

**Testimony of Edmund Mierzwinski**  
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**Before the Subcommittee on Financial Services and General Government**  
**of the U.S. Senate Appropriations Committee**  
**Hearing on Interchange Fees**  
**16 June 2010**

Chairman Durbin and Ranking Member Collins, members of the Subcommittee on Financial Services and General Government, thank you for the privilege of testifying today on the important subject of credit card interchange fees. I am Consumer Program Director of the U.S. Public Interest Research Group, the nonpartisan and nonprofit federation of state PIRGs.<sup>1</sup> As an advocate for consumers we welcome the opportunity to discuss issues regarding interchange fees imposed on merchants by credit card networks.

A primary purpose of my organization is to advocate on behalf of all consumers for a fair and competitive marketplace. We regularly advocate before state and federal regulators and legislators on both consumer protection and competition policy issues in the credit card marketplace.<sup>2</sup> We have also launched a major campaign on over 40 college campuses around the country against unfair credit card marketing practices.<sup>3</sup>

**SUMMARY:**

The Durbin interchange amendment to the Restoring American Financial Stability Act,<sup>4</sup> takes important steps to end unfair and anti-competitive practices in the credit and debit card marketplace. As shown in the reports released today, excessive, non-transparent and non-negotiable interchange fees even harm the federal government and that harms taxpayers.

For the past three or more years I have testified before Congress and presented a simple message: the deceptive and anticompetitive practices of the two credit card associations – Visa and MasterCard – have injured both consumers and merchants for many years. That message still rings true.

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<sup>1</sup> 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](http://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](http://www.uspirg.org) or [www.truthaboutcredit.org](http://www.truthaboutcredit.org).

<sup>2</sup> For example, see my recent testimony before the House Judiciary Committee on interchange fees, available at <http://judiciary.house.gov/hearings/pdf/Mierzwinski100428.pdf>, (28 April 2010), the Financial Services Committee, on interchange fees (8 October 2009), available at [http://www.house.gov/apps/list/hearing/financialsvcs\\_dem/fchrCC\\_100809.shtml](http://www.house.gov/apps/list/hearing/financialsvcs_dem/fchrCC_100809.shtml); on financial regulatory reform (16 July 2009) available at [http://www.house.gov/apps/list/hearing/financialsvcs\\_dem/fchr\\_071809.shtml](http://www.house.gov/apps/list/hearing/financialsvcs_dem/fchr_071809.shtml) and on consumer financial protection (24 June 2009) available at [http://www.house.gov/apps/list/hearing/financialsvcs\\_dem/hrfc\\_062409.shtml](http://www.house.gov/apps/list/hearing/financialsvcs_dem/hrfc_062409.shtml). Also, on whether unfair consumer credit card practices lead to bankruptcy before the House Subcommittee on Commercial and Administrative Law on bankruptcy and credit card debt (2 April 2009), available at [http://judiciary.house.gov/hearings/hear\\_090402\\_1.html.06243](http://judiciary.house.gov/hearings/hear_090402_1.html.06243)

<sup>3</sup> See "<http://www.truthaboutcredit.org>

<sup>4</sup> The bill was originally S 3217 and was re-numbered HR 4173 on passage and for conference consideration.

Interchange fees are hidden charges paid by all Americans, regardless of whether they use credit, debit, checks or cash. Put another way, all consumers pay more at the store and more at the pump because of the non-transparent, non-negotiable, non-competitive interchange fee system. 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 by paying inflated prices for many goods and services. These prices are inflated by the billions of dollars of anticompetitive interchange fees, which are used to subsidize rewards programs, promotions, and riskier credit underwriting for credit card users. 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.

### **The New GAO and Treasury Studies and the Durbin Amendment**

Information provided to your committee by the U.S. Treasury Financial Management Service (FMS) and the Government Accountability Office (GAO) re-affirms their previous findings. Even the federal government, in many ways one of the biggest merchants, pays hundreds of millions of dollars or more in non-negotiable interchange fees.

In response to this and other problems with interchange, you proposed the Durbin interchange amendment to the Restoring American Financial Stability Act. It would provide the Federal Reserve Board with authority to set fees for debit interchange that are reasonable and proportional, rather than based on what the card networks call “value” but really means “whatever they want and think that they can get.”

Your amendment also responds to certain unfair practices in the card network contracts that prohibit merchants from offering otherwise legal discounts or setting minimums for transactions to offset the high cost of interchange. In consideration of Wall Street reform, we have talked about the need to reform the shadow markets of over-the-counter derivatives and hedge funds – interchange is yet another shadowy market in need of reform. As Louis Brandeis said, “Sunlight is the best disinfectant, electric light the best policeman.” By allowing merchants to educate consumers about this marketplace, the Durbin amendment will improve transparency and force better practices by the card networks. By allowing the Federal Reserve to act, the amendment will alleviate the market’s lack of competition that has resulted in U.S. merchants paying the highest interchange fees in the world.

The Durbin amendment does not accomplish everything that the merchants seek in order to obtain redress in this market. Instead, it takes a rifle shot to some of the worst industry practices but will not change the entire interchange fee system. It will have a positive effect. But in addition, because it is incremental, there is simply no way it could be as disruptive as its opponents claim. While the Durbin amendment is being implemented and its effects reviewed, the Congress will have the time to determine what additional changes are needed to interchange practices.

The amendment’s primary focus is on the area of most rapid interchange growth—debit transactions. Just a few years ago, debit and credit (plastic) transactions combined surpassed the volume of cash and check transactions. Yet, in House testimony this year, a small merchant testified that, already, 80% of his convenience store transactions were plastic. The most rapid growth in the interchange marketplace has been the substitution of debit for cash transactions. So, merchants are facing a system where -- on the one hand, despite technological advance, the rate of interchange has not declined -- while on the other the volume of interchange has increased rapidly. The merchants, and their customers, cannot win.

**Reasonable and proportional:** The first part of the amendment requires the Federal Reserve to issue a rule assessing whether debit interchange is “reasonable and proportional,” and to determine whether debit card transactions are similar to checking transactions, which clear “at par.” The amendment exempts all small bank and credit union institutions from its requirements.

**Anti-Competitive Practices:** The second part of the amendment addresses anti-competitive card network rules that merchants find unfair. The merchants tell me that when they attempt to offer a legal (under the Truth in Lending Act) discount for cash -- the networks accuse them instead of using prohibited and “disguised” surcharges. This is not an empty accusation as it comes with the threat of multi-thousand dollar per day fines and penalties.

- First, the Durbin amendment allows merchants to offer consumers discounts for use of lower cost payment networks and lower cost forms of payment.
- Second, the Durbin amendment, in credit card transactions only, allows merchants to set non-discriminatory minimums or maximums for transactions to offset the high cost of interchange.

**Why Credit Cards Only:** Unbanked and under-banked consumers are increasingly receiving federal, state and local benefits on prepaid debit cards through programs known as Electronic Benefits Transfer or EBT. This important provision will ensure that a parent using an EBT debit card needing one item, such as a gallon of milk, will not need to purchase, for example, \$15 worth of additional, unnecessary goods.

Along with other consumer groups, U.S. PIRG has long been concerned that despite all the taxpayer benefits provided to the insured banking system – from taxpayer-guaranteed deposit insurance to the Federal Reserve discount window and even to bailouts – banks have either chosen to ignore or been unwilling to provide the un- and under-banked with reasonable-cost accounts. Consequently, many have become victims of the fringe banking system – payday lenders, rent-to-own stores, check cashers, etc.<sup>5</sup> According to a mammoth 2009 survey by the FDIC, “up to 10 percent of American families are unbanked and that a substantial share of the population may be under-banked.”<sup>6</sup>

EBT programs, and other emerging innovative, prepaid debit card products – because of lower electronic transaction costs -- have emerged as important bridges to allow the unbanked to become banked, where they can open deposit accounts and grow their assets and savings. Studies have shown that with the cushion of just a small savings account of as little as \$500, under-banked families can avoid the wealth-depleting practices of payday lenders in the event of a family emergency. Building the assets of un- and under-banked families is an important policy goal.

So, although I believe that the government cross-subsidy issues in interchange are complex, and that the Durbin amendment will actually save governments substantial sums of money that they are paying to bank networks, it makes sense to consider a carve-out for government EBT programs, some of which have been designed around bank claims that interchange fee revenues are the key offset to costs that the governments would otherwise pay. Such a carveout should not, however, apply to poorly-designed government programs that allow the bank or other vendor to impose a harsh fee structure on benefits recipients.

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<sup>5</sup> See Mierzwinski, Edmund. 2008. The Poor Still Pay More. *Trial Magazine, Journal of the American Association for Justice*, 44 (September): 40-49.

<sup>6</sup> News release, 5 February 2009, “FDIC Releases First National Survey of Banks' Efforts to Serve the Unbanked and Underbanked,” available at <http://www.fdic.gov/news/news/press/2009/pr09015.html>, (last visited 4 June 2009).

The opponents of the legislation may suggest that consumers will be harmed from the enactment of the legislation because if fees are set to be “reasonable and proportional” then banks will claim that they will no longer be able to provide allegedly attractive rewards programs or will otherwise change fee structures adversely. Even if that were true – and it is not – that should not drive the Conference Committee’s evaluation of the Durbin Amendment. Rewards programs are not a “free gift” given by banks. Rather, all consumers pay for rewards in the form of higher prices for the goods they purchase everyday. Indeed, card issuers actually account for reward programs in their public financials as reductions in interchange income. Only a small portion of cardholders actually receive rewards and the portion they receive is very modest compared to what cardholders pay in interchange. 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.

Further, any system that allows sellers to control the terms of trade in anti-competitive ways – prohibiting discounts or prohibiting advising customers so that they can understand the differences between the costs of a rewards credit, plain old classic credit, debit, check or cash transaction – is a non-transparent system. Consumers always benefit from transparency. Is there a situation where they have not?

### **Further Discussion**

None of the alternatives to legislation is particularly likely to resolve the fundamental competitive concerns in this market. The rapidly accelerating interchange fees appear to be a clear exercise of market power by Visa and MasterCard. In the past year alone the total amount of interchange fees collected has reached \$48 billion after years of constant increases. This is a staggering number given the fact that retail sales have suffered as a result of the recession. 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 fashion? 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 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 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 and Its Effects**

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. Ten banks account for approximately 90% of the issuance market. 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.

### **Interchange Fees Force Consumers to Pay Higher Prices**

The interchange fee system is hidden from consumers and the public. The card associations do not disclose publicly their fees or the basis for these fees. Some public reports maintain that, on average, interchange fees cost merchants 2.0 percent or more of each transaction on a credit or signature debit card. In 2009, credit card interchange fees alone cost merchants and consumers an estimated \$48 billion.<sup>7</sup>

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 dubious value of these programs, many consumers with credit cards do not use them and those without credit cards receive no benefits.<sup>8</sup> Over 27 percent of Americans do not have credit cards. For these consumers, interchange fees are especially pernicious and regressive.<sup>9</sup> These low-income Americans subsidize interchange fees for

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<sup>7</sup> Foer, Bert. "Our \$48 Billion Credit Card Bill." *New York Times*. April 20, 2010.

<sup>8</sup> 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.

<sup>9</sup> U.S. Census Bureau, *Statistical Abstract 2006*, Table 1176.

“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 Hispanic Institute, an organization that educates Hispanic Americans on a number of issues, released a report last November titled “Trickle-Up Wealth Transfer: Cross-subsidization in the payment card market” that details the findings of a study the Institute conducted on American consumers. They found that those Americans who do not benefit from credit card rewards pay in excess of \$1 billion annually to subsidize those awards, which typically accrue to higher-income consumers, as a result of the higher prices consumers pay because of interchange fees.<sup>10</sup> This imbalance makes it clear that interchange fees are no friend to the vast majority of consumers. In the report, the Hispanic Institute recommends policies or regulatory actions to remedy this tax on low-income consumers, including those that would lower interchange fees and thus reduce the wealth transfer that occurs as a result of the higher costs card issuers pass on to all consumers.<sup>11</sup>

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.<sup>12</sup> This problem will increase if gas prices continue to increase. It is difficult enough for low- and moderate-income consumers to afford skyrocketing gasoline prices without having to pay additional fees that are passed on to them.

### **Increases in Interchange Fees Signal a Broken Market**

Credit card interchange fees were intended to compensate card-issuers for certain costs, such as the costs of issuance, fraud, risk of loss, float and processing. Yet as all these costs have decreased in the past decade credit card interchange fees have increased. According to the Food Marketing Institute (FMI), these fees have increased over 20 percent in the past few years even though all the costs of card processing and issuance have fallen. The United States appears to be the only country in which credit card interchange fees are increasing and it has far higher fees than almost any other industrialized country. FMI projects that these fees will increase 22 percent annually.<sup>13</sup>

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. What about merchants and consumers? Merchants certainly have no choice but to accept Visa or MasterCard.

In the recent Department of Justice antitrust litigation against Visa and MasterCard, the Second Circuit Court of Appeals determined that both associations had market power because merchants were compelled to accept these cards even in the face of a significant price increase. Almost all

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<sup>10</sup> In a recent study, the GAO also cites this issue: “Consumers who do not use credit cards may be worse off by paying higher prices for goods and services.” Government Accountability Office. “Credit Cards: Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges.” November 2009.

<sup>11</sup> The Hispanic Institute. “Trickle-Up Wealth Transfer: Cross-subsidization in the payment card market.” November 2009. [http://www.thehispanicinstitute.net/files/u2/Trickle-Up\\_Wealth\\_Transfer\\_Paper.pdf](http://www.thehispanicinstitute.net/files/u2/Trickle-Up_Wealth_Transfer_Paper.pdf)

<sup>12</sup> Margaret Webb Pressler, “Card Companies Are Filling Up at the Station,” in Washington Post. 25 September 2005: pg. F01.

<sup>13</sup> Food Marketing Institute, “Hidden Credit Card Fees: The True Cost of a Plastic Marketplace” (February, 2006).

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.<sup>14</sup>

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 an effort to head off the European Commission's antitrust proceedings against them, Visa Europe recently announced that they would be slashing transaction fees on debit cards by fully 60%, down to just 0.2% – a small fraction of the interchange fees here, and a clear sign that the fees here are artificially inflated. Visa Europe certainly isn't cutting rates below what it will cost them to remain profitable.<sup>15</sup>

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.<sup>16</sup>

New Zealand has also taken action to reduce interchange fees and enhance competition between credit card issuers. The country's Commerce Commission ultimately settled with both Visa and Mastercard to set maximum allowable interchange fees, imposing caps at 2% or lower for all categories of purchases.<sup>17</sup>

There is a great deal of debate about the impact of reductions in interchange fees in Australia, but a careful, neutral 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 percent to 0.55 percent (both rates far lower than the current rates in the U.S.) It was recently reported that fees to merchants were 1.1 billion Australian dollars lower from March 2007 to February 2008 as a result.<sup>18</sup> 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. The federal Reserve Bank of Australia (RBA) 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.

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<sup>14</sup> A recent GAO report reads, "Our own analysis of Visa and MasterCard interchange rate schedules shows that the interchange rates for credit cards have been increasing and their structures have become more complex, as hundreds of different interchange fee rate categories for accepting credit cards now exist." Government Accountability Office. "Credit Cards: Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges." November 2009.

<sup>15</sup> PaymentsSource. "Bulletin: Visa Europe Agrees To Cap Intra-regional Debit Interchange Rate." April 26, 2010.

<sup>16</sup> Gordon Schnell and Jeffrey Shinder. "The Great Canadian Debit Debate," *Credit Card Management*, May 2004. [http://www.constantinecannon.com/pdf\\_etc/TheGreatCanadianDebit.pdf](http://www.constantinecannon.com/pdf_etc/TheGreatCanadianDebit.pdf).

<sup>17</sup> See "Visa New Zealand Domestic Maximum Interchange Reimbursement Fees,"

<http://www.visa-asia.com/ap/nz/mediacenter/factsheets/interchange.shtml> and "Interchange Fees: MasterCard Domestic Purchase Transactions Interchange Fees for New Zealand,"

<http://www.mastercard.com/nz/merchant/en/interchangefees/index.html>

<sup>18</sup> Government Accountability Office. "Credit Cards: Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges." November 2009.

While a study funded by MasterCard found no benefit to consumers from the reduction of interchange fees in Australia, the federal Reserve Bank of Australia vigorously disputes this finding.

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 all consumers: 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:

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.<sup>19</sup>

For those individuals holding credit cards, there are 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.

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. A reduction in interchange fees will only result in an increase in other fees to the extent that the credit card market is not competitive. If the market is in fact competitive, it will instead result in banks striving for greater efficiency by reducing their costs or by simply having reduced profit margins. Cost cutting could come in a reduction of the blizzard of promotional mailings sent out by banks on a daily basis. It could also come from a reduction in rewards programs. To the extent that rewards programs are scaled back, however, it will mean that banks must compete in terms of interest rates and other fees, thereby benefiting consumers. In the U.S., 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.

### **Durbin Amendment Slows Deceptive Practices That 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.

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

First, as the Durbin amendment recognizes, 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 priced credit cards or to other cheaper payment systems such as cash, checks and online debit.<sup>20</sup>

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 efforts of the card associations to “convert” cardholders from regular credit cards to so-called “premium cards” such as the Visa “Signature” or the MasterCard “World” cards. These cards have a significantly higher interchange fee than traditional cards, among the highest of all interchange fees. For example, a premium card may cost merchants well over 2.0 percent compared to 1.6 percent for a traditional card. These premium cards focus only on the highest-income consumers. However, they offer minimal additional benefits. Consumers do not realize 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.

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.<sup>21</sup> Conversely, credit and signature debit cards cost merchants up to 2% of the entire transaction, no matter how large. Instead of promoting online debit which is safer and less costly, banks increasingly surcharge consumers seeking to make these transactions with penalty fees of as much as 50 cents a transaction.<sup>22</sup> Consumers are paying more for a less safe and more costly

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<sup>20</sup> We note that the standard canned industry response is that “nothing in our rules prevents cash discounts from being offered.” This argument is both irrelevant and only technically correct. For a merchant that wishes to accept credit cards, but does not want to accept high-cost premium cards, the ability to offer a cash discount is irrelevant. And for merchants that wish to steer customers to other payment options, the ability to cash discount (from federal and state law) is rendered largely useless by card association regulations that require 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 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.

<sup>21</sup> 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>.

<sup>22</sup> 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>

product.<sup>23</sup> 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. The Durbin amendment's provisions on anti-competitive practices aim a rifle shot right at these problems and will let sunlight into what has been a dark room.

Not surprisingly, outside the United States, where these anticompetitive practices are not permissible, online (PIN) debit is the most preferred form of debit. Online debit is a far safer and more secure product, with a much lower incidence of identity theft than signature debit or credit cards. Where market forces are not restrained and consumers can make fully informed choices, the lower-priced, more efficient product prevails.

### **Increased Consolidation of Card-issuers Harms Consumers More Broadly**

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

Of course, we expect the card associations and their members to suggest that the credit card issuance market is un-concentrated and vigorously competitive.<sup>24</sup> 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.<sup>25</sup> While concentration has increased dramatically over the past seven years, interchange fees, other fees charged to consumers, deceptive practices, and interest rates have increased significantly. Although the parties to these mergers suggested that there would be significant efficiencies from these mergers, consumers have seen few, if any, benefits. After years of consolidation the bad news for consumers is clear: an oligopolistic market which is a fertile environment for collusion, higher prices, more hidden fees, and more deceptive practices.

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<sup>23</sup> 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.

<sup>24</sup> 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."

<sup>25</sup> In 2006, Visa, MasterCard and several card-issuing banks 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.)).

Congress has taken on financial reform as a response to the laundry list of reckless practices in financial markets. The very existence of interchange fees explains the perverse incentives that may have encouraged card-issuing banks to engage in indiscriminate lending rather than curb credit risk. Banks and the card companies profit from these fees regardless of the consumer's ultimate ability to fulfill their debt obligations, and thus have an immediate incentive to issue cards and encourage a high volume of transactions.<sup>26</sup> This undermines the safety and soundness of the entire financial system.

### **The Credit Card Oligopoly Also Allows Issuers to Use Anti-Consumer Practices Against Cardholders**

Last May, President Obama signed into law the Credit Card Accountability, Responsibility and Disclosure Act<sup>27</sup>, which addresses a number of deceptive practices credit card companies regularly engage in at a high cost to consumers. That legislation gave the Fed authority to ensure that certain credit card penalty fee practices are "reasonable and proportional,"<sup>28</sup> which is similar authority to that of the Durbin amendment, which is simply a necessary complement to the CARD Act's provisions, which ban credit card companies from a number of practices.

There is no question, of course, that the current bank regulators will not adequately enforce the Durbin amendment, if it becomes law. We also need to enact a strong independent Consumer Financial Protection Bureau and restore the right of states to enact stronger consumer laws and the right of their Attorneys General to enforce both federal and state laws against both state and nationally-chartered banks.

We also need to restore full private rights of action to enforce laws. Encouragingly, both the Senate and the House-passed versions of Wall Street reform give the CFPB/A broad authority to ban forced mandatory arbitration clauses that limit consumer rights to enforce the law, although the House language is preferred.

The fact that credit card companies freely engaged in such a wide range of deceptive and unfair practices that resulted in higher costs to consumers without being wholly rejected by market forces suggests that Visa and MasterCard have simply enjoyed market power. The oligopolistic market structure of the card-issuance market facilitates these deceptive and onerous practices. The ability of these dominant card-issuers to impose these terms is derived from the tight oligopoly that the largest issuing firms maintain in the marketplace. There is a clear lack of competition in the card network market. Visa and MasterCard have the ability to prevent many of these practices through their regulation of card-issuers. Yet these associations -- which are aggressive in regulating merchants (e.g., preventing them from offering cash discounts that the Durbin amendment would instead encourage) -- are timid when it comes to restricting the deceptive practices of their bank members. If there was active competition in the card network market one would expect Visa and MasterCard would compete in trying to self-regulate and stop these anticonsumer practices. Similarly, if there were not substantial entry barriers one might expect a more consumer friendly card network to arise. But the dominance of Visa and MasterCard and the substantial entry barriers effectively protect these deceptive and anti-consumer practices.

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<sup>26</sup> Adam Levitin, Associate Professor of Law, Georgetown University Law Center. Testimony before the U.S. House of Representatives, Committee on the Judiciary, Subcommittee on Commercial and Administrative Law. Hearing: Consumer Debt -- Are Credit Cards Bankrupting Americans? April 2, 2009.

<sup>27</sup> The Credit CARD Act, HR 627, became Publ. L. 111-24.

<sup>28</sup> See Section 102(b) of Publ. Law 111-24. The reasonable and proportional rules became final yesterday. See Federal Reserve press release of 15 June 2010, <http://www.federalreserve.gov/newsevents/press/bcreg/20100615a.htm> (last visited 15 June 2010).

## **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.” This claim could not have been more wrong. If consumers understood the existence or the dimensions of the hidden, shadow-market 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. As a consumer advocate, I am gravely concerned about the fairness and legality of bank schemes to increase credit and debit card fee income.

We applaud you for recognizing the problem and proposing thoughtful legislation that 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.