

Testimony of Bruce Sullivan

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INTRODUCTION

Chairman Durbin, Ranking Member Collins and distinguished members of the subcommittee, thank you for inviting me here today to discuss Federal Payment of Interchange Fees and how Electronic Payments are saving Taxpayer Dollars.

My name is Bruce Sullivan, and I am Vice President and Head of Government Services for Visa Inc. In this capacity, I work with issuing banks and federal agencies participating in the General Services Administration's SmartPay program and I work with the Department of Treasury's Financial Management Service on new payment technologies available for use by Federal agencies.

Prior to joining Visa seven years ago, I proudly served our country in both military and civilian capacities for more than 33 years. As a retired public servant, I am acutely aware of the need to both reduce costs and increase efficiencies within the government due to declining budgets. Throughout my career, I tirelessly fought for the elimination of waste, fraud and abuse at the Department of Defense and continue to do so in my position at Visa.

Visa Inc. is pleased to testify before the Subcommittee on Financial Services and General Government to discuss how interchange enables programs that help federal, state and local government agencies, our nation's most vulnerable citizens and, ultimately, all taxpayers.

As a global payments network, Visa provides a platform for business and governmental efficiency, consistently delivering a highly reliable, secure and innovative system over which a wide range of payment products and services can be delivered to both those accepting Visa for payment and those seeking to pay with Visa. Visa has been the federal government's primary provider of these services for over a decade. We believe our products provide extraordinary value to all participants in the payment chain by facilitating commerce across the United States and global economies, reducing operational costs and expanding the availability of electronic payments to the nation's unbanked. Visa is proud to be a partner of both the federal and state governments in pursuing these goals.

For many years, government agencies have increasingly embraced electronic payment products as a cheaper, more secure and more convenient alternative to cash, checks and purchase orders. These products include GSA Purchasing cards as well as federal and state benefits disbursement programs – all of which have been shown to provide tremendous savings and efficiencies for both the government and, in turn, U.S. taxpayers. Indeed, the U.S. Government Accountability Office (GAO) reported that the U.S. government saved *close to \$2 billion dollars* in 2006 just from the efficiencies gained from use of GSA Purchasing cards.

Just this week, the Department of the Treasury announced plans to modernize government and eliminate outdated, wasteful processes to create savings for taxpayers: distributing most benefits from the U.S. Government to consumers via direct deposit or pre-paid cards, thus eliminating the need for paper checks for all benefits payments.

By switching from inefficient paper forms of payment to digital currency, the Director of the Office of Management estimates the Federal Government will save more than \$300 million over the first five years, and more than \$120 million each year thereafter. As the Director noted in a blog posting, “this is a win-win for the American public because it makes government more convenient and cost-effective. This is precisely the type of smart, streamlined improvement that this Administration is committed to making across government to boost efficiency and modernize how we do business.”

But electronic payments provide far more than just cost savings – they are also an incredibly effective tool for ensuring that our nation’s most under-served consumers have access to ready funds, both in moments of crisis and, indeed, each and every day. For example, following Hurricane Katrina, Louisiana’s Department of Environmental Quality (DEQ) used Visa Purchasing cards to pay for vital supplies – everything from generators to sunscreen. As another important example, forty-seven states use or are in the process of implementing the use of debit or prepaid cards for disbursing essential benefits such as supplemental child support and unemployment, saving state governments and their taxpayers hundreds of millions of dollars in the process.

As explained below, federal and state governments – and ultimately taxpayers – receive tremendous value from electronic payments. These benefits are evident both when a government agency or enterprise chooses to accept cards for payment, and when it provides them to its employees or others as a way to pay, or to receive funds.

Visa is committed to ensuring that our nation’s federal, state and local governments are able to maximize these benefits through programs customized to their unique needs. We appreciate the opportunity to detail these efforts and continue an important dialogue with the government, both on these effort’s successes as well as how they can be expanded.

WHAT IS INTERCHANGE?

The term “interchange” is often misunderstood, but it is important to recognize both what it is and, just as importantly, what it is not. Interchange is not revenue to Visa; rather it is a transfer of value from a merchant’s bank to the cardholder’s bank. Visa sets interchange to maximize the participation in its network, seeking out the largest level of Visa issuance to cardholders and Visa acceptance by merchants. Visa has no interest in setting the level of interchange too high (which might lead to lost acceptance) or too low (which could lead issuers to put other payment products in the hands of cardholders). Please let me repeat: Visa receives no revenue from interchange.

Interchange is also but one component of the cost of acceptance a merchant, or a government agency or enterprise, faces when arranging with an acquiring bank to accept cards for payment. Typically, each agency that accepts cards for payment pays a “merchant discount rate,” which may include interchange and the acquirer’s own expenses and return on investment. The level and structure of the merchant discount rate paid by an agency or enterprise is entirely a function of its acceptance contract with its chosen acquiring bank. Visa has no role in that negotiation.

As issuer revenue, interchange supports an issuer’s significant investment in providing cardholders with access to a national and global payment system, and investing in developing and supporting payment innovations that ultimately benefit both the government and U.S. taxpayers. Issuer interchange helps many federal and state agencies enjoy a no-cost proposition when it comes to using Visa prepaid products to disburse benefits to eligible beneficiaries—because issuers get paid a small fraction of the value of the transaction when recipient of government benefits use their cards, they are able to provide those cards at no cost to the government. And, in some cases, federal or state agencies may earn financial rebates from the use of Visa products by their employees—rebates provided by the issuer, supported by the interchange revenues that issuer receives. Interchange revenue is also a major component of driving financial inclusion to the unbanked, allowing employers to deliver payroll cards to their low income, unbanked workers at little or no cost. Prepaid payroll programs allow the unbanked to keep more of their wages instead of paying high check-cashing fees and having the risk of carrying significant amount of cash.

GOVERNMENT BENEFITS FROM ACCEPTING ELECTRONIC PAYMENTS

Federal government agencies have benefitted tremendously from accepting payment cards as a more efficient and less costly method of payment than cash or check. Indeed, the GAO released a report in 2008 on the costs and benefits of accepting payment cards and concluded that: “By accepting cards, federal entities realize benefits, including more satisfied customers, fewer bad checks and cash thefts, and improved operational efficiency.” The day-to-day, routine costs that are minimized through electronic payments do not often receive much attention or discussion. But all that paper is expensive to handle, expensive to collect and expensive to track. It is challenging to determine all the direct and indirect costs of paper-based payments, including losses on lost or bad checks, pilferage of cash, errors in record keeping and slower receipt of funds. These are, however, incredibly important savings at the end of the day – savings that ultimately benefit U.S. taxpayers. Some examples of specific agency benefits identified in the GAO report included:

- *Reduction of cash-associated expenses* – “By accepting cards, federal entities incurred less expense in transporting cash, lower losses from theft of cash, and had fewer bad check expenses. For example, officials at the Department of the Interior noted that cash transport costs can be high for some remote parks and wildlife refuges. Several federal officials also stated that accepting cards has reduced the costs associated with processing checks, and that funds are deposited in accounts faster when customers use credit or debit cards than when they use checks.”

- *Improved internal operations and more streamlined bookkeeping through reduced paperwork* – for example, “officials at the Department of the Interior stated that payments made by credit cards result in a more streamlined bookkeeping approach because card sales involve less paperwork (for reconciliation) than other payment forms.”
- *Reduced labor costs* – “Accepting cards also has enabled entities to conduct business via the Internet, which can reduce labor costs associated with sales and also can provide greater convenience to customers. For example, officials from the U.S. Mint stated that about 50 percent of their sales occurred through the Mint’s Web site.”
- *Re-allocation of staff to more productive uses* – “Officials at the Department of the Interior explained that card acceptance at automated kiosks allowed them to reallocate some staff that used to collect entrance fees to more productive tasks. Amtrak officials also stated that customers’ ability to purchase tickets using cards, especially through the Amtrak Web site, has reduced their labor costs.”
- *Reduced fraud and errors from miscounting or losing cash and checks* – “Additional operational efficiencies mentioned by officials included a reduction in costs and exposure to fraud and errors from misplacing or miscounting cash or checks.”
- *Fewer instances of employee theft* – “Amtrak officials told us that accepting cards onboard trains for ticket and food and beverage sales resulted in fewer instances of employee theft of cash.”
- *Improved customer satisfaction* – “agencies reported that card acceptance improves customer satisfaction with their organizations because consumers like to use their cards for convenience, credit card reward programs, and security reasons.”

In a time of a declining workforce and budget dollars, agencies are able to leverage these benefits and make people that might otherwise be behind the counter more productive, resulting in a friendlier, more responsive and less costly government.¹ Ultimately, as noted by Amtrak, payments are “a win-win” for customers and employees”²

Visa recognizes that government payments represent a major area of mutual opportunity and, for that reason, has consistently sought out ways to ensure that the interchange applied to government transactions on its major product sets is attractive for broad acceptance. For more than 14 years, Visa has allowed transactions from the majority of government-oriented

¹ A second GAO report—released just about six months ago—reported that private-sector retail merchants realized the same benefits from card acceptance: incremental sales, faster and more certain payments, fewer bounced checks, and reduced cash handling. Also, merchants use electronic payments to speed and automate checkout, and expedite credits or merchandise returns.

² March 28, 2007 Amtrak Press Release.

merchant category codes to qualify for one of its most attractive interchange rates on consumer credit and debit transactions, its “emerging segments” rate (this rate appears as “CPS-Retail 2” on Visa’s published rate sheet, which is posted online with all Visa interchange rates at Visa.com).

Visa has also created new, unique interchange rates for the government sector, or for select types of governmental transactions, as part of its on-going efforts to expand acceptance and grow the volume of governmental transactions going over the Visa network. For example, only GSA cards receive a special large ticket interchange rate, available with fewer restrictions compared to the equivalent non-GSA Purchasing card large ticket interchange rate, and only tax payment transactions may qualify for a unique flat debit interchange rate.³

Importantly, the level of the Visa interchange rate applied to government sector transactions has remained essentially flat over the past ten years. Looking at all Visa payment methods from 1999 through 2009, volume (i.e., cardholder usage) in governmental categories has increased by almost 600% over the past ten years, to roughly \$25 billion in 2009. Visa interchange applied to these transactions grew over this period, in line with volume growth, to roughly \$392 million. The resulting percentage, or volume-weighted interchange rate, of 1.57% is just over three percent higher than it was in 1999 – an exceptionally low level of change when one considers all of the ways in which the value of access to the Visa system increased over that ten year period, including access to more cardholders, improved system reliability, and increased speed of authorization and settlement, among other enhancements.

When looking just at Visa debit products over this same time frame, Visa volume has increased almost 2000% since 1999 – a remarkable growth rate reflecting the increasing adoption of electronic payments by governments as a method of acceptance and by cardholders as their preferred method of payment. At the same time, the effective interchange rate on these transactions has actually *declined* by 5%. Visa believes these figures are a compelling testimonial to its efforts to ensure that the government maximizes the benefits of card acceptance while minimizing its costs.

In their “Report on Credit and Debit Interchange and Other Fees,” the Financial Management Service (FMS) indicated that they accounted for \$8.6 billion in government payment volume across all networks in their fiscal year 2009, and \$116 million in interchange and other fees – which would equate to a merchant discount fee of 1.35%. Interchange is only one component of the merchant discount fee, therefore interchange would be an amount less than the 1.35% computed from FMS figures.

Visa welcomes the additional feedback from the FMS provided as part of their own testimony to this hearing, just as we welcome engagement and feedback from any and all merchants and other federal and state government agencies accepting Visa. We are eager to engage directly

³ Again, these rates may be found as part of Visa’s published rate sheet posted online at Visa.com.

with the FMS so that we can discuss each element of their report and request in more detail, and determine what adjustments Visa might make to its interchange rates and structure in order to maximize the joint opportunity for more Visa volume processed in a more cost-effective manner for the U.S. government and ultimately U.S. taxpayers.

While the FMS' comments were not directed at Visa alone, Visa certainly recognizes many of the issues raised – including the need for any new solutions to be both operational and financially viable for participants across the entire payment system including acquirers, issuers and processors. Ultimately, for any solution to work for all stakeholders there must be a business case for each: for acquirers (who must implement any new changes on behalf of their merchant), for networks (who are interested in expanding and improving network volumes) and issuers (who seek to increase payment transactions while reducing costs and improving cardholder value). And all of this is in the context of a highly competitive environment for each.

While we are still absorbing and thinking through the full range of implications of each specific element of their proposal, a few points are worth making here:

- First, the “government segment” or even the volume within FMS is not a singular agency, but instead represents thousands of agencies covering a very broad range of possible transaction sizes and types (government-to-government payments, everyday commissary purchases, admissions and other transactions at national parks, U.S. Mint eCommerce sales, traffic and court fines, etc.). When the USPS and Amtrak are included, the range expands further to include postage stamps, larger-scale packaging and mailing invoices, and railway tickets (in a variety of modes, including onboard trains, at kiosks, and via the internet). Sometimes consumers prefer to pay for these things with credit, and sometimes with debit, differences reflected in each agency's own payment mix and customer base. And many of these differences are reflected in the current Visa interchange structure, to the merchant's benefit.
- Second, while Visa is happy to discuss the potential merits of a singular interchange rate for credit or debit transactions, such a structure creates the potential for an interchange rate that will be lower on some portion of today's volume, but may be higher on some portion as well. This becomes increasingly likely when moving away from a variable structure (e.g., interchange is a percent of the total transaction amount) and towards a fixed structure (e.g., the interchange is always the same, regardless of transaction size). And as a result, a singular interchange rate could have detrimental impacts on acceptance of electronic payment transactions in specific situations, e.g., rate is too high to effectively promote small dollar transactions.
- Third, FMS has raised some issues in regard to certain of Visa's rules, including the requirement that merchants accept Visa for payments of all amounts and the prohibition on cardholder surcharges. Visa has adopted these rules to protect all cardholders, including government cardholders. While FMS, in its capacity as a payment card acceptor, might appreciate the ability to set transaction maximums or surcharge customers, allowing such anti-consumer practices would hardly seem to be in the

interest of the government as a card user. Government purchasing cards would be far less useful if merchants could set maximum transaction sizes, and the government could face hundreds of millions of dollars of surcharges on its own purchases. Allowing minimum transaction sizes and surcharges would also disadvantage users of government benefit cards.

Regardless of any open issues, Visa would like to engage FMS directly and explore ways in which Visa might address their core issues in such a way that also remains viable for all other participants in the transaction. As the FMS said itself, “The desired outcome would be not to reject any transactions...” While our business and system connections are to issuers and acquirers, Visa has a good history of engaging merchants directly and, when mutually viable terms can be found, customizing interchange and other elements of our network parameters to work better for a given merchant’s business model. We would very much like to have that opportunity with the FMS and the broader federal government.

GOVERNMENT BENEFITS FROM CARD ISSUANCE

Both federal and state governments have decided that their issuance of payment cards is an important tool to both minimize costs and expand their ability to offer a convenient and efficient method of distributing benefits to the nation’s unbanked and under-served, both for their everyday expenses but also for an essential method of commerce during both national and international crises.

Additionally, over 350 federal agencies use GSA purchasing and travel cards to eliminate paper-based purchasing processes as well as to eliminate the need for advance travel payments.⁴ These cards have saved billions of dollars in reduced annual expenses and have enabled military and civilian personnel to respond faster to military deployments, natural disasters and national emergencies. These essential government programs are detailed below.

Government Distribution of Benefits to the Unbanked and Under-Served

State Benefits Electronic Payment Programs

Almost every state in the nation has concluded that electronic distribution of government benefits both saves taxpayers money and, just as importantly, ensures that the unbanked have equal, quick and convenient access to funds. As mentioned, forty-seven states are using or are in the process of implementing electronic payments in the form of debit (or prepaid) cards for supplemental child support and unemployment benefits. Just like in the federal sector, state budgets have endured significant cuts and continuing this trend would cause a lasting impact on critical services for their most vulnerable citizens. Visa believes the thoughts from Dennis

⁴ As noted by the U.S. General Services Administration, “estimated administrative savings for the purchase card alone is \$1.7 billion per year (\$70 per transaction) when used in place of a written purchase order.”

McKinney, Treasurer of the State of Kansas, hits this point home: “The move to digital technology, including their prepaid debit card usage, with less reliance on the issuance of paper checks has been one key step to reducing costs while preserving funds for services for those most in need of assistance.” Visa, too, believes that these programs have offered significant benefits both to state governments and the constituencies they serve.

As Treasurer McKinney noted in his letter to Senator Christopher Dodd and Representative Barney Frank on June 4, 2010:

- “Electronic disbursement of benefits offers significant cost controls for the state, ranging from the obvious savings in paper and postage to the elimination of hidden costs for carrying “undisbursed collections” in the form of un-cashed checks that must be accounted for and reported to federal regulators. It also prevents problems that occur when a criminal counterfeits a state check—cheating the merchant who accepts the counterfeit and hampering honest citizens who subsequently have difficulty cashing legitimate state checks. Electronic disbursement also improves service to citizens by giving them quick access to state benefits and eliminating mail delays and disruptions due to address changes, inclement weather or catastrophic events. Families, whether banked or unbanked, benefit from having access to ATM withdrawals and teller withdrawals while eliminating the expense of check cashing fees. Electronic disbursement also protects benefit recipients from theft of support checks from mailboxes, wallets, and purses.”
- “Finally, recipients of these debit cards no longer have to worry about being displaced in the event of natural disasters or national emergencies as their benefits travel with them. As seen in the aftermath of Katrina, many people receiving government benefits by checks had no way of obtaining those benefits (in fact the post office was closed) and the beneficiaries had to rely on various federal agency personnel to provide them with some form of government relief hastily put together...and we all remember the fraud and waste that occurred from that effort.”

Federal Benefits Electronic Payment Programs

Like state governments, the federal government has also embraced the convenience and cost-savings associated with the distribution of government benefits through electronic payments.

For example, the Department of the Treasury is currently using prepaid debit cards to distribute social security and supplemental security income payments to hundreds of thousands of citizens under its Direct Express program. Although originally designed for the unbanked, this program is open to anyone who receives these benefits, providing citizens with a convenient and more efficient alternative to paper checks and saving the federal government the cost of check distribution. This program also allows the unbanked to avoid costly check-cashing fees,

essentially providing them an additional 3% of benefits by avoiding fees which average above 3.24%, according to a 2008 study by The Brookings Institution.⁵

Deputy Assistant Secretary for Fiscal Operations & Policy recognized these efficiencies in his 2008 testimony before the House Committee on Ways and Means, Subcommittee on Social Security:

“Electronic payments provide real and meaningful savings not only to the government and the taxpayer but also to the financial industry. For Treasury, it costs approximately 98 cents to issue a check versus 10 cents to issue an electronic payment. When this 88 cents per item savings is multiplied over the millions of federal payments issued annually, and as recipients convert from checks to electronic payments, the savings can become substantial.”

Today, Financial Management Services is looking to migrate roughly four million unbanked social security recipients to the Direct Express card by 2013. In fact, as mentioned above, just this week the Treasury Department announced that it intends to move most government payments to direct deposit or, in the case of the unbanked, to prepaid cards. The government estimates that this will cut about \$48 million dollars in postage costs and will save taxpayers approximately \$303 million dollars in the first five years.

General Services Administration (GSA) SmartPay Program

The General Services Administration (GSA) SmartPay program provides purchase, travel, fleet and integrated card programs to over 350 federal agencies and departments. The SmartPay program enables agencies to reengineer their purchasing, financial and logistics business processes by implementing a commercial payment process used by millions across the globe. The travel program has saved millions by eliminating the need for advance travel payments and has allowed military and civilian personnel to respond faster to military deployments, natural disasters and national emergencies. The GSA purchasing card has streamlined commercial low dollar purchases and saves the government an average of \$70 for every purchase. Repair times and equipment down times are shorter, as the individuals needing parts/supplies can order them and pay for them immediately. The programs are offered with state-of-the-art technologies to both military departments and civilian agencies. In fact, a web-based cardholder statement review and approval system with electronic feeds to supporting finance and accounting systems was fielded by the issuing banks to the Department of Defense as early as 2000 – years before online banking was available to consumers.

The GSA travel card programs have also provided tremendous savings by helping to eliminate administrative tasks and expense. For the Department of Homeland Security, the use of travel cards has eliminated the need for 75% of the staff that would be necessary for a paper-based

⁵ The Brookings Institution, *Banking on Wealth: America's New Retail Banking Infrastructure and Its Wealth-Building Potential*, p.13.

system. The Department of Agriculture has also saved staff expenses through new automated electronic payment tools.⁶

An additional benefit received by government agencies from the issuance of electronic payments cards is the receipt of rebates from the card issuing bank. These rebates are only possible because of interchange fees. Federal agencies use these rebates in several ways; some return the rebates directly to the federal agency where the purchase was made, others invest the rebates to fund specific agency initiatives. In 2008, for example, rebates totaled \$187 million dollars.

Finally, federal agencies receive a variety of additional benefits associated with electronic payments. In particular, government transactions typically have detailed data about the items purchase—or line item invoice details. By analyzing electronic purchase data patterns, the government is able to identify opportunities for negotiating strategically-sourced contracts, thereby reducing the cost of items being purchased by the government. Transparency also allows the government to identify misuse of funds; indeed, the GAO stated that without the use of the cards, instances of misuse may never have been identified.

Conclusion

Electronic payments – whether being paid by government employees or beneficiaries, or paid to governmental agencies or enterprises – promote efficiency, reduce costs and save taxpayer dollars. Electronic payments increase transparency and accountability within the government by facilitating better record-keeping and reporting of how and where government funds are spent. Electronic payments also provide a critical point of access to the financial system for the nation's unbanked, lower-income taxpayers and citizens at large. And we believe that electronic payments will continue to innovate and expand in their efficiency, offering taxpayers even more benefits as additional programs are implemented and adopted – so long as the industry has a business case for ongoing investment and innovation.

While the exact total amount of cost savings to the U.S., state and local governments of card acceptance and issuance has not been determined, we know from the GAO's past work that federal savings alone are measured in the billions of dollars. Certainly, Visa believes the overall value of Visa acceptance far exceeds the cost. Reductions in paper-based processes, labor costs, reduced fraud, and errors from miscounting or losing cash and checks allow government entities to reallocate staff to more productive uses, reducing costs and increasing the quality of service and efficiency to the taxpayers. Electronic payments also allow for a more accessible government, in moving tax and other payments from over the counter to the internet, thereby reducing the time it takes to transact with government.

Interchange, as transaction-based revenue that goes to the issuers of a particular payment product, is integral to the health of the payment system, and ongoing expansion of benefits and

⁶ Credit and Debit Cards, GAO Report 08-558, p. 42-43.

innovation in the services provided by the issuers that participate. Cash and check are cost items – and costly to banks that handle and process them, just as they are to those that accept cash and check for payment. The growth, stability and efficiency of the Visa payment system is thanks, in part, to the bank's business case for ongoing investment in improving their portion of the system. Visa, as the operator of the central "network switch," is equally invested in ensuring our own portion of the value chain is as secure, and sound, and innovative as the others, and that we continue to refine our system to keep it viable and competitive in the eyes of our customers.

As noted, we welcome the feedback from the FMS as to how the interchange portion of their costs of acceptance could be simplified and streamlined, and are committed to demonstrating our willingness to be flexible and set interchange in such a way that it balances the needs of the FMS and the government agencies they support, alongside the needs of our acquirer and issuer clients who collectively participate in each transaction.

Visa looks forward to our continuing discussion with the government on how Visa can be a valued partner in maximizing the benefits of electronic payments for U.S. taxpayers.