Nick Bourke, and I am the manager of the Safe Credit Cards Project at the Pew Charitable Trusts. We are a nonprofit, nonpartisan organization dedicated to fact-based solutions to important public policy challenges, including safe and transparent credit cards.

In 2007, my project began studying the perceived dangers in credit cards. And one of the things that we did is we reached out to the industry, and we tried to find some voluntary market-based solutions, and we tried to find other solutions, including doing independent research. I am going to talk about some of our research here today. More results will be published later this month.

In 2008, the Federal Reserve made the legal determination that certain practices are unfair and deceptive. And one of the questions we had was, how widespread are these practices? So we looked at the application disclosures of all consumer credit cards offered online from the largest 12 issuers. This is a group that accounts for approximately 90 percent of the outstanding balances.

We did this research last December and we did it again this July. And our July study covered more than 350 credit cards from these issuers. We found several things, including that median advertised rates had gone up significantly, 13 to 20 percent, depending upon a consumer's credit profile. But that is not all.

The first point I would like to make today is that since the passage of the Credit CARD Act, the situation has not become better for consumers. For example, 97.7 percent of the cards that we reviewed included anytime/any-reason change in terms and policies, which allowed the issuer to change the agreements, including raise interest rates on outstanding balances. That is up from 93 percent in December.

Overall, more than 90 percent of the cards that we looked at contained the most troublesome, unfair, and deceptive practices in the Federal Reserve's review, low to high application of payments, so-called hair-trigger penalty repricing, and so on.

None, not one of the cards that we looked at would have met the Federal Reserve's fairness threshold, let alone met the Credit CARD Act. In fact, we saw some evidence that some issuers were moving in the opposite direction.

My second point is while issuers wait to remove these unfair and deceptive practices, or to implement the Credit CARD Act, American families are at risk of significant harm. I have heard a lot of concern in this chamber just today, asking what is the impact on consumers and how can they benefit?

Well, let's look at two of these practices. Anytime/any-reason changes in terms and penalty interest rate increases on outstanding balances: In our March 2009 report, we discussed how just these two practices cost consumers at least $10 billion in a 1-year period. That is more than $800 million per month. So it would seem that time is against consumers in this situation.

What does it mean to an individual? Well, let's assume that you have a $3,000 balance, a relatively modest balance. If an issuer decides to raise your rate by 5 percentage points, that is about $150 a year. But if they decide to raise your interest rate by about 15 percentage points, that is $450 per year. And 15-percentage point increases are all too common based on our research. And your monthly minimum payment is going to swell dramatically.

So in conclusion, our research supports accelerating the consumer protections in the Credit CARD Act. The Act will strengthen the agreements between cardholders and issuers, and it is designed to enhance transparency and fair dealing, which should make the market more competitive over time.

Now, I do want to take this opportunity to recognize that the long-term benefits of the Credit CARD Act will depend in large part on what the Federal Reserve does next, especially in its rule-making, to prevent unreasonable or disproportionate penalty fees and charges.

Whatever the effective date of the Credit CARD Act, it will be important to ensure that the Federal Reserve takes the time and the effort to enact strong consumer protections as well. And we have made some suggestions in that regard. Thank you very much.

[The prepared statement of Mr. Bourke can be found on page 59 of the appendix.]

Mr. GREEN. Thank you for the additional 50 seconds that you have yielded.

Mr. BOURKE. My pleasure.

Mr. GREEN. The gentleman, Mr. Watt, is recognized for 5 minutes.

Mr. WATT. I was kind of hoping you would go first, Mr. Chairman, so I could gather my thoughts.

First of all, I apologize for missing the first three testimonies. I was trying to get here because I always like to hear the testimony more than I like to hear the questions, really. It is generally more helpful.

I assume, Mr. Clayton, you disagree vigorously with what Mr. Bourke testified. Do you?

Mr. CLAYTON. It depends on which part you are talking about.

Mr. WATT. The part where he thinks either that these practices have gotten worse, or that we need to expedite the implementation of—

Mr. CLAYTON. We disagree with both.

Mr. WATT. Okay. And why?

Mr. CLAYTON. In terms of expediting, as I mentioned in my opening statement—and I apologize, and I will be glad to chat with you about it—it is impossible for us to comply with the moving up of the effective date of the provisions of the Act. This is a massive rewrite of the way we do business. We understand that Congress has spoken, and we understand that we have to change our ways.

Mr. WATT. If he is right that you are changing the terms and moving the target on your own, is it less difficult to do that than to change the targets in a direction that complies with the new statutory provisions that are coming online?

Mr. CLAYTON. Mr. Watt, we disagree with the statement that—

Mr. WATT. Okay. Well, maybe I should have gotten you to address that part of it first, then.

Mr. CLAYTON. Can I say quickly that Congress has already acted on the issue of interest rate increases and basically said, as of August 20th of this year, that consumers have to get 45 days advance notice, and they can say no to any rate increases. So we have heard the concerns about increased rates. The Congress has spoken and said you cannot do that, and they have given an implementation/transition period. And they have said if someone in the marketplace increases the rate, as alleged, the consumer can say no, they can close their account, and they can pay back their balance in a reasonable amount of time. So the problem that is being alleged isn't there anymore.

Are interest rates being increased? Yes. It is broadly a function of the marketplace and the economy and the significant number of unemployed people who are out there, and the fact that a lot of people aren't paying back their bills, and the only way we can loan in the future is to have people pay back their bills, and we have to deal with that. And so that is how the market is reacting.

Mr. WATT. I assume that nobody on this panel is dealing with interchange fees. Has that issue come up on this panel, or that was all of the last panel dealing with that? Nobody here is dealing with that? Okay. I won't ask any questions about it. We beat that horse to death in the last panel.

Okay. I am sure I could be more constructive if I had heard the testimony or if I had read the testimony, either one, both of which I confess to not having done. So I think, constructively, I will just yield back to the gentleman who heard the testimony. I will yield him the balance of my time.

Mr. GREEN. Your time will be put to good use. Thank you, Mr. Chairman.

We will now hear from Mr. Cleaver for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman.

I do want to bring up interchange fees because I think there is a connection. I am wondering about the coincidence that the interchange fees are rising so dramatically now at the same time that we are closing in on the deadline for the new credit card law coming into effect. I am sure you were here earlier, so you heard the exchange with the representative from the bank. I talked about overdraft fees reaching $24 billion, which is up 35 percent from the previous year.

Are all of you saying that is just coincidental? Will anybody say it is coincidental?

Mr. MCCRACKEN. I am not sure there is a strong connection. We think the interchange fees need to be looked at, and it does create a difficult situation for a lot of small companies, especially small retailers. They can't control the prices, they are deeply frustrated by it, and we think the system needs to change.

I don't see a significant connection because this has been building for some time now with interchange fees. I don't see something that has happened in the last 6 months.

Mr. CLEAVER. Well, I am just basing this on the FDIC study. I didn't just pull that figure up. It was a 35 percent increase?

Mr. MCCRACKEN. Well, if you are talking about a 35 percent increase in—one of the things that you have seen happening is more people are using cards increasingly—

Mr. CLEAVER. Debit cards?

Mr. MCCRACKEN. Debit cards, and we have seen, of course, the trend in the increasing use of credit cards for a long time. It has been a steady rise. But you have mentioned and all of us mentioned before the increase in overdraft fees. And that I think also is directly tied to the increasing use of debit cards over credit cards.

Mr. CLAYTON. Mr. Cleaver, can I jump in for a second?

Mr. CLEAVER. Yes.

Mr. CLAYTON. I want to be clear here. Interchange fees are not going up. The aggregate amount of fees taken in because of interchange has increased because—

Mr. CLEAVER. I understand that. It is about 2 percent, 175 of which probably is the interchange fee.

Mr. CLAYTON. That is credit cards. For debit cards, it is below 1 percent. That is different from overdrafts. I just wanted to be clear.

Mr. CLEAVER. I understand that. What I want to do is make sure that I am wrong, that there is no coincidence.

Mr. DEMANGONE. Sir, speaking on behalf of Federal credit unions, I can say there is no correlation to any increases in fee income with regard to overdraft protection and the changes that were in the Credit CARD Act. Those are separate.

I would like to point out that our entire industry has been dealing with the overdraft issue. The Federal Reserve and the NCUA were working on this as far back as 2005, giving best practices on ways to better implement these plans more transparently. And the Federal Reserve has a proposal out there which will take effect sometime in 2010 which will greatly give consumers the ability to either opt in or opt out of overdraft protection programs. So the regulators have really taken this issue up strongly. And I think if things would just be allowed to play out as they are, I think you will see consumers are already on track to gain a lot of new benefits and rights in the coming year just from the existing regulations that are about to be implemented.

Mr. CLEAVER. Okay. Since you brought up the issue of regulations, I think all of you would agree I think that—or maybe I should ask whether or not you think you should be able to impose on consumers rules that are unfair or deceptive or anticompetitive.

Mr. DEMANGONE. I can obviously say, no, we don't think any unfair, deceptive rules should be placed on members. As member-owned financial institutions, a lot of the problems that you have heard, people keep talking about the top 10 credit card lenders, I guarantee you there is not a Federal Credit Union that is one of them. We have a usury ceiling of 18 percent. We have a prohibition against prepayment penalties. So it is frustrating for us as an industry to sometimes be painted with a broad brush. People point to the big credit card lenders—

Mr. CLEAVER. I don't want to do that. So everybody would agree that you do not want the ability to impose rules that are unfair or deceptive or anticompetitive; everybody agrees? Okay. So then why won't you support giving a regulatory body the authority to review rules that you already comply with?

Mr. DEMANGONE. Ultimately, I think what it is going to do is it is like adding another referee to the football game. We are going to have to pay for that referee's salaries. Ultimately, it is going to increase compliance costs for each Federal credit union. And who bears those costs ultimately? The member owners.

The Federal Reserve and NCUA we think already do a commendable job of enforcing actions. Are they perfect? No. And I think you will see them redouble their efforts in the years and months moving forward, but just to create a brand new agency, thinking that just another agency is going to protect consumers, I think there is a risk that it will be completely the opposite. Federal credit unions may move out of—

Mr. CLEAVER. I know. But you already comply with the things that would be regulated.

Mr. DEMANGONE. But if it applies to credit unions and there is another layer of examinations, that will greatly increase their compliance costs. It will be another examination that we have to prepare for, deal with, and that ultimately costs dollars in personnel and lost time, and ultimately member owners will bear those costs.

Mr. CLEAVER. Thank you, Mr. Chairman.

Mr. GREEN. Ms. Susswein, you were interrupted, and I apologized to you, and you haven't had an opportunity to speak, so I would like to accord you some of my time. I have about 5 minutes, so I would like to accord you some of my time to finish your statement.

If you could, please leave just enough for me to ask one question, please.

Ms. SUSSWEIN. Thank you, and thank you for your time.

I really just wanted to make a couple of final points. One was that we think that, frankly, lenders have taken advantage of Congress' generous timeframe in which to implement the law. Lawmakers accommodated card issuers who claimed that they needed time to reprogram computer systems. And we understand it is complex, but issuers have used the time to use consumers as pawns in their game to maximize profits.

If card issuers allocate payments right now from the lowest rate to the highest rate, my question is, why do they need 9 months to reverse that practice? That is a huge benefit to consumers, and one that wouldn't seem to take so long.

There are elements to this legislation, as we understand it, that won't really be put into practice actually until August, 15 months after enactment. That seems to be an enormous amount of time. And we see the kind of damage that has been inflicted that I discussed earlier in my testimony to consumers.

The main point we want to say is that we strongly support implementation of this credit card law as soon as possible. December 1st sounds just fine to us. Consumers need the assistance now. Consumers have cried out to Congress over time saying that what we need is help in limiting some of these practices and curbing some of these abusive tactics. Congress heard us and enacted the Credit CARD Act, and we feel that it is time to move it up and to be able to take advantage of those protections.

Lastly, I just want to point out that while Mr. Clayton may feel that the problem is solved, from a consumer's perspective, having an opt-out is an excellent tool and we are very pleased to have it. But if we were all to opt out of every card we have because of its abusive practices, we wouldn't have any credit as consumers, and companies would be out of business because they wouldn't have anyone to lend to.

Mr. GREEN. Thank you.

Mr. Demangone, you indicated by way of gesture that you would like to respond to that, very briefly.

Mr. DEMANGONE. Well, the issue of how you process payments is not all that complicated, and it is something that could be done rather quickly, but I would say that is probably one of 2,000 issues that lenders need to deal with within the Credit CARD Act and subsequent regulations. It is kind of a death by a thousand blows.

Fee structuring and disclosures need to be changed, periodic statements need to be reworked. There are so many operational issues that credit unions need to rely on third parties. Those third parties have indicated to us, the individuals who would be responsible for doing this, that they can't actually make the operational changes necessary just for the periodic statements.

Just yesterday, I spent literally 3½ hours with a credit union dealing with their rate and fee schedule trying to interpret 2 sections of the HOEPA rules which became effective October 1st. Every aspect of lending in a financial institution is being amended right now, so they need all the time they can to comply with RESPA, Truth in Lending, HOEPA, MDIA, all those requirements that are coming together all at once.

Mr. GREEN. Mr. Bourke, you have indicated by way of gesture that you would like to respond. As briefly as possible, please.

Mr. BOURKE. Thank you, Mr. Chairman.

The low to high application of payments rule is one of the biggest aspects of this bill in terms of what it will save consumers. I would argue that probably the biggest aspect of this bill, the most important one for consumers, is stopping the practice of increasing interest rates on outstanding balances. And even though we do have new disclosure rules and right-to-cancel rules in place as of August, the core of the bill, the part that prevents issuers from raising interest rates on outstanding balances and really giving the consumers the benefit of the bargain that they already made isn't going to take effect until February. And between those two issues, outstanding balances and application of payments, those are probably the biggest money-saving components for consumers.

Mr. GREEN. Thank you. My question, quickly, will be a follow-up on what you said, Mr. Bourke, and follow-up to what Mr. Cleaver broached, and it is, are you convinced that all of this is coincidental with reference to the interest rate question that you just raised? Is it coincidental? That was the essence of what Mr. Cleaver was asking. If you think that it is coincidental, kindly extend a hand into the air so that I may see—

Mr. BOURKE. I am sorry?

Mr. GREEN. If you think the raising of the interest rates is coincidental, kindly raise a hand into the air.

Mr. CLAYTON. I know I am not allowed to rephrase the question—

Mr. GREEN. My time is up, but I would like to at least get the answer, if you would. If it is coincidental that interest rates going up at this time, to the extent that they have, it just happens to work this way, it has nothing to do with the fact that there are some rules that will be taking effect later on in the year, in fact, that would be February 22, 2010. Hands, please.

If not, I will indicate for the record that everyone on the panel thinks that it is not coincidental. We do have one.

Mr. CLAYTON. Mr. Green, I would like to add something into an explanation to that question, if you would like.

Mr. GREEN. What I will have to ask you to do is submit it for the record in writing if you would.

Our time has expired. And the Chair will note that some members may have additional questions for the panel, this panel as well as the others, which may be submitted in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

The hearing is now adjourned.

[Whereupon, at 1:45 p.m., the hearing was adjourned.]

A P P E N D I X

October 8, 2009

Opening Statement

Honorable Maxine Waters, D-35th CA

Financial Services Committee Hearing on

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

October 8, 2009

Room 2128, Rayburn Building

10:00 a.m.

Thank you, Mr. Chairman and thank you for arranging this hearing. We are in the midst a recession, one that is battering consumers and crippling small businesses. Many merchants are seeing their credit being cut and their revenues being reduced. These businesspersons are working as hard as possible to control their costs and keep their companies operating.

One cost businesses cannot control, however, is interchange fees. These fees, which are paid to banks and credit card networks such as Visa and Mastercard, are charged to merchants every time a consumer uses a credit card.

Interchange fees started as a business expense, but have grown into a $50 billion revenue stream for banks and credit card networks alike. At the same time, local businesses have seen their profits nose dive. Interchange fees have become one of the highest costs of business, and currently exceed the amount that retailers spend on energy and health care costs.

Congress needs to address how the principles of fairness and consumer protection are practiced, and how we balance the interests of private business needs against overly burdensome fees. Merchants and small businesses everywhere need our help.

Today's hearing will also address a problem that has surfaced since we passed the Credit CARD Act into law. In anticipation of tougher consumer protection standards, some banks such as Wells Fargo, have publicly announced plans to penalize consumers by raising their interest rates before the Credit CARD law can go into effect. Pushing this law's effective date up to December will end these practices.

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

STATEMENT OF CONGRESSMAN BILL SHUSTER

BEFORE THE HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES

CREDIT CARD OVERHAUL AND H.R. 2382, THE CREDIT CARD INTERCHANGE FEE ACT

OCTOBER 8, 2009

Thank you Chairman Frank, Ranking Member Bachus, and members of the Committee for allowing me to share information on this very important topic of interchange fees. I would also like to thank Congressman Welch for his leadership on this issue.

I believe action is needed to help level the playing field between consumers, small businesses, and credit card companies by requiring greater transparency and prohibiting unfair and abusive practices when it comes to interchange fees.

Last summer's dramatic rise in gas prices was a prime example of inflexibility by credit card companies towards merchants and consumers over the interchange fee. As fuel purchases rose above authorized transaction limits, major card companies reserved the right to repay gasoline merchants a lower price than was actually purchased, particularly on smaller transactions.

I joined with Congressman Welch to introduce H.R. 2382, to curb this type of practice. This legislation focuses heavily on transparency in the hopes of determining whether credit card companies are pursuing anti-competitive practices. It makes Interchange Fees subject to full disclosure and terms and conditions set by credit card companies easily accessible by consumers. It would also prohibit profits from Interchange Fees from being used to subsidize credit card rewards programs. Small businesses, and ultimately consumers, should not be financing perks of luxury card holders.

To put the impact of Interchange Fees into the perspective of a business take, consider the convenience store chain Sheetz as a real life example. The Sheetz Corporation, which has 363 stores in 6 states, is headquartered in my congressional district. Last year, Sheetz paid twice as much in interchange fees as they took in net income after tax. Their second largest expense, after payroll, is the interchange fee. This means that for Sheetz, the interchange fee eclipses the company's cost of rent for their 363 stores; and the interchange fee is one and a half times the cost of providing health care to their nearly 13,000 employees.

Sheetz is not alone. Sadly, it is joined by thousands of businesses across the country who are being unfairly penalized through interchange fees. Something must be done and I believe H.R. 2382 is the right vehicle for change.

Mr. Chairman, Members of the Committee, I hope you will consider the merits of this bill, as well as the serious struggle of business owners and their need for transparency, simplicity, and fairness when it comes to the issue of Interchange Fees. Thank you for having me here today.

Statement of Congressman Peter Welch on H.R. 2382 before the

House Financial Services Committee

October 8, 2009

Mr. Chairman and members of the Financial Services Committee, thank you for the opportunity to testify on credit card interchange legislation that I introduced with Congressman Bill Shuster from Pennsylvania.

Credit cards are necessary in today's economy. They provide a great service to merchants in the form of secure payment. They provide a great service to consumers in terms of convenience. And it's reasonable to expect that merchants pay a fair fee for this service, just as consumers should pay a reasonable interest rate on credit.

But just as with credit cards issued to consumers, the near monopoly of big banks and credit card companies leads to abuse. The amount of interchange collected by big banks tripled from 2001 to 2008. Credit card companies and big banks are finding more and more ways to squeeze merchants, for whom the profit on an individual sale can be completely canceled out by the cost of the burdensome interchange fee.

The Welch-Shuster bill addresses these abusive interchange practices. Our bill raises some fundamental policy questions that you, as members of the Financial Services Committee, must decide.

- Should credit card companies and banks have to disclose information about interchange rates? My view is yes; our bill would require such disclosure to the public.

- Should merchants be able to freely advertise cash discounts without credit card company intervention? My view is yes; our bill would ensure merchants have this freedom.

- Should merchants have to subsidize rewards or premium credit cards from which they derive no benefit? My view is no; our bill would prohibit this practice. If a bank or credit card company wants to offer me airline miles, for example, my corner store shouldn't have to pay for that.

- Should the government be able to set rules of the road and require the banks and credit card companies to play fair? My view is yes, and that is why this bill empowers the Federal Trade Commission to prohibit unfair or anticompetitive practices.

Mr. Chairman, what is at issue here is a question of basic fairness and reasonable regulation of credit card and large bank practices. Thank you for the opportunity to testify on this issue. I welcome your questions or comments.

Testimony of Nick Bourke, Manager of the Safe Credit Cards Project at The Pew Charitable Trusts, Regarding HR 3639.

Chairman Frank, Ranking Member Bachus and Members of the Committee:

Thank you for the opportunity to offer comments on H.R. 3639, the Expedited CARD Reform for Consumers Act of 2009. My name is Nick Bourke and I am the manager of the Safe Credit Cards Project at The Pew Charitable Trusts.

Pew is a non-profit, non-partisan research and advocacy organization. My project is part of the Pew Health Group, and one of our key goals is promoting fact-based solutions to important public policy challenges, such as the safety and transparency of consumer financial products.

I have been with Pew working on consumer credit card issues for nearly two and a half years. Before joining Pew I served as a product manager, marketing specialist, strategy consultant and legal advisor serving financial and high tech companies, including in the electronic payments space.

The Pew Safe Credit Cards Project began in early 2007 with a mandate to research perceived dangers associated with consumer credit cards and pursue strategies for making cards safer. Originally, we focused on developing a voluntary, market-based certification program based on a set of safety standards that Pew would establish. Led by a former credit card company CEO, we engaged consumer groups and credit card businesses alike over the course of many months. Our Safe Credit Card Standards are one of the products of that effort.

Over time, we shifted our focus to policy-based reforms, including the Credit CARD Act. Though I am proud to say that we established relationships with many in the industry who were receptive to our work, what we ultimately heard is that the industry would not change significantly unless the government stepped in to establish a level playing field that would foster fair competition based on transparent pricing – which has led us to where we are today.

SUMMARY

What We Studied

Last year, the Federal Reserve determined that certain credit card practices were "unfair or deceptive," and in some cases "harmful."[1] The Pew Charitable Trusts conducted research to identify how widespread these practices are in the market, and to analyze the impact to American consumers. In December of last year, and again in July of this year, we analyzed the application disclosures for all consumer credit cards offered online by the largest 12 credit card issuers – a group that controls more than 90 percent of all credit card debt in America. Our July sample included nearly 400 credit cards.

[1] See: Board of Governors of the Federal Reserve System, Office of Thrift Supervision, Treasury and National Credit Union Administration, "Unfair or Deceptive Acts or Practices," 74 FR 18 (January 29, 2009) at p. 5498 et. seq.

One finding from our research is that between December 2008 and July 2009, before any part of the Credit CARD Act had taken effect, the top 12 banks raised advertised interest rates significantly. In July, median advertised annual percentage rates (APRs) for purchases were between 12.24 and 17.99 percent – or 13 to 20 percent higher compared to last December. (Banks typically advertise a range of rates, with the lowest advertised rates reserved for cardholders with better credit profiles).[2]

More findings from our latest research are discussed below, and we will include additional detail in a report scheduled for publication later in October.

Key Points

Higher rates were not the only bad news cardholders had to contend with. In my testimony today I shall attempt to convey three key messages:

1. **Since passage of the Credit CARD Act, the situation has only become worse for cardholders. Americans remained exposed to widespread practices that the Federal Reserve deemed "unfair and deceptive," and a variety of hefty penalty charges.**

   The Credit CARD Act of 2009 includes many important new consumer protections that are not currently scheduled to take effect until 2010. Until then, banks may continue to raise rates on outstanding balances, impose what the Federal Reserve called "hair trigger" penalty repricing, apply payments in a way that maximizes interest costs and charge unrestricted overlimit fees.

   Our latest research shows that practices labeled "unfair or deceptive" by the Federal Reserve – practices at the core of the consumer protections provided in Title I of the Credit CARD Act – remain widespread, with some policies worsening since our December 2008 study.

2. **While issuers wait to remove these "unfair or deceptive" practices or implement the Credit CARD Act, American families are at risk of significant harm.**

   Many practices, particularly penalty rate increases, can add hundreds or even thousands of dollars in costs per year. These costs are not reflected in advertised interest rates, and when imposed can drastically increase the amount of a cardholder's minimum payment due.

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[2] Advertised rates are not the only rates that have been rising lately, as issuers have exercised their contractual powers to raise interest rates on existing balances too. In a one-year period between 2007 and 2008, issuers used their powers to raise interest rates on nearly one quarter of all existing cardholder accounts, or approximately 70 million accounts. See: Ireland, Oliver, Letter to the Federal Reserve, et. al. (Morrison & Foerster LLP, August 7, 2008), at Exhibit 6, Tables 1a and 3a (based on data from Argus; totaling percentage of accounts repriced for penalty or change in terms reasons from March 2007 through February 2008, a total of 22.3 percent of all accounts). Note that these figures may include a number of accounts which entered penalty status or were repriced more than once during the period (this number is not determinable from the data presented). The letter is available at http://files.ots.treas.gov/comments/bdc5cc5c-1e0b-8562-eb23-ff7159e49505.pdf. Overall, we estimate that 70 million accounts were affected based on approximately 315 million total active credit card accounts in 2007 (Nilson Report, Issue 902, May 2008).

3. **Accelerating the effective date of the Credit CARD Act will help Americans quickly; but the long-term benefits will depend on how well the Federal Reserve seizes its mandate to protect consumers from unreasonable or disproportionate penalty fees and charges.**

   The sooner the Credit CARD Act takes effect, the sooner a host of "unfair or deceptive" practices will be eliminated from the list of financial dangers threatening American households. How much the law benefits consumers over time will depend to a large degree on the actions the Federal Reserve takes to enforce it – especially with regard to ensuring reasonable and proportional penalty fees and charges. We have provided several suggestions.

MAIN COMMENTS

1. **Since passage of the Credit CARD Act, the situation has only become worse for cardholders. Americans remained exposed to widespread practices that the Federal Reserve deemed "unfair and deceptive," and a variety of hefty penalty charges.**

"Unfair or Deceptive" Practices Remained Widespread in the Market

The Credit CARD Act became law in spring of this year, paving the way for important new consumer protections. Unfortunately, most parts of the new law will not take effect until 2010,[3] and Pew's research shows that the situation has only become worse for American credit cardholders.

At-will interest rate increases on outstanding balances, so-called "hair trigger" penalty repricing, application of payments policies that maximized interest charges to cardholders – these practices were all part of the vast majority of credit cards offered by the largest banks last December, and they still are today.[4] Based on our July research:

- 97.7 percent of cards allowed issuers to raise any interest rate at any time (even on outstanding balances) by changing the account agreement – up from 93 percent in December.

[3] Most consumer protections under Title I of the Credit CARD Act of 2009 are scheduled to take effect on February 22, 2010. These include the general prohibition of retroactive rate increases (with few exceptions) and double cycle billing, overlimit fee safeguards such as requiring specific consumer opt-in before the fee may apply, and requiring payments beyond the minimum payment due to be applied first to high-rate balances. Some protections have already become effective (advance notice and notice of right to cancel requirements). Other protections will not become effective until August 22, 2010, including "reasonable and proportional" penalty fee and charges rules, and requiring issuers to have policies allowing for the reduction of interest rates following interest rate increases that are predicated on risk factors. See: Pub. L. 111-24.

[4] The research discussed in this testimony is primarily based on our July 2009 review of credit cards. Since July, we have sampled additional card disclosures periodically. We continue to find that issuers have not discontinued the use of these and other practices that are the subject of recent Federal Reserve rulemaking and the Credit CARD Act.

- 90 percent of bank cards included penalty rate increases that could apply automatically to all balances. All but 10 percent of these cards had "hair trigger" repricing terms per Federal Reserve guidelines (triggers of one or two late payments in 12 months).

- 95 percent of cards allowed the issuer to apply payments in a "low-to-high" manner that would violate the requirements of the Credit CARD Act and that were, in the Federal Reserve's judgment, likely to cause substantial monetary injury to consumers. (The remaining five percent did not disclose the issuer's policy).

Altogether, 90 percent of the cards from the largest 12 issuers contained all three of the practices just mentioned. None – not one – of the cards would have met the Federal Reserve's December 2008 final rules against "unfair or deceptive" acts or practices, let alone the requirements of the Credit CARD Act. In fact, we have seen evidence that issuers have been changing their products in ways that would contravene the Act's requirements, or even exploit potential loopholes.

New Trend: Partially variable rates with fixed minimum rate requirements.

For example, a new trend is emerging as bank issuers moved away from fixed fee cards.[5] Many more cards now feature partially variable interest rates that may increase based on an index rate but cannot decrease below a fixed minimum set by the issuer. As of July, partially variable rates with fixed minimum requirement were present on only a minority of cards (about 10 percent of purchase rates and about 40 percent of cash advance rates included the feature). But these numbers were up sharply compared to December.

We have encouraged the Federal Reserve to scrutinize cards with partial variable rates carefully for compliance with the Credit CARD Act. In sum, we urged the Board to rule that cards with partially variable rates are not "variable rates" under the Credit CARD Act and are not entitled to exceptions under the act allowing issuers to raise rates on outstanding balances or avoid the Act's 45-day and right to cancel notice requirements. Our rationale is included in comments we submitted to the Federal Reserve in September of this year, a copy of which is attached to this testimony.

More About Partial Variable Rate Cards with Fixed Minimum Rate Requirements

Our specific comments to the Federal Reserve may be summarized as follows:

- The Federal Reserve should rule that card accounts with variable rates including fixed minimum rate requirements are not eligible for the variable rate exception to the general ban on retroactive rate increases.

[5] Nearly one third of bank cards in our December 2008 study included "fixed" rates, versus less than one percent in July. On credit card products, the term "fixed rate" has meant that rates will not fluctuate according to a third party index rate. However, it has not meant that the rate cannot change, as almost all cards came with caveats that gave issuers the right to change outstanding rates at any time for any reason.

- For similar reasons, the Federal Reserve should enforce the Credit CARD Act's 45-day notice and right to cancel rules on card accounts with minimum rate requirements.

As you know, Section 101(b) of the Credit CARD Act will generally prohibit issuers from raising rates on outstanding balances. Cards with variable rates, which operate according to an index not under the issuer's control, are exempted – meaning their rates can fluctuate up or down as the index moves. The variable rate exception also exempts issuers from Section 101(a) 45-day notice and notice of right to cancel requirements. However, cards featuring this new "partial variable rate" should not qualify for the exception, for at least three reasons:

- First, these partial variable rate accounts do not provide for changes "according to operation of an index."

- Furthermore, by placing a minimum fixed floor against which the index cannot operate, the issuer has exercised control over the index in a way that violates the law's requirement.

- Finally, accounts with minimum rate requirements do not justify an exception allowing rate increases on outstanding balances because they allow issuers to expose cardholders to risk of higher rates if the index rises while limiting cardholders' ability to benefit if the index falls

Our September 21, 2009 comments to the Federal Reserve Board (attached) provide more information about partial variable rate cards and also outline arguments for requiring issuers to send advance notice of changes and notice of rights to reject and cancel as required by the Credit CARD Act.

Penalty Fees and Charges Remained Substantial

The Credit CARD Act will require any penalty fee or charge to be "reasonable and proportional" to a cardholder's "acts or omissions" according to rules to be prescribed by the Federal Reserve. Meanwhile, our research showed that credit card penalties remained substantial, with potentially drastic penalty rate increases applying indefinitely even for relatively minor transgressions.

Penalty Fees

Based on our July 2009 analysis of all consumer credit cards offered online by the largest 12 issuers:

- 99 percent of bank cards included a late fee. The median fee was $39. Late fees could apply as soon as the due date passed.

- 80 percent of bank cards included an overlimit fee. The median fee was $39. None of the application disclosures we reviewed limited overlimit fees to once per billing cycle, nor gave the consumer any option to opt-in or opt-out.

Penalty Rate Increases

In addition to these penalty fees, penalty rate increases could also apply, instantly raising rates on all balances including outstanding balances. The Credit CARD Act will eventually create strong new protections against disproportionate and hair-trigger penalty interest rate increases; for example, the only allowable penalty rate trigger will be a serious delinquency of 60 days past due. Until then, Americans remain widely at risk of these harmful practices. Based on our July research:

- All of the largest 12 bank issuers used automatic penalty rate provisions, including on outstanding balances. 90 percent of their cards included penalty rates.

- Among this subset of bank cards that included penalty rates:

    - 51 percent of penalty rates could be triggered after a single late payment and most of the rest (39 percent) could be triggered upon missing a second late payment in a 12-month period – meaning 89 percent of bank penalty triggers qualified as "hair trigger" repricing per the Federal Reserve.[6]

    - 80 percent of bank penalty rates could be triggered by one or more overlimit transaction, a practice the Credit CARD Act will prohibit.

- The median penalty rate was 28.99 percent. That penalty would add between 11 and 16.75 percentage points on top of median advertised purchase rates, more than doubling the non-penalty rate for many cardholders.

    - Our Safe Credit Card Standards call for a maximum seven-point premium over the standard non-penalty rates of interest.[7]

- Almost 90 percent of penalty rate terms provided no cure period to restore the original non-penalty interest rates – meaning issuers had the right to penalize cardholders indefinitely even after they returned to perfect payment behavior.

    - Our Safe Credit Card Standards call for a rolling six-month cure period that would apply whenever a cardholders makes six consecutive on-time payments, regardless of when that repayment begins.[8]

Since we completed our review in July, we have continued to monitor cards in the market. Though some issuers, such as American Express and Discover, have recently announced that they will remove overlimit fees entirely from their cards,[9] there remains little movement toward implementing the core consumer protections found in Title I of the Credit CARD Act.

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[6] 74 FR 18 (January 29, 2009) at p. 5527.
[7] The Safe Credit Card Standards and related information are available at www.pewtrusts.org/creditcards.
[8] Note that the Credit CARD Act requires issuers to provide a 6-month cure period for penalty interest rates, but only if the cardholder resumes on-time payment *immediately* when the penalty rate is imposed.
[9] e.g. Aspan, Maria. "Law Hits Home as Cards Opt out of Overlimit Fees", American Banker, August 10, 2009.

2. While issuers wait to remove these "unfair or deceptive" practices or implement the Credit CARD Act, American families are at risk of significant harm.

For consumers, there are significant costs associated with the practices that have remained in place but will be prohibited once the Credit CARD Act takes effect. To illustrate these costs, I have outlined a number of scenarios below.

Unless otherwise noted, I take for an example an account with a competitive 14 percent purchase rate of interest and a relatively modest balance of $3,000. I believe that a 14 percent annual percent rate (APR) is a conservative estimate because it is close to the median lowest advertised rate in our sample (12.24 percent) and lower than the "average credit card rate" currently reported on online credit card aggregator sites.[10] *Similarly, I propose that a $3,000 balance is a modest example given that it equals the median family credit card debt and is far lower than the average family credit card debt of $7,300.*[11] *Other estimates have shown significantly higher levels of average credit card debt.*

In the examples below, interest is calculated assuming an average daily balance across the whole year. Monthly required minimum payments are estimated.[12]

Impact of Penalty Fees

The median late fee was $39. Even in cases where the amount of the fee was tiered based on account balance, the maximum fee of $39 typically applied to any account with a balance of $250 or more – i.e., most accounts. All late fees in our study could apply immediately once an account became past due by any amount of time.

Similarly, the median overlimit fee was $39 and could apply regardless of the amount by which the account had exceeded its credit limit. There was no evidence of any opt-in or opt-out programs to give cardholders the choice to be subject to the fee, let alone to having their accounts exceed the credit limit. In other words, whenever issuers received an authorization request for a transaction, they did not have to alert the cardholder that completing the transaction would incur a fee, and it was in the issuer's sole control whether the overlimit transaction plus accompanying fee would be approved.

As demonstrated below, a $39 fee may represent only a small portion of most overall account balances, but it can create significant cash flow issues for cardholders by drastically increasing the amount of the monthly minimum payment due. In the future, whether a fee is reasonable and proportional should depend on an analysis of its relationship to the minimum payment due.

Impact of Penalty Interest Rate Increases

[10] See, e.g., www.indexcreditcards.com (15.39% average credit card rate reported week of October 5, 2009).
[11] Bucks, Brian et. al., "Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances," (Board of Governors of the Federal Reserve, February 2009).
[12] Calculation: Balance * (APR/12) + Balance * 1 percent principal reduction + current fees = Minimum Payment Due.

Currently, when a penalty interest rate is triggered it automatically applies to all balances, including outstanding balances. As noted above, the median penalty interest rate from our July 2009 study was 28.99 percent. The table below shows the impact when a sample account with a 14 percent standard non-penalty interest rate is penalty repriced to 28.99 percent.

For an account with a non-penalty rate of 14% that is triggered to a penalty of 28.99%

If the average daily balance is:	Then the extra penalty interest each year is:	And the extra monthly interest payment is:
$1,000	$150	$12
$3,000	$450	$37
$7,000	$1,049	$87
$10,000	$1,499	$125
$15,000	$2,249	$187

Summing All the Penalties Up

Penalties can be overlapping – e.g., a late payment can trigger a late fee plus a penalty interest rate. For our sample account with a 14 percent non-penalty interest rate and a $3,000 balance, here is how overlapping penalties can drastically affect the monthly minimum payment due:

Base (non-penalty) monthly minimum required payment:	$65
Late Fee	+ $39 [+ 60 %]
Extra required payment due to penalty interest charges	+ $37 [+ 57 %]
TOTAL:	**$141 [+ 117 %]**

For more than half of all consumer cards from the largest 12 issuers in our study, this penalty could result from missing a single late payment by a single day.

While I have focused here on penalty fees and charges, consumers are also paying significant costs due to current policies such as low-to-high application of payments, at-will change repricing of existing balances, and other practices that will remain legal until the Credit CARD Act takes effect.

3. **Accelerating the effective date of the Credit CARD Act will help Americans quickly; but the long-term benefits will depend on how well the Federal Reserve seizes its mandate to protect consumers from unreasonable or disproportionate penalty fees and charges.**

The sooner the Credit CARD Act takes effect, the sooner "unfair or deceptive" practices may be eliminated from the list of most pressing dangers to American household finances. How much the law benefits consumers over time will depend to a large degree on the actions regulators, especially the Federal Reserve, take to enforce it.

One of the most important rulemaking responsibilities given to the Federal Reserve Board under the Credit CARD Act is ensuring that any penalty fee or charge is "reasonable and proportional" to the "omission or violation" to which the penalty relates. Currently, the Federal Reserve is responsible for creating rules to implement this "reasonable and proportional" requirement by August 2010.

Suggestions at a Glance – Federal Reserve "Reasonable and Proportional" Rules

Pew's June 25, 2009 comments to the Board suggested guidelines for "reasonable and proportional" penalty fees.[13] Below, I summarize these comments. A full copy of our letter to the Board is attached.

The Board should regulate penalty rate increases under its reasonable and proportional rules.

The Credit CARD Act outlaws any unreasonable or disproportionate "penalty fee or charge." Penalty rate increase apply as a punishment when cardholders fail to pay on time. Even under the Act, many consumers will be left at risk of drastic and/or indefinite penalty charges – even after they resume perfect on-time payment behavior. Without strong rules covering penalty interest rate increases from the Federal Reserve, American consumers will remain subject to many unreasonable or disproportionate credit card penalties.

Penalty rates should not be more than seven percentage points above non-penalty interest rates under the Board's "reasonable and proportional" rules

Regulatory review should consider how severely penalty rate increases impact the amount of the *monthly minimum payment due*. Prevailing penalties can add substantially to the cost of a cardholder's required minimum payment. For example, assuming a modest balance of $3,000 (median household credit card debt) and a base interest rate of 14 percent, a 28.99 percent penalty rate would cause the monthly minimum payment due to increase by approximately 65 percent and add over $400 per year in penalty interest costs (this example is demonstrated earlier in this testimony).

By comparison, our recommended maximum seven-point penalty premium would add only 28 percent to the required minimum payment, greatly reducing the risk of insurmountable price shocks to the consumer while still allowing issuers to generate

[13] Bourke, Nick, "Reasonable and Proportional Rules under Credit CARD Act of 2009 (Pub L. 111-24)" (The Pew Charitable Trusts, June 25, 2009). Available at: www.pewtrusts.org/news_room_detail.aspx?id=53840.

millions of dollars of additional revenue to compensate for any marginal costs of delinquencies.[14]

The Board's rules should ensure that cardholders have a guaranteed right to return to non-penalty rates of interest whenever they resume on-time payments for six months.

The Credit CARD Act provides a *partial* right to cure, guaranteeing a right to return to non-penalty rates but only for cardholders who pay on-time during the first six months after the penalty begins to apply. With just a partial cure in place, penalty rates could apply indefinitely, even permanently, for anyone who pays on-time for six months but does not begin doing so immediately when the penalty rate is triggered. This partial cure establishes in law the concept of a pathway back to the original rate, but it is not sufficient to ensure reasonability and proportionality for all consumers. The Federal Reserve must add supplementary rules.

- Any penalty that may last indefinitely should be presumed to violate the reasonable and proportional requirements of the Credit CARD Act.

- The Board should prohibit penalty rate increases on existing balances except where issuers guarantee to restore non-penalty rates automatically after six months of on-time payments, regardless of when repayment begins.

The Board should judge late fees in proportion to the amount that is past due, not the overall account balance, and should be scrutinized closely if they may apply immediately upon the payment due date.

- Generally, the size of a late fee should be in proportion to the amount that is *past due* (i.e. the minimum payment due), not the overall account balance. The median late fee ($39) represents only 1.3 percent of the median household credit card balance of $3,000. But it is equal to approximately 60 percent of the applicable required minimum payment. A fee that increases the minimum payment due by 60 percent may be difficult to justify as being proportional.

- Issuers are unlikely to incur additional costs immediately on the due date. For the fee to be based on deterrence and cardholder behavior factors outlined in the Act, it is appropriate to create a leniency period of several days after the due date to ensure that the late payment is not due to factors beyond the cardholder's control, mail delivery or payment processing delays.

Overlimit fees should be banned because they are not justifiable based on the factors identified in the Credit CARD Act.

[14] More information is provided in our June 25, 2009 comment letter to the Board. See: Appendix B; see also pp. 10-13.

- Because overlimit transactions are processed automatically, it is unclear what additional costs the issuer may be said to incur due to a "violation or omission" of the cardholder. Further, because the cardholder often will have incomplete information about the account's proximity to the credit limit, and because the issuer *always* can control whether the account exceeds the limit, it is difficult to see how an overlimit fee furthers such goals as deterrence or punitive action (indeed, better forms of deterrence and punishment are available, in the form of denied transactions).

- However, if allowed, only de minimis overlimit fees should be tolerated, and only when accounts are significantly overlimit.

In general, the Federal Reserve Board should narrowly interpret the justification factors for penalty fees and charges under the Credit CARD Act.

Section 102(b) of the Act instructs the Board to establish rules for ensuring that all "any penalty fee or charge" is "reasonable and proportional" to a cardholder's acts or omissions. The law provides three specific factors that may contribute to the "reasonable and proportional" analysis: the cost incurred by the creditor for the associated omission or violation, the deterrence value of the penalty and the conduct of the cardholder. The Board may also identify other factors it deems appropriate.

- The factors identified in the law (cost, deterrence and cardholder behavior) establish a very narrow basis for justifying penalties, including late and overlimit fees. The Board's rules should reflect that narrowing approach, particularly in regard to the cost considerations that may justify a penalty. For example, the only relevant costs incurred by the creditor are those that relate to the specific "omission or violation" that is being penalized. Generally applicable costs of doing business, including risk exposure, must not be included; rather, the only relevant costs are whatever actual marginal costs the issuer incurs in responding to the penalized behavior.

- Similarly, because the law is designed in favor of maximizing price transparency and market efficiency, the Board's rules generally should err on the side of those goals by constraining the proliferation of confusing or potentially "rent seeking" fee structures ("rent seeking" refers to situations in which issuers would have a counter-intuitive incentive to allow or even encourage their customers to engage in "bad" behavior as a way of maximizing penalty fee income).[15]

- For penalties that are not readily justifiable based on the factors provided in the law, the Board should tolerate no more than nominal fees.

More detail on our recommendations for the Federal Reserve's reasonable and proportional penalty fees or charges rules are included in our June 25 comment letter to the Board. A full copy of this letter is attached, and more information is available on our website (www.pewtrusts.org/creditcards).

[15] As we noted in our June comments to the Federal Reserve (p.7), there is evidence of a "rent extraction" or "rent seeking" problem associated with penalty fees.

CONCLUSION

Our research shows that practices labeled "unfair or deceptive" by the Federal Reserve have remained widespread, and cards from the top issuers still do not comply with the consumer protections provisions of the Credit CARD Act. As Americans wait for issuers to change their practices, hefty penalty fees and charges continue to apply. Congress can help bring fast relief to consumers by accelerating the effective date of the Credit CARD Act – but the long-term benefits to consumers depend in large part on the Federal Reserve, and we hope they seize their mandate to protect Americans from unreasonable or disproportionate credit card penalties.

Thank you for the opportunity to present this testimony. As always, we are happy to discuss this or any other aspect of our work at any time.

Summary of Attachments

A. Biographical information about Nick Bourke

B. Truth in Testimony statement.

C. Copy of The Pew Charitable Trusts' letter to the Federal Reserve Board, dated June 25, 2009 regarding "Reasonable and Proportional Rules Under Credit CARD Act of 2009," proposing elements of an analytical framework for creating the rules and suggesting considerations for safe harbor guidelines.

D. Copy of The Pew Charitable Trusts' comments to the Federal Reserve Board, dated September 21, 2009 regarding "Regulation Z; Docket No. R—1364 (Interim Final Rule)," with a focus on urging the Board to rule that credit cards with partial variable rates including fixed minimum rate requirements are not eligible for exceptions to certain 45-day notice, notice of right to cancel and interest rate requirements found in the Credit CARD Act of 2009.

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Attachment A: Biographical Information – Nick Bourke

Nick Bourke is manager of the Safe Credit Cards Project at The Pew Charitable Trusts, a non-profit, non-partisan organization committed to developing fact-based solutions to challenging public policy issues. Previously, he worked with companies in the financial services and high tech sectors, serving as product manager, marketing specialist, strategy consultant and legal advisor, with particular expertise in electronic payments. Most recently, Bourke was senior consultant and project manager for the Ziba Group. His clients included Visa and other financial services firms. Before that Bourke served as senior product manager for Encirq Corporation, where he developed marketing analytics tools for credit card providers and other institutions, and as business analyst for CheckPoint Software. He holds a bachelor's degree from Stanford University and a juris doctor degree from University of California, Davis. Bourke is a member of the State Bar of California.

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ATTACHMENT C

Copy of The Pew Charitable Trusts' letter to the Federal Reserve Board, dated June 25, 2009 regarding "Reasonable and Proportional Rules Under Credit CARD Act of 2009," proposing elements of an analytical framework for creating the rules and suggesting considerations for safe harbor guidelines.

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June 25, 2009

By Electronic Delivery

Ms. Sandra Braunstein
Division of Consumer & Community Affairs
Board of Governors of the Federal Reserve System
Washington, D.C 20551

RE: "Reasonable and Proportional" Rules Under Credit CARD Act of 2009 (Pub. L. 111-24)

Dear Ms. Braunstein:

I am writing to share comments in support of the Board's rulemaking efforts under the Credit CARD Act of 2009. As you may know, Pew's Safe Credit Cards Project began in 2007 as an effort to protect customers from unfair credit card practices and promote responsible management of debt. Since then, we have published a set of Safe Credit Card Standards as well as various results from our research and analysis. On several occasions we have discussed our work with your team.

We applaud the significant accomplishments you and your team have made recently, particularly in establishing balanced safeguards against unfair and deceptive acts and practices. The new law is in many ways a testament to your efforts. I hope that the comments we enclose below are helpful as your team develops the rules called for in this new law.

Our comments focus specifically on the new law's requirement that penalty fees and charges must be reasonable and proportional to the violations or omissions that trigger those penalties. The law has defined a very narrow basis for justifying these penalties. The Board's rules should reflect that narrowing approach, particularly in regard to the cost considerations that may justify a penalty. Similarly, because the law is designed in favor of maximizing price transparency and market efficiency, the Board's rules generally should err on the side of those goals by constraining the proliferation of confusing or potentially "rent seeking" penalty structures. For penalties that are not readily justifiable based on the factors provided in the law, we urge the Board to tolerate no more than *de minimis* fees.

We look forward to continuing our dialogue with your team, and we are available to discuss these comments or any other aspect of our work on credit cards at any time.

Sincerely,

Nick Bourke
Manager, Pew Safe Credit Cards Project
nbourke@pewtrusts.com | 202-552-2123 direct
www.pewtrusts.com/creditcards

CC: Leonard Chanin, Ben Olson

Reasonable and Proportional Penalty Fees and Charges

In 2007, The Pew Charitable Trusts launched an effort, in partnership with the Sandler Foundation, to address growing concerns about abuses in the credit card industry. The project team, led by a former credit card company chief executive officer, researched consumer use of credit cards, conducted economic analyses of credit card practices and revenues, and closely reviewed hundreds of credit card products. Based on these efforts, we published a set of Safe Credit Card Standards to promote responsible lending and borrowing, and to help make credit card products more transparent, simple and predictable. In the following comments, we have drawn on these experiences as well as additional research and analysis specifically intended to address requirements found in the new law.

These comments are divided into the following sections:

A. Definitional Issues. We discuss ways the Board may simplify the analysis regarding which penalties and charges will be subject to the reasonable and proportional rules.
   - The Board should define a set of fees and charges that will *not* be subject to the reasonable and proportional rules, and presume that any other type of fee or charge will be subject to the rule.
   - Taking the further step of requiring all fees for the issuance or availability of credit to be disclosed in the form of a single, annualized figure would greatly enhance pricing transparency.

B. Analytical Factors. This section discusses the analytical factors established in the law.
   - Costs are to be determined based on the actual consequences of the cardholder's violation or omission; therefore, while marginal costs of special mailings or other actions may be considered, compensation for risk or lost revenue may not.
   - The deterrence value of penalty fees is not clear, and must be balanced carefully against established problems of rent extraction.
   - Cardholder behavior is the only purely punitive factor in the analysis; and penalties can only be justified on this basis to the extent they are closely tied to "bad actions" that are in the cardholder's power to control.
   - Other appropriate considerations are timing issues (how quickly, how long and how substantially the fee or charge may be applied) and relationship to the law's fundamental goals of transparency and efficient market behavior.

C. Discussion of Specific Penalty Fees and Charges; Safe Harbor Issues. Key points for late fees, penalty interest rate increases and over-the-limit fees are discussed. Where possible, we suggest safe harbor guidelines.

Appendix A: Data on Penalty Fees and Charges in the Market

Appendix B: Discussion of Proposed Seven-Point Penalty Premium Threshold

Appendix C: Sample State Law Limiting Penalty Fees

A. Definitional Issues

Section 102(b) of the Credit CARD Act of 2009 (Pub. L. 111-24) adds the following language to the Truth in Lending Act:

> **Sec. 149. REASONABLE PENALTY FEES ON OPEN END CONSUMER CREDIT PLANS**
>
> (a) IN GENERAL.—The amount of any penalty fee or charge that a card issuer may impose with respect to a credit card account under an open end consumer credit plan in connection with any omission with respect to, or violation of, the cardholder agreement, including any late payment fee, over-the-limit fee, or any other penalty fee or charge, shall be reasonable and proportional to such omission or violation.

The law requires the Board, in consultation with the federal financial supervisory agencies, to issue rules "to establish standards for assessing whether the amount of any penalty fee or charge… is reasonable and proportional to the omission or violation to which the fee or charge relates." The law specifically authorizes the Board to set "safe harbor" guidelines for penalties that will be presumed to be reasonable and proportional.

The reasonable and proportional requirement applies to "any penalty fee or charge… in connection with any omission with respect to, or violation of, the cardholder agreement…." These fees may include any "late payment fee," "over-the-limit fee," or "any other penalty fee or charge;" but the law does not provide a complete definition. We encourage the Board to define "penalty fees or charges" in a manner that minimizes the incentive for card issuers to introduce new or duplicative fees.[1] By doing so, the Board will help promote the specific legislative intent to restrain penalties to reasonable levels, as well as the general intent to maximize price transparency.

The best way to maximize the efficacy of the rule, and to minimize issuers' incentive to circumvent the reasonable and proportional requirement, is to define fees that will *not* be subject to those requirements and apply the rules to all other fees or charges. In the course of developing our Safe Credit Card Standards[2], we learned that creating a structure to constrain the proliferation of fees was vital to achieving the fundamental goals of transparent and predictable pricing. Similarly, in the present rulemaking, constraining fees in such a way that there is little room for argument about which fees will be subject to the reasonable and proportional rule will be vital to achieving the rule's purpose.

Therefore, we propose that the Board define three types of fees that will *not* be considered penalties for purposes of the reasonable and proportional rules, and declare that all other fees *will* be subject to the rules. The three suggested types of exempt fees are as follows:

---

[1] There is evidence of a "rent extraction" problem related to penalty fees, which may encourage issuers to allow or even encourage their customers to engage in behavior that maximizes penalty fee income. See further below in these comments for a discussion.

[2] See www.pewtrusts.org/creditcards The Safe Credit Card Standards were designed to protect cardholders and promote a functional marketplace, largely by ensuring transparent and predictable pricing. Pew developed the Standards after extensive consultation with industry, consumer group and government representatives.

1. *Fees for the issuance or availability of credit.* The Board has already defined this type of fee, and we would encourage the Board to use that definition in its present rulemaking. In § 227.26 of Regulation AA (as effective July 1, 2010), the Board defines "fees for the issuance or availability of credit" to include any annual or other periodic fee for issuance or availability of credit, including any fee based on account activity or inactivity, and any non-periodic fee related to opening an account. Elsewhere, Regulation Z requires disclosures of "any annual or other periodic fee that may be imposed for the issuance or availability of a credit or charge card, including any fee based on account activity or inactivity" and a statement of how frequently it will be imposed and the annualized amount of the fee (§ 226.5a(b)(2) as effective July 1, 2010).

   Further, we strongly encourage the Board to take the additional step of requiring issuers to disclose all fees for the issuance or availability of credit *in the form of a single, annualized cost figure*. In our Safe Credit Card Standards, we proposed requiring all such account-level fees to be expressed as an annual account maintenance fee. Consolidating fees for the issuance or availability of credit in this way would greatly enhance pricing transparency and reduce incentives issuers may have to embed multiple service fees that make the overall price of credit difficult to identify or compare. It would also help to limit the number of fees that must be disclosed by issuers, evaluated by consumers and analyzed by government authorities.

   This requirement to express fees for the issuance or availability of credit as a single annualized cost figure would fit easily within the Board's existing rule structure. The fee would be disclosed as a single, annualized fee, but could be charged periodically throughout the year as appropriate. Thus, this requirement would not interfere with the requirement, in § 226.26 of Regulation AA, to charge the fee in installments over a period of months in cases where the fee would exceed 25 percent of the initial credit limit for the account.

   This new requirement should take precedence over related disclosure rules. For example, to accommodate the requirement in Regulation Z, § 226.5(a)(b)(2), which will require issuers to label any non-periodic account opening fee as a "one-time" fee, issuers may be directed to provide the single annualized cost figure prominently with a notation underneath indicating the portion of the annualized fee represented by the one-time application fee.

2. *Transaction surcharges.* These fees would be surcharges imposed on any approved transaction meeting specified characteristics based on the place or nature of the transaction. Examples include transactions occurring at a foreign point of sale or requiring foreign currency exchange, cash advances or balance transfers.[3]

   To strengthen the definition of this type of fee, we encourage the Board to create a definitive list of fees which it would consider transaction surcharges, with the

[3] It should be noted that an excess of transaction surcharges on an account would tend to undermine pricing transparency by shrouding the true cost of credit. Though these types of fees may require safeguards to ensure transparency and protect consumers from unfair and deceptive practices, we have not addressed those issues in this comment.

presumption that any other type of charge will not be considered a transaction charge without further analysis.

3. *Customer-initiated service fees.* These fees would result from non-transactional, customer-initiated service requests, such as copy charges or rush delivery of a new card. A fee will not qualify as a customer-initiated service fee unless the cardholder expressly requests the service and explicitly agrees to pay the stated fee.

   As with transaction surcharges, the Board may wish to create a list of fees considered to be customer-initiated service fees, with a presumption that other types of fess will not be categorized as such without further analysis. This list may include: Expedited payment fee, card replacement fee, expedited delivery fee, copy fee, research fee and/or stop payment fee.

All other fees or charges, with the exception of standard (non-punitive) interest charges established at the account opening or via a change in terms notice, should be presumed to be penalty fees or charges for purposes of the reasonable and proportional requirements. (We also note that our Safe Credit Card Standards would prohibit any penalty fee or charge, other than a late fee, a returned payment fee and a limited temporary penalty interest rate increase, and that the Board could consider a similar rule as a way to clarify the analysis and restrict the confusing proliferation of fees and charges).

B. Analytical Factors

Section 102(b) of the law instructs The Board to consider the following in forming the reasonable and proportional standards:

"(1) The cost incurred by the creditor for such omission or violation;
"(2) The deterrence of such omission or violation by the cardholder;
"(3) The conduct of the cardholder; and
"(4) Such other factors as the Board may deem necessary or appropriate."

Cost

The first factor, cost, is specifically constrained to include only those costs the creditor incurs for the "omission or violation" for which the penalty is being imposed. By delimiting costs to those incurred for the omission or violation specifically, the legislation makes it clear that any costs related to the normal costs of doing business, such as general overhead, risk exposure, customer service, billing and account maintenance costs, must not be included. The only costs that remain to be considered are whatever actual marginal costs may be attributable to any extraordinary efforts an issuer makes in response to the omission or violation, such as sending a special letter or email, making a phone call or suspending a delinquent account.

An estimation of these costs should *not* include an accounting for the marginal risk an account may pose because of the omission or violation.

Compared to commercial and investment banking, the risk involved with retail lending portfolios is both more diverse and more predictable. Though risk concentrations can vary in retail portfolios, risks tend to be spread widely, with credit delivered in small pieces, over an extended period of time, to thousands or millions of borrowers. Consequently, retail lenders can confidently estimate future losses based on their initial underwriting policies. "The high predictability of retail credit losses mean that the expected loss rate dominates retail credit risk and can be built into the price charged to the customer," notes the authors of *The Essentials of Risk Management*.[4]

Though it may be possible for an issuer to demonstrate that accounts with certain violations (such as a late payment) have a higher incidence of chargeoffs, it is not reasonable to translate that risk into a punitive fee or charge that will apply when an account demonstrates the supposedly risky behavior. At a portfolio-wide level, card issuers create complex pricing models that are intended to account for a number of factors, including risk as well as corporate goals such as profitability and market share. In fact, the book *The Essentials of Risk Management* advises that a "well-designed RBP [Risk-Based Pricing] strategy allows the bank to map alternative pricing strategies at the credit score level to key corporate metrics (e.g., revenue, profit, loss, risk-adjusted return, market share, and portfolio value…."[5] Depending on the overall mix of these corporate metrics, creditors will accept more or less risk, set more or less aggressive pricing, and market their products more or less broadly.

It is at the portfolio level, not the specific account level, where issuers make these determinations. Thus, the risk associated with omissions and violations of account agreements may be factored into the price of a credit card account at the front end, so that by the time an omission or violation occurs, risk is not part of the new costs the issuer will incur. Every day, as issuers earn interest on outstanding balances, they are compensated for risk and the costs of doing business in the context of their overall marketing, pricing and risk management strategy.

Deterrence

The second factor relates to deterring the specific omission or violation in question. There is little available research to help identify the deterrence value of fees, let alone how to distinguish between a fee that is used to discourage behavior versus one that is primarily a revenue tool. In a recent paper, Sumit Agarwal, et. al., identified a learning affect associated with fees. It found that cardholders pay "very large" fees immediately after opening an account, but learn to reduce those fees over time, such that monthly fee payments fell by 75 percent during the first four years of an account's life. The more recently a fee was applied, the less likely the cardholder was to incur the fee again in subsequent months.[6]

In theory, credit card issuers will want to take advantage of this learning effect to discourage their customers from missing payment due dates, exceeding credit limits or any other activity which warrants a penalty fee. However, companies also have a powerful incentive to allow, or even encourage, their customers to trigger fees as a way of boosting revenue. As a recent

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[4] Crouhy, Michel, Dan Galai and Robert Mark, *The Essentials of Risk Management* (McGraw-Hill, 2006), at p. 209.
[5] Ibid., at p. 228.
[6] Agarwal, Sumit, John C. Driscoll, Xavier Gabaix and David I. Laibson, "Learning in the Credit Card Market" (Februray 8, 2008). Available at SSRN: http://ssrn.com/abstract=1091623.

Harvard Business Review feature noted, "a company is less likely to help customers make good choices if it knows that it can generate more profits when they make poor ones."[7] The problem extends particularly to penalty fees:

> Such charges may have been conceived as a way to deter undesirable customer behavior and offset the costs that businesses incur as a result of that behavior. Penalties for bouncing a check, for example, were originally designed to discourage banking customers from spending more than they had and to recoup administrative costs. The practice was thus fair to company and customer alike. But many firms have discovered just how profitable penalties can be; as a result, they have an incentive to encourage their customers to incur them – or at least, not to discourage them from doing so.[8]

Given the strong incentive companies have to allow or encourage customers to trigger penalty fees, it is unclear how strongly Agarwal's learning effect may be attributed to deterrence. In learning to avoid penalty fees that are common in the early stages of an account's life, customers may be adopting more responsible behavior based on a deterrent effect; or, they may simply be gaining a fuller understanding of the actual costs they can incur and a sophistication about how to reduce those costs.[9]

Another study, by Nadia Massoud et. al., would suggest the latter. While this study identified a correlation between penalty fees and default risk, no deterrence effect was found. However, the authors did identify a strong correlation between an issuer's market power and the magnitude of penalty fees. Banks with higher market share were able to "extract rents" in the form of penalty fees, even after holding consumer risk constant.[10]

While the deterrence value of penalty fees would seem to be limited, the incentive for companies to allow or encourage customer behavior that maximizes revenues, including fee revenues, is significant. In 2008, penalty fees (exclusive of penalty interest rate increases) accounted for 6.6 percent of credit card revenue, or more than $8.5 billion dollars.[11] The Center for Responsible Lending, in separate comments currently being submitted to the Board, has estimated that these fees have steadily increased as a percentage of revenue since the Supreme Court's *Smiley* decision effectively deregulated credit card fees.

To be reasonable and proportional, a penalty fee or charge should be designed to allow for a modest deterrence effect while minimizing the negative "rent extraction" factors. To accomplish this balance, penalties generally should be kept to a *de minimis* level, particularly absent compelling evidence from issuers that larger fees are both necessary for deterrence *and* can be designed with sufficient safeguards to minimize risks of rent extraction.

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[7] McGovern, Gail and Youngmee Moon, "Companies and the Customers who Hate Them" Harvard Business Review, June, 2007.
[8] Ibid.
[9] For an overview of scholarly studies exploring how sophisticated firms may attempt to exploit consumer ignorance or biases, see: Gabaix, Xavier and David I. Laibson, "Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets" (April 11, 2005), MIT Department of Economics Working Paper No. 05-18 (at footnote 1). Available at SSRN: http://ssrn.com/abstract=728545.
[10] Massoud, Nadia, Anthony Saunders and Barry Scholnick, "The Cost of Being Late: The Case of Credit Card Penalty Fees" (March 2006), AFA 2007 Chicago Meetings Paper (see p.29-32 for a discussion of the correlations among penalty fees, risk and market share). Available at SSRN: http://ssrn.com/abstract=890826.
[11] Cards & Payments, May, 2009.

Cardholder Conduct

The third factor relates to the conduct of the cardholder. Presumably, this factor may be intended to allow for a consideration of the cardholder's prior omissions or violations in setting the rate of a current penalty. It follows that cardholders who repeatedly pay late, for example, may be subjected to a higher degree of penalty fee or charge as a punishment for the repeated bad conduct.

Given that the law sets aside cost and deterrence in separate factors, the conduct factor is the only purely punitive factor in the analysis. As such, any consideration of cardholder conduct should focus on "bad" behavior, such as willful failures to pay on time, and not any additional costs or need for deterrence that may stem from the behavior. The key question regards what may an issuer reasonably do to punish a cardholder's behavior, and whether the punishment is proportional to the behavior.

Similarly, penalties for bad conduct should only respond to violations or omissions that are fully in the cardholder's power to control. The less an issuer can directly tie the punitive fee to the cardholder's willful bad conduct, the less reasonable and proportional the fee will be.

Other Factors

Among the other factors the board may generally consider, we suggest the following:

- *Timing issues.* The timing of when a penalty fee or charge is imposed, and in some cases how long the penalty charge will be applied, will affect the reasonability and proportionality analysis. For simplicity, an issuer may wish to impose a fee or charge according to uniform rules, which may in some cases mean that a penalty is imposed even before the issuer has incurred a cost. While this type of simplification is understandable, even desirable, it may require that the amount of the fee, or the duration of the charge, must be sufficiently low to ensure that the fee is reasonable and proportional portfolio-wide.

- *Impact on transparency.* Among the primary objectives of the Credit CARD Act of 2009 were improving the transparency of credit card pricing arrangements and protecting consumers from unfair, misleading or deceptive practices.[12] In evaluating whether a penalty fee or charge is reasonable and proportional, the Board should consider whether the penalty in question would tend to undermine these goals. Penalty schemes that would tend to create non-transparent pricing arrangements, complexity, unpredictability regarding the expected cost of an account, or risk of rent extraction should be closely scrutinized.

[12] See, e.g., the report, "Amending the Consumer Protection Act, to Ban Abusive Credit Card Practices, Enhance Consumer Disclosures, Protect Underage Consumers, and for Other Purposes," submitted by Chairman Chris Dodd, May 4, 2009. Available at: http://www.thomas.gov/cgi-bin/cpquery/T?&report=sr016&dbname=111&.

C. Discussion of Specific Penalty Fees and Charges; Safe Harbor Issues

In this section, we review common types of penalty fees and charges. For each, we discuss the analytical factors outlined above and suggest potential safe harbor guidelines.

1. Late Fees

Key Points

- Hair-trigger penalties for the late fee, such as allowing the fee to apply immediately on the payment due date, should be closely scrutinized.
    - Issuers will tend not to incur additional costs due to the late payment immediately after the due date; rather, any additional costs that may arise would not occur before several days have passed.
    - For the fee to be based on deterrence and cardholder behavior factors, it is appropriate to create a leniency period of several days after the due date to ensure that the late payment is not due to factors beyond the cardholder's control, such as delays in the mail or the payment posting process.
- Generally, the size of the fee should be in proportion to the amount of the payment that is *past due*.
    - The median late fee on a credit card account is $39 for accounts with outstanding balances of $250 or more (see Appendix A for data on current market conditions). Most credit card accounts, which have balances significantly higher than the $250 threshold, are subject to this $39 late fee.
    - For an account with a balance of $3,000 (the median household credit card debt[13]), a $39 fee represents only 1.3 percent of the overall account balance. But compared to the *minimum payment due* for the month, which is likely to be approximately $65, a $39 late fee represents a penalty of approximately 60 percent of the past due amount.[14] A 60 fee that increases a cardholder's minimum required payment by 60 percent may be difficult to justify as being proportional.

[13] Our estimate based on Survey of Consumer Finance Data. See: Bucks, Brian K., Arthur B. Kennickell, Traci L. Mach and Kevin B. Moore, "Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances," Federal Reserve Bulletin, vol. 95, February 12, 2009, at p. A45

[14] The minimum payment due is demonstrated based on an annual percentage rate of 14 percent (roughly the current average advertised purchase rate – see e.g. www.indexcreditcards.com) multiplied by the $3,000 average daily balance, plus a one percent principal reduction.
[i.e.: $3,000 * (.14/12) + $3,000 * 0.01, or $35 + $30 = $65]

Safe Harbor Considerations

We have not established complete safe harbor guidelines for late fees. However, we refer the Board to a State of California law that may serve as a useful guideline. This law establishes a maximum late fee based on the number of days past due an account becomes (starting at five days past due), and limits issuers to charging only one late fee per billing cycle. This structure helps prevent hair trigger penalties. The relevant section of the law, Cal Fin Code § 4001, is provided in Appendix C.

Note that in separate comments currently being presented to the Board, Center for Responsible Lending and other consumer groups have suggested the Board review common standards for late fees from the time period before the Supreme Court's *Smiley* decision effectively deregulated late fees (e.g., the less of a fixed amount, such as $5-$10 or a specified percentage of the minimum payment due, such as five percent). We agree that these structures provide appropriate models, particularly to the extent they looked to the *past due* amount and not the *total account balance* as the relevant factor in establishing proportionality.

2. Penalty Interest Rate Increases

Key Points

- A penalty interest rate increase is subject to the reasonable and proportional rules because it is imposed in response to a cardholder's violation of the account agreement and would not qualify as any other type of fee or charge.

- In prior comments to the Board we emphasized the importance of three key variables regarding penalty interest rate increases.[15] These variables are the trigger (what actions activate the penalty rate and which balances are affected); the cure (how long may the penalty rate apply and whether the original rate is guaranteed to be restored); and the penalty premium (the difference between the penalty rate and the original rate). These three variables together constitute the penalty interest rate, and any consideration of whether such penalty is reasonable and proportional must consider the three variables together.

- Penalty interest rate increases on *existing balances* are justifiable only to the extent they compensate the issuer for actual marginal costs caused by the cardholder's violation.

    - In general, where separate penalty fees are imposed for the violation that may trigger the penalty interest rate increase, those fees should be looked to first for cost recovery.

    - Penalty interest rates on existing balances may be justified as compensation for costs if the issuer follows policies, such as credit counseling or establishment of workout arrangements, for seriously delinquent accounts (i.e., accounts that are 60 or more days past due, the threshold established in the law).

[15] Comments from the Pew Charitable Trusts, dated October 3, 2008, available at: www.pewtrusts.org/creditcards.

- The deterrence value of penalty rate increases on existing balances is not shown. Nor is it reasonable to allow creditors to have the power to use retroactive price increases (in effect, a rewriting of the past agreement after the cardholder has incurred the debt) as a tool for deterrence. Similarly, though penalty fees may justifiably punish a cardholder for errant behavior, there is no basis for deeming retroactive price increases an appropriate punitive response to a cardholder's behavior. In contrast, the threat of rate increases on *future* balances as a deterrent to violating the account agreement would be appropriate, but only because it would apply to transactions that have not yet been completed and are therefore still subject to negotiation between the cardholder and the issuer.

- Retroactive rate increases that can last indefinitely should be presumed to be unreasonable. Definite cure periods, which guarantee automatic restoration of the originally agreed rate after a period of on-time payments, are essential features of reasonable and proportional penalty interest rate increases. Cardholders should always have the opportunity to escape ongoing penalty charges whenever they resume making on-time payments for a reasonable period of time.

- The appropriateness of the penalty rate increase should be balanced against the potential for price shocks that could trap cardholders in high levels of debt, or for payments that they could not have predicted and may be unable to pay. For example, it may be unreasonable and disproportionate to allow the penalty to have the effect of instantly doubling the minimum payment due for the month.

- Interest rate increases on *future balances* may be justified based on a variety of factors, including cost, cardholder behavior factors and risk factors. However, it is questionable whether such a rate increase can be justified as a *penalty* for specific cardholder violations or omissions, or as compensation for costs specifically related to those violations or omissions, since it is in effect the result of a new underwriting analysis.

Safe Harbor Considerations

We recommend the following safe harbor guidelines for interest rate increases on *existing balances*. These guidelines are based on our Safe Credit Card Standards.

- Triggered only if an account is 60 or more days past due (per § 102(b) of the law).

- Cure period of six months, requiring the original rate of interest applicable to each penalized balance to resume automatically after six consecutive months of on-time payment behavior. This cure would exceed the explicit requirements of § 102 (b) of the law by requiring the cure no matter when the cardholder begins the six-month repayment process.

- Penalty premium of no more than seven percentage points above the original rate. (For discussion of how we established this threshold, see Appendix B).

Additionally, the Board may wish to require issuers to provide representations or substantiation regarding the actual marginal costs associated with penalized accounts that are not otherwise covered by normal interest rates or specific penalty fees such as late fees.

Regarding penalty interest rate increases on *future balances,* it is our recommendation that (1) the Board impose the same safe harbor guidelines expressed for increases on existing balances; and (2) the Board establish a presumption that any form of automatic penalty rate increase on future balances that does not meet the safe harbor guidelines is unreasonable. Instead, issuers that wish to raise interest rates on future balances under circumstances not covered by the safe harbor should be instructed to use a process of account underwriting and amending the account agreement.

- As noted above, the case for allowing penalty interest rate increase on *future balances* as an automatic response to specific cardholder violations or omissions is questionable; but the negative effects associated with problems of rent seeking are clear. Automatic interest rate increases would create a significant incentive for issuers to allow or encourage specific cardholder behavior, such as exceeding a credit limit, that would trigger a rate increase.

- Though we see possible justifications for increasing *go-forward* interest rates based on a variety of changing factors, including risk factors, we see no reason why automatic penalty interest rate increases would be the proper mechanism for doing so, except perhaps in cases of serious delinquency (60 days past due) as a means to recuperate costs of administering credit counseling or workout plans (as the safe harbor would allow).

Under this formulation, issuers would be free to exercise discretion regarding to whom they will continue to lend and on what terms, and cardholders will experience less risk of experiencing significant penalties for insignificant transgressions (of course, individual fees for late payments and the like may still apply). These rules would benefit issuers by not automatically requiring them to reduce rates on future balances, leaving the issuers free to consider a variety of factors, such as marketing priorities or overall economic conditions, when setting go-forward pricing. However, the law has already provided a mechanism, under § 101(c), to protect cardholders by requiring issuers to review repriced accounts periodically for possible rate reductions. Further, § 101(d) of the law will reduce the risks of "bait and switch" repricing by prohibiting most interest rate increases during the account's first year. The proposed safe harbor would conform to these requirements.

Finally, we note that this formulation should not exempt issuers from the Board's authority, including its authority to ensure reasonable and proportional penalty charges, in cases where issuers are found to be engaging in systematic repricing practices that are injuring cardholders, exceeding the bounds of reasonability and proportionality, undermining transparency or otherwise frustrating the law's purpose.

Should the Board disagree, and allow automatic penalty rate increases on future balances other than according to the safe harbor proposed above, we make the following additional observations:

- Hair triggers, such allowing automatic interest rate increases based on a single late payment or overlimit event, should be prohibited. Instead, triggers should be based on the severity of the transgression and should only apply once the individual triggering event has exceeded a threshold, such as when an account becomes several days past due.

- For any automatic penalty rate increase, a guaranteed cure should apply, restoring the originally agreed rate after any six month period of on-time payment.

3. Over-the-Limit Fees

Key Points

- Whether an account exceeds the credit limit is entirely within the issuer's control. The issuer sets the credit limit, authorizes the transactions and decides how far beyond the limit the account may extend. Conversely, cardholders often have no knowledge or control of their account's proximity to the credit limit, due to factors such as unavailability of information at the point of sale and, potentially, unknowable holds placed against the account due to hotel reservations or for other reasons.[16] Therefore, any penalty fee associated with exceeding the limit should be scrutinized carefully to identify how the fee relates to an omission or violation on the cardholder's part.

- We question whether over-the-limit fees can be justified by any of the factors identified in the law. Because over-limit transactions are processed automatically, it is unclear what additional costs the issuer may be said to incur due to the violation or omission of the cardholder. Further, because the cardholder is often unaware of the account's proximity to the credit limit, and because the issuer *always* can control whether the account exceeds the limit, it is difficult to see how an over-the-limit fee furthers goals such as deterrence or punitive action (indeed, better forms of deterrence and punitive action are available, in the form of denied transactions). Penalties that are triggered at the instant an account exceeds its limit, or which charge more than a *de minimis* amount, are especially difficult to justify.

- In our Credit Card Standards, we proposed to prohibit all over-the-limit fees, both for the reasons noted above and because of the complexity of expressing sufficient safeguards to avoid abuse of the fee (some of these safeguards, such as requiring the cardholder to opt-in and restricting application of over-the-limit fees to once per month, are explicitly provided in the law, while others are left to the Board to determine). We encourage the Board to prohibit over-limit fees, or else restrict all but the most minimal forms of this fee.

Safe Harbor Considerations

Absent a ban on the over-the-limit fee, we encourage the board to consider safe harbor guidelines that would allow only a *de minimis* fee that could apply only once an account has exceeded the credit limit by a certain threshold. Establishing a buffer threshold would help avoid problems associated with a cardholder's lack of information about the account's proximity to the credit limit, holds placed against the account and potential rent extraction motivations.

Though we have not established complete safe harbor guidelines for over-the-limit fees, we refer the Board to a State of California law that may serve as a useful guideline (e.g., "[n]o overlimit

[16] The Board discussed similar concerns in its December, 2008, notice of final rulemaking for Regulation AA. The Board declined address credit holds at the time, but the new law adds weight to arguments in favor of creating safeguards on when over-the-limit fees may apply.

fee may be charged unless the charge causes the outstanding balance to exceed the credit limit by five hundred dollars ($500) or 120 percent, whichever is less"). The relevant section of the law, Cal Fin Code § 4001, is provided in Appendix C.

APPENDIX A: Data on Penalty Fees and Charges in the Market

Included below are selected findings from Pew's research on commonly deployed penalty fees in the market.[17] These findings are based on our review of credit card terms of the country's 12 largest issuers, which together hold more than 88 percent of outstanding credit card debt.[18] In December, 2008, researchers gathered available online disclosures for all of the more than 400 Visa®, MasterCard®, American Express® and Discover® branded consumer credit card products offered by these top issuers.

Late Fees

We found that 99 percent of cards included a late fee. The late fee was tiered based on account balance in 98 percent of these instances. For these accounts, the amount of the late fee was expressed in two or three tiers, as follows:

Table A-1: Allowable Late Fees (Tiered Accounts)

	Median Balance Thresholds	Median Late Fee	Range of Late Fee
Late Fee Tier 1	$0 to $100	$15	$15 - $20
Late Fee Tier 2	$100 to $250	$29	$15 - $29
Late Fee Tier 3	$250 or Above	$39	$35 - $39

For most of these accounts, the maximum late fee became applicable once an account's balance exceeded $250. This maximum fee, ranging from $35 to $39, represents as much as 15.6 percent of the entire account balance (and a much higher percentage of the minimum monthly payment due). For the two percent of cards with fixed late fees, the median late fee was $35, with a range from $30 to $39.

Over-the-Limit Fees

Fees for exceeding the credit limit applied to 92 percent of the cards. As with late fees, most overlimit fees were tiered based on account balances (though the figure was lower, at 56 percent). The amount of the overlimit fee for these accounts was expressed in two or three tiers, as follows:

Table A-2: Allowable Overlimit Fees (Tiered Accounts)

	Median Balance Thresholds	Median Late Fee	Range of Late Fee
Overlimit Fee Tier 1	$0 to $500	$15	$15 - $19
Overlimit Fee Tier 2	$500 to $1,000	$29	$15 - $29
Overlimit Fee Tier 3	$1,000 or Above	$39	$35 - $39

[17] Some data in this section was published in March, 2009, in a report by the Pew Health Group, *Safe Credit Card Standards*, available at www.pewtrusts.org/creditcards. Other data is published here for the first time.
[18] The largest twelve issuers included the top-10 Visa / MasterCard issuers, American Express and Discover (issuer size is measured by outstanding balances based on data available as of December, 2008). See: The Nilson Report, Issue 895 (January 2008) and Issue 902 (May 2008).

For the 44 percent of cards with fixed overlimit fees, the median overlimit fee was $39, with a range from $29 to $39.

Penalty Interest Rate Increases

Current Conditions. We found that 87 percent of cards allowed the issuer to impose automatic interest rate increases on all balances as a penalty for paying late, exceeding the credit limit or for other reasons. Under present rules, this penalty charge may apply equally to existing balances as well as balances resulting from future transactions. The median advertised (non-penalty) annual interest rates for purchases made with the cards were between 9.99 percent to 17.99 percent (issuers advertise a range of interest rates which may apply depending on a consumer's credit profile). By comparison, the median allowable penalty interest rate applicable to these accounts was 27.99 percent per year. The additional allowable charges represented by this 27.99 percent penalty rate are summarized in the following table.

Table A-3: Allowable Penalty Costs due to Penalty Interest Rate Increases, Market-Wide

Avg. Daily Balance	18-Point Penalty Premium *(27.99% penalty rate applied to card with 9.99% base rate)*		10-Point Penalty Premium *(27.99% penalty rate applied to card with 17.99% base rate)*	
	Annual Cost	Monthly Cost	Annual Cost	Monthly Cost
$1,000	$180	$15	$100	$8
$2,000	$360	$30	$200	$17
$3,000	$540	$45	$300	$25
$4,000	$720	$60	$400	$33
$5,000	$900	$75	$500	$42
$6,000	$1,080	$90	$600	$50
$7,000	$1,260	$105	$700	$58
$8,000	$1,440	$120	$800	$67
$9,000	$1,620	$135	$900	$75
$10,000	$1,800	$150	$1,000	$83

Note: Amounts shown in the table above are only the costs of the penalty interest rate premium, not inclusive of the base interest charges

Significantly, most cards allowed issuers to impose penalty rate increases indefinitely once they were triggered. Only eight percent of cards with penalty rate conditions offered to restore the original rate terms when payments are made on-time, usually after 12 months.

Cumulative Penalties

For all cards surveyed, penalty fees and charges could be cumulative. A penalty interest rate increase, a late fee and an overlimit fee could all apply concurrently to an account during any given time period (in addition to any other applicable fee or charge).

APPENDIX B: Discussion of Proposed Seven-Point Penalty Premium Threshold

In Section C(2) of our comments, we recommend several safe harbor guidelines on penalty interest rate increases, including a maximum penalty premium of seven percentage points above the base, non-penalty rate. In our judgment, this seven-point threshold establishes a simple rule that will in most cases allow for a reasonable and proportional fee, when imposed in connection with an appropriate cure period and penalty rate trigger. We selected this threshold, which is part of our Safe Credit Card Standards, after considering a wide variety of factors and discussing the issue with industry and consumer groups. Some of the considerations are outlined below.

Impact on cardholder

- A seven percentage-point premium would significantly reduce the overall amount of penalties a cardholder may be required to pay compared to today's conditions.
    - A seven-point premium would add nearly $6.00 in interest charges, per month, for every $1,000 borrowed.[19] At an account balance of $3,000 (the median household credit card balance[20]), a seven-point interest penalty would add $17.50 per month[21].
    - The total cost for a cardholder who cures the penalty after six months would be $105 ($17.50 * 6 months). Additional monthly charges of $17.50 could apply, up to a maximum of $210 per year, if the penalty is not cured and removed.
    - By comparison, allowable penalty interest rate increases in the market today typically would add between $25 and $45 per month to this $3,000 balance.[22] Because cures are seldom guaranteed on accounts currently, this premium could last for an unlimited number of months, even in cases where the cardholder resumes on-time payments. A $45 monthly penalty would add $540 in additional charges each year.
    - Whereas a cardholder with a $3,000 balance in a proposed safe harbor account would pay $105 in penalties after six months of on-time payment, a cardholder in today's market would be charged up to $540 in additional penalties *in the first year alone*, with additional charges possible indefinitely thereafter, regardless of his or her subsequent repayment behavior.

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[19] $1,000 * (.07/12) = $5.83

[20] Our estimate based on Survey of Consumer Finance Data. See: Bucks, Brian K., Arthur B. Kennickell, Traci L. Mach and Kevin B. Moore, "Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances," Federal Reserve Bulletin, vol. 95, February 12, 2009, at p. A45

[21] $3,000 * (.07/12) = $17.50.

[22] See Table A-3 in Appendix A, showing current market conditions and demonstrating that current allowable monthly penalties on a $3,000 balance equal $25 to $45 dollars.

- A penalty interest rate increase can create substantial increases in the amount of the monthly minimum payment due. While current penalty premiums can increase the monthly minimum payment due by 50 to 100 percent, a seven-point premium would create a much smaller payment shock.

    - Table B-1, below, estimates the minimum payment due for accounts based on the average daily balance and the applicable annual percentage rate.

    - For example, an account with a balance of $3,000 that is subject to a 14 percent annual interest rate would be have a monthly minimum payment due of approximately $65.[23] Raising the interest rate to 28 percent (the current median allowable penalty rate[24]) would bring the monthly minimum payment to $100, an increase of 65 percent.

    - By comparison, the maximum safe harbor penalty premium of seven points would bring the interest rate to 21 percent. The monthly minimum payment due would reach $83, an increase of only 28 percent.

    - Note: The lower the base annual interest rate, the greater the proportional impact of the penalty. For example, if the base interest rate is ten percent, the minimum monthly payment due on an account with a $3,000 balance would be $55. Raising this account's interest rate to 28 percent would bring the minimum monthly payment to $100, an increase of 82 percent. Limiting the penalty premium to seven points would bring the monthly minimum payment to $73, an increase of 33 percent.

    - The seven-point premium would significantly reduce the risk of payment shock by noticeably reducing monthly penalty charges compared to their current levels. Restricting payment shocks in this way can help cardholders to return to responsible payment behavior and effectively work toward eliminating their debt burden. We believe that this benefit makes the seven-point premium more reasonable than current market conditions allow, and represents a penalty that is more proportional to the cardholder's offense.

Continued on next page...

[23] The current average advertised interest rate is approximately 14 percent (see, e.g., www.indexcreditcards).
[24] See Appendix B for a summary of current market conditions.

Table B-1: Minimum Payment Due Based on Applicable Annual Percentage Rate

Avg Daily Balance	Minimum Payment Due Based on Applicable APR									
	9%	10%	11%	12%	13%	14%	15%	16%	17%	18%
$1,000	$18	$18	$19	$20	$21	$22	$23	$23	$24	$25
$2,000	$35	$37	$38	$40	$42	$43	$45	$47	$48	$50
$3,000	$53	$55	$58	$60	$63	$65	$68	$70	$73	$75
$4,000	$70	$73	$77	$80	$83	$87	$90	$93	$97	$100
$5,000	$88	$92	$96	$100	$104	$108	$113	$117	$121	$125
$6,000	$105	$110	$115	$120	$125	$130	$135	$140	$145	$150
$7,000	$123	$128	$134	$140	$146	$152	$158	$163	$169	$175
$8,000	$140	$147	$153	$160	$167	$173	$180	$187	$193	$200
$9,000	$158	$165	$173	$180	$188	$195	$203	$210	$218	$225
$10,000	$175	$183	$192	$200	$208	$217	$225	$233	$242	$250

Avg Daily Balance	Minimum Payment Due Based on Applicable APR									
	19%	20%	21%	22%	23%	24%	25%	26%	27%	28%
$1,000	$26	$27	$28	$28	$29	$30	$31	$32	$33	$33
$2,000	$52	$53	$55	$57	$58	$60	$62	$63	$65	$67
$3,000	$78	$80	$83	$85	$88	$90	$93	$95	$98	$100
$4,000	$103	$107	$110	$113	$117	$120	$123	$127	$130	$133
$5,000	$129	$133	$138	$142	$146	$150	$154	$158	$163	$167
$6,000	$155	$160	$165	$170	$175	$180	$185	$190	$195	$200
$7,000	$181	$187	$193	$198	$204	$210	$216	$222	$228	$233
$8,000	$207	$213	$220	$227	$233	$240	$247	$253	$260	$267
$9,000	$233	$240	$248	$255	$263	$270	$278	$285	$293	$300
$10,000	$258	$267	$275	$283	$292	$300	$308	$317	$325	$333

Minimum payment due is estimated by multiplying the monthly periodic rate by the account balance and adding an amount equal to a one percent principal reduction:
*Balance * (APR/12) + Balance * .01 = Minimum Payment Due*

Impact on issuer

- In developing our Safe Credit Card Standards we created an issuer revenue model and tested the Standards to determine their impact on issuer revenue streams. Though this revenue analysis is not necessarily relevant to the present reasonable and proportional analysis, we note that our estimates show that issuers would receive a significant amount of penalty interest income even under our proposed safe harbor guidelines, including the seven-point penalty premium.

- An example calculation illustrates that issuers can earn significant income even from constrained penalty interest charges. For every one million credit card accounts held by an issuer, several thousand will be delinquent at any given time. In 2008, the average overall delinquency rate (accounts 30 days past due) was approximately five percent.[25] Though we do not have data showing the number of accounts that are 60 days past due(the minimum trigger for applying penalty interest rate increases on existing balances under the new law), we will assume the figure to be between two and three percent for the present illustration. If 2.5 percent of accounts are 60 days past due, 25,000 accounts per million would be subject to a penalty interest charge. If the average minimum charge were $105 for a six month penalty, as noted above, the issuer's *minimum* revenue on the penalty interest rate increase would be $2.6 million per one million accounts. The actual charges are likely to be higher because some accounts will take longer than six months to establish the cure.

- Even if a percentage of these charges would not be collected due to chargeoffs, the example illustrates that issuers may expect to receive an amount of revenue from the new safeguarded penalty charges that is significant enough to cover the marginal costs associated with workouts or counseling of seriously delinquent accounts. We are unaware of any data showing otherwise.

In the final analysis, we agreed with the seven-point threshold suggested in several proposed pieces of legislation in the 110th Congress, including those from Senator Levin (S.1395) and Senator Menendez (S.2753). A set threshold based on the number of allowable percentage points sets a clear and easily understandable rule. We believe that a seven-point threshold is both reasonable and proportional because it offers cardholders substantial relief from the risks of price shocks found in the market today, while retaining a significant revenue stream that issuers can rely on to cover the costs of responding to seriously delinquent accounts.

[25] Federal Reserve Statistical Release

Appendix C: Sample State Law Limiting Penalty Fees

Cal Fin Code § 4001

§ 4001. Permissible amounts to be charged by supervised financial organization or charge card issuer

(a) A supervised financial organization or charge card issuer may not charge more than any of the following amounts:

(1) If set forth in the consumer credit or charge card agreement, one of the following fees:

(A) Seven dollars ($7) with respect to any monthly billing cycle as a late payment charge on the minimum payment due that is not paid within five days after the date the payment is due.

(B) Ten dollars ($10) with respect to any monthly billing cycle as a late payment charge on the minimum payment due that is not paid within 10 days after the date the payment is due.

(C) Fifteen dollars ($15) with respect to any monthly billing cycle as a late payment charge on the minimum payment due that is not paid within 15 days after the date the payment is due.

(2) In lieu of the fee permitted by paragraph (1), if the consumer has already incurred two late payment fees during the preceding 12-month period, the fee charged may be no more than ten dollars ($10) with respect to any monthly billing cycle as a late payment charge on the minimum payment due that is not paid within five days after the date the payment is due.

(3) Ten dollars ($10) with respect to any charge that causes the outstanding balance to exceed the credit limit by five hundred dollars ($500) or 120 percent, whichever is less. No overlimit fee may be charged unless the charge causes the outstanding balance to exceed the credit limit by five hundred dollars ($500) or 120 percent, whichever is less. Not more than one overlimit charge may be assessed with respect to any monthly billing cycle.

* * *

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ATTACHMENT D

Copy of The Pew Charitable Trusts' comments to the Federal Reserve Board, dated September 21, 2009 regarding "Regulation Z; Docket No. R—1364 (Interim Final Rule)," with a focus on urging the Board to rule that credit cards with partial variable rates including fixed minimum rate requirements are not eligible for exceptions to certain 45-day notice, notice of right to cancel and interest rate requirements found in the Credit CARD Act of 2009.

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September 21, 2009

By Electronic Delivery

Jennifer J. Johnson, Secretary,
Board of Governors of the Federal Reserve System
20th St. and Constitution Avenue, NW
Washington, DC 20551

RE: Regulation Z; Docket No. R–1364 (Interim Final Rule)

Dear Ms. Johnson:

In the following comments, we respond to the Board's Interim Final Rule under Regulation Z, published at 74 FR 139 (July 22, 2009) at p. 36077 et. seq., according to new requirements found in the Credit CARD Act of 2009. Our comments include the following key points:

1. Exceptions to § 226.9 notice requirements for fluctuations in variable interest rates should not apply to any account for which the issuer requires a fixed minimum interest rate to apply.

2. There is no basis in the Act for the proposed exception to the right to reject changes in terms for increases in minimum required payments, and it should be deleted.

3. The proposed exception to the requirement to notify cardholders of their right to cancel and avoid interest rate increases or other significant changes in cases where accounts are 60 days past due is unwarranted, and overbroad.

4. Issuers should be required to provide notice to cardholders within 45 days of the expiration of deferred interest periods.

Pew's Safe Credit Cards Project began in 2007 as a research-based effort to protect consumers from unfair credit card practices and promote responsible management of debt. We have published a set of Safe Credit Card Standards as well as various results from our research and analysis. Recently, we completed a new analysis of all credit cards offered by the largest 12 bank issuers and the largest 12 credit union issuers. We have included in our comments selected findings from this research, which will be published soon. Additional results will be available in our future comment letters to the Board. As always, we are available to discuss these comments or any other aspect of our work at any time.

Sincerely,

Nick Bourke
Manager, Pew Safe Credit Cards Project
nbourke@pewtrusts.com | 202-552-2123 direct
www.pewtrusts.com/creditcards

1. **Exceptions to § 226.9 notice requirements for fluctuations in variable interest rates should not apply on any account for which the issuer requires a fixed minimum interest rate to apply.**

Pew's latest analysis of all consumer credit cards offered by the largest bank and credit union issuers found that bank issuers moved away from "fixed" interest rates and toward "variable" rates during the first half of this year.[1] We found that there is a related and possibly troubling trend emerging. A growing number of credit cards include terms designed to ensure that even variable rates will not fall lower than a fixed minimum set by the issuer. For these cards, issuers will benefit as interest rates rise according to operation of a third-party index rate, but many cardholders will be prevented from enjoying the benefits of falling index rates due to the fixed minimums set by issuers. For these cards, the issuer's chosen fixed minimum rate will apply regardless of the disclosed variable interest rate formula. We call this mechanism a *minimum rate requirement.*

The following example, taken from the application disclosures for the Wells Fargo Visa Platinum Card, demonstrates how the minimum rate requirement works.

Example: Wells Fargo Visa Platinum Card – Minimum Rate Requirement

Annual percentage rate (APR) for purchases	Introductory APRs range from 0.00% to 5 90% for the first 6 or 9 billing periods the account is open.[1] After that, APRs range from 8 65% to 22 65% depending on applicant's credit qualifications

Variable rate information	Your APRs for purchase, cash advance and overdraft protection balances may vary The purchase APR is determined by adding a margin ranging from 2.90 to 16 90 percentage points to the Index Rate The cash advances and overdraft protection advances APR is determined monthly by adding 17 74 percentage points to the Index Rate. The Default Rate varies and is determined monthly by adding up to 23 99 percentage points to the Index Rate [3]

[3]This Index Rate is equal to the highest prime rate published in the Money Rates column of *The Wall Street Journal* three business days prior to your billing statement closing date, subject to the applicable minimum APRs. The standard APRs for purchases are subject to minimum rates ranging from 8 65% to 22 65% and will not decrease below the applicable minimum rate regardless of changes to the Index Rate The standard APRs on cash advances and overdraft protection advances are subject to a minimum rate of 23 49% and will not decrease below 23 49% regardless of changes to the Index Rate

Source: Wells Fargo website, July 9, 2009

Since December of last year, use of this minimum rate requirement has increased among credit cards issued by the largest banks, from one percent to nine percent of cards (for purchase rates) and from ten percent to 38 percent of cards (for cash advance rates). In the

[1] Pew will soon release the second in our series of reports on credit card practices. In July of this year, we analyzed application disclosures for all consumer credit cards offered online by the largest 12 bank issuers and the largest 12 credit union issuers (a total of nearly 400 cards). Research of this analysis showed that, while nearly one-third of advertised purchase rates on bank cards were "fixed" in December, fewer than one percent were "fixed" in July. Additional results of this survey may appear in our future comment letters to the Board.

example above, this mechanism added a premium of 2.5 percentage points to the rate that would otherwise have applied based on the disclosed variable rate formula (assuming a current 3.25 percent index rate). The largest minimum rate requirement premium observed in our study was five percentage points.

Section 101(a) of the Credit CARD Act adds new Truth in Lending Act (TILA) Section 127, which requires 45-day advance notice of increases in interest rates, except under three conditions. These exceptions are referenced directly from new Section 171 of TILA, an excerpt of which follows [emphasis added]:

> SEC. 171. LIMITS ON INTEREST RATE, FEE, AND FINANCE CHARGE INCREASES APPLICABLE TO OUTSTANDING BALANCES.
>
> (a) In General- In the case of any credit card account under an open end consumer credit plan, no creditor may increase any annual percentage rate, fee, or finance charge applicable to any outstanding balance, except as permitted under subsection (b).
>
> (b) Exceptions- The prohibition under subsection (a) shall not apply to--
>
> * * *
>
> (2) an increase in a variable annual percentage rate in accordance with a credit card agreement that provides for changes in the rate **according to operation of an index** that is **not under the control of the creditor** and is available to the general public;
>
> * * *

This exception, reflected in the Board's proposed paragraph (c)(2)(v)(C) of § 226.9, should not apply to cards including a minimum rate requirement because these cards do not provide for changes "according to operation of an index." Furthermore, by placing a minimum fixed floor against which the index cannot operate, the issuer has exercised control over the index in a way that violates the law's requirement.

The Board noted that changes based on operation of an index generally would not require notice because none of the terms required to be included in application disclosures have changed. 74 FR 139 at p. 36085. However, new Section 127(i) specifically requires 45 day advance notice before any "increase in interest rate" unless one of the three provided exceptions apply. The Board should clearly state that accounts including a minimum rate requirement are subject to the 45 day notice requirement because they do not meet the requirements set in new TILA Section 171(b)(2) for changes in rates according to operation of an index not under the control of the creditor. Since no other exception would apply, issuers should be required to send notice before rates increase.

Similarly, in its upcoming rulemaking efforts, the Board should make clear that accounts with minimum rate requirements will not qualify for the variable rate exception to the prohibition against interest rate increases on outstanding balances (new TILA Section 171(a)). As with the notice requirements, accounts with minimum fixed rates fall short of the law's exception for cards that operate in accordance with an index that is not under the control of the issuer. Furthermore, accounts with minimum rate requirements do not justify an exception allowing interest rates on outstanding balances to increase because they allow issuers to expose cardholders to risk of higher rates if the index rises while limiting cardholders' ability to benefit if the index falls.

2. **There is no basis in the Act for the proposed exception to the right to reject changes in terms for increases in minimum required payments, and it should be deleted.**

The interim rule concludes that an increase in the required minimum payment is not a change that the cardholder has a right to reject. 74 FR 139 at p. 36084. The effect of the Board's rule, taken to its conclusion, is that issuers can on 45 days notice require payment of all outstanding balances in full. This effect is not consistent with the clear intent of the legislation to eliminate practices under which issuers can unilaterally dictate repayment terms different from those to which cardholders agreed when they borrowed the credit.

For changes in terms that a cardholder has a right to reject, the Credit CARD Act provides protection from undue acceleration of the outstanding balance. Specifically, new TILA Sections 127(i)(4) and 171(c)(2) provide that when a cardholder rejects a change in terms, the issuer can close the account for future purchases but cannot require repayment of the outstanding balance on new terms less favorable than a five year repayment, or a minimum payment that no more than doubles the percentage of the balance due.

Increases in minimum payment are by the Board's proposed rule effectively exempted from this protection. The proposed rule would mean that while cardholders must get 45 days notice of an increase in the minimum payment, they have no remedy. The debtor must accept the increased payment requirement or be prepared to pay off the balance in full and close the account – not a solution that will help cardholders for whom an increase is a problem.

Thus, the Board's treatment of minimum payment increases creates a significant loophole in the protections Congress envisioned limiting acceleration of repayment of outstanding balances when cardholders choose to close an account. An issuer seeking to avoid the carefully crafted repayment protections of the law has only to increase the minimum payment to take away those protections from the cardholder and force repayment of the balance on a schedule far more accelerated than the Act otherwise provides.

The Board justifies forcing cardholders to accept unilateral minimum payment increases by pointing to Congress's concern that cardholders understand the result of paying only the minimum amount. 74 FR 139 at p.36085. Indeed, amended TILA Section 127(b)(11) requires that issuers disclose to cardholders that making only minimum payments will maximize the amount of interest they pay and the amortization period. Clearly Congress wanted cardholders to have this information to foster informed judgments about whether to pay more than the minimum required payment.

But the mandate that consumers have better information about the effects of minimum payments does not lead to the Board's conclusion that cardholders should not be able to reject an increase in the required minimum payment imposed by the issuer. If anything, that mandate points in the opposite direction. If cardholders do not have the right to continue making the minimum payment amounts they originally agreed to, even if doing so would lead to longer and more expensive payouts, the disclosures required by the Act about the adverse effect of such a choice would be meaningless.

3. **The proposed exception to the requirement to notify cardholders of their right to cancel and avoid interest rate increases or other significant changes in cases where accounts are 60 days past due is unwarranted, and overbroad.**

As explained below, we strongly encourage the Board to require issuers to provide cardholders with notice of the right to cancel any significant change in the account terms, even if the account is 60 days past due. Even if the Board finds that it can and should create an exception such that cardholders may not reject penalty rate increases after accounts become 60 days past due, the exception should be narrowly tailored so that only penalty interest rate increases triggered by the 60 day delinquency are exempted from the right to cancel requirement.

Section 101 of the Credit CARD Act of 2009 ("*Protection of Credit Cardholders*") requires issuers to provide advance notice of interest rate increases and other significant changes, and gives consumers the right to reject these changes by canceling the account. New Section 127 of TILA, as amended by the Credit CARD Act, includes the following language [emphasis added]:

(i) Advance Notice of Rate Increase and Other Changes Required-

(1) ADVANCE NOTICE OF INCREASE IN INTEREST RATE REQUIRED- In the case of any credit card account under an open end consumer credit plan, a creditor shall provide a written notice of an increase in an annual percentage rate (except in the case of an increase described in paragraph (1), (2), or (3) of section 171(b)) not later than 45 days prior to the effective date of the increase.

(2) ADVANCE NOTICE OF OTHER SIGNIFICANT CHANGES REQUIRED- In the case of any credit card account under an open end consumer credit plan, a creditor shall provide a written notice of **any significant change**, as determined by rule of the Board, in the terms (including an increase in any fee or finance charge, other than as provided in paragraph (1)) of the cardholder agreement between the creditor and the obligor, not later than 45 days prior to the effective date of the change.

(3) NOTICE OF RIGHT TO CANCEL- **Each notice** required by paragraph (1) or (2) shall be made in a clear and conspicuous manner, and **shall contain a brief statement of the right of the obligor to cancel** the account pursuant to rules established by the Board before the effective date of the subject rate increase or other change.

This right to cancel found in paragraph 127(i)(3) attaches to "each notice" required by either 127(i)(1) or (i)(2). The law specifically allows only three exceptions when notice and right to cancel requirements do not attach, based on incorporating three of the four exceptions outlined in paragraph 171(b) of the law: for accounts that experience increased interest rates due to (1) expiration of a promotional rate, (2) changes in the rate according to operation of an index not under the control of the issuer, or (3) a cardholder's failure to complete a workout plan. The fourth paragraph and final 171(b) exception, for penalty rates triggered by delinquencies of 60 days or more, is pointedly not incorporated. Consequently, even in cases where accounts are 60 days past due, the new TILA Section 127(i) notice and right to cancel requirements should apply.

The Board's rules correctly reflect that issuers who reprice outstanding balances on accounts that are 60 days past due will be required to give 45 days advance notice of the increase. But the proposed rules create a new exception, excusing issuers from providing notice of the right to cancel and avoid the rate increase. Part of the Board's justification for creating this exception is based on "new TILA Section 127(i)(3)'s express grant of authority to establish rules implementing the right to cancel." 74 FR 139 at p. 36089. But while the relevant sections of the new law quoted above give the Board responsibility for determining what constitutes a "significant change" that triggers a right to notice (Section 127(i)(2)), and for establishing rules governing the manner in which an obligor can cancel the account (Section 127(i)(2)), they do not give the Board authority to create exceptions to the substantive right to receive these notices. The legislative text clearly incorporated a list of allowable exceptions, and this list pointedly did not include reference to the exception that the Board would create. In interpreting the new law, the Board should avoid allowing exceptions to a statutorily prescribed list in the absence of a specific mandate to do so.

The Board also based its authority for creating the exception to the notice of right to cancel requirement on its general authority under 15 U.S.C. 1604(a) to "make adjustments and exceptions to carry out the purposes of TILA. 74 FR 139 at p. 36089. The Board noted that, absent the creation of this exception:

> [A] consumer who is more than 60 days delinquent could use the right to reject a rate increase to override the exception specifically created by the Credit Card Act for such circumstances. The Board does not believe that this was Congress's intent because the Credit Card Act's exception for delinquencies of more than 60 days contains its own remedy for consumers. Specifically, the exception provides that, if an increased rate, fee, or finance charge is applied to an outstanding balance based on a delinquency of more than 60 days, the creditor must 'terminate such increase not later than 6 months after the date on which it is imposed, if the creditor receives the required minimum payments on time during that period.... Thus, based on its review of the Credit Card Act as a whole, the Board believes it would be inconsistent to extend the right to reject to circumstances where a consumer is more than 60 days delinquent. 74 FR 139 at p. 36090.

We disagree. The proposed exception would run contrary to the both the plain language and the purposes of the new law. The "exception specifically created by the Credit Card Act" referenced by the Board is an exception to a rule designed to protect cardholders from interest rate increases on outstanding balances, something the Board itself has determined to cause "substantial consumer injury," particularly in cases where issuers impose penalty rates using "hair trigger" repricing that can cause "unfair surprise." 74 FR 18 (29 January 2009) at pp. 5522 and 5527. Congress created the 60-day exception as a bright-line rule indicating where outstanding balances could *possibly* be subject to an interest rate increase, but Congress did not intend for issuers to have unfettered power to raise rates in these cases. The cardholder's rights continue to apply. Congress specifically established that consumers have a "right to cancel" that includes the right to avoid disclosed changes that are the subject of the notices required in new TILA Section 121(i)(1) and (2), including notices of penalty interest rates triggered by 60-day delinquencies.

Even if the Board holds that this exception to the right to cancel is necessary and appropriate, the proposed rules are overbroad, and go too far in exempting all accounts that are past due by 60 days from the right to reject *any* significant change. The Board's true concern in creating the exception appears to be preventing cardholders from rejecting penalty charges triggered according to the provisions of new TILA Section 171(b)(4). However, proposed Section 226.9(c)(2)(iv)(D)(1) of the rules would prevent cardholders from rejecting *any* of the changes covered by paragraph (c)(2)(ii) of that section, including changes in annual percentage rates but also changes to fees for issuance or availability of the account, transaction charges, grace periods or a variety of fees and methods of calculating charges. While the Board is correct to note that a specific remedy for penalty increases is available, the Board's proposed rule would create a loophole for non-penalty-related changes that would leave cardholders with no remedy at all.

This blanket exemption is overbroad and would not meet the law's goal of giving consumers the option to reject substantive amendments to their account agreements. The Board should amend the proposed rule, either to remove the exemption completely or, at a minimum, to exempt issuers from the notice of right to cancel requirement *only* for penalty-related charges triggered by 60-day delinquencies (to which the law's six-month cure period would apply). For all other significant changes identified by the Board, the notice of right to cancel should be provided for all accounts regardless of delinquency status.

4. Issuers should be required to provide notice to cardholders within 45 days of the expiration of deferred interest periods.

The Board stated that it intends to apply the exception to notice requirements found in Section 226.9(c)(2)(v)(B), regarding expiration of promotional interest rate periods, to deferred interest arrangements as well. 74 FR 139 at p. 36085. Because deferred interest promotions contain a unique danger to consumers (i.e., significant lump-sum interest charges that have accrued for 12 months or more *before* the promotion expires), we request that the Board refine its position so that issuers will be required to notify cardholders before the expiration of the deferred interest period even if cardholders will not have the right to reject imposition of deferred interest at the end of the period.

Our Safe Credit Card Standards call for the prohibition of deferred interest rates because they can be confusing and dangerous to consumers.[2] Deferred interest arrangements allow

[2] Pew's Safe Credit Cards Project began in 2007 as an effort to protect customers from unfair credit card practices and promote responsible management of debt. Since then, we have published a set of Safe Credit Card Standards as

borrowers to avoid all interest if a promotional balance is paid in full by the end of the deferment period, or else pay the entire sum of accrued interest. Creditors providing deferred interest offers must count on a certain portion of debtors finding themselves unable to pay off a balance within the allotted time, or forgetting when the balance is due. Though none of the general purpose consumer cards we studied from the largest bank and credit union issuers currently include deferred interest arrangements, we are concerned about the dangers these arrangements pose on the margins.[3]

Without arguing for the prohibition of deferred interest arrangements at this time, we urge the Board to change its proposed rules to help improve price transparency and reduce the risk of large debt shocks to cardholders. Specifically, issuers should be required to send notice to cardholders at least 45 days prior to the expiration of a deferred interest period. The general exception for promotional rates should not apply. Unlike the expiration of promotional rates, which merely marks the beginning of higher interest charges on outstanding balances going forward, expiration of deferment periods results in instant and potentially significant increases in a cardholder's debt burden. This change in debt burden is more akin to a significant change in the account agreement than it is to expiration of a temporary promotional rate.

Requiring issuers to notify cardholders prior to expiration of a deferred interest period is consistent with the overall goals of the Credit CARD Act, including the establishment of "fair and transparent practices" relating to credit card plans. It would also complement Congress's intent to give cardholders a chance to repay deferred interest amounts fully before the end of the deferment period. In amended TILA Section 164, Congress required issuers to apply payments (beyond the minimum payment due) first to high-rate balances before low-rate balances, but created an exception that allows cardholders to pay off deferred interest arrangements during the last two months of the deferment period. Requiring issuers to send notice at this time would further that goal by helping cardholders make informed decisions about paying off the deferred balance.

The Board may address its concerns about unintended adverse consequences (74 FR 139 at p. 36085) by requiring notice that the deferred interest period is about to expire without requiring notice of a cardholder's right to cancel and reject the imposition of accrued interest. Cardholders would thus be required to pay off the deferred interest balance prior to the end date or accept the lump sum accrued interest charge as provided in the original deferred interest agreement.

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well as various results from our research and analysis. The Safe Credit Card Standards and related information are available at www.pewtrusts.org/creditcards.

[3] Recently, we completed a new analysis of all credit cards offered by the largest 12 bank issuer and the largest 12 credit union issuers. See footnote 1, supra.

CUNA & Affiliates

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**WRITTEN TESTIMONY
OF
MARK CAVERLY
EXECUTIVE VICE PRESIDENT
LOCAL GOVERNMENT FEDERAL CREDIT UNION
RALEIGH, NC**

**ON BEHALF OF
CREDIT UNION NATIONAL ASSOCIATION (CUNA) AND
ELECTRONIC PAYMENTS COALITION (EPC)**

**BEFORE THE COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES**

"H.R. 2382, the Credit Card Interchange Fees Act of 2009"

Thursday, October 8, 2009

WRITTEN TESTIMONY
OF
MARK CAVERLY
EXECUTIVE VICE PRESIDENT
LOCAL GOVERNMENT FEDERAL CREDIT UNION
RALEIGH, NC

ON BEHALF OF
CREDIT UNION NATIONAL ASSOCIATION (CUNA) AND
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BEFORE THE COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

"H.R. 2382, the Credit Card Interchange Fees Act of 2009"

Thursday, October 8, 2009

Chairman Frank, Ranking Member Bachus, Members of the Committee, thank you for the opportunity to testify at today's hearing on H.R. 2382, the Credit Card Interchange Fees Act of 2009. My name is Mark Caverly and I serve as Executive Vice President of Local Government Federal Credit Union[1] in Raleigh, North Carolina, where I am responsible for oversight of the credit union's marketing, human resources, and information technology departments. I am testifying on behalf of the Credit Union National Association[2] and the Electronic Payments Coalition.[3]

At LGFCU, we put member needs first. Over the years we have stayed the course amid a whirlwind of changes in society, to the economy and among financial institutions, all to fulfill our original purpose of improving members' lives. We remain committed to helping our members prosper by offering affordable, safe and comprehensive financial services through good times and bad. LGFCU has $957 million in assets and 178,000 members. We are the issuers of 173,000 debit cards and 16,000 credit cards. Interchange from debit card usage represents 14.4 % of LGFCU's monthly income.

[1] Local Government Federal Credit Union (LGFCU) is a not-for-profit, member-owned financial cooperative established to serve the financial needs of local government employees, elected officials, volunteers and their families. With the support of the N.C. League of Municipalities and the N.C. Association of County Commissioners, LGFCU received its federal charter on March 24, 1983 from the National Credit Union Administration (NCUA).

[2] Credit Union National Association (CUNA) is the largest credit union advocacy organization in the United States, representing approximately 90% of America's 8,000 credit unions and 92 million credit union members.

[3] The Electronic Payments Coalition (EPC) includes credit unions, banks, and payment card networks that move electronic payments quickly and securely between millions of merchants and millions of consumers across the globe. EPC's goal is to protect the value, innovation, convenience and competition in today's growing electronic payments system. EPC educates policymakers, consumers, and the media on the system's role economic growth, and the importance of protecting consumer choice and stability for the continued growth of global commerce.

The Truth about Interchange

To begin, let me cover some basic facts about interchange. First, interchange is one part of what is referred to as the "merchant discount fee," which has been described by the Government Accountability Office (GAO) in the following manner:

> "The majority of the costs associated with accepting cards are the 'merchant discount fees' paid to the banks that merchants use to process their transactions. Generally, for each Visa or MasterCard transaction, a portion of the merchant discount fee is paid from the merchant's bank—called the acquiring bank—to the bank that issued the card. This portion, called the interchange fee, reimburses card issuers for a portion of the costs they incur in providing card services."[4]

Many wonder who is responsible for interchange and who receives it. Interchange is the responsibility of the merchant and the merchant's bank. Card issuers, like my credit union, which assume the risks of fraud, nonpayment and the administration of the card program, receive interchange.

The merchants like to describe interchange as a fee on consumers; however, interchange represents the merchants' assumption of their fair share of the financial responsibility for the card payment system. Merchants receive many benefits as a result of their participation in the payment system. In short, interchange is a 'cost of doing business' for a merchant which chooses to accept this valuable form of payment.

Interchange is important to credit unions and their members because it helps support the card program. It helps to cover some of the costs associated with the risk of non-payment that the card issuers assume, the risk of fraud and other data breaches that occur at merchants, and the administrative costs of the program. And, as the GAO notes, it only covers a portion of those costs. In short, the benefits merchants receive from accepting our cards far exceeds any interchange fees we receive.

Card Issuers Oppose H.R. 2382

As debit and credit card issuers, credit unions oppose H.R. 2382. The bill aims to disrupt the functional debit and credit card marketplace to the detriment of consumers. Credit unions are particularly concerned that this legislation would permit merchants to refuse to accept credit union cards, creating a strategic

[4] Government Accountability Office. "Credit and Debit Cards: Federal Entities Are Taking Actions to Limit Their Interchange Fees, but Additional Revenue Collection Cost Savings May Exist." GAO-08-558. May 15, 2008. 1.

advantage for cards issued by other institutions. In addition to H.R. 2382, credit unions also oppose H.R. 2695, a bill to give merchants an anti-trust advantage in negotiations to reduce the amount of interchange received by issuing institutions.

I would also like to point out that it appears to be the objective of at least some merchant organizations to drive credit unions like LGFCU out of the payment card business. In 2007, the National Retail Federation (NRF) testified in the House Committee on the Judiciary that interchange is, "so high that even small banks can make a profit."[5] I would like to confirm that interchange supports our ability to make payment cards available to our members. I would also like to confirm if the big retailers are successful at having Congress reduce interchange, LGFCU may not be able to offer payment cards to its members. With respect to NRF's statement, the only disagreement between the retailers' statement and our view is whether putting credit unions and community banks out of the payment card business is a good result. NRF apparently believes it is. We strongly disagree.

Today's Card Payment System Provides Value to Credit Unions, Consumers, and Merchants

To credit unions and their members, interchange and the card payment system are important elements of the successful, competitive banking experience. It happens every day: a member makes a purchase with a debit or credit card, the merchant is paid immediately, and the credit union that issued the card receives interchange from the merchant's bank. Interchange reflects a merchant's fair share of the costs of this convenient system and helps the credit union address the costs of maintaining a card program. Of the 92 million credit union members nationwide, 98% belong to a credit union that issues debit cards and 84% belong to a credit union that issues credit cards. Of credit unions nationwide, 71% issue debit cards and 51% issue credit cards. Consumer-friendly and cost-effective card programs are vital for a credit union's ability to attract, serve, and retain members. Card programs allow credit unions to compete with the largest of financial institutions.

For our consumer members, the card payment system ensures competitive rates and programs and consumer-friendly terms. The consumer benefits when credit unions serve as card-issuing institutions. The payment system is a highly competitive market, evidenced by the fact that consumers have thousands of payment card options available to them, and they can use their payment cards with merchants across the country and around the world. H.R. 2382 would result in cost-shifting from the merchants to the

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[5] Committee on the Judiciary. United States House of Representatives. Hearing on "Credit Card Interchange Fees." July 19, 2007. http://judiciary.house.gov/hearings/printers/110th/36785.PDF. 48.

consumers, and increased fees for consumers to obtain debit and credit cards. The strongest evidence of this is the fact that the merchants are not willing to warrant that any savings they realize from a proposed reduction in their interchange expense would be passed on to consumers in the form of lower prices. If issuing institutions terminated their card programs due to a decrease in interchange, consumers would have fewer choices in providers. Those of us who work in smaller financial institutions believe that more choices lead to lower costs for consumers.

For merchants, the payment card networks provide value in immediate payment and increased customer satisfaction. Merchants which accept payment cards benefit through reduced risk and immediate payment on debit and credit transactions. Merchants get paid immediately for purchases even when consumers do not pay their credit card bills; they also enjoy reduced costs associated with accepting checks and cash, the ability to do business on-line, and increased sales volume and expedited sales. These benefits are possible because the card-issuing credit union assumes the credit risk for the transaction. There are costs to receiving the value of the payment processing system and interchange represents the merchant's fair share of these costs.

H.R. 2382 Would Fundamentally Change the Payment System, Adversely Affecting Consumers and Credit Unions

H.R. 2382 attacks many of the essential characteristics of the payment card system upon which consumers depend every day. This legislation would disenfranchise consumers and increase their costs of debit cards and credit cards. For example, as I explain in more detail below, H.R. 2382 would reduce consumer choice for payment options, allow merchants to discriminate against credit unions and other small issuers, and facilitate deceptive (and sometimes illegal) surcharging by merchants.

Reducing Consumer Choice

Consumers appreciate that they can travel virtually anywhere in the world and use one of our payment cards to make a purchase. They see the network logo displayed by a merchant, such as a Visa credit card logo, and our members know they can use their LGFCU Visa credit card—*or any other Visa credit card*—to pay for a purchase with that merchant. The member could choose to use our Visa credit card, and I hope they would. But our member may also choose to use a Visa credit card issued by another financial institution. The choice is the cardholder's—not ours, and not the merchant's. Cardholders' ability to choose which Visa credit card to use benefits not only our members, but also merchants because it gives consumers peace of mind that they can shop at the merchant and have a convenient and safe way to pay for their purchase.

H.R. 2382 would eliminate this peace of mind for our members and reduce their payment choices. The legislation would allow a merchant to reject the consumer's choice of Visa credit card and force the cardholder to use only certain kinds of Visa credit cards (*e.g.*, those that do not have rewards available, or that do not provide benefits to charities). Not only would this rob consumers of their ability to choose how to make a payment, but it would also force consumers to carry more payment cards in their wallet. If this legislation were enacted, consumers would need to carry several credit and debit cards even just for emergencies because consumers will no longer have confidence that their LGFCU Visa credit card will be accepted by merchants, even those which purport to accept Visa credit cards!

Discriminating Against Credit Unions

Today, the payment card networks allow smaller institutions, such as LGFCU and other credit unions, to compete on a level playing field against larger payment card issuers. A credit card issued by LGFCU is just as functional as one issued by our competitors and is accepted at the same locations. This allows LGFCU to compete for cardholders based on service level, price, and other factors.

H.R. 2382 would make it much more difficult for us to compete against the larger credit card issuers. The legislation, for example, would allow a large big-box merchant to team with a large card issuer to enter into an exclusive payment card acceptance arrangement and allow the merchant to reject all other issuers' cards on "cost" grounds. There is simply no way that a community bank or credit union would be able to enter into such an acceptance deal with a large big-box retailer. Similarly, even if the big-box retailer did not sign an exclusive acceptance arrangement with a large bank, the legislation would allow the merchant to coerce cardholders into choosing the payment cards issued by the large banks that are willing to share revenue with that merchant. Again, the ability to enter into such an agreement is not a luxury my credit union would have.

Deceptive (and Sometimes Illegal) Surcharging

Generally speaking, merchants cannot impose a surcharge in connection with the acceptance of a LGFCU Visa credit card. Not only is this good economic news for consumers, but it is also an important consumer protection. Surcharges for payment card usage are oftentimes unpleasant surprises to cardholders who feel as though they have been the victim of a bait and switch. In fact, surcharges are illegal in many states as a matter of consumer protection. Yet, H.R. 2382 is designed to facilitate deceptive surcharging by merchants. The legislation would prohibit payment card networks from ensuring that consumers are not victimized by merchants imposing deceptive surcharges on them. It is unclear to me why Congress would want to prevent Visa, MasterCard, or anyone else for that matter from protecting consumers from these circumstances.

It is my understanding that merchants believe the payment card networks have interfered with merchants' legitimate rights to offer cash discounts. To do so would be illegal under federal law. Despite merchants' complaints, I am not aware of any serious allegation of such a violation, nor am I aware of any law enforcement action in this regard. However, I do know that law enforcement authorities have shown plenty of interest in cracking down on merchants' deceptive surcharging.[6]

Other Concerns Regarding H.R. 2382

The following is a discussion of additional serious concerns we have with the specific provisions of H.R. 2382:

Honor All Cards Rule

H.R. 2382 proposes to abolish the "honor all cards" rule that applies to all merchants which accept cards within a card network's brand (Section 193(b)). This means that, under H.R. 2382, a big-box retailer could tell a customer that they do not accept my credit union's Visa card, but that they do accept Visa cards issued by the top three financial institutions. Our card program is only valuable if our credit union cards are honored across the country and around the world, as any other Visa card issued by another institution. This proposed change would make it impossible for my credit union to provide a competitive card program to consumers, which would result in the inability to attract or retain members.

Chargebacks

H.R. 2382 would absolve merchants from all responsibility when they process a consumer's purchase in violation of the amount that was actually pre-authorized for the merchant's terminal (Section 193(e)). The proposed merchant "free pass" would protect them from repercussions when they exceed the dollar limit established to protect against fraud. We see no justification for rewarding a merchant that chooses to neglect an important fraud protection. Moreover, if the merchants get a free pass for the their risky business, consumers will pay the price.

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[6] http://www.oag.state.ny.us/media_center/2008/aug/aug28a_08.html

Premium Cards

H.R. 2382 would give merchants the ability to refuse to pay a different interchange rate for a premium card, resulting in merchants refusing to accept a consumer's premium card at the point of sale (Section 192). This provision gives merchants control over the consumer's choice. Many consumers choose to use premium cards because they want the services and benefits that accompany such cards.

Pricing Displays

Without any oversight from the card network or the consumer's issuing bank, H.R. 2382 would give the merchant sole discretion in displaying and advertising different acceptance terms for different cards (Section 193(a)), thereby causing customer confusion in the face of the merchant's possibly misleading and deceptive communications. In fact, the legislation specifically states the merchants can "steer a consumer" to a merchant's preferred form of payment, with no oversight or regard for the consumer's best interests. Most concerning, however, is the bill's language that would give merchants the ability to mislead consumers with regard to surcharging.

Regulation by the Federal Trade Commission (FTC) and the Federal Reserve Board

H.R. 2382 would direct the FTC to promulgate and enforce rules to ensure that the card payment system rules, terms and conditions are not unfair, deceptive, or anti-competitive to consumers and merchants (Section 194(b)). It also calls upon the Federal Reserve Board to issue regulations and orders.

While the bill talks about regulation by the Federal Trade Commission (FTC) and the Federal Reserve Board for everyone except the merchants, it never addresses the "elephant in the room." Quite simply, the data security breaches involving consumers' debit cards and credit cards have one trait in common: The breaches occurred on the merchant side of the transaction. Consumers are outraged whenever we have to tell them their card was compromised in a breach. As a card-issuer, we do everything we can to protect our customers, but there is nothing we can do to protect them from the negligence or recklessness of a merchant's data security practices.

In 2009, Heartland Payment Systems, a processor for merchants, announced that *100 million* accounts may have been compromised in a breach. What impact did that have on my credit union? More than 45,000 debit cards and 2,000 credit cards were affected. Because the credit union wanted to protect its members against unwanted charges on their accounts and the confusion that could occur, we reissued cards totaling nearly $150,000 in added expense for this one breach. This was just part of our costs for addressing the breach—a breach we did not cause.

Interchange Fee Disclosure to Consumer at Time of Card Issuance

H.R. 2382 would require card issuers to disclose the amount of interchange fees, as well as any other "fees," to consumers when they apply for a credit card or are issued a debit card. As noted above, consumers do not pay interchange or merchant fees. Disclosing to consumers a fee they do not pay will only lead to confusion. Also it is important to note that merchants already have the right to disclose these fees. Any merchant that believes these disclosures are important should provide them to their customers. If merchants fail to make these disclosures, they do so by choice. Federal legislation on this point is unnecessary.

Conclusion

In conclusion, CUNA and the EPC strongly oppose H.R. 2382. The card payment system provides my credit union with interchange to address the expenses and responsibilities of our card program, including functions such as reissuing cards, staffing call centers, investigating fraud, and covering the risk of nonpayment. Issuing debit and credit cards allows my credit union to compete with the largest financial institutions and gives my credit union the ability to offer cards to build relationships with my members. This provides my members the opportunity to deal with a local institution they know and trust while at the same time gaining access to a global payments system. But most importantly, from the perspective of our consumer-members, the card payment system and interchange work because:

- More competition in the issuing market, specifically from credit unions, will ensure consumers will have access to cards with more consumer-friendly terms and conditions;
- If merchants do not pay their fair share for the benefits they receive from the card payment system (as compared to their operating losses with cash and checks), consumers will either pay more for cards and banking services or, even worse, have fewer options for cards; and
- If the merchants' financial responsibility for the card system is reduced unreasonably by legislative interference, that amount will be padded to the merchants' earnings and not experienced as savings by consumers.

As long as merchants pursue reducing their obligation to support the card payment system, credit unions will stand up for their members nationwide who carry a credit union-issued debit card or credit card in their wallet. We will continue to reach out to our policymakers to share the credit union perspective regarding interchange. Mr. Chairman, on behalf of the Credit Union National Association, and the Electronic Payments Coalition, thank you very much for the opportunity to testify today. I would be happy to answer any questions from the Committee.

Testimony of

Kenneth J. Clayton

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Committee on Financial Services

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Chairman Frank, Ranking Member Bachus, and members of the Committee, my name is Kenneth J. Clayton, senior vice president and general counsel of the American Bankers Association (ABA) Card Policy Council, the group within the ABA that deals with card issues. The American Bankers Association brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.3 trillion in assets and employ over 2 million men and women.

I appreciate the opportunity to testify today on H.R. 3639, the Expedited CARD Reform for Consumers Act of 2009, which would significantly accelerate the effective dates of the broad provisions of the Credit CARD Act ("CARD Act") to December 1, 2009 from either the February 22, 2010 or August 22, 2010 effective dates already provided.[1] The changes made by the CARD Act will provide important benefits to many card holders, and are so broad they are affecting every aspect of the credit card business. As a consequence, all credit card issuers are currently undertaking a massive overhaul of their business practices.

Let me say at the outset that all card lenders – whether part of the largest financial institutions or the smallest community banks – are working vigorously to implement as soon as possible the protections afforded by the CARD Act. Indeed, they have already implemented the interest rate increase restrictions that went into effect on August 20, 2009. The CARD Act represents a fundamental shift in how the credit card marketplace must look, and consumers will be provided greater protections and control with respect to their credit cards.

[1] The vast majority of the provisions of the CARD Act are scheduled to come into effect on February 22, 2010, with certain other provisions scheduled to come into effect on August 22, 2010. The Congress specifically required two provisions – those requiring lenders to provide consumers with 45-days advanced notice of rate increases and that consumers have at least 21 days time from statement mailing to pay their bills – ***to become effective on August 20, 2009***. Essentially, Congress sought to provide consumers with the ability to avoid rate increases as soon as reasonably practical, while providing an expedited time frame for the implementation of the extensive changes to business systems otherwise required by the CARD Act. Prior to passage of the legislation, the Federal Reserve (and the Office of Thrift Supervision and the National Credit Union Administration) had previously issued proposed regulations on a wide range of issues subsequently included in the CARD Act. Those legislative provisions that were similar to those put forth by the regulators were subject to an earlier effective date (February 22, 2010) – one still four months earlier than the July 1, 2010 effective date in the proposed regulation. Provisions that went beyond those originally proposed by the Federal Reserve – such as those involving fee regulation, mandatory review of prior interest rate increases, and gift cards – were given longer implementation periods so as to provide sufficient time to make necessary changes.

Card issuers recognize that Congress has spoken and that changes must come to how we interact with our customers. But I cannot stress to you enough the enormity of this task for issuers. It requires a massive reworking of internal operations, risk management models, and funding calculations. It involves enormous employee re-training and computer recoding. And it requires significant testing and re-testing of the infrastructure necessary to service hundreds of millions of accounts every day, with all of this coming at a time of enormous economic uncertainty and pressure on institution profitability. To do this right requires an investment of hundreds of millions of dollars, thousands upon thousands of manpower hours, and perhaps most importantly, sufficient time. We do not believe that the time frame provided in H.R. 3639 is adequate for the task at hand, and, as a result, consumers, small businesses, and the American economy will suffer.

Simply put, the shortening of the original 18-month implementation period from that which was originally contemplated by regulators is already creating enormous operational challenges for institutions, with very little time cushion for the industry to get done all that it needs to. The Federal Reserve has just issued an 800-page proposed rule, with a short 30-day period for the public to comment.[2] The comments are due early to mid-November. The practical problem is obvious: there is not sufficient time for the Federal Reserve to review the comments received, re-write to incorporate all the changes necessary to get this right, and issue a final rule before December 1, 2009. In turn, lenders would have no time to implement any changes to existing automated programs and manual procedures and to test to be sure that they are in compliance with all the changes.

It becomes even more difficult when you consider that in some instances proposed rules do not yet exist, and that technological solutions to the various challenges posed by the new rules take time to develop. For example, there are some provisions, e.g., reasonableness of fees and requirements to reconsider re-pricings six months after such actions – that have not even been put out for comment by the regulators, yet under the terms of the proposed legislation would still be required to be complied with immediately, even though the industry has no idea what will be involved. Moreover, certain provisions of the CARD Act (e.g., requirements related to payment allocation, minimum payment calculations and disclosures, the posting of all agreements on the Internet, and ensuring that the payment date is the same date each month) cannot be avoided by simply changing practices or policies. They require certainty with regard to what the requirements are so that technological solutions and implementation procedures can be developed. Pushing the implementation date up to December 1, 2009 will make this virtually impossible to do, while placing institutions in violation of federal law and subject to class action litigation.

When the Federal Reserve first required many of the changes ultimately enacted into law, it stated very clearly the consequences of ***not*** providing a reasonable time frame for institutions to come in to compliance: "If institutions were not provided a reasonable time to make changes to their operations and systems to comply with the final rule, they would either incur excessively large expenses, which would be passed on to consumers, or

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[2] Typically, regulators provide two or three times as long for comments so that affected institutions and the public have time to fully evaluate the impact of any proposal.

cease engaging in the regulated activity altogether, to the detriment of consumers."[3] Thus, it should come as no surprise that what the Federal Reserve had predicted has largely come true. Any further acceleration – ***which takes the original regulatory implementation period from 18 months to 10 months (CARD Act) and now to 7 months*** – certainly does nothing to ease the compliance burden on banks and will only further exacerbate the problems lenders are encountering, which inevitably will lead to further credit restrictions in the market for consumers.

Beyond the consequences of a shortened time period for implementation, it is important to understand that there are significant consequences resulting from the changes that were made in the CARD Act. Clearly, changes made will benefit consumers and there will be greater clarity about the credit products and terms on their credit cards. But many of the changes impede lenders' ability to quickly assess increasing risk of loss that some borrowers pose and to take remedial action. As we testified before the CARD Act was enacted, the inevitable result will be that the cost of credit will rise and that some amount of available credit will decline. These natural consequences are now becoming a reality, not because there is an attempt to make changes before the compliance date, but rather because these are a response to the fundamental economic forces to which these laws have become a contributing factor. In other words, these same forces exist before ***and*** after any arbitrary compliance date. We testified before to this trade-off: that greater consumer protection and greater restraint on banks' ability to adjust to changing risk comes at a price of higher cost of credit and less access to credit for many small businesses and individuals. Shortening further the time frame for implementation only exacerbates the burden, resulting in even more disruption for lenders and their customers.

In my statement, I would like to focus on three points:

- Legislation requires extensive reworking of all internal systems, funding mechanisms and risk management tools, which take time, manpower, and resources. Aggressively moving implementation dates forward will only exacerbate the substantial challenges lenders face in meeting the existing timetable.

- The provision requiring 45-day advanced notice for any re-pricing of existing and future balances is already in effect – ***as of August 20, 2009.*** Thus, consumers are already protected from re-pricing actions taken by lenders.

- At a time when the economy is still fragile and consumer spending is anemic, consideration should be given to the unintended consequences of accelerated implementation that can truly harm consumers, small businesses, lenders and the broader economy.

I'll address each of these in turn.

[3] 74 Federal Register 5548

I. Legislation requires extensive reworking of all internal systems, funding mechanisms and risk management tools

The sweeping nature of the CARD ACT is affecting all aspects of the card business – funding, pricing, credit availability, marketing, and compliance. The 800-plus pages of proposed rules (which cover all aspects of card practices) and the new disclosures required (which cover all the printed – and electronic – materials, advertising, applications, solicitations, and credit card contracts) means that compliance with this new law is an enormous undertaking.

Integral to all of these key business decisions are the operational changes that must be made to business practices, software/programming, product design, periodic statements, advertisements, contracts, testing/auditing for compliance, customer service, training, printing of new forms, and training of customer service personnel, just to mention a few. Training for customer service personnel alone requires hundreds of thousands of hours for each of the largest card issuers. Changes to the huge technological infrastructure that underpins the entire card system – including billing and account receivables – is taking hundreds of thousands of hours. Periodic statements must be completely revamped, involving programming changes, testing, legal analysis to ensure compliance, focus group testing, and modifications of services from outside vendors. These changes are likely to take an additional hundreds of thousands of hours for large issuers.

Beyond the business decisions and technical changes that must be made, every issuer must make sure that they are in full compliance with the changes. The penalties can be severe for non-compliance, including significant administrative penalties and class-action lawsuits. With a proposed rule of over 800 pages in length, and potential changes expected following the public comment period, the legal and compliance reviews are time-consuming and expensive. The acceleration of the deadline would make compliance practically impossible, which, in some instances, means that the lender will have no choice but to stop providing credit and reduce existing lines until there can be greater certainty of compliance.

Because of the massive changes to pricing models, funding options and internal operations precipitated by the rule, overall compliance is going to take time. As Sandra Braunstein, the Director of Consumer and Community Affairs for the Federal Reserve stressed in testimony before this Committee that "[i]n order to implement this, card issuers are going to need to rethink their entire business models...reprogram all their systems...redesign all the pieces of paper that they use...there needs to be adequate time allotted for that." And, as there are 6,000 credit card issuers, it is unreasonable to assume that all could easily or simply change to be in compliance.

While it is natural to think of the credit card industry as being composed of very large institutions, it is important to note that there are thousands of small banks with credit card programs. Smaller issuers simply do not have the staff or resources to deal with many of the changes, let alone deal with an acceleration of the compliance date. In fact, we have heard from some of these smaller issuers that they may be forced to exit the business and sell portfolios to larger issuers. This would create more consolidation in the industry and hurt many smaller banks.

Let me provide some practical examples that illustrate the problems that are created by the shortened time frame:

- **System changes would be impossible under such tight time frames.**
  Changes require extensive computer recoding, the application of complicated algorithms, coordination among various computer systems, and rigorous testing. It is impossible for a bank to implement the final rules before the details of that rule are known. Given the process underway by the regulators, it is likely that banks will not know the details until mere days before they must be implemented.

- **Private label cards offered by retailers face real risk of system failure.**
  Not having sufficient time to make changes can have a significant impact on private label cards – those offered by retailers to consumers, in partnership with card lenders. This partnership requires seamless integration among multiple operating systems at both the retailer and the card lender, with any change requiring the dedication of extensive man-hours of computer recoding, testing, employee retraining and the like. It also involves coordination among all stores of the retailer, which can be quite complicated for large nationwide (and international) retail stores with hundreds and even thousands of locations. Such changes would be difficult even under the best of circumstances. Given the limited implementation time contemplated by the pending legislation, it is highly likely that system failures would occur, potentially causing significant loss of revenue to retailers during the peak holiday season, as well as substantial customer confusion, loss of convenience and anger.

- **Gift cards may not be available for the holiday.**
  Gift cards are an extremely popular gift during the holidays. Merchants value these as they increase sales not only during the holiday season, but for many months after. The gift card provisions of the CARD Act include substantive restrictions and required disclosures for gift cards that are not currently provided. It will not be possible to make software and card changes and provide new disclosures (especially as it is not clear what those disclosures are) for new cards in time for the holiday season. In order to avoid violating the CARD Act, gift card issuers, including retailers who issue or sell cards, would need to pull cards already delivered or already in stores by December 1. This is an almost impossible task, and again one that could expose gift card issuers, including retail merchants, to class action liability.

These are just some of the problems the shortened time frame imposes. There are also problems with implementing the payment allocation requirement, the requirement to have payment dates fall on the same day each month, the requirement to make minimum payment disclosures correctly, and the requirement to post credit card agreements on the Internet. All require sufficient time for system development, testing and execution, and cannot be done in the time frame provided under the bill. As a result, this would place these practices in violation of federal law and subject lenders to the possibility of class action lawsuits. Lenders will be faced with a Catch-22 – move forward and provide a card product that may be subject to significant administrative problems, customer confusion, and potential litigation risk, or take drastic action to somehow mitigate that risk, which may include increased prices and reduced access. It is hard to see how the vast majority of American consumers, let alone our economy, can benefit from such a result.

II. Notification of re-pricing is already in effect

Increasing rates on existing balances was one of the biggest concerns of policy makers, and one that Congresswoman Maloney, Chairman Frank and others have repeatedly emphasized. Yet the Committee, and the Congress, heard testimony that imposing any immediate freeze on re-pricing exposed institutions to significant credit risk and substantial compliance challenges. As a result, Congress enacted the provision (that had been proposed by Congresswoman Maloney) that provides customers 45-day advanced notice for rate or fee increases related to existing and future balances, and the right to decline the price increase and pay off the existing balances over time at the original rate. ***This provision is already in effect – as of August 20, 2009,*** thus ensuring that concerns over re-pricing have already been addressed.

III. At a time when the economy is still fragile and consumer spending is anemic, the impact of unintended consequences can be magnified

With any proposed change, it is important to consider the potential long-run consequences as well as the near-term consequences on consumers, small business, and lenders. The underlying changes are already having an impact on lending and the price of credit, and any acceleration of the implementation dates will only add turmoil and make matters worse – all of which have implications for the depth of the recession and speed of recovery.

Credit card loans are the riskiest consumer credit product made available since they are unsecured, have no limits on use, and can be used 24/7 anywhere in the world. They are often the first bill – not even the first loan – that goes unpaid when a borrower loses income. The current environment is no exception; the cumulative impact of six straight quarters of job losses – 7 million since the recession began – is placing enormous financial stress on some individuals. With jobs lost and work hours cut, it does not take long for the financial pressure to become overwhelming. Falling behind on debt payments is an unfortunate side effect of high unemployment and a frozen job market. Last week, ABA reported that second quarter delinquencies (30-days past due) on credit cards reached an all-time high of 5.03 percent (seasonally adjusted). Charge-off of bad loans is also running at very high levels. This picture will not change until the labor market improves and the economy picks up steam – something that most economists believe is not likely until the middle of next year. Simply put, this has made for a very difficult lending environment, requiring lenders to take steps to mitigate risk – ***steps which our bank regulators demand we take.***

While the risk is substantial (and increasing during this recession), the new statutory requirements and prohibitions limit lenders' ability to manage it. Thus, it exacerbates the need to price for risk on the ***front*** end since lenders cannot do so on the ***back*** end. Lenders are deeply concerned about the impact their actions will have on their customers; after all, lenders have a vested interest in having their customers happy and willing to stay with them, as there are a multitude of choices in this very competitive marketplace. However, lenders are left with no other choice but to take risk-averse actions like we have seen in the marketplace; it is the only prudent course and way to stay in business.

As you are aware, the ability of bankers to prudently leverage available capital to make loans is an important ingredient to our economic recovery. Today, $1 of capital supports $10 of bank assets (loans and securities). Thus, any additional cost or losses to capital have an impact up to 10 times the initial impact. Analysts have already noted that the economic downturn and newly-imposed regulatory restrictions will lead to a substantial loss of available liquidity – that is, potential new loans – up to as much as $2.7 trillion.[4] We run the risk that inappropriately speeding up the effective date of the CARD Act will further exacerbate this already serious problem. That will have a real impact on consumers, small businesses, and the broader economy dependent on these loans as their lifeblood.

Moreover, the disruption to the flow of credit – ***at the start of the holiday season*** – is likely to be enormous. This year, loss of income and wealth has meant that consumers are saving more and spending less. ***Any*** disruption in the availability of credit for consumers will dash the hopes of retailers, who rely on holiday sales for the majority of their yearly revenue. Simply put, accelerating this deadline at any time during the year would have a negative impact, but moving the date to December 1 could greatly exacerbate this problem.

Finally, we would urge Congress to consider the impact of not just this proposal to shorten the implementation period, but also the impact of various other proposals that affect a lender's ability to profitably offer credit. The actions we have seen taken by lenders in the marketplace are in many ways the only rational course they have to follow under the circumstances. Failure to do so – in other words, to get the right balance – will only lead to greater losses, a greater pullback from lending, and a greater impact on consumers, small

[4] For example, well-known equity analyst, Meredith Whitney, estimated the potential cost in a Wall Street Journal Op-ed on March 10, 2009: "Just six months ago, I estimated that at least $2 trillion of available credit-card lines would be expunged from the system by the end of 2010. However, today, that estimate now looks optimistic, as available lines were reduced by nearly $500 billion in the fourth quarter of 2008 alone. My revised estimates are that over $2 trillion of credit-card lines will be cut inside of 2009, and $2.7 trillion by the end of 2010."

businesses and the American economy. We would urge Congress to consider these important points as they deliberate on this and other important proposals.

Conclusion

Mr. Chairman, Mr. Bachus, and members of the committee, ABA believes that credit cards provide an invaluable service to consumer and small businesses, and have become integral to our economic system. Any additional actions must be carefully considered so as to not further limit the availability of credit at reasonable rates to all creditworthy borrowers. This is particularly important given the current weak economy and the need for consumers to have access to credit to meet their daily needs.

The adjustments required under the CARD ACT need time to implement even under the best of economic circumstances. Unfortunately, the economic recession adds additional concerns; changes in rules and business practices – and their implications for credit availability and pricing – will certainly be magnified in this recession. Secondary market funding is already in disarray; unemployment is rising; and delinquencies and losses on credit cards are increasing as individuals struggle to make ends meet. Further shortening the implementation period will only make the adjustment more complicated, expensive, and potentially risky (as failure to comply with law and regulation carries with it significant penalties). This will only further inhibit credit availability and raise the cost of credit for all borrowers.

NAFCU

Testimony of

Anthony Demangone

Director of Regulatory Compliance/Senior Compliance Counsel

The National Association of Federal Credit Unions

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

Before the
House Financial Services Committee
United States House of Representatives

October 8, 2009

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Introduction

Good morning Chairman Frank and Ranking Member Bachus. My name is Anthony Demangone and I am here today to testify on behalf of the National Association of Federal Credit Unions (NAFCU). I serve as NAFCU's Director of Regulatory Compliance and its Senior Compliance Counsel.

In my job, I am responsible for all aspects of NAFCU's compliance-related products and services. I personally have spoken to hundreds of credit unions regarding the Credit CARD Act and revisions to Regulation Z's lending rules in the past few months. I have devoted my time, as well as the time of my staff, to help our members understand and implement all of the changes we are facing.

NAFCU is the only national organization exclusively representing the interests of the nation's federally chartered credit unions. NAFCU is comprised of 780 federal credit unions—member owned financial institutions across the nation—representing more than 28 million individual credit union members. NAFCU–member credit unions collectively account for 79 percent of the assets of all federal credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this hearing regarding the *Expedited CARD Reform for Consumers Act of 2009*.

Historically, credit unions have served a unique function in the delivery of financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was created, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have no access to financial services. Congress established credit unions as an alternative to banks and to fill a precise public need—a niche that credit unions continue to fill today for approximately 90 million Americans. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 USC 1752(1)). While nearly 75 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- Credit unions remain committed to providing their members with efficient, low cost personal service; and,
- Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Credit unions are not banks. The nation's 7,691 federally insured credit unions serve a different purpose and have a fundamentally different structure, existing solely for the purpose of providing financial services to their members. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. Unlike their counterparts at banks and thrifts, federal credit union directors generally serve without pay—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

The Expedited CARD Reform for Consumers Act of 2009

There have been a number of changes to the Truth in Lending Act (TILA) and Regulation Z over the last year and a half.

- As this committee knows, Congress amended TILA in May of this year, when it passed the *Credit Card Accountability, Responsibility and Disclosure Act* (CARD Act).
- The Federal Reserve Board (the Board) approved five amendments to Regulation Z in the last 15 months.
- An additional regulation on unfair or deceptive acts and practices (UDAP) was finalized by the functional banking regulators earlier this year. That regulation did not technically amend Regulation Z; however, it dealt with the very same issues regarding credit card lending.
- In September, the Board issued two comprehensive new proposals on closed end real estate lending and home equity lines of credit (HELOCs) spanning more than 1,200 pages.
- Just last week, the Board announced an 841 page proposal to implement provisions of the CARD Act set to go into effect on Feb. 22, 2010.

Notably, this most recent proposal – comprehensive though it may be – does not address the final provisions of the CARD act currently slated to go into effect in August of next year. Moreover, these changes are taking place within an environment that is witnessing major changes to other regulatory systems, such as RESPA reform, appraisal requirements, student lending, and overdraft protection. The list above represents a truly staggering number of changes to Regulation Z. In short, America's credit unions are reeling from the seemingly never-ending number of amendments to the lending law.

The credit union industry is quite small compared to the commercial banking industry. I fear that these myriad changes are being adopted with only those larger institutions in mind. I assure you, however, the resources of the credit union industry, and other small institutions, are being stretched to the limit by the compliance burden created by the numerous, rapid changes to the law. The difficulty with complying with the number of changes is greatly exacerbated by the short effective dates that were included in the CARD Act; compliance dates that would be made even shorter by the legislation this Committee is examining today. Accordingly, NAFCU strongly opposes the *Expedited CARD Reform for Consumers Act.*

Let me be clear, NAFCU understands that the CARD Act was a response to a very legitimate need to reign in unscrupulous and deceptive credit card practices. Credit unions, by and large, do not engage in the sort of practices targeted by the CARD Act. That said, the credit union industry simply will not be able to comply with the myriad changes to TILA and Regulation Z by December 1st of this year. Though we are meeting the spirit of the changes already, many credit unions do not have the resources to fully analyze and implement the letter of the changes in such a short time period.

Congress should not act to move up the effective dates of the provisions included in the CARD Act. The 21 day notice requirement, which I discuss below, illustrates the unintended consequences of just the sort of action contemplated here. It would be impossible for regulations to be promulgated in time for lenders to comply. Shortening the already quick timeline for compliance will further deny institutions the time necessary to complete the strategic planning required to respond to the wholesale changes to lending law prompted by the CARD Act. For all these reasons, NAFCU requests the Committee not to take action on this proposal.

The 21 Day Notice Requirement

The most compelling – not to mention, timely – argument against moving the current effective date forward is the unintended consequences of the 21 day notice requirement included in Section 106 of the CARD Act. This seemingly innocuous and well-intentioned provision appeared to require credit card issuers to mail out periodic statements for credit card accounts at least 21 days before the payment due date. The existing law required periodic statements to be mailed out 14 days in advance. Thus, issuers simply needed to send out the statements seven days earlier. Further, many issuers already provided more than the 14 day minimum required by law. Consequently, the provision was not a concern for most issuers. However, this one provision in the CARD Act applies to all "open end consumer credit plan[s]", which includes some auto loans and signature loans, amongst others. The rest of the CARD Act applies only to credit card accounts. This seemingly small issue, in fact, proved to be a very substantial and costly problem for credit unions and other lenders. More importantly, it is an issue that probably could have been resolved relatively easily, were it not for the fact that the effective date followed so quickly after the bill was signed in to law.

Many credit unions use multi-featured open-end lending systems. Under a master open-end agreement with each member, credit unions can offer several sub-accounts, including open-end automobile loans and signature loans. First, however, credit union members must establish a share account. Subsequently, the member may add share draft (checking), share certificates and loan products to their membership relationship. The credit union membership, rather than a single product, drives the members-credit union relationship. For that reason, many credit unions send a combined member statement, which includes information about the member's savings accounts, checking account, and loans. Therefore, if a member has an open-end automobile loan, the loan's periodic statement is normally included with the members' monthly share statement. Credit unions mail the statements early in the month to reflect activity from the previous month. For open-end automobile loans, members often choose their due date, based on what makes sense for their personal situation. The TILA requirement that periodic statements be mailed at least 14 days before the expiration of a grace period does not apply, as open-end automobile loans have no grace period. They are simple-interest loans with no advances and no retail-purchase component. For that reason, credit unions could previously mail these statements any time for these accounts after the billing cycle closes.

Using consolidated statements is beneficial for two primary reasons. First, our members enjoy receiving a single periodic statement, summarizing all of the accounts they have with the credit union. Second, consolidated statements save the credit union money in printing and postage costs. The provision in the CARD Act, however, forced credit unions to alter their operations in a way that cost a considerable amount of time and money, without providing any tangible benefit to consumers.

Credit unions generally have only two options for complying with the 21-day rule. First, the credit union may simply send a notice in the mail at least 21 days before the due date for each loan. Sending notices for every loan, however, increases operating costs. More importantly, this option will almost certainly cause confusion for many borrowers who do not understand why they are receiving several statements each month, instead of the single consolidated statement to which they have grown accustomed. While sending out new disclosures for each loan will be costly and potentially confusing for members, many credit unions have chosen that route as they believe keeping the current due date is the least burdensome solution for the membership.

The second option is to push back due dates towards the end of the month. This will enable the institution to continue providing statements at the beginning of each month, as is the current practice, without running afoul of the 21-day notice requirement. Regardless of what option credit unions choose for current accounts, very few institutions plan to continue allowing borrowers to pick their own due dates in the future.

While moving back due dates is one of only two viable options under the rule as it exists, this practice will harm consumers more than it helps. Consumers invariably appreciate being able to choose their own due dates. For many consumers this is a mere luxury. However, others who live paycheck to paycheck, plan their payments accordingly; paying known expenses first, then spending what remains. Ideally, moving back the due date would have no impact as it does not affect the consumer's salary or expenses. Nonetheless, it is a certainty that some consumers, who live paycheck to paycheck, and who get paid at the beginning of the month, will end up having not quite enough to pay all of their bills if every loan is due at the end of the month.

Additionally, credit unions will almost certainly eliminate the practice of allowing weekly or bi-weekly due dates as it would be extremely onerous to provide the 21 day disclosures on loans that are due every 7 or 14 days. Weekly and bi-weekly due dates are, of course, beneficial to consumers as they are a useful tool in budgeting. Further, weekly and bi-weekly due dates decrease the overall cost of the loan.

Once a credit union determined whether to keep due dates as is or move them back, a number of other time consuming and costly adjustments had to be made. For credit unions that push back due dates, members must be notified of the new due date, and phones must be answered when members call asking why their due date has been changed.

Additionally, the 21 day notice requirement has three significant operational effects on credit unions that choose to move payments towards the end of each month. First, lenders previously were able to rely on a more-or-less steady stream of loan income throughout the month. With open-end loan income only arriving at the end of the month, operational changes may be necessary to accommodate the fact that there will be significantly less loan income during the rest of the month.

Second, all payments will be due the same day, or at the very least, within just a few days. This will put a tremendous strain on payment processing as every open-end loan in the lender's portfolio will need to be processed and posted to the customer's account in short order. This will, in turn, create staffing issues. Currently, most credit unions process transactions in one of two ways. Some credit unions have a dedicated staff for processing payments. Most credit unions, however, employ a two pronged approach for processing transactions. These credit unions have a small number of staff dedicated to processing; however, that staff is augmented by tellers who also process payments during down time. Regardless of which approach a credit union uses, grouping all open-end loan payments at the end of the month will cause staffing issues. A full time staff for processing transactions will no longer be necessary as each month will feature a short period full of activity, followed by a long period with very few payments to process. Likewise, tellers will no longer be able to augment the process throughout the month as the sheer number of payments coming in at the end of each month will require a dedicated staff for a very short period of time.

The change also will require relatively expensive modifications to the credit union's software in order to reconfigure periodic statements and/or send out new statements for each loan that was previously included on the periodic statement.

NAFCU, and indeed the entire financial services industry, attempted to work with Congress and the Federal Reserve to find a solution to this problem. However, as of today, there has been no resolution.

When Congress passes legislation it dictates *what* must be done. Federal agencies and the industries they oversee, however, are responsible for determining *how* it gets done. Simply put, there needs to be sufficient time between when Congress decides what must be done and when industry can reasonably be expected to have the operational systems in place to accomplish that end. The myriad problems created by this seemingly trivial issue is a particularly timely and elegant argument in favor of providing longer, not shorter, effective dates for the sort of comprehensive changes encompassed in the CARD Act. For this reason, NAFCU opposes any effort to speed up any provisions in the CARD Act.

It is Impossible to Comply with the Act by December 1.

The Federal Reserve will, almost certainly, not be able to promulgate new regulations in time to meet a Dec. 1 effective date. Congress passed the CARD Act on May 20, 2009. On July 22, the Federal Reserve issued an interim final rule implementing the provisions of the CARD Act set to go into effect on August 20. Lenders had less than one month from the day the regulations were published until the effective date. The provisions that went into effect in August were, relative to the rest of the legislation, simple and straightforward. Even still, the Federal Reserve indicated it will provide additional time to come in to compliance because it understands that financial institutions could not possibly make all of the operational adjustments necessary in the short amount of time provided.

As mentioned above, the Board recently announced an 841 page proposed rule to implement the provisions that go in to effect in February. That proposal, however, does not even address the provisions set to go into effect in August of next year. Yet, H.R. 3639 would require all of the bill's provisions to go into effect less than eight weeks from today. As a practical matter, the Federal Reserve could simply decide to make its recently announced proposed rule a final interim rule. However unlikely, the Board also could theoretically issue another final interim rule implementing the provisions of the bill that are not set to go in to effect until August of next year.

Such a rapid rulemaking process, however, would prove problematic. First, such a short timeline, with little or no chance for notice or comment, would almost certainly lead to more unintended problems, similar to the 21 day issue. Moreover, it is just the kind of substantive issues addressed by the bill, and the accompanying operational burdens, which spurred Congress to pass the *Administrative Procedures Act* (APA), which generally requires a notice and comment period for federal rulemakings. Moving up the effective date to Dec. 1, however, would force the Federal Reserve to promulgate regulations with virtually no input from any of the affected parties.

Regardless of whether the Federal Reserve can issue final rules in time, I assure this Committee that industry will not be able to fully comply with the provisions by Dec. 1. The February provisions include new disclosure requirements, new rules on when terms can and cannot be changed, new rules for accepting payments and new requirements on assessing consumers' ability to repay, just to name a few. Periodic statements need to be reconfigured, disclosures need to be rewritten and printed, and software must be modified. In short, it would simply be impossible for the entire industry to make all of the changes necessary to comply with all of the new requirements by Dec. 1. Given that compliance is a factual impossibility, there seems little reason to move the date forward.

An Early Effective Date will Complicate Long Term Strategic Planning

Taken together, the CARD Act and the subsequent changes to Regulation Z will create significant changes in the credit card industry. It is customary, natural, and necessary for lenders to reconsider their own business plan and practices in light of such dramatic changes. Indeed it would border on negligence for a credit card issuer to blithely carry on its current practices, changing only as much as necessary to comply with the new law, without considering the long term effect the changes will have on the market. Yet, a shorter effective date would force many lenders to ignore or discount long term planning for the simple reason that they would have to spend so much time, energy and money ensuring compliance.

The bill's provisions regarding increasing interest rates and changing terms make sense when considered individually, and few of them are exceedingly onerous. Taken together, however, they will require many institutions to reassess risk based lending programs. Some institutions may reasonably decide to eliminate or significantly curtail lending to individuals with low credit scores. Other lenders may decide to aggressively pursue that exact same market. Likewise, given the considerable changes to disclosure requirements, periodic statements and payment processing, now would be a wise time for credit card issuers to thoroughly review their current systems to determine whether they are well suited for the changes to Regulation Z. Some lenders may choose to simply modify their existing systems. Others may realize that the changes are sufficient to justify upgrading to new systems for managing credit card accounts. If institutions are forced to comply even sooner, existing systems will be updated only to the extent necessary to comply with the changes in the law. Later, when issuers have time to examine the big picture, many will realize they wasted money making minor modifications to existing systems, when they should have been upgrading to entirely new systems.

An artificially short effective date – and I believe that is what this bill would create – handcuffs senior management. When forced to choose between *what we have to do* – comply with new changes in the law – and *what we know we should do* – comply with new changes in the law while also taking stock of the long term – we will choose the former for the simple reason that we have been denied the opportunity to perform the latter.

Further complicating the matter is the subject of the earlier portion of this hearing; the issue of interchange fees. Interchange revenue helps make it possible for credit unions to offer card services to their customers on an equal footing with larger banks.

These fees also play an integral role in providing credit union members with important services and benefits. Interchange revenue also helps offset the cost of card re-issuance in the event of a data security breach and helps pay for critical credit union compliance costs discussed earlier.

Merchants, on the other hand, derive tremendous benefits from accepting credit and debit cards, in the form of increased average sales per transaction and limited risk of non-payment. At the point of sale, merchants get paid immediately and all of the risk is transferred onto the card issuing financial institution. The consumer also benefits from the convenience provided by the electronic payment system.

The *Credit Card Interchange Fees Act of 2009* would allow merchants to ignore the "Honor All Cards" requirement contained in rules set out by Visa and Mastercard. This exemption would allow merchants to pick and choose which cards they accept and open the door for card discrimination, possibly at the expense of credit unions. The Welch bill would also grant the Federal Trade Commission broad authority over the current electronic payment system. Given this authority, the FTC will have the ability to place a cap on interchange fees and thus dramatically reduce this revenue stream for credit unions, in some cases up to 50%.

Therefore, it is NAFCU's belief that Congress should not interfere with a system that is clearly working, by enabling the government to impose price controls. A government set price will drive up costs for consumers, strangle innovation and dramatically reduce credit union ability to pay for compliance costs. Ultimately, any cap on interchange fees will be passed on from financial institutions to consumers in the form of higher interest rates, and lower yields on investment products.

Conclusion

NAFCU respectfully opposes both H.R. 3639, the Expedited CARD Reform Act of 2009 and H.R. 2382, the Credit Card Interchange Fees Act of 2009. While we understand your legitimate concerns with abuses in the credit card industry, a Dec. 1 effective date for the CARD Act will do little to alleviate those problems. At the same time, an earlier effective date will exacerbate existing operational problems, likely create new problems, and increase the overall cost of compliance for all lenders, with very little – if any – benefit for consumers.

The problems highlighted by the 21 day notice provision, the literal impossibility of complying by Dec. 1 and the costs created by forcing institutions to work towards short term compliance at the expense of long term strategic planning are all compelling reasons not to accelerate the effective date of the CARD Act. The *Credit Card Interchange Fees Act of 2009* will have the net effect of severely limiting a revenue stream for credit unions, which helps pay for the costs associated with data security breaches and compliance associated with increased regulation. Arbitrarily limiting these fees will come at the expense of the consumer, the 90 million credit union members in America, and our nation's smaller financial institutions. I thank you for your time and I am happy to field any questions the Committee may have.

STATEMENT OF MALLORY DUNCAN

SENIOR VICE PRESIDENT, GENERAL COUNSEL

ON BEHALF OF

THE NATIONAL RETAIL FEDERATION

AND

THE MERCHANTS PAYMENTS COALITION

BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES FINANCIAL SERVICES COMMITTEE

HEARING ON

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

OCTOBER 8, 2009

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

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

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

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

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

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

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

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

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

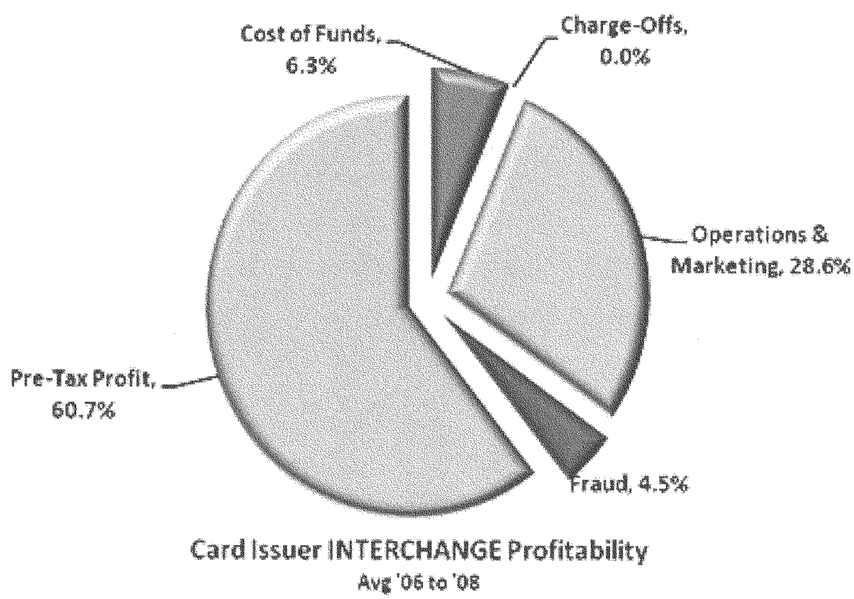
Visa and MasterCard are able to get away with this because they have market power – both individually and jointly – according to the courts. By a very conservative estimate, Visa and MasterCard together control more than eighty percent of the credit card market. The vast majority of merchants therefore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

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

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

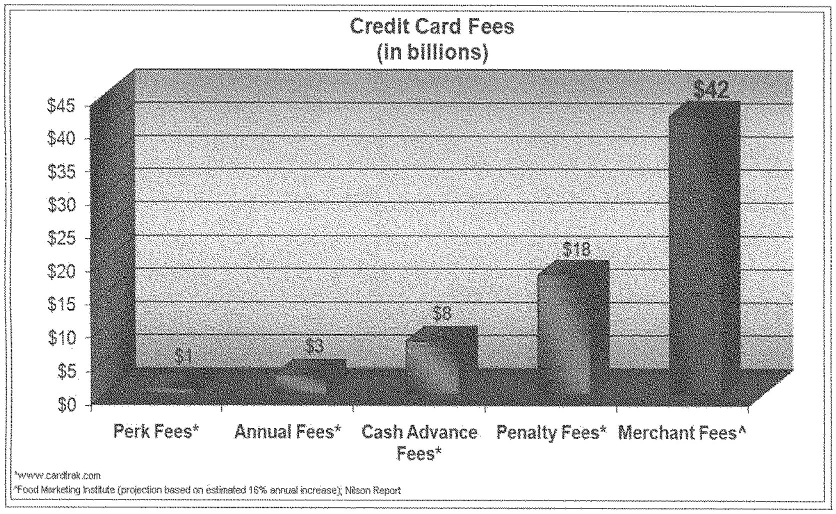
contributing to monopoly profits in the process. Indeed, the funds Visa and MasterCard banks collect through these fees goes toward marketing efforts such as the more than 6 billion credit card solicitations sent to consumers in 2005. As you can see in Figure 1, a primary source of funding for this marketing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

Figure 1



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

Figure 2 (2007 Numbers)



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

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

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

II. THE CARD ASSOCIATIONS ACT LIKE CARTELS.

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

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

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

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

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

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

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

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

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

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

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

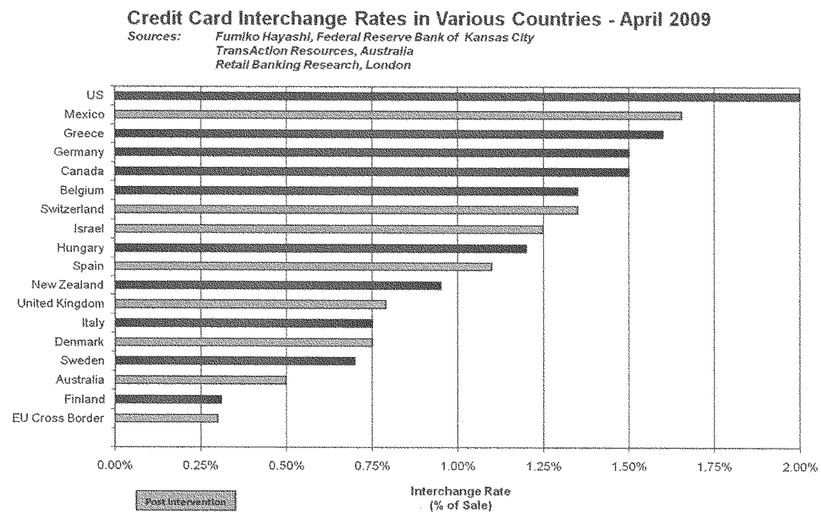
Thus, the evidence is clearly mounting that the theoretical arguments in favor of any use of interchange fees as a subsidy for card-issuers' costs are factually unsupportable, and cannot serve as a justification for cartel price fixing.

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

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

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

Figure 3



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

IV. ADDRESSING THE MYTHS

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

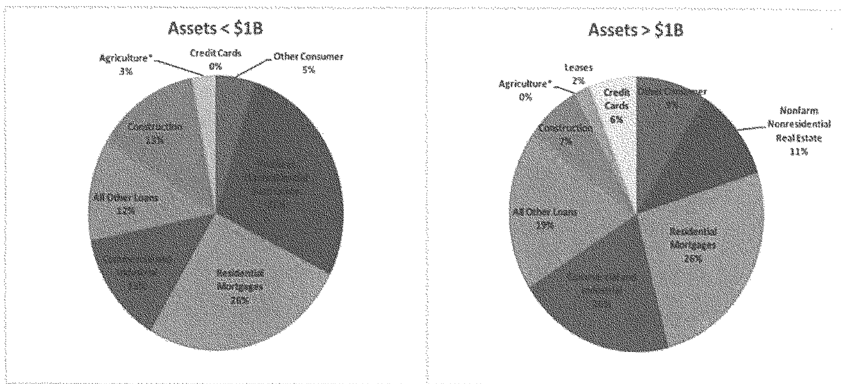
Myth: *Small banks and credit unions will suffer if the interchange fee system is reformed.*

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

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

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

Figure 4



* OTS – supervised savings associations do not identify agricultural loans

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

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

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

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

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

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

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

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

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

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

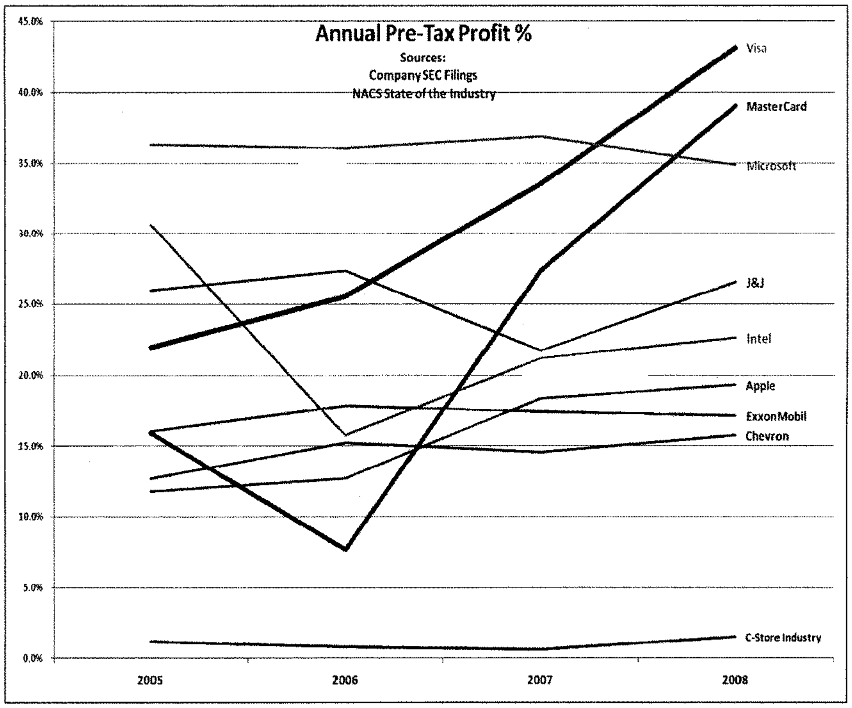
Myth: *Congress shouldn't reform interchange fees because merchants will just pad their profits.*

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

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

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

Figure 5



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

V. CONCLUSION: CONGRESS SHOULD ACT

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

Share of Interchange Collected by Card Type

Credit Card Interchange

Sources: Nilson, #918, #919, #923

Federal Reserve Bank of Kansas City

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

Share of Interchange Collected by Card Type

Credit Card Interchange - Continued

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

Share of Interchange Collected by Card Type

Signature Debit Card Interchange

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

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

PIN Debit Card Interchange

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

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

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

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

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

Top industries: Most profitable

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

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

23	Information Technology Services	4.5
24	Computers, Office Equipment	4.3
25	Metals	3.9
26	Wholesalers: Diversified	3 5
27	Insurance Property and Casualty (stock)	3.3
28	Specialty Retailers	3.2
29	General Merchandisers	3 2
30	Health Care: Pharmacy and Other Services	3.0
31	Packaging, Containers	3 0
32	Beverages	2.9
33	Engineering, Construction	2.7
34	Health Care: Medical Facilities	2.4
35	Health Care: Insurance and Managed Care	2.2
36	Petroleum Refining	2.1
37	Food and Drug Stores	1.5
38	Pipelines	1.5
39	Wholesalers: Health Care	1.3
40	Semiconductors and Other Electronic Components	1.0
41	Energy	0.9
42	Home Equipment, Furnishings	0 7
43	Food Production	0.6
44	Wholesalers: Electronics and Office Equipment	-0.3
45	Diversified Financials	-0.6
46	Motor Vehicles and Parts	-0.7
47	Insurance: Life, Health (mutual)	-3.0
48	Hotels, Casinos, Resorts	-4 5
49	Automotive Retailing, Services	-7.9
50	Forest and Paper Products	-9.6
51	Entertainment	-10.0
52	Real Estate	-13.4

53	Airlines	-13.5

Issue date: May 4, 2009

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

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

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

Top industries: Most profitable

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

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

23	Beverages	7.2
24	Chemicals	7.0
25	Internet Services and Retailing	7.0
26	Food Consumer Products	6.5
27	Telecommunications	6.4
28	Health Care: Insurance and Managed Care	6 2
29	Petroleum Refining	6 2
30	Computers, Office Equipment	6.0
31	Metals	5 5
32	Packaging, Containers	5.5
33	Home Equipment, Furnishings	5 3
34	Wholesalers Diversified	4 3
35	Specialty Retailers	3.8
36	Information Technology Services	3.8
37	Energy	3 7
38	Airlines	3.6
39	General Merchandisers	3 5
40	Health Care Medical Facilities	3.3
41	Pipelines	3.1
42	Engineering, Construction	2.8
43	Health Care: Pharmacy and Other Services	2 6
44	Food and Drug Stores	2.1
45	Wholesalers: Electronics and Office Equipment	1.6
46	Automotive Retailing, Services	1.1
47	Wholesalers: Health Care	1.1
48	Motor Vehicles and Parts	1.1
49	Food Production	1.0
50	Semiconductors and Other Electronic Components	0 6
51	Diversified Financials	-0.9
52	Homebuilders	-9.5

FORTUNE 500 2007

Our annual ranking of America's largest corporations

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

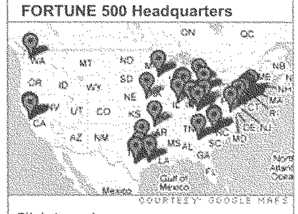
Top industries

Most Profitable Industries: Return on Revenues

Revenues Assets Shareholder equity

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

FORTUNE 500 Headquarters



COURTESY GOOGLE MAPS

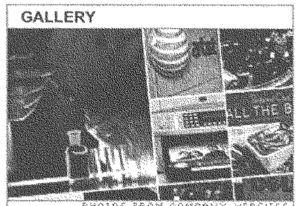
Click to enlarge
Show FORTUNE 500 Companies:
Top 50 | 25 Most profitable | Full list

What readers say...

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

Have your say

GALLERY



PHOTOS FROM COMPANY WEBSITES

Top 50

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

GALLERY

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

From the April 30th, 2007 issue

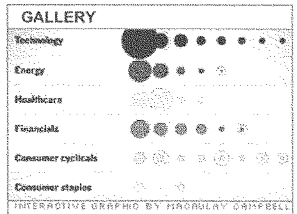
Note:
Due to slight differences in rounding, industry data online may not exactly match the FORTUNE 500 magazine version.

PHOTOS FROM COMPANY WEBSITES

Best employers

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

GALLERY



INTERACTIVE GRAPHIC BY MACAULAY CAMPBELL

Big deals

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

FORTUNE 500 2006

Our annual ranking of America's largest corporations

Full list	Companies	States	Industries	CEOs
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Arrivals	Exits	Losers	50/50	FAQ

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

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

From the April 17th, 2006 issue

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

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

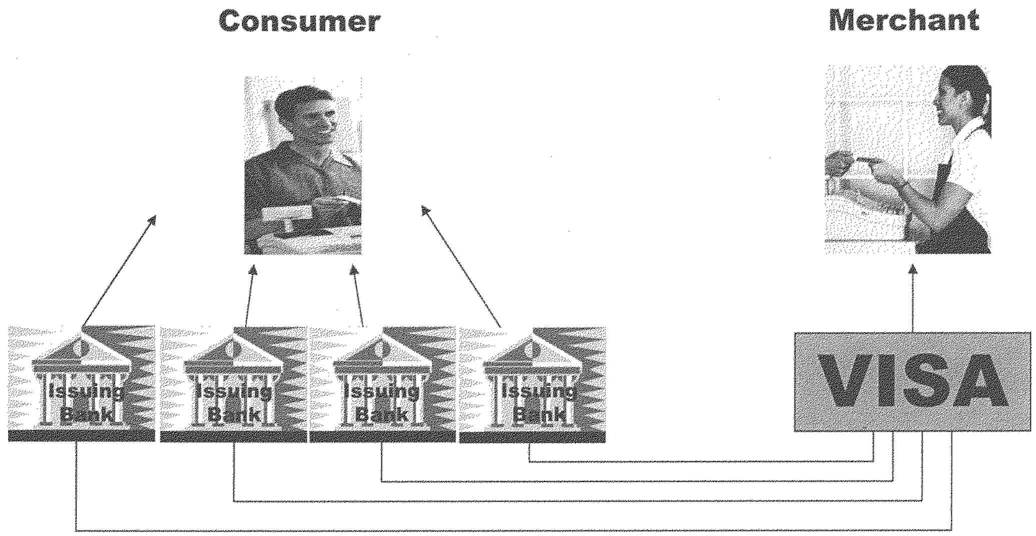
	Profits After Income Taxes	Net Sales Receipts & Operating Revenues	Retail Profits as a Share of Sales
2003	**$45,364**	**$1,524,730**	**2.98%**
1st quarter	11,283	354,328	3.18
2nd quarter	9,656	364,426	2.65
3rd quarter	9,518	377,950	2.52
4th quarter	14,907	428,026	3.48
2004	**$53,186**	**$1,666,495**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

* Retailers with assets of $50 million and over.

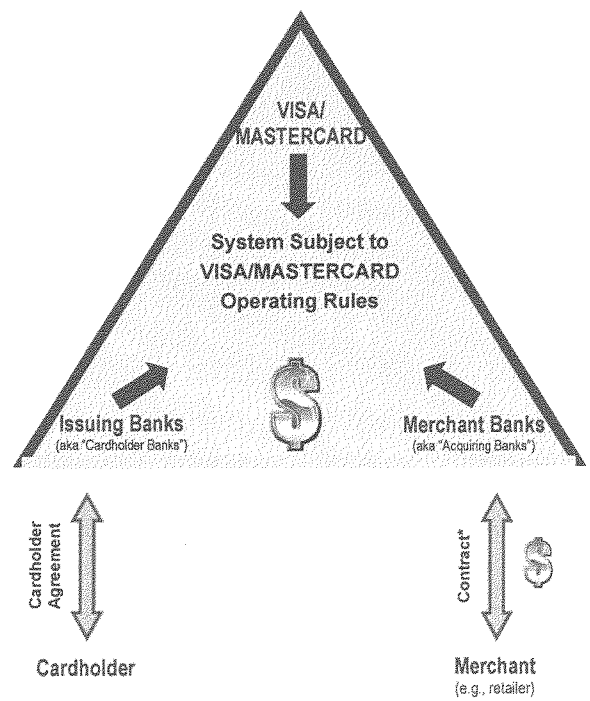
Source: Derived from U.S. Department of Commerce, Bureau of the Census data.

Appendix A

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



Appendix B



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

INDEPENDENT COMMUNITY
BANKERS *of* AMERICA

Testimony of

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

On behalf of the
Independent Community Bankers of America

Before the

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

Hearing on

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

October 8, 2009
Washington, D.C.

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

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

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

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

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

On behalf of ICBA's nearly 5,000 member banks, I want to express our appreciation for the opportunity to testify on the important role credit and debit card interchange fees play in supporting community bank customers. The payment card system has proven to be a tremendous benefit to consumers and merchants, but is not cost-free to operate, and it is not self-sustaining. Interchange is a key component to maintaining the viability of the system, while ensuring that costs are allocated fairly between consumers and merchants.

Benefits to merchants

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

Just as consumers should always shop around for a financial institution that best meets their banking needs, a merchant who is setting up a credit card acceptance process should shop around for a level of service, customer support, and range of fees that best fits their business plan. If a merchant opts to sign with Liberty Bank, at the end of the day, it is getting tremendous value because of the card payments system that I, even as a relatively small acquirer, am able to access. Among these benefits are more efficient check out times, reduced cash and check costs (*e.g.*, theft of cash, bounced checks), increased sales and profits, and the ability to make sales without taking any credit risk. By accepting card payments, merchants also shift the costs of debt collection, regulatory compliance, billing, customer service and transaction processing onto others.

However, providing these services is not free, and the costs are primarily imposed on the bank that issued the payment card. Card networks generally have a mechanism to compensate the card issuers for the services they provide which ultimately benefit merchants. Specifically, in the MasterCard and Visa systems, there is an interchange fee. An interchange fee is a small fee paid by a merchant's bank to a card issuing bank in connection with a payment card transaction initiated by a cardholder. The amount of interchange fees received by Liberty Bank is well below our cost to perform the services from which merchants ultimately benefit when they accept our payment cards. Merchants get guaranteed funds in their account right away, the ability to accept credit and debit cards carried by millions of consumers, and do not have to worry about bounced checks. And also because of interchange, merchants, as well as cardholders and card issuers, all benefit from state-of-the-art fraud detection systems. These fraud-detection systems are even more important to smaller merchants who lack the deep pockets of their much larger competitors. The same applies to my bank as a small card issuer.

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

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

There was a time when, if you wanted to use credit for a purchase, you had to shop at a large department store that could afford an in-house credit program. Today, most consumers can use credit to shop at even the smallest merchant because most consumers carry a line of credit in the form of a credit card in their wallets. What small retailer could afford its own proprietary card nowadays? Because of my ability to issue cards and be a merchant acquirer, small businesses in and around my community can set up a deal where they are paying competitive fees, can accept cards, are assured a consistent payment experience. This acceptance is important to the viability of my local merchants and the economic base of my community.

Benefits to consumers

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

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

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

[2] 2009 ICBA Payments Survey.

service and opportunity to build a lasting relationship that a community bank can offer. While big banks will always beat us in terms of economies of scale, they just can't offer the flexibility to customers that we do.

Without interchange revenue and network rules to ensure fairness and equity for consumers, issuers, and merchants, however, there is no question that fewer community banks would be able to justify the economics of their payment card offerings. As it stands today, I know that many of my community bank colleagues do not earn sufficient interchange revenue to cover the costs of running a debit card program. Any reduction in interchange would clearly jeopardize the ability of community banks to continue to offer such programs to their consumers. If more small banks stop offering interchange-fee-supported products and services, I think it's very likely the industry would consolidate into just a few very large issuers and acquirers, and costs of running the system that are currently covered by interchange would be passed on through the payments chain, with the final burden falling on your average consumer who uses a payment card. In the end, consumers will be harmed.

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

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

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

Consumer harm

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

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

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

FTC as Merchant Protection Agency.

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

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

Conclusion

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

I also believe it is inaccurate and misleading to characterize interchange as a hidden tax on consumers. It is no more a hidden tax than is the cost of check processing, counting cash, or utility bills that a merchant pays. Interchange is a fee for a service that brings tremendous value to merchants that accept debit and credit cards, and the consumers that carry them. Were there not some value to be added to a business model by accepting the costs of accepting debit and credit cards, we would see rates of card payments on the decline. Of course we all know that is not the case and the number of card payments continues to grow. Only thanks to interchange can complete strangers exchange plastic for large-dollar items within the parameters of a controlled, predictable system. Gutting the rules of that system, as does H.R. 2382, will harm everyone.

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

Thank you, and I look forward to your questions.

TESTIMONY

David S. Evans
Lecturer, University of Chicago Law School
Executive Director, Jevons Institute for Competition Law and Economics, University College London

Before the
Committee on Financial Services
The United States House of Representatives
Hearing on
Credit Card Interchange Fees Act of 2009
October 8, 2009

I would like to thank Chairman Frank and Ranking Member Bachus for inviting me to testify. Members of the Committee: My name is David S. Evans. I teach at the University of Chicago Law School where I am a Lecturer and at the University College London where I am Executive Director of the Jevons Institute for Competition Law and Economics and Visiting Professor. Despite the law school affiliations I am an economist. I've written widely on the payments card industry from both a business and policy perspective. I'm the co-author of *Paying with Plastic: The Digital Revolution in Buying and Borrowing* which has become the standard reference work on the industry.

I represent solely myself at this hearing. In the interest of transparency, Visa funded my research on the payments card industry for many years. In recent times I have been a business advisor to many of the innovative entrants into the payments industry, including several companies that compete with the incumbent networks and issuers and which offer merchants payment services at much lower fees than do the incumbents.

Economists have been studying the subject of interchange fees and related practices since the early 1980s. There has been a flurry of research in the last decade. Much of the research is based on a new field of economics known as two-sided markets. This field studies businesses that create value by bringing different kinds of customers together. A stock exchange, for example, brings liquidity providers and liquidity takers together while a matchmaking service brings men and women together.

Payment cards help merchants and individuals to transact with each other. This research provides several insights. I have appended to this statement an article that I co-authored with Professor Richard Schmalensee, "The Economics of Interchange Fees and Their Regulation" which was published by the Kansas City Federal Reserve Bank and provides many of the key references.

First, it turns out that it is very difficult to say in practice that the interchange fee charged by a payment network is too high, too low, or just right from the standpoint of public welfare and even more difficult for a regulator to have any confidence that it could establish a better interchange fee. This argues for caution in price regulation of interchange fees. Government regulation is appropriate when it is possible to both identify a market failure and fix that failure without creating unintended consequences. That is not possible with the current economic state of knowledge on interchange fees. HR 2382 wisely stays away from specific price regulation in my view.

Second, any change that is made to the pricing for one side of a two-sided business will tend to have an opposite effect on the other side. Two-sided businesses recover their costs and earn profits from both sides. So if a two-sided business earns less on one side it usually has to earn more on the other side. Many daily newspapers are charging people more because they are making less from advertisers. In evaluating HR 2382 it would be prudent to anticipate how the changes to merchant pricing will ultimately affect cardholders. There probably isn't a free lunch here.

Third, the customers of two-sided businesses interact a lot. The platform makes money by promoting valuable interactions. But the platform has an interest in policing bad behavior. eBay is a two-sided business for example. It tries to get buyers and sellers to swap a lot of stuff. But it also has rules that buyers and sellers have to follow. eBay protects buyers by kicking sellers that repeatedly fail to meet their end of the bargain off of eBay. I mention this in the context of HR 2382 because many of the policies that the bill seeks to restrict at least arguably benefit one side of the market—individuals who carry cards and want to use them to pay. A card brand can provide benefits to individuals by assuring them that their card will be accepted everywhere and that these individuals won't be surcharged. One could also argue that the network policies that are the subject of HR 2382 are anticompetitive or are contrary to the public interest for some other reason. But I believe it would be prudent to consider the pro-competitive explanations as well as the anti-competitive ones. Most likely there's no free lunch here either. Prohibiting the networks from imposing various restrictions will likely impose some collateral cost on consumers.

There are many elements to this bill. I have not done a careful study of it. I would like to suggest however that payment cards is one of the most complex industries that economists study. There are many moving parts. There are also many interdependencies between the merchants, cardholders, processors, acquirers, networks, and other players. As a result there is a greater risk in this industry than in others for government interventions to have unintended consequences. Finally, I am not aware of any systematic evidence that would support the position that the payment card network practices targeted by HR 2382 cause overall public harm or that the types of restrictions on payment card networks suggested in the bill would inure to the public benefit.

Thank you again for the opportunity to appear before this Committee. I would be happy to respond to your questions.

NSBA
National Small Business Association®

TESTIMONY OF TODD MCCRACKEN, PRESIDENT

NATIONAL SMALL BUSINESS ASSOCIATION

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

Before the U.S. House Committee on Financial Services

October 8, 2009

Good morning Chairman Frank, Ranking Member Bachus, Congresswoman Maloney, and members of the committee; thank you for inviting me here today to discuss the *Expedited CARD Reform for Consumers Act (H.R. 3639)* and small businesses' immediate need for credit-card reform. My name is Todd McCracken and I am the president of the National Small Business Association (NSBA), America's oldest small-business advocacy organization.

SMALL-BUSINESS CREDIT CRUNCH CONTINUES

When I testified before this committee's Subcommittee on Financial Institutions and Consumer Credit in March, I spoke at some length to the difficulties America's small-business owners were encountering in their attempts to access credit. Unfortunately, the situation is little improved.

In its July 2009 quarterly Senior Loan Officer Opinion Survey, the U.S. Federal Reserve reported that, over the previous three months, domestic banks continued to tighten standards and terms on all major types of loans to businesses and households. Banks also reported that they expected their lending standards across all loan categories to remain tighter than their average levels over the past decade until at least the second half of 2010.

While Congress should be pleased that the small-business provisions of the *American Recovery and Reinvestment Act*, specifically the temporary elimination of the upfront borrower fees and the increased guarantee, have had a positive effect on the lending programs at the U.S. Small Business Administration (SBA), they hardly were a panacea. In Fiscal Year 2009, the SBA approved 44,221 7(a) loans. This represents 36 percent fewer loans than in FY 2008 and 56 percent fewer loans than in FY 2007. The total dollar amount of these loans also plummeted—by about $3.4 billion—to $9.3 billion.

SMALL BUSINESSES' RELIANCE ON CREDIT-CARD FINANCING

Credit cards are now the most common source of financing for America's small-business owners. According to NSBA's 2008 nationwide survey of small- and mid- sized business owners (henceforth: NSBA Survey), 44 percent of small-business owners identified credit cards as a source of financing that their company had used in the previous 12 months—more than any other source of financing, including business earnings. The results of more recent internal surveys have been even more dramatic.

When asked what types of financing their firm used in the previous 12 months, 59 percent of the small-business respondents to NSBA's 2009 Small Business Credit Card Survey (henceforth: credit-card survey), identified credit cards. In 1993, only 16 percent of small-businesses owners identified credit cards as a source of funding they had used in the preceding 12 months. Over a third of the respondents to the credit-card survey also reported that a quarter or more of their overall debt/financing was comprised of credit-card debt.

DETERIORATING CREDIT-CARD TERMS AND "UNFAIR" AND "DECEPTIVE" PRACTICES

When I testified in March, I said: "As the small-business owners who serve as the engine of America's economy and the backbone of its communities suffer, along with the rest of the country, through an economic crisis not witnessed in seventy years, it is unconscionable that Congress would allow issuers to perpetuate—with impunity—practices recognized as "unfair" and "deceptive" against them for 16 more months."

The 16 months became, for the most part, nine months but the sentiment remains unchanged: the small-business members of NSBA believe that the rules codified by the *Credit Card Accountability, Responsibility and Disclosure (CARD) Act of 2009* need to be implemented prior to February 22, 2010.

In 2009, small-business owners have experienced a litany of abuses and deteriorating credit terms unrelated to their past performances. Nearly 80 percent (79) of the small-business respondents to the credit-card survey said that the terms of their credit cards had gotten worse in the last five years. Almost half (48 percent) of the respondents reported that they had encountered a credit-card due date that seemed to change randomly; and 57 percent reported that they had received a bill too close to the due date to mail their payment in on time.

Furthermore, a quarter of the respondents reported that their interest rates increased between February and April 2009; while a third reported that their credit limit had been reduced in the previous six months. According to a recent article in the *Wall Street Journal*, credit-card lines have been cut by over $1.25 trillion in the last two years and 10 percent of all credit-card accounts have been cancelled. The same article asserts that lenders began reducing available credit by zip code in the fourth quarter of 2007 and have been cutting "'inactive' accounts (whether or not the customer viewed the account as a liquidity vehicle)" for the last four quarters.

ADDITIONAL CREDIT-CARD REFORMS MEASURES NEEDED

While NSBA supports the expedited enactment of the protections contained in the *Credit CARD Act*, it also urges Congress and this committee to address two additional aspects of the credit-card industry that urgently need reform: (1) the absence of explicit protections for small-business cards, and (2) the secretive and unfair interchange system.

The Small Business Credit Card Act of 2009 (H.R. 3457)

The largest loophole in the *Credit CARD Act* was the absence of explicit protection for small-business owners who use their card(s) for business purposes. Since the legislation amended the *Truth in Lending Act* (*TILA*)—which, except for a few provisions, does not apply to business cards—its protections were limited to consumer credit cards. Although the credit cards of many—if not most—small-business owners are based on the individual owner's personal credit history, it is conceivable that issuers could legally consider them exempt from the law's vital protections.

TILA defines a "consumer" as a "natural person who seeks or acquires goods, services, or money for personal, family, household use other than for the purchase of real property." While a small-business owner who opens a personal credit-card account and uses it occasionally for business should be covered under *TILA*, it is far from clear that this legislation would protect a small-business owner who used his card exclusively or even primarily for business purposes. Eighty-six percent of the respondents to NSBA's credit-card survey reported using their consumer or business credit-cards primarily or exclusively for business purposes.

Although in the past, issuers appear largely to have kept most of their cards in compliance with *TILA*, there is no guarantee this convention will continue, especially when one considers that its basis appears to have been practicality and not legal obligation. Since issuers were able to subject consumer cards to the most egregious of practices, there was little incentive to distinguish between consumer and small-business cards. An unintended consequence the *Credit CARD Act* is that it could provide just such an incentive.

Thankfully, legislation has been introduced that would correct this oversight and extend equal protection to the cards used by small-business owners with 50 or fewer employees. The *Small Business Credit Card Act of 2009 (H.R. 3457)*—introduced by Reps. Neil Abercrombie (D-Hawaii), Nita Lowey (D-N.Y.), Michael Michaud (D-Maine), Thomas Perriello (D-Va.), and Don Young (R-Alaska)—also contains an "opt-out" provision, so that small-business owners who did not want their cards protected in such a manner can choose to keep any current agreements.

H.R. 3457 is supported by a diverse range of small-business organizations and consumer groups—from U.S. PIRG to the Consumer Federation of America to the Associated General Contractors of America to the Hispanic, Black, and Women's Chambers of Commerce—and I respectfully request that this committee consider this bipartisan, common-sense legislation as soon as possible.

The Credit Card Interchange Fees Act (H.R. 2382)

Interchange is the fee paid by a merchant's bank every time a credit or debit card is used to pay for a good or service to the bank that issued the consumer's credit card. The fees—which vary depending on the type and size of the merchant's business, the way the transaction is processed, and the specific kind of card used—are set by Visa and MasterCard and the issuing banks and are not subject to negotiation. As much as $2 of every $100 in credit or debit card receipts goes to the card issuers, which inflates the cost of nearly everything consumers buy—since merchants are prohibited from surcharging the customers who use the most high-fee cards. It is important to note, especially as states across the U.S. raise their state sales taxes to meet budgetary shortfalls, that these interchange fees are based on the *total* transaction amount, including taxes.

Interchange fees originated in the 1960s as a way to cover the real cost of a credit-card transaction. Despite vast technological advancements, which have led to greatly diminished processing times and manpower requirements, interchange fees have more than tripled since 2001 alone. As Professor Adam Levitin, of Georgetown University Law Center, has noted, since "interchange is transaction-based revenue; the issuer doesn't incur the consumer's credit risk. That means that issuers can risk greater credit losses because they've already made a nice bit of money via interchange with virtually no risk. Not surprisingly, interchange has increased over the last decade from being about 13 percent of card issuer revenue to being 20 percent." In total, Americans paid more than $48 billion in interchange fees in 2008.

Visa and MasterCard force merchants to sign a contract when they decide to accept credit cards, agreeing to all current and future operating rules. Merchants rarely have seen these rules and are prohibited from disclosing their terms to consumers, preventing merchants from alerting their customers to the true cost of accepting credit and debit cards. Many argue that Visa and MasterCard, which control roughly 80 percent of the credit-card market, and their card network function like "price-fixing cartels," operating in collusion and in violation of federal antirust laws by using their market power to impose non-negotiable rates and terms on merchants.

The *Credit Card Interchange Fees Act* (*H.R. 2382*)—introduced by Reps. Peter Welch (D-Vt.) and Bill Shuster (R-Pa.)—directs the Federal Trade Commission (FTC) to fulfill a regulatory void and review the credit-card industry's interchange practices and rules. The bill also grants the FTC the authority to prohibit any practices that it deems unfair, deceptive, or anticompetitive; and prohibits a number of practices that NSBA believes clearly meet this definition.

In an attempt to provide transparency to the system, *H.R. 2382* also would require the Federal Reserve to collect and disseminate information on interchange fees and the rules that currently govern the system. It also requires the Visa, MasterCard, and the rest of the credit-card industry to make their operating rules available to participating merchants and the public.

Believing that *H.R. 2382* provides critical transparency to the currently shrouded interchange rules and addresses some of the most egregiously unfair, deceptive, or anticompetitive practices of the industry, the small-business members of NSBA join Americans for Financial Reform and more than 20 national trade associations in urging Congress to adopt it.

Conclusion

With the unemployment rate at a 26-year high and America's entrepreneurs—existent and, importantly, aspiring—suffering through a crippling credit crunch, it is high time that Congress provide U.S. small businesses with the credit-card protection they so desperately deserve—protection against practices already identified as "unfair" and "deceptive" by the U.S Federal Reserve Board, the Office of Thrift Supervision at the U.S. Department of the Treasury, the National Credit Union Administration, and an overwhelming majority of the Congress.

If millions of new, small firms are going to be created during this recession—as they have been in previous recessions and economic downturns—then they largely are going to be financed through credit-cards, given the current lending environment. Although credit cards are an inherently expensive and volatile source of financing for entrepreneurs, they also are indispensable. Congress can and must ensure, however, that they are not allowed to function simply as a mechanism with which to siphon capital—through "unfair" and "deceptive" practices—from the backbone of the economy to the top 10 U.S. banks, which controlled 83 percent of the small business credit-card market (understood as their proportion of outstanding credit-card debt) in 2005.

NSBA is pleased to support the *Expedited CARD Reform for Consumers Act (H.R. 3639)* and urges the members of this committee to do the same.

I thank you for your time and welcome any questions.

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

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

Honorable Barney Frank, Chairman

Hearing on

HR 2382, the Credit Card Interchange Fees Act of 2009

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

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8 October 2009

Testimony of Edmund Mierzwinski
Consumer Program Director
U.S. PIRG
Before the U.S. House Committee on Financial Services

Hearing on HR 2382, the Credit Card Interchange Fees Act of 2009
8 October 2009

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

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

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

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

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[1] The United States Public Interest Research Group (U.S. PIRG) serves as the federation of and the federal lobbying office for the state PIRGs. State PIRGs are non-profit, non-partisan consumer, public health and good government watchdog groups with over one million members around the United States. U.S. PIRG places a special emphasis on predatory financial practices and financial education and maintains a website at www.truthaboutcredit.org for consumers to obtain non-partisan information and fact sheets about credit card company practices. Recent major PIRG reports on credit card practices include the following: Characteristics of Fair Campus Credit Cards (April 2008); The Campus Credit Card Trap: A Survey of College Students and Credit Card Marketing (March 2008); Graduating Into Debt: A Survey of On-Campus Credit Card Marketing In Maryland (2004); Deflate Your Rate: How To Lower Your Credit Card APR (2002) and The Credit Card Trap: How To Spot It, How To Avoid It (2001). www.uspirg.org or www.truthaboutcredit.org.

[2] See truthaboutcredit.org for information about the campaign.

[3] Public Law No: 111-24, signed into law May 22, 2009.

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

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

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

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

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

The Interchange Fee Problem

Interchange fees are hidden charges paid by all Americans, regardless of whether they use credit, debit, checks or cash. These fees impose the greatest hardship on the most vulnerable consumers – the millions of American consumers without credit cards or banking relationships. These consumers basically subsidize credit and debit card[6] usage by paying inflated prices – prices

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

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

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

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

We present six main points:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Interchange Fees Force Consumers to Pay Higher Prices

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

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

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

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

Increases in Interchange Fees Signal a Broken Market

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Deceptive Practices Increase Prices for Consumers

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

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

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

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

Transparency is essential for any market to function effectively

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

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

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

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

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

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

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

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

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

The Potential Impact of the Proposed Legislation On These Problems

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Conclusion

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

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

Americans for Financial Reform
Accountability, Fairness, Security

Position Paper on Interchange Fees

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

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

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

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

Markets don't work when there are hidden fees and rules – and no one hides fees and rules better than the credit card companies. Credit card markets lack the information necessary for both consumers and merchants to make informed choices. For merchants, the markets lack adequate information because the associations prevent merchants from accurately informing consumers of the costs of credit card acceptance or attempting to direct them to more efficient and lower priced payment mechanisms. In fact, merchants have no alternative but to accept the card associations' cards even when the associations significantly increase prices

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Swipe fees have grown at a staggering pace – from about $16 billion in 2001 to about $48 billion in 2008. This is a clear sign of a broken market. Not only do these huge fees injure consumers by inflating the cost of goods and services, they create incentives for banks to view credit and debit cards as fee engines. It is not coincidence that consumer-side fees such as late fees, over-limit fees, overdraft fees and others have seen rapid increases during the last several years, just as swipe fees have exploded. Seeing the potential income from fees has made banks' business models develop such that they often view their customers as fee-generating machines. These business models have dictated the proliferation of cards and incentives for increased card use without appropriate attention to the risks that consumers might not have the ability to repay the debts they incur on these cards.

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

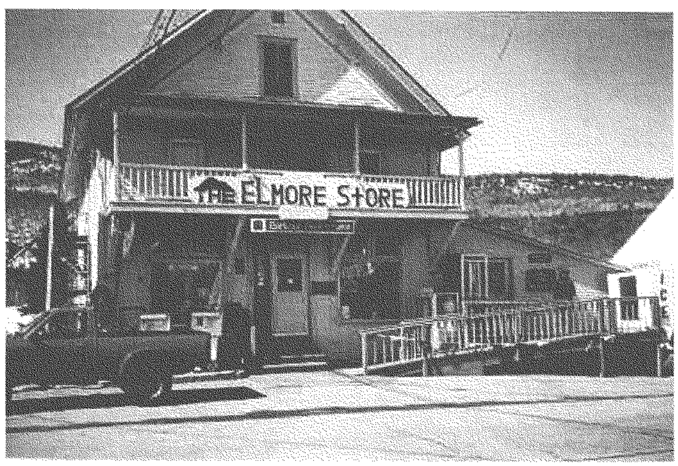
Visa and MasterCard rules that are unfair, deceptive, or anticompetitive must also be abolished. This should start with a strong regulatory agency such as the Federal Trade Commission (or Consumer Financial Protection Agency) having the power to review the rules and prohibit any it finds to violate these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

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

A large set of organizations are working together to advance our common interest in an accountable, transparent and secure financial system, and to accomplish our shared policy goals. Because the organizations involved and the issues addressed are diverse, not every organization works on or has a policy position on every specific issue. We are unanimous in our call for change to repair our nation's broken financial system, establish integrity in the financial markets, and facilitate productive economic activity that benefits all segments of our communities.

TESTIMONY OF KATHY MILLER
OWNER, OPERATOR

THE ELMORE STORE
ELMORE, VERMONT



HOUSE FINANCIAL SERVICES COMMITTEE

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

October 8, 2009

Mr. Chairman, Congressman Welch and Members of the House Financial Services Committee:

Good morning. I would like to say thank you for allowing me to testify today. My name is Kathy Miller and I, along with my husband Warren and daughter Kelly, am the owner of the Elmore Store in Elmore, VT. I am also here today as a past chair of the Vermont Grocers Association and on behalf of the Food Marketing Institute and National Grocers Association which represent our nation's supermarkets and grocery stores.

We appreciate you holding this hearing and for the opportunity to provide testimony on credit card interchange fees also know as swipe fees to merchants who have to pay a fee each time a card is swiped. Thank you to my Congressman, Peter Welch, for inviting me here today to testify. It has been three years since I last testified before the Senate Judiciary Committee at the invitation of Senator Leahy on the anti-competitive and anti-consumer practices of the credit card companies. Unfortunately, many of the same problems still exist today, and interchange fee costs have continued to rise at the expense of small businesses like ours.

This is the store that we have owned and operated now for 26 years. I am a 5th generation Vermonter with deep roots in Elmore, VT. I am the "Mom" part of the operation. My husband Warren "Pop" is minding the store so that I could be with you today. Warren has recently served 2 terms in the state legislature in Montpelier. We are not only committed to our store, but our community and the state of Vermont as well.

You may wonder why we do what we do – 7 days a week – 96 hours a week – 364 days a year – to be honest, some days we ask ourselves. But we believe that we can and do make a difference to the people and community that depend on us.

My concern as a small independent store may seem small to you, but it is a huge burden for us and very real.

Credit card fees are set by the card companies and we have no control over them. The same is true for the operating rules Visa and MasterCard include in the contract we must sign to accept their cards. However, unlike any other business contract we sign, we have no ability to negotiate the terms of card acceptance with Visa and MasterCard. Sometimes we don't even see the full terms of the 1000+ page contract before we sign. The fees keep increasing and there isn't anything we can do to stop them or even slow them down.

Congressman Welch listened to these concerns from Vermont store keepers like me and he wrote legislation to try to address several of them. Warren and I commend Congressman Welch for introducing this important legislation to protect small businesses like our store in Vermont and we look forward to consideration of the Credit Card Interchange Fees Act by this Committee.

Since I told my customers I was going to Washington, DC to testify on this issue – I can't even tell you how many of my customers were unaware of the hidden fees. They swipe their cards and think all is "free" because there is "no charge" to them at all. Obviously we lose money on many small transactions and too much on others – so we have to raise prices – because we can't absorb it all. In the grocery business, we compete by lowering prices, not raising them. I am not a lawyer, but I know this is a huge problem that retailers across the U.S. - large and small - are facing, so I ask that you look into this matter seriously. I have customers who apologize to me for using their cards. I keep telling them, PLEASE keep shopping with us we need and appreciate your business!

We have streamlined our business to reduce costs as best we can – maintenance doesn't get done as it should, less money goes out in payroll, but we just can't keep absorbing these fees and survive in these tough economic times. If interchange swipe fees were fair and reasonable, Warren and I would have more money to invest back into our business. An example is we have only one phone line to help save money. I cannot take deli or grocery orders with my only line tied up to swipe cards.

What happens in a small country store when a customer swipes their card: a pack of 35 cent gum costs us 21 cents. The swipe fee on that sale costs us 21 cents, so I just lost money. I should just let them take it. A 99 cent bag of chips cost us 74 cents and the fees are 23 cents so I can only make 2 cents on that sale. What is wrong with this picture?

It doesn't take a P.H.D. to figure out that this is a quick way to go bankrupt. Congressman Welch's bill would allow us to set reasonable minimum purchase requirements.

Visa and MasterCard require us to accept all of their cards if we take any. And then they market a whole host of affinity cards with so called "free" features like airline miles. What they don't tell you is they charge merchants higher interchange rates for accepting those cards. Warren and I have not gone away on vacation in 10 years, yet every day we are paying for our customer's trips when we take their credit cards.

The Visa and MasterCard contract rules are not law so why do we comply with them? Well, this hasn't happened to us yet, but we've heard stories of other small businesses be threatened with excessive fines for breaking the rules, even for something as minor as requiring a $5 minimum to use a credit card. A $5,000 a day fine, which I hear is the Visa and MasterCard going rate these days, would simply put us out of business. I had a store owner call me to say they are going to get fined $25,000, what should we do? I said take your signs down - we are not allowed to set minimums.

Last year in our store, 2008, we processed $87,000 worth of plastic transactions. The credit card fees to us (out-of-pocket) were $3,500 up from $3,200 last year.

In our store, we have 2 gas pumps that we own – not subsidized by any big petroleum company. When the price of gas goes up, so does the amount of interchange we pay. Because the fee is a percentage rate plus a flat fee, the banks make more and I must pay more, even though their costs for processing the transaction are still the same.

Last year alone, American consumers paid Visa and MasterCard around $48 billion in interchange fees. These fees are set by Visa and MasterCard and all the banks who issue their cards charge the same rates even though we would expect them to compete for our business. These fees and rules of card acceptance are not negotiable leaving a retailer in a take-it-or-leave-it situation. Of course, consumers don't realize they are paying the fee because merchants are effectively prohibited from informing their customers about them. These fees are reflected in the price of every product purchased at the front end of our store whether or not the customer pays with a credit card.

The rules of competition don't seem to apply to VISA and MasterCard and to the banks that issue cards. One reason is that, MasterCard and VISA have undisputed market power, with over eighty-five percent of the card marketplace. To the extent they compete with each other, it is a perverse competition. They compete to get banks to issue their cards. The way they do that is by providing them with higher interchange fees, by *raising prices.* Since merchants and ultimately consumers have no choice but to pay the fees, there is no constraint on this cycle of increasing fees.

The average supermarket industry profit margin last year was 1.43%. That means a profit of $1.43 on a $100 transaction. The interchange paid to the bank that issued the card on that same transaction is more than that! And when the price of food or gas goes up, so does interchange. Because the fee is a percentage rate + a flat amount, the banks make more, even though their costs are still the same. There is something wrong with this picture.

The reality is that interchange is used to subsidize VISA and MasterCard's expensive marketing programs and promotional schemes that benefit only the most privileged few. These include gold-plated reward programs that only the elite consumers qualify for, a blizzard of direct mail offers pushing cards on those who already have them or those who do not want them, and multi-million dollar event sponsorships designed to push consumers into using the most expensive forms of plastic payment. *Every* consumer, including those paying with cash, pay for these programs without knowing it.

In conclusion, interchange fees in this country reflect a market in which the normal, competitive forces are not working. This flawed market results in interchange fees that are not cost related, and which are intentionally kept hidden from consumers. As a result, consumers do not have the information they need to make sound economic decisions about their payment choices.

I would like to ask you on your next ride home to look and see how many vacant store fronts there are in your small downtowns. Just this last winter alone six stores closed within a 50 mile radius of us.

Some days I feel like I should just turn in my keys – but too many people count on us. Elmore is a town of 850 people. We are the hub of the community – when someone needs something, who do you call? "Mom" or "Pop" at the Elmore Store. We are just trying to keep our doors open.

I thank this Committee for shining some light on these fees and the impact they have on our business and on consumer prices. I would be pleased to answer your questions.

Thank you.

Testimony of

Consumer Action
Ruth Susswein
Deputy Director, National Priorities

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

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

The Honorable Barney Frank, Chair

October 8, 2009

Testimony for the Committee on Financial Services
U.S. House of Representatives
The Expedited CARD Reform for Consumers Act of 2009 - HR 3639

Thank you for the invitation to testify on behalf of Consumer Action to discuss some of the reasons consumers need the protection that the Credit CARD Act contains sooner than currently scheduled.

Consumer Action (www.consumer-action.org), founded in 1971, is a San Francisco based nonprofit education and advocacy organization with offices in Los Angeles, CA and Washington, DC. For more than two decades, Consumer Action has regularly examined credit card rates and fees in order to track industry trends and assist consumers in comparing cards.

We appreciate the Chairman's leadership on consumer protection issues particularly in understanding the need for a Consumer Financial Protection Agency to set strong rules for all financial institutions and whose sole purpose is to protect the consumer. We are also grateful for the Chairman's foresight, along w/ Congresswoman Maloney, to act when the spirit of the impending credit card law continues to be violated by many industry players. We are grateful that with so many important matters on his plate these days that the Chairman felt compelled to return to the issue of credit card tricks and traps.

We strongly support H.R. 3639, the Expedited CARD Reform for Consumers Act of 2009, to establish an earlier effective date for the Credit CARD Act. We will focus our testimony on the expensive, exploitive practices card issuers have engaged in, in some cases, since the Credit CARD Act was signed into law by President Obama this May.

Consumer Action has been conducting annual credit card surveys since the mid 1980's. We analyze the online solicitations of all major credit card issuers, as well as conduct a 108-question survey of the practices of each of the top issuers of bankcards, credit union credit cards and six low rate issuers.[1]

In Consumer Action's 2009 survey we discovered that between March 2009 when we stopped surveying and June when we confirmed the data we had collected, that major credit card issuers had arbitrarily increased rates, spiked fees and hiked minimum payments.

There appeared to be no rational reason for the rate increases. There was no jump in the prime rate, nor other reason to explain rates rising by as much as three percentage points between March and June of this year... other than issuers making

[1] See 2009 Credit Card Survey - http://www.consumer-action.org/news/articles/2009_credit_card_survey/

good on threats that credit would dry up and cardholders would see costs rise with the passage of the Credit CARD Act.

Consumer Actions' 2009 Credit Card Survey showed some card issuers boosted purchase and cash advance rates by up to three percentage points within just three months this Spring.

- Bank of America Platinum Plus Visa Card had an increase of up to 46% in the purchase rate.
- Citigroup hiked the purchase rate on three of its cards by 26% to 42%. [2]
- Capital One increased its penalty (default) rate by 6.25%, bringing the rate to 29.4% on its Standard Platinum and No Hassle Miles cards.
- Chase 's penalty rate jumped almost three points to (29.99%) on it Perfect MasterCard.

Consumer Acton's credit card survey also found fees spiked between March and June of 2009, long before the new law would take effect. Balance transfer fees jumped to as high as 5% in recent months.

- Bank of America's balance transfer fee went from 3% to 4% (Platinum Plus Cash Rewards & Platinum Plus Visa)
- Chase's balance transfer fee hit 5% in August
- HSBC charges some customers a $49 'processing' fee *and* a $79 annual fee, depending on creditworthiness, in addition to charging some card holders as much as 31.99% for a penalty rate.

In August, *American Banker* reported that Citigroup has started adding annual fees if the cardholder doesn't spend enough. The report said that the fee is between $30 to $90, unless the cardholder spends a specific amount – usually $2400.

With credit card reform slated for implementation, Consumer Action found that nearly all surveyed issuers had at least one practice that will be prohibited or limited by the new law including anytime/any reason changes in terms, payment allocation inequities, early payment cut-off times on the due dates, costly penalty rates and penalty fees imposition, and universal default.

Consumer Action also assists consumers through our complaint hotline where we regularly hear complaints about unanticipated minimum payment hikes, abrupt account closures, and spikes in interest rates.

Here is just a sample of what we hear regularly:

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[2] Citibank AT&T Universal Card, Citi Diamond Preferred Rewards Card, Citi Platinum Select Mastercard

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John DeCotret from California (a Chase customer for 19 years) says he never pays his bill late. The recent hike in minimum payments from 2 to 5% will increase his minimum monthly payment from about $250 /month to over $600 a month. He says, " We have excellent credit, we have done a terrific job managing under severe economic conditions. A $350 a month increase could put us in serious trouble. This is a terrible way to treat good customers."

One Maryland cardholder recently contacted Consumer Action in desperation after her interest rate more than doubled. Kelly saw her rate jump from 12.49% to a whopping 29.99%. (Kelly wants to maintain her anonymity since she works in the financial services industry). Kelly's monthly minimum payment had gone from an affordable $151 to $471 and she could not pay it. When she contacted the issuer to try to arrange for an affordable payment plan she was denied assistance. Kelly acknowledged that she had been late with a payment, after her due date was moved back a week (from the 4^{th} of the month to the 30^{th}). She understood being hit with a $39 late fee but could not comprehend, nor afford, a 140% rate hike.

We intervened on Kelly's behalf and put her in touch with some people at the bank who were ultimately able to help her. But the average cardholder may not be so fortunate.

Had the Credit CARD Act been in effect already, Kelly's late payment would not have caused her rate to more than double (because she was not more than 60 days late) and this entire ordeal would have been avoided.

We've heard from scores of cardholders in recent months who've paid on time each month, yet have seen their rates rise, often for no reason at all.

Lori (Davis) from Florence, Massachusetts says her Capitol One card went from 7.9% fixed to 17.9%variable rate. When she called to complain she was told it was "a business decision".

Virginia Simpson of Greenville S. Carolina who never paid late and always made more than the minimum payment, yet her Bank of America interest rate jumped from 9.9% to 25.9% because, according to her issuer, she was now carrying 'too big a balance'.

Lillie Durbin from Houston Texas saw her (B of A) limits slashed and rates rise from 13.9% to 26%,. She too, always paid more than the minimum and never paid late. The arbitrary changes hurt her credit score and in turn hurt her chances of transferring that balance to a more affordable rate.

Joe 'Prager, a Florida small business man with excellent credit, says his Capital One cards went from 5.9% to 15.9% and 6.9% to 16.9%, according to his issuer, due to "economic uncertain times".

Consumer Action's survey shows that card companies continue to include "market conditions", "economic conditions" and "competitive factors" as reasons to raise rates & fees. Still others complain of "too many inquiries in a credit report," or "increased use of a credit line" as reason enough to raise an interest rate.

If the Credit CARD law was effective today issuers would still have the freedom to raise rates for arbitrary reasons but they would not be able to apply that increase to a cardholder's balance (except in limited circumstances).

Lenders insist that they do not practice universal default, but language in cardholder agreements seems to clearly say they do. In this year's Credit Card survey, Consumer Action found fine print online for US Bank that states that the APR may increase "if you fail to make timely payments to another creditor as reflected in your credit report." However, US Bank maintains that they "do not have and have never had universal default."

HSBC's fine print reads "we have the right to change your APR, fees, other terms anytime for any reason including… use of your credit line with us or any creditor, or our financial return."
But HSBC says it "does not increase rates on a customer's account solely because a customer has defaulted with another creditor." [3]

Under the new credit card law, limitations will be placed on the practice of raising a cardholder's rate based on one's payment history with *another* lender – but it will only apply to existing balances. (Card issuers will remain free to increase cardholders' future interest rates for this reason.)

As lenders look for ways to reduce financial risk, consumers who have done nothing wrong can find that their credit lines have been closed or reduced. They may be hit with another costly surprise - their credit score may have suffered. Approximately one-third of a consumer's credit score is based on the amount of credit they have compared to the amount of credit they use (utilization ratio). A card issuer can close an account or sharply reduce a credit line, thus reducing the total amount of the cardholder's available credit, and raise the percentage of credit used, leaving the impression that the cardholder now has a higher proportion of debt - even if the debt load in actual dollars may not have budged at all.

For cardholders who have been responsible customers this can have serious ramifications -- from reducing the opportunity to make a major purchase if credit lines have been drastically cut or disappear, to ruining dreams of buying a home.

We do not accept the notion that card issuers must find ways to replenish their coffers on the backs of cardholders. Credit card companies start with the premise that they must now compensate for the funds that they stand to lose once the most

[3] US Bank & HSBC universal default language attached

valuable elements of the Credit Card Act take effect – once unjustified rate hikes will not be allowed to apply to a cardholder balances (w/ certain exceptions), and payments will no longer automatically be wholly allocated to a consumers' lowest rate balance. We don't believe that it should be assumed that limits on how penalty rates and fees are applied must promptly be replaced for the benefit of shareholders.

Card issuers have been fortunate enough to make handsome profits over the years. For the industry to assume that as the economy changes and unfair, exploitive practices are limited - or prohibited, that in time gluttonous profits should continue is the height of hubris.

Just as cardholders, in some cases, are expected to accept the harsh reality that credit is far less available today and that it may cost more to receive a loan, it is time for card issuers to face the fact that reasonable levels of profit may have to suffice, as well.

Lenders have been arguing lately that greater risk means higher rates for consumers, but extreme rate hikes only help to make a cardholder far more risky, endangering both the family and the firm's financial health. We would argue that there is a direct link between some of these indefensible practices and today's high default rates, hovering around 10%.

There is no logic in taking a responsible cardholder who is meeting his monthly bills and paying interest to boot, and hiking his rates, and fees or spiking his minimum payment to such a level that he is transformed into an unhealthy customer who can no longer meet his obligations.

This is the result of some of these practices. No one defends an irresponsible cardholder, but the practices of arbitrary rates increases, unreasonable minimum payment spikes - sometimes without notice, and unjustifiable fees are unfair and unaffordable.

For years, cardholders have cried out to Congress to add some fairness and some limits to this lopsided lending system. Congress has responded with the Credit CARD Act.

Congress carefully crafted the credit card law to afford lenders the freedom to continue to raise rates and fees as they see fit... while at the same time putting in place some common sense, reasonable limits as to how those increases may apply.

Quite frankly, from the consumer's perspective, lenders have taken advantage of Congress's generous time frame in which to implement the law. After lawmakers accommodated card issuers who claimed that they needed time to reprogram computer systems, issuers have used this time to use consumers as pawns in their game to maximize profits. It's an insult to Congress.

As you know, the bulk of the new credit card law does not take effect until February 22, 2010, with some parts not applying until August 22, a full 15 months after passage.[4] As we've seen, that is enough time for card issuers to inflict an extraordinary amount of damage.

We strongly support the solution spelled out in H.R. 3639 – to expedite the implementation date of the law that would help protect cardholders from many of these abusive tactics. Card issuers' actions have ensured that the need for the Credit CARD Act is greater today than ever. Thank you Chairman Frank, and Congresswoman Maloney for recognizing that need and for working diligently to address it.

We also firmly support the recommendations outlined this week by Chairman Frank, Congresswoman Maloney, Senators Levin & McCaskill, to define precisely what detailed rate and fee information the Federal Reserve should require issuers to collect and report on, as part of their mandate under the new law. Requiring lenders to regularly account for the rates and fees they charge and the income they earn will help to make the credit card market a more responsible and transparent system. Consumers continue to count on you to ensure that the system works for all of us.

Thank you for the opportunity to share a consumer perspective on this important issue.

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[4] 'SEC. 149. REASONABLE PENALTY FEES ON OPEN END CONSUMER CREDIT PLANS.
"(a) INGENERAL.-The amount of any penalty fee or charge that a card issuer may impose with respect to a credit card account under an open end consumer credit plan in connection with any omission with respect to, or violation of, the cardholder agreement, including any late payment fee, over-the-limit fee, or any other penalty fee or charge, shall be reasonable and proportional to such omission or violation.
"(b) RULEMAKINGREQUIRED.-The Board, in consultation with the Comptroller of the Currency, the Board of Directors of the Federal Deposit Insurance Corporation, the Director of the Office of Thrift Supervision, and the National Credit Union Administration Board, shall issue final rules not later than 9 months after the date of enactment of this section, to establish standards for assessing whether the amount of any penalty fee or charge described under subsection (a) is reasonable and proportional to the omission or violation to which the fee or charge relates. Subsection (a) shall become effective 15 months after the date of enactment of this section.

Statement for the Record

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Committee on Financial Services
United States House of Representatives

Statement for the Record
on behalf of the
American Bankers Association
before the
Committee on Financial Services
United States House of Representatives

October 8, 2009

The American Bankers Association appreciates the opportunity to submit a statement for the record on the Credit Card Interchange Fees Act of 2009, H.R. 2382. ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.3 trillion in assets and employ over 2 million men and women.

H.R. 2382 seeks to amend the Truth in Lending Act (TILA), a consumer protection statute, by extending protections to merchants who choose to accept credit and debit cards. Specifically, H.R. 2382 limits interchange fees and the ability of the payment system and banks to appropriately price interchange rates, while also removing a number of protections and benefits for consumers. If enacted, the bill would significantly reduce the benefits consumers have come to enjoy from using credit cards, subject consumers to confusing merchant advertising practices, and reduce consumer convenience by raising the significant possibility that a merchant will not accept certain credit cards.

The United States has the most innovative, efficient and cost-effective consumer credit market in the world, providing fast, safe and low-cost transactions that benefit consumers and retail merchants. Today, credit and debit cards are responsible for more than $3 trillion in transactions a year and are accepted at more than 24 million locations in more than 200 countries and territories. There are more than 6,000 U.S. credit card issuers. In the last 20 years, the number of debit cards has grown from 60 million to nearly 450 million. All payment cards rely on a processing system that handles more than 10,000 transactions *every second* and has enough communications lines to encircle the globe nearly 400 times. ***Clearly, it is a system that works and works very well.***

This highly advanced and efficient payment system is the result of a competitive and innovative industry that has invested heavily in its ideas and its customers. The value delivered through this payment system to consumers, merchants and financial services organizations far exceeds the costs. Merchants, in particular, receive significant benefits from accepting electronic payments, foremost the ability to maximize consumer satisfaction and company sales. These guaranteed, immediate payments help merchants avoid bad check losses, employee theft, check float loss, costs associated with billing and collections, and managing and depositing cash. When merchants *choose to accept* payment cards, they pay a penny or two on each dollar for the ability to accept electronic payments. This is a very small price to pay for all of these benefits.

Interchange fees help to cover the significant risks and costs associated with providing electronic payments, including payment risk, fraud risk, and the operational costs of providing the extremely efficient and seamless payment system we have today. They also provide small community banks, particularly, with an important revenue stream that enables them to offer payment cards to their customers, allowing them to compete on a level playing field with the world's largest banks. There is significant customer demand for community banks to offer card products to complement their traditional bank offerings.

Merchants, banks, and card networks have worked together for more than 50 years to build an efficient and accessible electronic payments system that is convenient, secure, reliable, and global. H.R. 2382, if enacted, would disrupt the balance established in a properly functioning and remarkably successful marketplace in which merchants, customers, financial institutions, and networks have benefited. We urge Members of Congress to oppose H.R. 2382.

There are three key points we would like to make in this statement:

- Payment cards play a vital role in our economy and offer many benefits to consumers, merchants, and the local financial institutions that provide services.

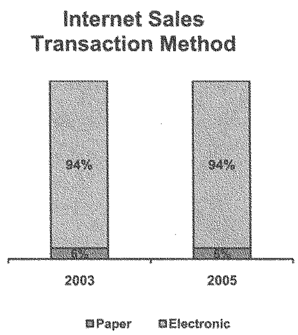
- Interchange is not a consumer protection concern but a business-to-business issue.

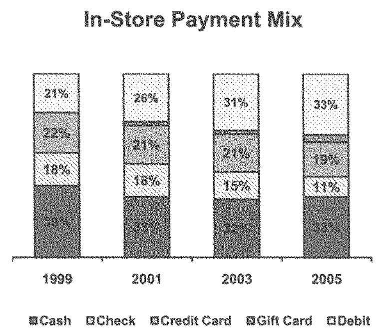
- H.R. 2382 is a "merchant" protection law that ends up hurting consumers.

I. Payment Cards Play a Vital Role in Our Economy and Offer Many Benefits to Consumers, Merchants, and Financial Institutions

Payment cards safely connect consumers and businesses instantly to a panoply of products and services. They provide merchants of all sizes with broad access to the buying public, funding for small businesses, and billions of dollars in annual payment-processing savings. Retail commerce, in particular online shopping, would not exist as we know it today without them. The charts on the next page clearly demonstrate the trend toward the use of payment cards; purchases over the Internet would hardly take place without them.

Millions of consumers and businesses have access to payment cards, and this is directly attributable to a pricing structure that has encouraged financial institutions to issue credit and debit cards, and merchants to accept them. ***It is a win-win situation for everyone*** involved that has resulted in an effective and reliable system for consumers and merchants that works so smoothly, they take it for granted. Further, the electronic payments system has fostered a fiercely competitive industry that has revolutionized how Americans do business, fueled e-commerce, provided small merchants unlimited growth potential, and offered millions of consumers convenience, security, and access to money when they need it.





<u>**Consumers have benefited tremendously from payment cards.**</u> In the early 1970s, cards were available only to those with relatively high incomes. This is not the case today as some type of payment card is available to most people. Payment cards provide myriad benefits to consumers, most notably the everyday convenience for making purchases that is enjoyed by individuals and businesses, 24/7 around the world. Card accounts help households keep track of exactly how much and where their money is spent with the help of customized monthly statements or via up-to-the-minute account access over the Internet. Payment cards provide confidence, safety, and convenience when traveling close to home or abroad, and they are a means of identification. Some cards entitle consumers to popular and valuable enhancements, such as rebates and awards tailored to their purchasing habits and special interests, which are a result of the intense competition issuers engage in as they fight for consumer loyalty. Short-term credit is also a proven means by which average consumers can weather unexpected financial disruptions or pay for unexpected expenses.

The pricing structure within this system ensures that financial institutions have incentives to offer new and innovative products, which helps fuel increased use of cards and which translates directly to greater use at merchants in the United States and world-wide. Perhaps most important of all, innovations in the payment card industry have resulted in strong protections against fraud, including state-of-the-art technology that protects consumers from unauthorized access to their accounts. For example, credit card issuers notify consumers if it seems likely their account security has been violated and can automatically suspend account access until the status of the account is verified. Consumers face little if any liability for unauthorized or unlawful use of their credit cards; rather, it is the banks that bear this cost. For credit cards, generally, consumers' liability is limited to $50 under federal law; however, in most cases, cardholders pay nothing for credit card losses, as issuers waive the $50. It is hard to imagine a more powerful, flexible tool that offers so many protections against loss or fraud. Put simply, Americans participate fully in today's world economy – largely because of the access that a spectrum of card products provides – but pay nothing directly for this privilege. Importantly, it is the interchange revenue that plays a major role in being able to offer the full spectrum of card services.

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

Sophisticated payment card systems provide merchants huge benefits compared with cash or checks. They are a form of guaranteed payment that protects merchants from the risk of fraud and non-payment. This allows retail merchants to instantly confirm that a customer has enough credit to make a purchase with his payment card and to have that payment transferred electronically from the customer's bank to the merchant's account. Retailers, while fully aware of the benefits these services provide, now do not want to pay for it. Rather, they want Congress to intervene to lower the cost of doing business.

The greater the use by both consumers and merchants, the more valuable the network is to all parties. It is no wonder that even retail businesses that deal in small dollar sales, such as fast food restaurants and coffee shops, are accepting card payment services. The firms had a choice to make regarding how best to increase sales and enhance the customers' need for convenient and fast service. The businesses have realized the significant value of the service and made an economic decision that it is in their best interest to be a part of the system.

Innovations by card issuers have rapidly expanded availability of payment cards to small businesses, further driving sales for retailers. Small firms benefit from access to credit to help finance their operations. They also benefit from flexible terms and greater ability to manage monthly expenses, track purchases, and weather short-term fluctuations in cash flow. Nearly half of all the small firms in the United States depend upon credit cards for their everyday operations. For example, small businesses made more than $100 billion in purchases using Visa Business cards last year. Again, it is a system that works very effectively.

The Economy Benefits from Payment Cards. No retailer acting on its own could arrange for an efficient payment system like this one, developed and paid for by the banks involved. The card payment system today has provided enormous benefits to retailers and the economy. The General Accountability Office (GAO) found that the number of credit cards in use has grown from less than

100 million in the mid-1980s, to over 690 million through 2005. Accounting for trillions of dollars in transactions every year, credit cards are responsible for a large and growing share of consumer spending in the United States. Economic performance depends upon a stable, efficient, and secure means of exchanging value. In the United States, payment cards make this exchange possible every minute of every day. Imposing price controls on a system that has returned such significant benefits for our economy makes no sense.

Local Community Institutions Benefit. Community banks, and their customers, have also benefited from the growth of payment systems as it enables smaller banks to compete for customers with larger financial institutions. There is significant customer demand for community banks to offer card products to complement their traditional bank offerings. In fact, debit cards are particularly popular with bank customers and are the fastest growing segment of the payment card market. Revenue derived from interchange fees is critical to community banks' ability to provide card transaction services and helps support the provision of financial services more generally. This benefits consumers by offering more choice and allows community banks to compete with large institutions on an equal footing.

II. Interchange is Not a Consumer Protection Concern but a Business-to-Business Issue

The electronic payments system is working for consumers, merchants, and the financial institutions that handle the transactions. The interchange fee is not paid by consumers but by acquiring banks to issuing banks. Acquiring banks pass these costs on to their merchant customers. Through H.R. 2382, merchants have sought to cloak interchange as a consumer protection issue. The bill goes as far as to place merchant protections under the Truth in Lending Act (TILA), a statute designed to provide consumer protections related to lending.

Every time a consumer uses a credit, charge, or debit card, data regarding the payment is transmitted across an elaborate electronic payments system to verify availability of funds and to confirm payment directly to the merchant. The system allows the various card issuers to bill consumers appropriately, in the case of credit and charge cards, and to correctly debit a consumer's account in the case of debit cards. Usually the merchant has payment in full for all purchased items within days, long before the consumer receives a billing statement, and often long before a bill is paid in full, thus leaving nearly all repayment risk with the issuing bank. Merchants pay to accept card payments because doing so enhances their business. In fact, according to Entrepreneur.com, merchants can expect to increase profits by up to 50 percent when accepting card payments. In short, the current payments system reflects a ***business arrangement among business partners*** that provides benefit to all involved.

The value conferred to merchants is significant and they ***choose*** to use these systems because they benefit from a fast and secure method of payment that customers like and are using with ever growing frequency. Merchants know that there are costs to other systems as well. Cash has to be counted, and tends to "shrink" from theft. Checks are more expensive to handle, and merchants pay extra fees for check management. In fact, the cost of returned checks was a major reason for the creation of the electronics payments system in the first place. All of this means that merchants have choices. ***Retailers can choose <u>not</u> to accept payment cards, but they know that they will lose customers to other retail competitors that do accept payment cards.***

Supporters of H.R. 2382 argue that the bill is necessary to place more control of payment acceptance in the hands of merchants. However, by allowing merchants to escape bait and switch prohibitions and by eliminating consumer choices in the form of payment, the bill seriously erodes existing protections available to consumers. Ironically, in the end, while providing protections to merchants, the bill, under TILA, fails to benefit consumers.

III. H.R. 2382 is a "Merchant" Protection Law that Ends Up Hurting Consumers.

ABA strongly believes that passage of H.R. 2382 would lead to significant new costs and reduced benefits for consumers, all for the purpose of increasing profits at merchants. Our banks strongly believe that such a policy choice merely hurts our ability to serve consumers. Please find below some examples of our concern with the legislation.

- The bill would require that interchange fees on premium cards not exceed the fees on non-premium cards. This provision would essentially end rewards benefits that consumers have come to enjoy. If premium card interchange rates are curtailed, consumers would either lose rewards benefits or the cost of the benefits would be transferred to consumers in the form of higher annual fees or credit costs.
- The bill would also impact what is known as the "Honor all Cards" rule, allowing merchants to refuse to accept cards due to a card's interchange fee. This would allow merchants to refuse to accept a VISA, MasterCard, AMEX or Discover carrying a particular brand, such as a store, association, or union brand, because the merchant believes the interchange fee on such card is too high. In that consumers do not pay interchange, they will not know which card is least costly to the merchant, and will be left to guess which card to use. Under present network rules, when merchants choose to accept payment cards, they generally elect to accept all cards under a particular logo. This is a convenience for customers and prevents consumer surprise at point of sale. H.R. 2382 would reverse all

that, allowing the merchant to dictate to consumers just what card choices that consumer has to make. It would also have the unintended consequence of limiting involvement by some of the smaller institutions in the marketplace, which would impact their ability to offer many services in small communities.

- The bill would allow merchants to establish minimum and maximum amounts for card acceptance, requiring consumers to use cash. While benefiting merchants, minimum and maximum amounts would inconvenience consumers who choose not to use cash for personal or safety reasons. The bill would eliminate consumer choice, add to consumer inconvenience and confusion, and place consumers at risk of harm.
- The bill would require that the identification of interchange fees comply with TILA disclosure mandates related to credit applications and billing statements. TILA disclosures exist for the purpose of informing consumers of fees or costs for which the consumer might be responsible under a covered lending agreement. Since interchange is a business cost ultimately paid by merchants, requiring disclosure under TILA would confuse consumers and serve no consumer protection purpose.

Conclusion

ABA strongly opposes H.R. 2382 because interchange rates and governance should be determined by the free operation of the private market. H.R. 2382 would dilute consumer protections and result in higher real costs to consumers while merchants reap windfall profits and government-backed protections.

Each year our credit and debit card system processes millions of transactions with amazing accuracy. Merchants do not have to participate in this system and are free to accept cash and checks as payment for goods and services. Indeed, most retail transactions are made via cash and checks, but increasingly, merchants have realized that the benefits of accepting card payments – access to millions of consumers through the Internet, guaranteed immediate payment for goods and services, and fraud protection – far outweigh the costs. The greater the willingness of consumers to use cards for payments, the more valuable the system becomes to merchants.

H.R. 2382 would turn back 50 years of development that has resulted in an efficient, accessible, secure, reliable, and global electronic payments system. It will undercut a pricing system that currently benefits consumers, businesses, and the broader economy. Rather than reduce costs at the cash register, H.R. 2382 would give merchants windfall profits; rather than encourage the development of new products that allow consumers to manage their money more easily, H.R. 2382 would take away options for consumers. The American Bankers Association urges Members of Congress to oppose H.R. 2382.

BLACKHAWK
NETWORK

The Honorable Barney Frank
Chairman, House Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20510

October 7, 2009

Dear Chairman Frank:

As CEO of Blackhawk Network, the largest provider of prepaid cards, both closed loop and open loop,[1] through retailers in the United States, I am writing to express my serious concerns with H.R. 3639, the Expedited CARD Reform for Consumers Act of 2009, which seeks amend the Credit Card Accountability, Responsibility And Disclosure Act ("CARD Act") to accelerate its effective date to December 1, 2009.

The CARD Act, as currently enacted, carries an effective date of August 22, 2010, institutes significant new requirements for both credit cards and prepaid cards,[2] and requires that new regulations in connection with network branded prepaid cards, store gift cards and gift certificates ("Prepaid Cards") must be issued in final form not later than February 22, 2010.

Since the adoption of the CARD Act, the Prepaid Card industry has been working to ensure that it can timely comply with its requirements; and Blackhawk Network has been actively engaged in constructive dialogue with legislators and regulators to ensure the enactment of reasonable laws and sensible regulations that will protect consumers, and ensure the continued vitality of our industry and our products. I believe that H.R. 3639's proposed acceleration of the effective date for the CARD Act's provisions to more than nine months earlier than originally contemplated is not warranted, and could have a devastating impact on the prepaid industry.

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[1] Closed loop prepaid cards are those that can only be used at a particular merchant, such as Starbucks cards. Open loop prepaid cards can be used at multiple merchants, such as a gift card that has a Visa logo on it, which can be used at merchants that accepts Visa debit cards.

[2] In the credit card arena, the legislation restricts the ability of credit card issuers to raise rates on existing credit card balances and mandates that banks receive permission from consumers before allowing them to exceed their credit limit, among other provisions. It is our understanding that H.R. 3639 was proposed in response to increases in interest rates and fees imposed recently by some credit card issuers. In contrast, prepaid card issuers have tended to lower fees since the CARD Act's adoption. For example, American Express (which operates its own network, and thus operates under a different business model from banks), recently announced it has eliminated all monthly fees after purchase on its gift cards.

Mailing address
5918 Stoneridge Mall Road
Pleasanton, CA 94588

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6220 Stoneridge Mall Road
Pleasanton, CA 94588

The Honorable Barney Frank
October 7, 2009
Re: H.R. 3639
Page 2 of 3

Passage of H.R. 3639 would result in significant restrictions on the availability of prepaid cards during the upcoming holiday season, as it would be extremely difficult to replace the current inventory of cards that are on the shelves of tens of thousands of retailers throughout the country, or that have already been ordered and scheduled for distribution. Suddenly, the mere existence of these cards would be a violation of the CARD Act. Production of millions of prepaid cards and other related activities (such as printing of terms and conditions) is already in process, and traditionally start in late Spring so that the products can be in retail stores for the holidays. I am concerned that in less than two months time, my company, as well as the rest of the prepaid card industry, will be unable to develop a new infrastructure and processes in order to be compliant with your proposed new effective date (if that result can be achieved at all). The industry would bear excessive costs if it is forced to remove all non-compliant prepaid cards from the market by December 1st, including expenses to remove non-compliant cards already in tens of thousands of stores nationwide and lost business resulting from our inability to produce and merchandise CARD Act-compliant cards before the accelerated implementation date.[3]

Moreover, restriction of access to these cards during the holiday season would unfairly harm consumers, especially the unbanked and underbanked. Retailers would be harmed by the decreased sales of their cards, which in turn will cause a decrease in purchases by cardholders who otherwise would be using the prepaid cards they received over the holidays to make purchases of clothes and other items. In short, accelerated implementation of the CARD Act's gift card provisions would cripple our industry at a time of year when our product is most popular among consumers (and at a critical time for our economy, a time when retail sales continue to struggle across the country, American jobs are at stake, and consumers are looking increasingly for these convenient products).

For the reasons stated above, we strongly oppose the provisions of H.R. 3639 that would accelerate the effective date of the CARD Act and urge you to give serious consideration to an exemption for the prepaid card industry so as to avoid the detrimental impact to consumers, retailers, and the industry overall. We would be happy to meet with you to discuss the ramifications in more depth, and look forward to working with you in a productive manner to reach common ground on the substance of this legislation.

Sincerely,

Donald Kingsborough

Donald Kingsborough
Chief Executive Officer

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[3] Blackhawk Network estimates that there would be a multi-million dollar cost to remove and destroy relevant inventory in its program by December 1, 2009. If compliance could be achieved by alternative means, such as stickering and signage, Blackhawk Network estimates that the industry cost would also be in the millions of dollars -- again, assuming that the retailers and others in the industry were able to bear this excessive cost and continue to make these products available to the consumers at a critical gift-giving time for American consumers.

cc:
Hon. Paul E. Kanjorski
Hon. Maxine Waters
Hon. Carolyn B. Maloney
Hon. Luis V. Gutierrez
Hon. Nydia M. Velázquez
Hon. Melvin L. Watt
Hon. Gary L. Ackerman
Hon. Brad Sherman
Hon. Gregory W. Meeks
Hon. Dennis Moore
Hon. Michael E. Capuano
Hon. Rubén Hinojosa
Hon. William Lacy Clay
Hon. Carolyn McCarthy
Hon. Joe Baca
Hon. Stephen F. Lynch
Hon. Brad Miller
Hon. David Scott
Hon. Al Green
Hon. Emanuel Cleaver
Hon. Melissa L. Bean
Hon. Gwen Moore
Hon. Paul W. Hodes
Hon. Keith Ellison
Hon. Ron Klein
Hon. Charles Wilson
Hon. Ed Perlmutter
Hon. Joe Donnelly
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Hon. Travis Childers
Hon. Walt Minnick
Hon. John Adler
Hon. Mary Jo Kilroy
Hon. Steve Driehaus
Hon. Suzanne Kosmas
Hon. Alan Grayson
Hon. Jim Himes
Hon. Gary Peters
Hon. Dan Maffei

Hon. Spencer Bachus
Hon. Michael N. Castle
Hon. Peter King
Hon. Edward R. Royce
Hon. Frank D. Lucas
Hon. Ron Paul
Hon. Donald A. Manzullo
Hon. Walter B. Jones
Hon. Judy Biggert
Hon. Gary G. Miller
Hon. Shelley Moore Capito
Hon. Jeb Hensarling
Hon. Scott Garrett
Hon. J. Gresham Barrett
Hon. Jim Gerlach
Hon. Randy Neugebauer
Hon. Tom Price
Hon. Patrick T. McHenry
Hon. John Campbell
Hon. Adam Putnam
Hon. Michele Bachmann
Hon. Kenny Marchant
Hon. Thaddeus McCotter
Hon. Kevin McCarthy
Hon. Bill Posey
Hon. Lynn Jenkins
Hon. Christopher Lee
Hon. Erik Paulsen
Hon. Leonard Lance

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cuna.org
DANIEL A. MICA
PRESIDENT & CEO

October 8, 2009

The Honorable Barney Frank
Chairman
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable Spencer Bachus
Ranking Member
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Dear Chairman Frank and Ranking Member Bachus:

On behalf of the Credit Union National Association (CUNA), I am writing to express our opposition to H.R. 3639, the Expedited CARD Reform for Consumers Act, which is subject to a hearing today in your Committee. CUNA is the nation's largest credit union advocacy organization, representing approximately 90% of America's 8,000 state and federal credit unions and their 92 million members.

During the consideration of the Credit Card Accountability, Responsibility, and Disclosure (CARD) Act, CUNA recognized that the concerns about abusive credit card practices were legitimate, even though it was generally acknowledged that credit unions do not engage in abusive practices. As we testified before your Committee in March, we applauded the efforts to end discriminatory, predatory, deceptive and abusive lending practices. However, we also noted that these efforts should be balanced to avoid unintended consequences, which would ultimately be adverse to consumers, including making credit more expensive and less available. In our testimony, we also highlighted the effective dates of the then-proposed legislation as among our greatest concerns.

Four months after enactment, credit unions and their members have been significantly affected by the unintended consequences of a specific provision of the CARD Act; and, the relatively quick effective and compliance dates have compounded the problems credit unions face in order to comply with the new law. H.R. 3639, which would accelerate many of the remaining effective dates from February 2010 to December 2009, has the potential to make matters even worse for credit unions and their members. We urge the Committee not to approve H.R. 3639.

Accelerated Compliance with the CARD Act may be Impossible for Credit Unions

Some have suggested that moving the effective dates from February to December will only affect the largest credit card issuers; however, half of the nation's credit unions issue credit cards, and 84% of credit union members belong to a credit union that offers credit cards. Accelerating the effective date could raise even greater compliance concerns for credit unions as opposed to larger issuers because they do not typically run their own credit card operations and therefore cannot simply pour more resources into their programs to comply on short notice. Credit unions rely upon third-party vendors to provide necessary support, and these vendors are working diligently to comply by the February 2010 effective date.

The Honorable Barney Frank
The Honorable Spencer Bachus
October 8, 2009
Page Two

Data processing changes are still being developed and need to be tested, and additional Regulation Z changes to implement other provisions of the CARD Act were just proposed last week (in a 800-page proposal to which comments are due 30 days after publication). Imagine the harm consumers would experience if credit unions and other issuers were forced to implement changes that had not been fully tested. Eliminating any time for testing data processing changes will inevitably produce a tremendous number of errors, and consumer inquiries and complaints. In addition, the Regulation E amendments required by the CARD Act to impose restrictions on gift cards have not even been proposed by the Federal Reserve.

Simply put, many steps need to be taken before credit unions and others will be able to comply with the new law in any orderly fashion; while the three month period between December and February is a relatively short period of time, it is a critical period of time for credit unions to take these necessary steps. Therefore, we must oppose H.R. 3639 and urge the Committee not to approve this legislation.

On behalf of America's credit unions, we appreciate the opportunity to express our views on this legislation.

Sincerely,

Daniel A Mica

Daniel A. Mica
President & CEO

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Electronic Transactions Association

Statement of the Electronic Transactions Association on H.R. 2382, the "Credit Card Interchange Fees Act of 2009"

U.S. House of Representatives
Committee on Financial Services
October 8, 2009

The Electronic Transactions Association (ETA) is pleased to submit a statement to the House Financial Services Committee on H.R. 2382, the "Credit Card Interchange Fees Act of 2009." ETA members are a diverse group of businesses primarily involved in the sale of payment processing services to merchants. The kinds of businesses represented by ETA include: banks that are members of the card association networks; independent sales organizations (ISOs) sponsored by member banks of the card associations; and providers of infrastructure and services to the banks and sales organizations. ETA strongly recommends that the committee consider the adverse impacts H.R. 2382 will have on consumers.

The integrated system of interchange and electronic payments is a critical part of the national economy. In fact, the safe and efficient flow of electronic payments might well be considered the scaffold required to support the continued growth of commerce in the United States and around the world. Interchange networks are highly specialized and robustly developed tools that are needed to move funds from a card issuing bank to a merchant (or acquiring) bank. These networks are responsible for facilitating the rapid growth in electronic payments witnessed in just the last ten years. Recently, interest groups have focused only on the price of conducting transactions through these networks rather than on the infrastructure required to safely and efficiently process an ever-increasing number of transactions moving through the interchange system.

Interchange and payments systems provide significant benefits to consumers, retailers and the financial services industry. For the consumer, interchange systems provide a secure, cash-free way to make purchases and to receive instantaneous "credit." For retailers and the financial services industry, the interchange system is a well-established way to facilitate business, grow sales, and mitigate certain risks. Over the past few years, as the volume of electronic payments has grown enormously, the interchange system has simultaneously grown, adapted, and continues to mitigate payment risks while increasing consumer convenience.

To begin, here is a brief and simplified description of an electronic payment transaction cycle: when a consumer makes a purchase with a payment card, usually that card is swiped through a terminal at a store. Instantaneously, a transaction "pulse" flows through the payments system to the card issuing bank to seek approval of the consumer's purchase. Immediately, another transaction flows back to the merchant terminal with approval (or declination) of the purchase. Upon approval, the immediate benefits to the consumer are the speed, safety, and convenience of the process; the benefit to the merchant is assurance that payment for the purchase is guaranteed by the card issuing bank.

Within the next 24 hours, another set of electronic exchanges take place for the actual settling of accounts and transfer of funds from the card issuing bank to the merchant (or acquiring) bank. (In fact, the origin of the word "interchange" is as shorthand for "the exchange of funds" between banks.) Depending on the kind of arrangement the merchant has chosen for payment processing, payment for the consumer's purchase can be credited to the merchant's bank account in 24 hours or, in rare cases, 48 hours from the time the sales transactions are received by the processor. The safety and efficiency of this system is so well established, and this procedure has become such a part of our daily lives, that most of us rely on it without a second thought.

Given the necessity of such transactions to most consumers, ETA strongly recommends that the committee consider the adverse impacts H.R. 2382 will have on consumers. First, the bill ends ubiquitous acceptance. Second, the bill seeks to interfere in the carefully calibrated risk mitigation of the electronic payments system; and third, there is no evidence that merchants would attain savings or guarantee to pass price reductions, if any, on to consumers. As an attempt to insert the federal government into a series of business-to-business agreements, H.R. 2382 would hurt consumers, not help them.

H.R. 2382 would do away with ubiquitous acceptance. Today, a person could decide to hail a cab to the airport, buy a plane ticket to Mumbai, board the plane, fly to Mumbai, arrive there and pick up a fresh pair of jeans and a shirt, enjoy dinner in a local restaurant, check into a hotel, order a nightcap, go to sleep, wake up the next morning and do it all over again – with one card in their pocket. This is known as ubiquitous acceptance and H.R. 2382 would terminate every consumer's ability to do this. Upon enactment of this bill, consumers would be very surprised to learn, when they head to the grocery store or to the outlet mall, that there is a chance their favored card will no longer be accepted. It is not helpful or necessary to pass a federal law that allows merchants to discriminate against consumers' preferred payment choices.

H.R. 2382 would cause current risk calculations to become invalid. It is important to note that the bank sponsors of the card networks underwrite the risk in the payments system. Sources of that risk include merchants, independent sales organizations (ISOs), and payment processors. An acquiring (or merchant) bank's primary risks are: 1) merchant going out of business; 2) merchant fraud; 3) fraud perpetrated on the merchant; 4) charge offs (uncollectable sales); and 5) data security breaches. Also, in some circumstances, the acquiring bank extends credit to the merchant so that merchants can receive their funds more quickly. For instance, the acquiring bank will credit the merchant's account for sales transactions in advance of receiving the ultimate settlement amounts from the issuing banks for those sales.

The total fee that a merchant pays for accepting credit and debit card payments for the sale of goods and services is referred to as the "discount rate" or "merchant discount". The merchant discount has several components, including:

1) the cost(s) to process and handle bank card sales transactions;
2) an interchange fee; and
3) the cost(s) of providing deposit credit to the merchant.

The "interchange rate" (or "interchange") represents a wholesale, market-driven fee for credit card processing service and is charged by the card brand associations (like Visa and MasterCard) to the acquiring bank. Interchange rates include the cost of keeping the interchange networks up and running, the costs associated with keeping the networks secure (and those expenses are increasing), and a payment for risk assumed by the issuing and acquiring financial institutions. While interchange is set by the card brand associations to pay for use of their payment networks, other parts of the merchant discount rate are determined by the acquiring bank. Thus, the merchant discount rate is subject to fierce negotiation and competition between different acquiring banks in the marketplace.

There are many different categories of interchange rates and they vary based on the volume of sales at the merchant, the type of business of the merchant (i.e., is the merchant an unattended gas station kiosk, a florist, a tattoo parlor, or a book binder), and the type of transaction processed. For example, a "card-not-present" transaction carries a higher risk of fraud than a "card present" transaction. A premium card transaction may have a higher interchange rate than a regular card transaction because, in the case of one of the world's largest payment processors, the premium card average transaction size is 45% higher than those on regular cards.[1] Premium cards are a substantial benefit to merchants and also represent a greater expense exposure for the issuing banks. Because there are many different categories of interchange rates, the percentage of the merchant discount fee that is made up of interchange may vary from transaction to transaction. ETA members and others in the field assume the risk of payment for interchange if their pricing model incorrectly assesses the ratio of interchange cost to total merchant discount cost.

H.R. 2382 would not provide financial relief to consumers. This bill falsely presumes that interchange and merchant discount rates are not negotiated. In fact, merchants routinely negotiate for the lowest possible discount rates from the thousands of banks and card processors (like First Data and Moneris) that offer this service. While large retailers may negotiate based on a high volume of transactions, smaller merchants have access to trade associations, professional associations, and local chambers of commerce for group-negotiated rates that offer significant savings on card acceptance. For example, the First National Bank of Omaha offers over 400 such programs to smaller merchants.

In addition, there is nothing that prevents a merchant from engaging in a negotiation directly with Visa and MasterCard. Merchants can – and do – negotiate interchange fees directly with MasterCard or Visa, based on the same factors that are used by merchants in negotiating deals with other types of vendors in markets with similar dynamics. Merchants have a much greater ability to negotiate transaction processing expenses than they do for most other business services, such as electricity, postage, water, or trash collection.

Merchants who accept cards are not prohibited from offering a cash discount. Federal law allows merchants to offer cash discounts, and card associations have clear rules stating that cash discounts are allowed. Last year, at a time of skyrocketing gas prices,

[1] Moneris Solutions, Toronto, Canada, October 7, 2009.

cash discounts were widespread at gas retailers across the country. Consumers would be hurt by the fact that merchants could reject specific cards, diminishing consumer benefit from rewards programs and causing consumers to enter into more card agreements to be assured of having a valid payment mechanism at a given retailer.

In conclusion, ETA requests that the committee fully consider the ill effects of H.R. 2382. The termination of ubiquitous acceptance will cause consumers to extend themselves into the personal credit markets even further then they are today. Consumers will need to increase the number of payment cards they carry in order to ensure that they have enough variety to be able to make purchases at different retailers. Consumers will also lose the benefit of premium reward cards if merchants are able to refuse them for payment.

The interchange and electronic payments systems provide significant benefits to consumers, retailers and the financial services industry. Interchange and merchant discount rates exist today in a highly competitive marketplace and merchant discount packages are fiercely negotiated. In addition, each card transaction carries a carefully calibrated risk profile for the issuing and acquiring banks. Inserting an artificial government price control mechanism into the middle of these business-to-business contract agreements will hurt consumers, not help them.

ICBA
INDEPENDENT COMMUNITY
BANKERS *of* AMERICA

Statement of the

Independent Community Bankers of America

For the Record
in the
Hearing on

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

Before the

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

October 8, 2009
Washington, D.C.

The Independent Community Bankers of America[1] (ICBA) welcomes the opportunity to share its views with members of the Committee on Financial Services on H.R. 3639, the Expedited CARD Reform for Consumers Act of 2009, which would advance the February 22, 2010 and July 22, 2010 effective dates for the reforms in the Credit Card Accountability, Responsibility and Disclosure Act of 2009 (H.R. 627) to December 1, 2009.

Our nation's more than 8,000 community banks are common-sense lenders that offer credit and debit cards on fair terms as a means of providing valuable services to their customers. The recently enacted Credit CARD Act and its effective dates are already placing substantial burdens on the 74 percent of community banks that offer credit card programs as they change systems, train employees and implement procedures to comply with the new rules.

Moreover, most of the cannot be completed until the Federal Reserve finalizes the implementing regulation. On September 29, 2009, the Federal Reserve released proposed revisions to Regulation Z (Truth in Lending Act) in order to implement provisions of the Credit Card Accountability, Responsibility and Disclosure Act of 2009 that are effective on February 22, 2010. Additionally, the 841-page proposal republishes portions of the final rules amending Regulation Z's provisions regarding open-end credit published in the *Federal Register* on

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[1] The Independent Community Bankers of America, the nation's voice for community banks, represents 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve.

With nearly 5,000 members, representing more than 20,000 locations nationwide and employing nearly 300,000 Americans, ICBA members hold $1 trillion in assets, $800 billion in deposits, and $700 billion in loans to consumers, small businesses and the agricultural community.

January 29, 2009 and several proposed amendments to the January 2009 Regulation Z Rule that were originally published in the *Federal Register* on May 5, 2009.

Speeding up the compliance date from February and August 2010 to Dec. 1, 2009 will harm America's Main Street community banks, which never engaged in the misleading practices targeted by the bill. It will be virtually impossible for most community banks to comply in time with the expedited date due to their limited compliance resources. As a result, many community banks may decide they must discontinue offering these products to their customers, which will likely result in the consolidation of the credit card industry into the hands of a few large financial institutions that can absorb the compliance burden.

ICBA urges Congress not to change the effective dates for community banks, so that they can continue working to comply with the requirements by the original dates. Community banks remain the backbone of our national and local economies. During this time of economic crisis, reputable community banks should not be asked to endure further burdensome regulations that divert attention away from their key purpose—to lend to their customers and keep money flowing where it is needed—in communities throughout Main Street America.

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HEARING STATEMENT
COMMITTEE ON FINANCIAL SERVICES
CONGRESSWOMAN BETSY MARKEY
HR 3639, the Expedited CARD Reform for Consumers Act of 2009
October 8, 2009

Chairman Frank and Ranking Member Bachus, thank you for allowing me the opportunity to submit testimony for this hearing. I have received an alarming number of complaints from my constituents regarding unreasonable credit card rate increases prior to the enactment of the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act) reforms. The most troubling aspect is that these notices were received mere days before the credit industry would be required to provide forty five days of written notice of rate increases.

As you know, Wells Fargo & Co. announced just yesterday that they will raise interest rates by three percentage points in advance of the new rules taking effect. For a corporation that includes "do what's right for the consumer" on their list of company values, this announcement is a complete betrayal of consumer trust, and creates undue financial stress on Americans who are already facing tough economic times.

According to a report by The Pew Charitable Trust, interest rates have increased an average of 20% this year from issuers changing account agreements, revoking promotional rates, and imposing interest rate increases on existing balances, including those less than 30 days past due. Such actions violate the notions of fair play.

The Credit CARD Act was passed by Congress with bipartisan support to prevent exactly these types of deceptive credit card practices. Furthermore, the effective date for the bulk of this legislation was set for February of 2010 to give credit card companies time to implement federal regulations – not additional time to violate the spirit of the law by hiking interest rates on consumers.

Yesterday, I, along with seventeen of my fellow members of Congress, sent a letter to the major credit card issuers urging them to follow the lead of Bank of America and refrain from implementing changes in their consumer credit card rates and fees. I urge these companies again to reconsider their billing practices and eliminate the need for even stricter regulations.

I thank Congresswoman Maloney for introducing the Expedited CARD Reform for Consumers Act and the Committee for holding this hearing to shed light on these recent interest rate increases.

Thank you again Chairman Frank and Ranking Member Bachus for allowing me the opportunity to submit testimony before the Committee this morning.

STATEMENT FOR THE RECORD OF
THE NATIONAL ASSOCIATION OF CONVENIENCE STORES
AND THE
SOCIETY OF INDEPENDENT GASOLINE MARKETERS OF AMERICA

BEFORE THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES

HEARING ON THE CREDIT CARD INTERCHANGES FEES ACT OF 2009 (H.R. 2382)
OCTOBER 8, 2009

Chairman Frank, Ranking Member Bachus and Members of the Committee, the National Association of Convenience Stores ("NACS") and the Society of Independent Gasoline Marketers of America ("SIGMA") thank you for this opportunity to provide you with our views regarding the Credit Card Interchanges Fees Act of 2009, H.R. 2382, a bill we wholeheartedly support.

Overview

NACS is an international trade association representing the convenience store industry. The industry as a whole includes about 145,000 stores in the United States, sells nearly 80 percent of the gasoline in the nation, and employs about 1.7 million workers. It is truly an industry for small businesses; more than 60 percent of convenience stores are owned by one-store operators. NACS also helped found the Merchants Payments Coalition, which includes more than 20 national and 80 state trade associations from diverse industries, to help promote a more competitive and transparent system of credit card interchange fees.

SIGMA is a national trade association comprised of approximately 250 independent marketers and chain retailers of motor fuels. SIGMA's members operate in all 50 of the States and collectively sell over 25 percent of the motor fuels consumed in the United States each year. SIGMA is also a member of the Merchants Payments Coalition.

As they currently exist, credit card interchange fees hurt U.S. consumers, who ultimately have to pay these fees, and they hurt our members' businesses, because they are imposed by large banks and card issuers in an unfair and anti-competitive manner. Consumers have long been unaware of just how much of an imposition these fees were because the credit card companies worked hard to keep consumers in the dark. But consumers are slowly starting to see the light. Just last week, several of our associations' members joined Rep. Peter Welch (D-VT) in presenting Congress with nearly 1.7 million petitions signed by 7-Eleven customers, who want Congress to help end the unfair way in which interchange fees are charged. So we greatly appreciate this Committee's consideration of the Credit Card Interchanges Fees Act of 2009 and we urge its swift approval.

Our statement will begin by discussing why the current interchange fee system presents such a tremendous problem for consumers and for businesses like convenience stores, and will then explain why we believe the Credit Card Interchanges Fees Act will be a helpful solution.

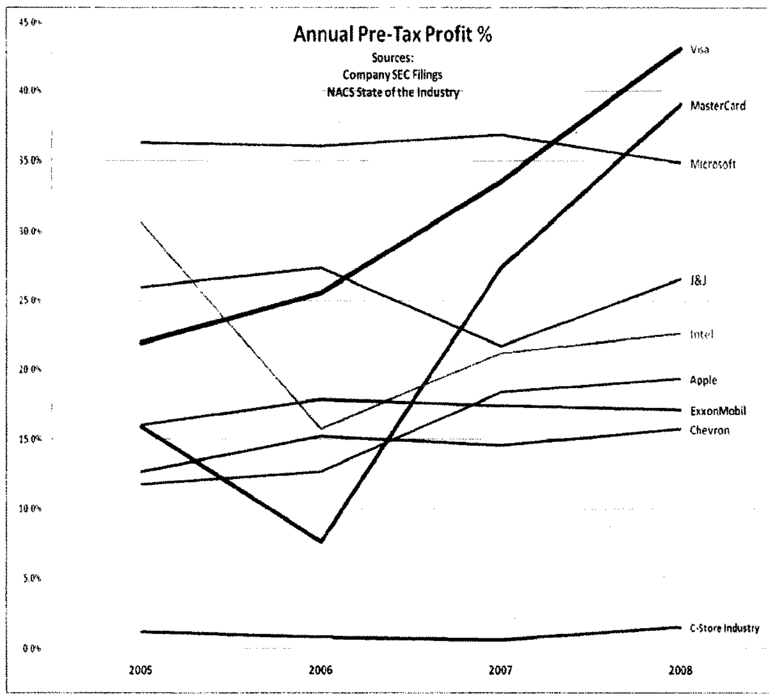
Out of Control Credit Card Fees

We will begin with a startling fact that we have shared with Members of Congress before – our industry now pays more to credit card companies to simply process our card payment transactions than we earn in pre-tax profits. Specifically, in 2008, the entire convenience store industry made a total of $5.2 billion in pre-tax profits; however, our industry paid $8.4 billion in fees to the credit card industry.

That is an astronomical number, is the largest in the history of our industry, and 2008 was the third year in a row that card fees exceeded the entire industry's pre-tax profits. Card fees have been so significant for our industry that they were the number one concern for us even before they began to exceed our industry's pre-tax profits. These fees have steadily climbed in terms of the percentage of operating costs they represent. Card fees are now on average the second highest operating cost for businesses in our industry; only labor costs more. Card fees cost us more than rent, utilities, and the like. When these facts are taken together with the difficult economic climate small businesses now face, it is easy to see why the businesses in our industry simply will not survive if this situation does not change.

Let's remember what these fees are. Interchange fees ought to compensate the card industry for the cost of processing a transaction. That is perfectly fair. But what started out as a fee to cover a legitimate cost has grown out of control. Even though the costs of processing have dropped dramatically, interchange has continued to rise – and is doing so faster than any other cost our industry faces.

The following chart demonstrates the inequities in this system. As Visa and MasterCard earn profit margins of more than and nearly 40 percent, respectively, the convenience store industry routinely makes profits of a couple of percentage points. Clearly, there is a huge amount of fat built into the interchange fee system – at the expense of our industry.



These fees are out of control because the credit card market is structured in a way that prevents competitive market forces from checking their increases. Visa has thousands of member banks, as does MasterCard. Regardless of the fact that some of these banks are huge, including such behemoths as Bank of America, JP Morgan Chase, Citigroup, and Wells Fargo, they present themselves to retailers as a united front in the guise of Visa or MasterCard. They have agreed among themselves to charge the same card fees and require adherence to the same practices, rather than compete with each other – conduct that clearly violates the antitrust laws.

Even the largest retailers in the country have no ability to negotiate with these banks when they pool their collective market power in this way. And not surprisingly, small businesses like mom-and-pop convenience stores routinely get the worst deals possible.

The card industry often tries to justify these exorbitant fees on the basis that they offer merchants a "payment guarantee" and absorb the risk of fraud. In our industry that is not accurate. The "payment guarantee" is more akin to a loose commitment to pay when they are in the mood. In our industry, for example, our members in 2008 were made to pay for fraudulent card use to the tune of $76 million each year while the card industry only takes responsibility for $28 million in fraud on our transactions. What kind of "guarantee" makes merchants absorb more of the costs of fraud than the credit card industry? This guarantee certainly isn't worth much to us.

Retailers, for their part, have little choice but to accept cards even though the processing fees are a drain on our business. Consumers demand the ability to pay with plastic, and the card companies know this. Not only is the market power of Visa and MasterCard so great that retailers have little choice but to accept credit cards, the card companies also impose legal restrictions on retailers to make it difficult for retailers to refuse to accept credit cards. Examples are:

- rules prohibiting merchants from providing discounts if customers use cards that are cheaper for the merchant. These rules (sometimes known as "non-discrimination" rules) remove any incentive for card companies to reduce their fees in order to compete. The result is that fees just keep getting bigger;

- Visa's all-or-nothing, take-it-or-leave-it rule requiring retailers with multiple locations to accept cards at all of their locations if they accept cards at one. This type of restriction prevents retailers from tailoring their business models to fit their needs and those of their customers (e.g., cash-only in locations where credit card usage is lower, or experimenting with cash-only in limited areas to see how that practice affects the bottom line before going cash-only at all locations);

- the "honor all cards" rule, which provides that if a retailer accepts any of their cards, the retailer must take all of them – no matter how high Visa and MasterCard raise the interchange fees on some of these premium cards. This is another rule that severely limits retailers' ability to make market decisions. NACS acknowledges that one aspect of this rule is understandable – part of the value of the Visa and MasterCard brands is that merchants will not discriminate based on which bank issued a particular consumer's card. But rather than impose an "honor all issuers" rule, Visa and MasterCard impose an honor all cards rule. And then they push more and more premium cards (e.g., platinum cards, rewards cards, corporate cards and other offerings) every year that carry higher interchange fees. By pushing these cards to consumers (often to existing consumers who have not even asked for a different type of card), Visa and MasterCard change the mix of cards consumers use, and that results in dramatic overall cost increases for us on interchange – even when the announced interchange fee increases for individual card types are relatively modest;

- rules that make it difficult to discount for cash, like the requirement that prices be displayed so that the credit price is treated as the "full" price for an item. Indeed, retailers have been instructed numerous times by their acquiring banks that the credit price must be more prominently displayed. Many types of retailers have so many different products in their stores that the double price-marking this requires is just not a practical option. That is why consumers see few cash discounts within stores, despite a federal law that is supposed to allow retailers to offer cash discounts. The credit card companies also threaten and coerce retailers, and generally work hard to ensure that retailers just do not want to take the risks involved in offering cash discounts;

- minimum transaction requirements and penalties or other adverse action if retailers fail to meet the minimum. This practice disparately impacts small businesses, especially when considered in light of the fact that some of the card associations' fee schedules are weighted to provide that larger businesses pay lower fees per transaction than small businesses. These types of restrictions make little sense in the context of providing an electronic processing service that does not enjoy economies of scale;

- network routing requirements that prevent retailers from using an electronic network other than Visa's or MasterCard's to process their respective transactions, which leaves retailers with no ability to find cheaper networks, and more fundamentally, raises competitive a barrier to new entrants in the networking market;

- a rule known as "Reason Code 96," which provides that when a credit card is swiped at a gasoline pump prior to a fill-up, Visa and MasterCard put a $75 limit on the transaction, and charge-back retailers for the amount over the limit. When gas prices rose and consumers started paying more than $50 or $75 for a tank of gas in significant numbers, our industry started losing large amounts of money on these transactions. Remarkably, the current charge-back policy is less draconian than the past practice, whereby Visa claimed the right to chargeback the entire amount of the transaction – not just the amount over $75. But the fact remains that this practice is unfair to retailers; and,

- practices that make it difficult for retailers to access and understand the complete terms of the agreements they make with the card companies. Most of our members sign a short (perhaps 15 page) contract with their bank or processor that allows the retailer to accept Visa and MasterCard. But that short contract incorporates by reference more than 1,000 pages of rules that govern the contractual relationship. Until recently, Visa and MasterCard would not even make these rules available over the Internet, or if they did, they only made excerpts available, and they required retailers to sign a non-disclosure agreement beforehand, preventing retailers from discussing the rules with one another or revealing them to the public. More fundamentally, however, whether disclosed or not, the rules remain unfair and anti-competitive.

None of this is good for businesses or consumers, but this is the way the large banks that control the credit card system have designed the interchange fee framework.

It does not have to be this way. More than 40 nations around the world have found problems with the way the credit card industry has structured and priced interchange and have taken action. They have adopted a wide variety of solutions, but the common point for all is that the current system violates competition and antitrust laws around the globe and is unfair to both merchants and consumers. We have attached with this testimony a report released last month by the Merchants Payments Coalition discussing actions taken against these fees in nations around the world, and finding that fees in the United States are:

- More than two times the rates in the United Kingdom and New Zealand;
- Four times the rates in Australia; and
- Over six times the cross-border rates recently agreed upon by MasterCard and the European Union.

Significantly, it should be kept in mind that interchange fees are just one part of a vast system of fees that the card industry charges. Penalty fees, finance charges and overdraft fees are just some of the other sources of revenue banks earn from their card operations. With interchange rising, one might expect other fees to be falling, but that is not the case. The Center for Responsible Lending recently found, for example, that overdraft fees alone have risen 35 percent in the last two years. And an August poll by Penn, Schoen found that 42 percent of voters had seen their credit card fees rise in just the last few months. MasterCard, to take only one example, has just doubled a debit card interchange fee our industry pays so that now, for a $1 purchase, we may pay an interchange fee of 20 cents – which can often be twenty times what our profit margin on that item might have been.

Moreover, the design of the system helped make credit cards a part of the financial crisis. The huge interchange fees being collected by the banks create an incentive for them to ignore the risks of consumer delinquencies. Even if someone gets into trouble years down the road and cannot pay their credit card bill, the bank has made huge fees on the purchases along the way. Not only that, but many of the losses resulting from that consumer's financial difficulties are taken by the investors who hold securities made up of credit card debts. The system, then, has been designed so that banks make big money on fees and the American taxpayer is left holding the bailout bag. If this system is not changed now, our nation's economic history is destined to repeat itself, and we will again face the same difficult economic challenges we have experienced over the last two years.

Why the Credit Card Interchange Fees Act Will Help Solve the Interchange Fee Problem

The Credit Card Interchange Fees Act directly confronts many of the specific problems that interchange fees present for businesses and consumers. As such, we believe its passage will result in some meaningful relief for us as well as our customers.

The bill would give retailers the flexibility to make their own business decisions about card acceptance, such as which of their locations will accept cards, and whether to refuse cards with higher interchange fees. Moreover, the bill would end the practice of charging higher fees for premium cards, to help ensure that consumers do not lose the option of using these cards.

The bill will encourage retailers to make cash discounts more readily available to consumers, by prohibiting the card companies from dictating how retailers display prices; and it will afford better choice to consumers and retailers in terms of methods of payments by allowing retailers to specify a preferred method of payment if they desire.

The bill will discourage anti-competitive pricing and practices by the card companies, by restricting Reason Code 96 charge-backs and similar practices, and banning network routing restrictions. The burden on small businesses should be eased by prohibitions in the bill on minimum transaction volume requirements and penalties.

And retailers should benefit across the board from provisions that will require, finally, that card payment systems disclose all of their contract terms to merchants without restricting the merchants' use of such information.

Finally, the bill ensures that regulators keep watch over the credit card companies by directing the Federal Trade Commission to promulgate specific rules concerning unfair and deceptive trade practices in this area. And it will give consumers a window into the world of credit card processing fees by directing the Federal Reserve to publicly disseminate information about the fees and credit card processors' practices.

We should make clear that adding some transparency and getting rid of unfair and deceptive rules won't hurt anyone. While small banks and credit unions claim they need these fees to keep issuing cards, nothing in the bill requires fees to go down. If there are certain fees that decrease once we have a system with transparency and a prohibition on unfair and deceptive rules, then that shows the current system is dysfunctional. Members of this Committee should also know that small banks and credit unions are at a disadvantage under the current system. Just 10 banks collect more than 80 percent of credit card interchange fees. And, for banks with less than $1 billion in assets, credit card operations do not, on average, amount to even 1 percent of their revenue. Even steep cuts to interchange would not hurt these small institutions – and again, the bill does not say anything about the level of interchange fees.

Conclusion

These are tough economic times for all, and many factors including the credit crunch and lower retail sales make them tougher for NACS and SIGMA members. But we cannot overemphasize the negative impact of interchange fees on our members, especially the ones that are small businesses. Fixing this problem is our industry's top priority, and we wholeheartedly support the Credit Card Interchange Fees Act as a measure to help address out of control interchange fees.

UNFAIR CREDIT CARD FEES.COM

"Swipe Fee" Reform – International Lessons

Have you ever wondered why small stores beg you not to use credit cards for low-dollar purchases or hope that you'll pay with cash? It's because of the cost of swipe fees, also known as interchange fees.

Unless you're a retailer, you've probably never heard of them, but swipe fees hit your pocketbook regardless of whether you pay with plastic. These huge hidden fees are what the big banks charge small businesses every time a customer uses a credit or debit card. Interchange costs Americans an average of $2 on every $100 they spend on cards – a higher percentage than anywhere else in the industrialized world.

Though we live in a global marketplace, other countries and their governments have been able to negotiate with the Big Banks and credit card companies for fair rates and transparency. But, in the United States merchants and their customers are still forced to pay skyrocketing swipe fees. If we paid the same low credit and debit card swipe fees as consumers in Australia pay, then the net benefit for American consumers would have totaled $125 billion over the last four years.

Swipe fees started out in the 1960s as a way for banks to cover the cost of processing credit card transactions. But even as technology has dropped that cost dramatically, the banks and credit card companies have pushed swipe fees higher and higher, turning it into a cash cow. For many businesses, swipe fees are now their single-highest non-labor operating cost.[i]

With almost any other equipment, supplier or service, a merchant can comparison-shop, negotiate or otherwise influence its final cost of doing business. Store owners can conserve on energy usage and seek out the most competitive prices for merchandise just to cite a few examples. Not so with credit card swipe fees. Visa and MasterCard control more than 80% of the marketplace. They set the swipe fees in secret, give businesses no ability to negotiate and virtually insist they be buried in the price of merchandise. Unfortunately, the card companies' hidden fees get passed on to all consumers in the form of higher prices and lower value for nearly everything they buy.

"It's bad enough that the credit card companies force these hidden fees on us and our customers when we can least afford it," says Tom Robinson, President of Robinson Oil Corporation, which operates a chain of thirty-four convenience stores. "But when we are paying more than anywhere else in the world, and other countries have taken action to protect their citizens from abuse, it is inconceivable that our government would turn a blind eye to the issue. It is time for Congress to step up and defend the principles of the free market economy by taking action on swipe fees."

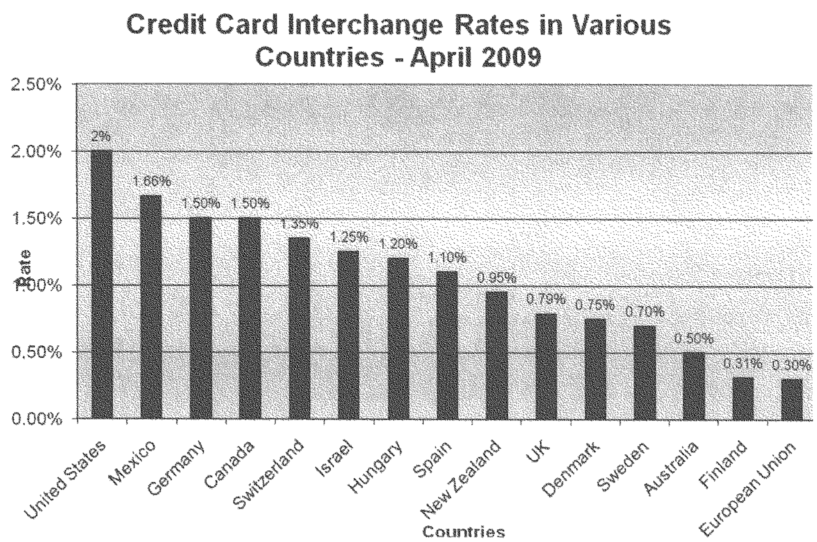
Though Congress and the White House have addressed other credit card reforms, any fix will be incomplete without addressing swipe fees. Consider:

- Banks raked in an estimated $48 billion in swipe fees in 2008 – an average of $427 per American household in just one year.
- This $48 billion total is more than triple the amount collected in 2001
- Hidden swipe fees cost Americans more than all credit card annual fees, cash advance fees, over-the-limit fees, and late fees combined
- U.S. swipe fees are the highest in the developed world
- The U.S. pays approximately 60% of swipe fees globally – about double the U.S. percentage share of global GDP[ii]

Compared to the rest of the world, U.S. swipe fees are:

- More than two times the rates in the UK and New Zealand
- Four times the rates in Australia
- Over six times the cross border rates recently agreed upon by MasterCard and the EU

Most Americans think of the United States as a sensible place to do business compared to many European countries. But when it comes to the cost of credit cards, as the below chart highlights, citizens in EU and NAFTA countries pay a much smaller interchange rate to Visa and MasterCard banks.[iii]



Not only do other nations provide lower interchange rates, but we can also learn from other countries' experiences with interchange reform. Major countries around the world have addressed interchange reform, with some already demonstrating beneficial results for their economies. In particular, lessons learned from experiences in Australia, New Zealand, Canada, and the European Union, provide instructive examples about why interchange reform makes economic sense in the U.S. – especially now.

Reforming swipe fees would be a boon to our economy and would benefit both merchants and their customers. Lower interchange rates and a more transparent and competitive process of determining these rates would lead to consumer savings and, in turn, would stimulate much needed spending.

Australia

"The competitive environment has been improved. Merchants have more choice. The veil of secrecy on interchange fees has been lifted. Access has been liberalised. And the price signals to consumers have been improved."

– Philip Lowe, Assistant Governor (Financial Systems), Reserve Bank of Australia

In 1997, an Australian committee tasked with studying the nation's financial and regulatory systems highlighted interchange fees as areas of "policy concern" in its final report. The Committee recommended the formation of a new Payments System Board as part of the Reserve Bank of Australia to examine interchange fee arrangements in more detail. The Board's subsequent findings, published in October 2000, concluded that "in card networks, competition is not working as it should."

In part because of the hidden nature of the swipe fees and the absence of informed consumer choice of payment method as a result, the Reserve Bank of Australia designated in April 2001 that the interchange rates payment systems were subject to regulation under a piece of financial legislation passed in 1998. As a result, Australia mandated a reduction in interchange fees and enacted a series of interchange reforms that "aimed to improve the efficiency of the overall payments system and to promote competition. In particular, they have sought to: increase the transparency of the system; remove or modify restrictions that hinder competitive forces; liberalize access arrangements; and promote price signals to consumers that are conducive to the efficient evolution of the payments system."[iv] The reforms went into effect in November 2003 and the fees have fallen by approximately .45 percentage points since that time.[v]

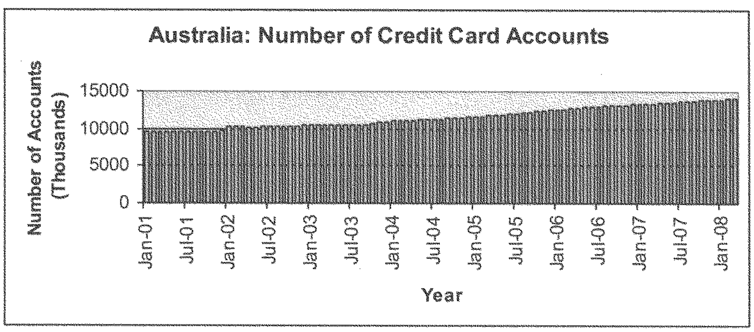
A series of subsequent analyses from the Reserve Bank of Australia and its Payments Systems Board have documented the numerous benefits that interchange reform has meant for the Australian economy.

- **Consumers save money from interchange reform**: As the Payments Systems Board stated in their 2005 Annual Report, "the most notable impact of the reforms has been a marked reduction in merchants' costs of accepting credit cards, which in turn, is flowing through into lower prices of goods and services for all consumers."[vi] The Report also noted "competition means that just as the banks passed on their lower costs to merchants, so too must merchants pass on their lower costs to consumers."[vii] In its *Preliminary Conclusions of the 2007/2008 Review*, the Reserve Bank estimated that "over the past year, these cost savings have amounted to around [AU]$1.1 billion" and estimated that the "bulk of these savings have been, or will eventually be, passed through into savings to consumers."[viii] Given the size differences between Australia and the U.S. and their respective economies, it is safe to say that the potential size of U.S. consumers' savings due to swipe fee reform could dramatically exceed the AU$1 billion figure from Australia. In fact, if Visa, MasterCard, and the issuing banks had charged Americans the same payment card swipe rates they charged Australians, American consumers would have saved $125 billion over the last four years alone.

- **Reduced swipe fees benefit credit card borrowers...**: As the Payment Systems Board noted in their '05 Report, "One group of consumers clearly better off are those who regularly borrow on their credit cards. They are now able to obtain a card with an interest rate of 10 to 13 per cent, rather than the 16 to 18 per cent payable on traditional cards. For many consumers the resulting savings can run into hundreds of dollars per year."[ix]

- **...As well as non-plastic users**: Australia found that non-credit card users benefited from swipe fee reforms as well, by paying lower prices as merchants passed along savings to all consumers. As the Payment Systems Board stated, "For many years, these consumers have helped subsidize the generous reward points of the credit card issuers through paying higher prices for goods and services. The reforms have helped unwind some of this subsidy."[x]

Additionally, despite the doomsday scenarios outlined by credit card companies, the Australian example shows that credit card accounts and activity have both continued to rise since the nation enacted interchange reforms. As the below chart illustrates, reforming the interchange rate process has not dampened the marketplace for credit card accounts in Australia, where credit card issuing continues to grow at 5% per year.



Overall, Australia's swipe fee reforms provide a real-life case study that shows that interchange reform is beneficial to both consumer and merchant. This example also helps refute the dire warnings of credit card companies that swipe fee regulation will cripple their businesses.

As the *2007/2008 Review* concludes, "The reforms have met their key objectives. They have: increased transparency; improved competition by removing restrictions on merchants and liberalising access; and promoted more appropriate price signals to consumers."[xi]

The Australian Merchants Payments Forum assessed the positive aspects of swipe fee reform as follows, "the RBA's reforms to the Australian cards market have been extremely effective in reducing merchant service fees and freeing merchants from anti-competitive restrictions imposed by card Schemes. These reforms have achieved welfare gains and improved the efficiency of Australia's payments system. Despite dire warnings from card Schemes and Issuers that their business and competitive position would be terminally damaged, key indicators such as the number of credit card accounts, the market shares of the card Schemes, and the number and value of credit card purchases indicate this has not eventuated."[xii]

In August 2009, after reviewing the progress of interchange reforms, Australia's Payment System Board announced that it would continue to oversee and regulate the swipe fee process in the nation, while maintaining the current interchange rate. Although the Board announced that some positive steps had been made to strengthen competition and ensure that swipe fee rates would not spike in the absence of regulation, they noted that "it would not be in the public interest" to go back to pre-reform days.[xiii]

The European Union

"The fee is passed on to retailers and, ultimately, consumers. In theory the purpose of this is to give each bank an incentive to issue and promote payment cards. However in practice these fees simply became a hidden source of revenue for the banks."

- Neelie Kroes, European Commissioner for Competition Policy

Swipe fee reform in the E.U. is "part of a move by Brussels to <u>stimulate economic growth</u> by boosting the affordability of goods and services through cheaper banking and card fees."

- *The Independent (U.K.)*, April 2, 2009

Europe has been recently cracking down on excessive interchange fees that their authorities have found to be antitrust violations.

Notably, European political leadership and market experts view the reform and reduction of hidden credit card interchange fees not only as pro-business and pro-consumer, but also as a painless way to put more money in the economy during a recession and to stimulate spending.

In December 2007, the European Commission ruled that MasterCard's cross-border interchange fee breached EU antitrust rules and had to be changed. The Commission concluded that the fees inflated the cost of card acceptance by retailers without leading to proven efficiencies.

As Competition Commissioner Neelie Kroes stated at the time, "Multilateral interchange fee agreements such as MasterCard's inflate the cost of card acceptance by retailers. Consumers foot the bill, as they risk paying twice for payment cards: once through annual fees to their bank and a second time through inflated retail prices paid not only by card users but also by customers paying cash. The Commission will accept these fees only where they are clearly fostering innovation to the benefit of all users." [xiv]

After years of investigation, in April 2009, the European Commission announced an agreement with MasterCard on cross-border interchange rates. As Commissioner Kroes noted, "I am happy to announce that MasterCard has undertaken to cut its original Multilateral Interchange Fees (or MIFs) for cross-border card payments in Europe and to repeal its recent scheme fee increases for cross-border transactions. Moreover, MasterCard has also agreed to introduce certain changes to its system that increase transparency and efficiency in the payment cards markets."[xv]

MasterCard agreed to reduce its cross-border interchange rates by about half, to 0.3% - less than one-sixth the average U.S. rate. Compared to the U.S., where the swipe fee means Americans pay $2 out of every $100 spent in stores, the MasterCard agreement "means that if you spend 100 euros with a payment card in another Member State, the merchant will be charged a fee of on average 30 cents as opposed to up to one euro and ninety cents in the past."[xvi]

In addition, in March 2008, the European Commission decided to open formal antitrust proceedings against Visa Europe in relation to its interchange fees associated with cross-border, point-of-sale transactions, which are currently at 0.7%. At this time, no agreement has been reached. However, given the MasterCard example, Visa and other purveyors must recognize that their "future must lie in transparent, sustainable behaviour and services that offer clear benefits to its customers."[xvii]

Clearly, the E.U. realizes that cutting unfair credit card fees is a smart move to encourage competition, transparency, and a fair playing field. However, cracking down on swipe fees also offers an efficient way of putting money into the economy. As *The Independent* noted in an article about the MasterCard agreement, the development, is also "part of a move by Brussels to stimulate economic growth by boosting the affordability of goods and services through cheaper banking and card fees."[xviii]

New Zealand

"The Commission considers that this increased transparency will assist retailers and customers in making decisions about their payment choices."

- New Zealand Commerce Commission Chair, Dr. Mark Berry

New Zealand recently announced agreements with both Visa and MasterCard to reform the nation's credit card swipe fee system to ensure a more transparent process and to empower small business owners with more room to negotiate swipe fees. These reforms will make the entire interchange process more equitable and accountable and will help eliminate the hidden charges that New Zealand retailers currently pass on to consumers as a result of swipe fees.

Visa and MasterCard are highly active in New Zealand. As of 2004, approximately 2.1 million Visa and 900 thousand MasterCards were in use in New Zealand, representing approximately 90% of the credit card billings in that country.[xix] Combined Visa and MasterCard transactions in New Zealand totaled $19 billion during '04.[xx] However, in November 2006, New Zealand's Commerce Commission ruled that both card issuers' interchange fee process was in violation of the restrictive trade practices provisions of the nation's Commerce Act.

Specifically, the Commission found that Visa and MasterCard were in violation of sections of the nation's Commerce Act that prohibited "contracts, arrangements or understandings that substantially lessen competition" and "price fixing, which is when people or businesses that are in competition with each other agree to control, fix or maintain the prices for the goods or services that they supply."[xxi]

Within two weeks of each other, in August 2009, Visa and MasterCard each agreed to a series of reforms designed to improve interchange process transparency, foster competition, and increase access to information for both consumers and retailers. The two companies also agreed to pay for some of the costs associated with the Commerce Commission's actions in investigating and pursuing the cases, with Visa agreeing to pay 2.6 million NZD and MasterCard agreeing to pay 3 million NZD.[xxii]

The agreements between the NZ government and the two companies include a number of specific changes to the swipe fee process, including: allowing credit card issuers to "individually set the interchange rates that will apply to transactions using their credit cards," ensuring that this rate information is publicly available, and allowing merchants to apply "surcharges to payments made by credit cards or by specific types of credit cards." Merchants are also newly able "to encourage customers to pay by other means," meaning that discounts for cash payments are no longer prohibited.[xxiii]

The *New Zealand Herald* editorialized in favor of the announced reforms, noting that the previous process resulted in retailers passing on their own high rates of swipe fees to all customers "regardless of the method of payment." As the *Herald* wrote, "In theory, of course, this should mean that prices will decrease. A cost formerly attached to all goods to compensate for credit-card transaction fees can now be sheeted home to the user."[xxiv]

Upon announcing the agreement with Visa, New Zealand Commerce Commission Chair Dr. Mark Berry stated that the reforms will, "improve competition between companies that provide credit card services to retailers in New Zealand" and noted that the changes "are in the long-term best interests of both New Zealand consumers and retailers."[xxv]

After the Commission announced the agreement with MasterCard, Dr. Berry stated, "The settlement can be expected to reduce overall costs to consumers of payment systems by driving down interchange fees and facilitating merchant steering towards lower cost payment methods."

Canada

"Small- and medium-sized businesses in Canada have not asked for government subsidies, and this is not requesting money from the government. This is only requesting action in regards to fairness in those fees for the merchant community"

- Senator Pierrette Ringuette
Member of Canada's Senate Committee on Banking, Trade and Commerce

Like its neighbor to the South, Canada faces problems of escalating swipe fee costs combined with limited leverage for consumers and retailers to rein in these costs. Canadians paid $4.5 billion in swipe fees last year, in part due to some of the highest interchange rates in the world (see chart on page 2).[xxvi] The Canadian government has started to take notice.

In March 2009, the Competition Bureau of Canada announced that the bureau was exploring whether Visa and MasterCard breached the nation's Competition Act and abused their dominant position in the Canadian marketplace.[xxvii]

In June 2009, the Canadian Senate's Committee on Banking, Trade and Commerce released an exhaustive report exploring the direction of the Canadian credit and debit card markets, including a detailed study on the role of swipe fees in the Canadian economy.[xxviii] Coming after months of testimony from merchant and consumer groups, credit card companies, and Canada's largest financial institutions, the report recommended reforming the swipe fee process to improve transparency and increase direct negotiation between merchants and Visa and MasterCard member banks.

Among its findings, the report stated, "The Committee believes that the Canadian credit card market needs improvement and clarity."[xxix] The report also found that "the relative power of the participants in the credit card payment system is unequal. We accept, to a great extent, the argument that most merchants lack the individual bargaining power needed to negotiate on an equal basis with other participants in the payment system... The end result of higher interchange rates is higher costs for merchants and higher retail prices for consumers."[xxx]

While recommending more oversight and accountability by the Canadian government over the credit and debit markets and the interchange system, the report and its findings have not yet led to legislative action. As Senator Pierrette Ringuette of the Committee on Banking, Trade and Commerce stated, "the priority right now is for the government not to sit on this report. This is not a political document; it's an action document, and it requests action immediately from the government." [xxxi]

Conclusions

Lawmakers and antitrust regulators in many of the world's top economies have recognized the antitrust and other policy problems with swipe fees and have moved to curb abuse of pricing and operating rules.

As Sonja Yates Hubbard, CEO of E-Z Mart Stores, puts it, "The U.S. has the greatest, most competitive economy in the world – except when it comes to swipe fees. I cannot understand why Congress would allow small businesses in the U.S. to pay larger swipe fees than businesses anywhere else in the industrialized world when so many other countries have found that reform works for business, for consumers, and for the economy as a whole."

Governmental intervention in all countries where interchange was curbed follows the same basic economic premise. For the free market model to work, competition must exist to keep pricing in check, and consumers must have requisite "knowledge" to choose which competitor offers the best value. An absence of any of these fundamental elements creates the toxic environment of abuse, and the American credit card system is a perfect example of this because just a couple of companies dominate and keep their fees hidden.

Reforming swipe fees is broadly supported by not only small business owners, but the public at large and consumer advocates as well. A July 2008 poll by Penn, Schoen, and Berland Associates found that 3 out of 4 Americans supported legislation to reform interchange fees.[xxxii] Edmund Mierzwinski, Consumer Program Director of the U.S. Public Interest Research Group stated the perspective of many consumer advocates in 2008 congressional testimony, "the credit card market lacks the critical foundations of healthy competition – choice and adequate information. As a consumer advocate, I am gravely concerned about the fairness and legality of bank schemes to increase credit and debit card fee income."[xxxiii]

As the examples from international competitors demonstrate, cracking down on interchange fees is a boon to consumers, merchants, and to the establishment of a fair and competitive marketplace. Though each nation is different, the underlying problem that must be addressed is the same. U.S. small businesses and consumers should not be treated worse than citizens elsewhere in the world.

As Congress and the White House have already taken on other credit card abuses, any lasting fix will be incomplete without addressing swipe fee reform.

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[xxviii] *Transparency, Balance, and Choice: Canada's Credit Card and Debit Card Systems*. Report of Canada's Standing Senate Committee on Banking, Trade and Commerce, June 2009: http://www.parl.gc.ca/40/2/parlbus/commbus/senate/com-e/bank-e/rep-e/rep04Jun09-e.pdf

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[xxxii] Poll from Penn, Schoen, and Berland Associates, July 2008. Available at www.unfaircreditcardfees.com.

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National Black Chamber of Commerce

October 8, 2009

The Honorable Barney Frank
Chairman, House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Frank:

The National Black Chamber of Commerce opposes H.R. 2382, the Credit Card Interchange Fees Act, because it would harm small businesses. The National Black Chamber of Commerce has 157 chapters in 41 states. We have direct reach to over 100,000 Black owned businesses and proudly represent the over one million Black enterprises doing business within the United States.

Although H.R. 2382 initially appears to be a list of "fixes" for a variety of grievances by some merchant lobbying groups, the clear intent of the bill is to arbitrarily reduce the costs of payment card acceptance for merchants—especially BigBox merchants. Such a result would harm not only consumers (in the form of higher payment card costs), but also small businesses.

If the BigBox merchant lobby is successful in artificially reducing the costs of payment card acceptance, that means the banks responsible for issuing the cards and extending credit will be forced to change their businesses to make up for the shortfall. This will produce at least two consequences. First, cardholders will pay more for payment cards and receive fewer benefits. Second, card issuers would be forced to reduce the amount of credit they extend, exacerbating the existing credit crunch.

Small business owners would be severely affected by these consequences. For example, *many of our members are small business cardholders themselves* and rely on credit cards to finance basic business operations. If merchants do not pay their fair share for payment card acceptance, small business cardholders will be forced to pay even more for credit cards than they do today. Perhaps more troubling is that small businesses will have even fewer credit cards made available to them. Small businesses are having a hard enough time finding banks willing to lend to them as it is. Congress should not pass legislation to make it even more difficult.

In addition, merchant lobbyist organizations refuse to recognize another critical issue. Specifically, if the cost of credit increases, its availability decreases. If credit availability decreases, consumer purchasing power will also decrease. This means even more reduced sales at the very merchants who are lobbying for special treatment under H.R. 2382. We do not believe that small businesses that truly understand the full impact of the legislation would support it.

For these reasons, the National Black Chamber of Commerce opposes H.R. 2382.

Sincerely,

Harry C. Alford
President/CEO

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STATEMENT FOR THE RECORD

THE FINANCIAL SERVICES ROUNDTABLE

on

H.R. 2382, THE CREDIT CARD INTERCHANGE FEES ACT OF 2009 AND H.R. 3639, THE EXPEDITED CARD REFORM FOR CONSUMERS ACT OF 2009

before the

House Financial Services Committee

October 8, 2009

The Financial Services Roundtable ("Roundtable") respectfully offers this statement for the record on H.R. 2382, the Credit Card Interchange Fees Act of 2009 and H.R. 3639, the Expedited CARD Reform for Consumers Act of 2009.

The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer.

Although comprehensive regulatory reform of the financial services industry is currently being debated, the financial services industry has already undergone many changes in the past year regarding credit cards and associated fees, such as interchange. Credit cards are a source of freedom for many Americans, as they provide necessary flexibility to purchase goods when regular savings will not allow. Cards have become as commonplace as cash, but it is their usage which is disputed.

<u>The Roundtable opposes H.R. 3639, the Expedited CARD Reform for Consumers Act of 2009.</u>
President Obama recently signed-into law the "Credit Card Protection Act" (Act) which established broad sweeping credit card practices legislation that will impact both the financial services industry and consumers.

The financial services industry has already started the compliance process for many of these reforms and initiated several card practices reforms separate from the Act. The comprehensive debate and input during the introduction and subsequent passage of the Act highlighted both the costs and time required for financial institutions to reprogram current systems for compliance. Since its passage, the industry has been working on reprogramming these systems and will be in full compliance with the Act's requirements. If Congress enacted H.R. 3639, it would circumvent its own compliance mandate for credit card reform. Additionally, the expedited effective date would add additional financial burdens to institutions at a very fragile time in the industry's recovery process.

<u>Firm Opposition to Welch Bill</u>
Similarly, other measures are underway to attack the credit card industry, like H.R. 2382, the Credit Card Interchange Fees Act of 2009 (the "Welch bill"). Cards have provided many freedoms to the American people, allowing them to debit or credit a purchase, and not have to carry cash on hand. The latter specifically allows for larger purchases at retailers who offer the option to pay by card. However, Representative Peter Welch (D-VT) and **<u>many retailers are leading a charge of government intervention and an effort to shift the costs of the current interchange structure from the retailer to the consumer.</u>** If enacted, this legislation would allow the government to set interchange rates and fees for the private sector and force consumers to pay the bills of retailers; And, additionally would harm community banks throughout the country.

The Roundtable believes that interchange rates and governance should be set by free private sector market forces. Interchange is the fee that retailers pay to access the credit and debit card payment system. Retailers that use the system are provided the benefit of safe and guaranteed payments transferred directly into the merchant's accounts, along with the transactions that are less expensive than cash or checks. The retailers bear no risk associated with fraud, failure to pay, or data breaches. When merchants choose to accept payment cards, they pay a penny or two on each dollar for the ability to accept electronic payments. This is a very small price to pay for all of these benefits.

In an effort to lower their costs of doing business, retailers want to use the Welch legislation to arbitrarily determine rates and terms for interchanges fees and in effect transfer the merchant's business cost directly to consumers. For Congress to regulate interchange rates would be unfair. Just like merchants pay their electricity bills and employee salaries, its stands to reason that they pay a small fee for the benefit they receive when they accept debit and credit cards.

The Roundtable opposes the Welch bill as an unfair regulation of price controls and interchange fees and a backdoor attempt by the retailers to shift their business costs to consumers.

Moreover, the Government Accounting Office (GAO) has underway an interchange study as mandated by the Act, due on November 20. Consideration of the Welch legislation, prior to this GAO report, would undercut a process initiated by Congressional mandate.

Conclusion:
The financial services industry is currently navigating uncharted waters. Customer satisfaction and financial competence is crucial to regaining steady footing. Expediting credit card reform will do nothing more but aggravate and rush a steady process of restructuring.

The industry takes responsibility for previous actions which have landed consumers in debt and is working hard to correct an ingrained system by the middle of next year, but much work remains to be done. The Expedited CARD Reform for Consumers Act of 2009 will do nothing more but put a strain on the process. Lastly, the Welch bill is nothing but retailers offsetting the cost of doing business to the consumer—an unaffordable action in these uncertain economic times, and one that will bear serious consequences for individual businesses and the economy.

The Roundtable recommends that Congress oppose both H.R. 2382 and H.R. 3639, and let the industry continue along its steady path to compliance.