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OVERSIGHT OF FEDERAL PAYMENT OF INTERCHANGE FEES: HOW TO SAVE TAXPAYER DOLLARS

HEARING

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON APPROPRIATIONS

UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

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OVERSIGHT OF FEDERAL PAYMENT OF INTERCHANGE FEES: HOW TO SAVE TAXPAYER DOLLARS

WEDNESDAY, JUNE 16, 2010

U.S. SENATE,
SUBCOMMITTEE ON FINANCIAL SERVICES
AND GENERAL GOVERNMENT,
COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2:35 p.m., in room SD–192, Dirksen Senate Office Building, Hon. Richard J. Durbin (chairman) presiding.

Present: Senators Durbin, Nelson, Tester, and Collins.

OPENING STATEMENT OF SENATOR RICHARD J. DURBIN

Senator DURBIN. Well, good afternoon, everyone. Thanks for being here. I am pleased to convene this hearing before the Senate Appropriations Subcommittee on Financial Services and General Government. Our hearing is titled "Oversight of Federal Payment of Interchange Fees: How to Save Taxpayer Dollars."

I welcome my distinguished ranking member, Senator Susan Collins of the great State of Maine, and other colleagues are to join us a little later during the course of this hearing.

We are also pleased to have a distinguished group of witnesses, and I will be introducing them in just a moment.

Credit and debit cards are rapidly replacing cash and checks in today's economy, accounting for more than one-half of all retail sales in America, and that percentage is growing.

Credit and debit cards are also used to buy nearly $30 billion a year in goods and services from our Federal Government.

People use cards to pay for things like admission passes to the national parks, groceries at military commissaries, tickets on Amtrak, and co-pays for Veterans Administration (VA) medical services.

There are benefits to being able to use plastic for transactions, but there are also some consequences. The more Americans use credit and debit cards, the more the American economy falls under the control of the two credit card giants, Visa and MasterCard.

Visa and MasterCard control 80 percent of the credit and debit card markets, and they have established a system of fees and rules that apply to every transaction conducted across their networks. Every time a credit or debit card sale is made, Visa and MasterCard take a cut of the transaction amount. Some of this cut they keep, but most of it is routed along to the bank that issued the card used in the transaction. This fee that they give to the card-issuing bank is called the interchange fee.

Interchange fees, also known as swipe fees, average around 1 to 3 percent of the transaction. Because the fees are deducted from the transaction, the seller who accepts the card ends up with less than 100 percent of the actual amount.

An estimated $48 billion in credit and debit card interchange fees were collected in 2008 from those who accept credit cards and debit cards, including small businesses, charities, Government agencies, universities, you name it.

While the interchange fee is not the only fee charged on debit and credit transactions, it is the largest. It is also unique in the way that it was established. Interchange fees are received by the card-issuing bank, but banks do not set the rates for the fees that they receive. Instead, interchange fees are set by Visa and MasterCard who apply the same schedule of rates to all card-issuing banks within their networks. All banks in the network are guaranteed the same interchange rates regardless of how efficient or inefficient a bank manages its card-issuance costs.

There is no agency with regulatory authority over the nearly $50 billion collected every year in interchange fees. Nor is there any competition or negotiation in the market to keep these fees in check. Visa and MasterCard set the fee rates as they see fit, tell the merchants take it or leave it.

Given the card companies' enormous market power and the rigid operating rules that they unilaterally mandate, it is extremely difficult for those who accept their cards, including the Federal Government, to influence how much Visa and MasterCard will make them pay.

We need to step back and recognize the reality of the situation: Visa and MasterCard and their big bank allies want credit and debit cards to completely replace cash and checks. That is their market goal, and we are already halfway there.

Already when a sale is made by a credit or debit card, the person who makes the sale only receives 98 cents or 97 cent on the dollar. The card companies automatically take a cut. The cut keeps growing.

If we do not take steps to reasonably regulate this system, a dollar will not be worth a dollar anymore. It will be worth whatever Visa and MasterCard want it to be. We will literally cede control of America's currency to the Visa and MasterCard duopoly. The economic consequences to American businesses, particularly small businesses operating on a thin margin, to consumers and to taxpayers could be staggering.

I sponsored an amendment in the Senate that would require debit interchange fees to be set at a reasonable level and prevent Visa and MasterCard from prohibiting those who accept cards from offering discounts to consumers. This amendment is critical to addressing the abuses of the card companies' fees and rules.

As chair of this subcommittee, I have also devoted particular attention to the amount of interchange fees that the Federal Government pays through Amtrak, the Department of Defense, the National Park Service, the Veterans Administration. Of course, interchange fees paid by the Federal Government are actually paid with taxpayer dollars, and we have an obligation to make sure the taxpayer is getting the best value possible.

At my request last year, the Appropriations Committee directed the Financial Management Service (FMS) within the Treasury Department to provide a report on potential cost savings that the Federal Government could receive if FMS were able to effectively negotiate changes to the interchange fees and operating rules established by the card networks. The report concludes that Treasury could save an estimated $36 million to $39 million per year in taxpayer dollars if Treasury were able to negotiate terms with the card networks.

We have invited the Treasury Department here to discuss this report and explain what terms they seek to negotiate with the card networks.

We are also pleased to be joined today by representatives of Amtrak, which also incurs significant interchange fees, as well as the Government Accountability Office (GAO), which issued a report on Federal payment of interchange fees in 2008.

On our second panel, we will have representatives from Visa, the U.S. Public Interest Research Group, and we will also hear from one of my constituents, Wendy Chronister, who grew up in my neighborhood and who operates several convenience stores in central Illinois and faces these fees every day.

Today's hearing is not to debate whether credit and debit cards can bring benefit to the Federal Government and other accepters of cards. We all agree that cards do provide benefits like convenience, electronic recordkeeping, and a lighter wallet. Instead, this hearing is about whether the current system of fees and rules that Visa and MasterCard have established are necessary to achieve those benefits. We will discuss how increased competition and an end to unrestrained fee increases will help improve the system and actually save taxpayer dollars.

I would like to now turn to my ranking member, Senator Collins, for any remarks she would like to make.

STATEMENT OF SENATOR SUSAN COLLINS

Senator COLLINS. Thank you, Mr. Chairman, and thank you for calling this oversight hearing on the issue of the Federal Government's payment of interchange fees on credit and debit cards.

I must say when you first brought this issue up when we were discussing our legislation, I had no idea how pervasive the use of credit and debit cards were within the Federal Government. The fact is hundreds of executive branch agencies, as well as legislative agencies and the judiciary, accept credit and debit cards as payments for goods and services provided by the Federal Government. From the Defense Department commissaries, to the U.S. Mint, to the national parks, all types of Federal agencies accept credit and debit cards.

And as you pointed out, Mr. Chairman, the use of those cards is growing. In fact, this is an area where I see a real age difference. I am sure you have found, as I have, that our younger staff members carry no cash and use debit cards for everything.

Because of concerns that the Federal Government may be paying excessive interchange fees associated with the use of those cards, this subcommittee required the Financial Management Service at the Department of the Treasury to provide a comprehensive report on issues associated with the rates, fees, and types of card payments, and the methods by which transactions are processed.

The Treasury Department witness today will discuss the new report issued by the FMS.

As the use of credit and debit cards by consumers continues to grow, Federal entities' acceptance of these cards can be expected to grow as well. We look forward to receiving more detailed information on those transactions so that we will be in a better position to evaluate just whether the best interests of taxpayers are being served in these transactions.

For that reason, to assist us, I am particularly looking forward to the testimony of the GAO. I understand that the GAO has done some analysis of the payment of fees by a number of Federal entities and quasi-Federal entities such as Amtrak and the Postal Service. I hate describing them as Federal entities, particularly the Postal Service, because that reinforces the view that they are getting these huge Federal subsidies, which they are not in the case of the Postal Service.

According to a 2008 GAO report, the cost of these fees to the Federal Government at that time was more than $400 million, and I understand we will get some updated data today.

As evidenced by the appearance of our second panel, as well as the chairman's remarks, the issue of interchange fees is not limited to the Federal Government. In fact, the chairman successfully offered one of the very few bipartisan supported amendments to the financial reform bill, calling on the Federal Reserve to establish reasonable fees for debit card transactions for institutions with more than $10 million in assets. That threshold was intended to exempt smaller banks and credit unions across the country. Some of these smaller institutions, however, from my State have expressed concerns to me about whether the amendment gives the Federal Reserve the flexibility it needs to ensure that all the costs that smaller institutions incur in providing card services are fully taken into account in setting interchange fees.

I am looking forward to hearing the testimony from Visa because I am interested to learn whether credit card companies will develop separate fees and rules for smaller versus larger institutions.

And finally, like the chairman, I am interested in hearing the views of consumer advocates and retailers. I must say convenience stores throughout my State have repeatedly talked to me about the burden of these fees, particularly when an individual is coming in and only buying a cup of coffee. And a lot of times, the profit from that sale goes to the interchange fees.

This is a difficult issue to deal with, but I also know that financial institutions, particularly smaller institutions, really rely on the fee income generated by these cards.

So it is my hope today that we will able to fill in some of the blanks and come to a better understanding, and I appreciate your leadership, Mr. Chairman.

Senator DURBIN. Thanks, Senator Collins.

Our first panel includes our first witness, Gary Grippo. Gary is the Deputy Assistant Secretary for Fiscal Operations and Policy at the Department of the Treasury, provides advice and recommendations on a broad range of Government fiscal affairs, including cash management, financial and housing stability programs.

Prior to this appointment, Mr. Grippo served as Assistant Commissioner for Federal Finance for the Financial Management Service, a bureau of the Department of the Treasury, where he managed the Government's revenue collection systems and depository banking relationships.

He studied at Harvard University and the London School of Economics.

Our second witness is Alicia Cackley, Director of Financial Markets and Community Investment at the U.S. Government Accountability Office. She manages several teams of analysts doing program evaluation and policy research on a broad range of issues, including consumer protection, financial literacy, and homelessness. Ms. Cackley received her Ph.D. in economics from the University of Michigan and has been with the Government Accountability Office for 20 years.

The third witness on the panel is Janet Langenderfer, the Senior Director of Credit Cards with the National Railroad Passenger Corporation, also known as Amtrak. She has been with Amtrak for 6 years and had extensive experience in the credit card industry. She has an M.B.A. from George Washington University and a B.A. in business and economics from the University of Maryland.

My thanks to all the members of the panel.

Mr. Grippo, we are going to let you start off. Your written statement will be a part of our record, and if you could take 5 minutes and summarize it, we will ask some questions after we are finished hearing from the entire panel.

STATEMENT OF GARY GRIPPO, DEPUTY ASSISTANT SECRETARY FOR FISCAL OPERATIONS AND POLICY, DEPARTMENT OF THE TREASURY

Mr. GRIPPO. Well, thank you, Chairman Durbin, Ranking Member Collins, and other members of the subcommittee. I am pleased to be here to testify about the Federal Government's costs of accepting credit and debit cards for collecting Federal revenue.

The Federal Government is among the largest entities that accept payment by credit and debit card. My statements today reflect the interests of the Federal Government acting as a participant in the card payment system and are not offered from the perspective of a regulator or policymaker commenting on financial regulatory reform.

The Treasury Department centrally collects and deposits all Federal revenue on behalf of 228 Federal agencies. In fiscal year 2009, the Treasury processed 391 million collection transactions, totaling \$2.86 trillion in gross Federal revenue. These transactions include collections for taxes, duties, fees, fines, sales of goods and services, leases, loan repayments, among many other transactions.

Credit and debit cards are an important mechanism for processing many of these collections, and Federal agencies increasingly rely upon them to deliver Government services, operating over 4,300 point-of-sale locations that accept cards.

Cards afford citizens and businesses with a convenient means of interacting with their Government, and examples include, some of which have already been cited, the Department of Education accepting payment for various student loan fees, the National Park Service for park entrance and camping fees, the Federal Communications Commission (FCC) for radio operator licenses, the Centers for Medicare and Medicaid Services for individual Medicare premiums, the Federal Bureau of Investigation (FBI) for Freedom of Information Act document fees, the VA medical centers for insurance copayments from veterans, Defense commissaries for the purchase of groceries by service members, and Customs and Border Protection for customs duties paid by citizens arriving at airports.

Last year, Federal agencies collected $8.6 billion through 80 million credit and debit card transactions. These transactions have been steadily increasing, with an average annual growth rate of over 15 percent over the last 5 years.

However, cards are by far the most expensive mechanism to process Federal collections. In fiscal year 2009, the Treasury spent $116 million on interchange and card network fees. By contrast, it cost the Treasury only $66 million to operate the electronic Federal tax payment system which processed $1.9 trillion in tax collections through wire transfers and electronic funds transfers.

Moreover, the average per transaction cost of cards is more than twice that of other collection mechanisms. Last year, for example, the average card transaction cost $1.45, while the average cost of processing a paper check that was mailed to a Federal agency cost 60 cents.

The cost structure of cards for the Federal Government can be summed up with this statistic. Cards collections represent three-tenths of 1 percent of total Federal revenue but constitute 20 percent of total collection costs. Credit card interchange fees are the largest component of these costs, with an average effective rate of 1.9 percent for all Federal credit card collections.

As mentioned, the Treasury and not each Federal agency pays for these card costs, and because these card costs are borne centrally by the Treasury, the mechanism for paying them differs from the commercial model. Normally a commercial merchant pays its card fees by means of a discount to its transactions such that a merchant charged card fees of 2 percent on a sales transaction of $100 would result in a deposit of $98 to the merchant with $2 withheld to cover the fees. When a Federal agency accepts payment for a $100 transaction with a $2 fee, however, the agency will receive a deposit at par for $100 and the Treasury will be separately billed for a $2 fee. Those card fees for agencies across the Government are borne by the general fund of the Treasury and any reductions to card costs would go directly to reducing the Federal deficit.

As a steward of taxpayer money, the Treasury has for some time been concerned about the relatively high cost of the Federal Government's card transactions and has taken several actions in recent years to help manage these costs. For example, the Treasury may not offer the option of card collections to an agency starting up a new Federal program when the average transaction amount may be too high and result in exorbitant costs to the Treasury.

These kinds of actions, while prudent and helpful in containing costs, do not address the level of interchange rates or the manner in which they are set, and while the Treasury does benefit relative to some commercial merchants from special interchange rates afforded only to Government entities, these rates are established unilaterally and are not applied to most transactions.

Although the Treasury has held discussions with card networks in attempts to reduce the Federal Government's card costs, it has been unable to negotiate real reductions in rates and must choose between paying the prescribed rates or not accepting cards under a given Federal program. Simply denying the public the option of making a payment by card, however, is not viable in many cases since it would mean turning away citizens that have tendered a card for a sensitive or essential Government service and instructing them to return with a check or cash.

As mentioned, the conference report to the fiscal year 2010 Consolidated Appropriations Act directed the Treasury to identify potential cost savings to the Federal Government if the Treasury were able to effectively negotiate changes in fees and operating rules imposed by card networks.

In our response to the conference report, we indicated that one potential solution to consider was providing the Treasury with a mechanism to restrict or opt out of accepting cards for particular transactions without incurring a penalty from a card network if processing the transaction would be contrary to the public interest.

For example, one mechanism may include granting Treasury legal authority to establish new standards for processing public financial transactions, similar to the authority the Treasury currently holds to establish standards for depositories that hold public money. Any such mechanism would not permit the Treasury to compel a card network or a member institution to reduce its fees or to provide services to the Government. Such a mechanism, including any new legal authority, would be targeted simply to allow the Treasury to establish standards for removing transactions from the restrictions of card network rules and to process them through some other payment mechanism.

The widespread limitation of card transactions would be neither the likely nor the desired result from this authority since the Federal Government would still have every incentive to let citizens pay by card. However, having the ability to opt out of certain transactions based on cost could allow the Treasury to negotiate pricing terms on behalf of the taxpayer from a more equitable position since the Treasury would have the credible option of avoiding outlying costly card transactions.

As we consider potential solutions, we are certainly mindful of the complex legal and business issues associated with the Treasury's conduct in the payments marketplace, but if the Treasury could effectively negotiate costs and certain processing rules with card payment providers, we believe that significant savings could be achieved. Although cards would still be the Treasury's highest cost collection mechanism, the Treasury could reduce the Federal Government's per-transaction cost by an estimated 45 cents to 49 cents, equating to $36 million to $39 million in reduced annual interchange fees.

I thank you for the opportunity for having this discussion and look forward to questions.

[The statement follows:]

PREPARED STATEMENT OF GARY GRIPPO

Chairman Durbin, Ranking Member Collins, and members of the Subcommittee, thank you for inviting me to testify about the Federal government's costs of accepting credit and debit cards to collect Federal revenue.

The Federal government is among the largest entities that accepts payments by credit and debit card. My statements today reflect the interests of the Federal government acting as a participant in the national payment card system, and are not offered from the perspective of a policy maker commenting on financial regulatory reform or on the interests of commercial participants in the larger economy.

OVERVIEW OF FEDERAL COLLECTIONS

The Treasury Department, through its bureau the Financial Management Service (FMS), centrally collects and deposits all Federal revenue on behalf of all Federal agencies. In fiscal year 2009, through a network of over 125 banks acting as financial agents to the Federal government, the Treasury processed 391 million collection transactions totaling nearly $2.86 trillion in gross revenue. These transactions include collections for taxes, duties, fees, fines, sales of goods and services, leases, and loan repayments, among many other types of transactions. The largest customer of these centrally provided collection services is the Internal Revenue Service for individual and corporate income taxes, but 228 other agencies rely on the Treasury for collection and deposit services.

To process these collections, the Treasury maintains an infrastructure that allows individuals and organizations around the world to make payments to any Federal agency. This infrastructure uses all the settlement mechanisms available in the U.S. payments system, including wire transfers, Automated Clearinghouse (ACH) entries, credit and debit cards, checks and other paper drafts, and cash, as well as a number of cross-border payment mechanisms. The Treasury's collections infrastructure also includes some of the largest cash management systems in the world, such as the Electronic Federal Tax Payment System (EFTPS), which in fiscal year 2009 processed $1.9 trillion in tax collections though wire transfers and ACH entries from 11.5 million businesses and individuals enrolled in EFTPS. The Treasury maintains extensive government-wide customer service capabilities to help Federal agencies process the collections required under their programs, and to assist with the accounting and reconciliation of transactions.

The Treasury has several objectives in managing this global collections infrastructure. One objective is to minimize collection float and to settle funds into the Treasury's main account at the Federal Reserve as soon as possible after a transaction is authorized or initiated. Another goal is to process transactions at the lowest possible cost, while recognizing that in some cases transaction costs are driven by the statutory requirements of a Federal agency's program and may not be discretionary. A third requirement is, of course, to timely and properly account for and report on the millions of transactions processed through the infrastructure. In measuring these goals, the Treasury monitors several important metrics, including the percentage of transactions conducted electronically versus through cash and checks, and the unit cost of collections, both by the cost per transaction and the cost per dollar collected.

USE OF CREDIT AND DEBIT CARDS IN FEDERAL COLLECTIONS

Credit and debit cards are an important part of the Treasury's collections service, and Federal agencies increasingly rely upon them to support Federal programs and deliver services. Cards help meet the Treasury's cash management objectives by improving the accuracy and timeliness of Federal collections through the displacement of cash and checks. Cards afford citizens and small businesses with a convenient means of transacting with their government, particularly online at Federal agency web sites. Through a commercial bank acting as a financial agent to the Federal government, the Treasury allows Federal agencies to accept American Express, Discover, MasterCard, and Visa credit and debit cards, as well as PIN-based debit cards. Over 200 Federal agencies operating 4,350 point of sale locations currently accept cards. Examples of Federal programs for which cards are accepted include the Federal Communications Commission for radio operator licenses, the Centers for Medicare and Medicaid Services for individual Medicare premiums, the Federal Bureau of Investigation for Freedom of Information Act document fees, and the U.S.

Mint for coin sales. In fiscal year 2009, Federal agencies collected $8.6 billion through 80.3 million credit and debit card transactions. Mirroring trends in the larger economy, the number of card transactions with Federal agencies has been steadily increasing, with an average annual growth rate of over 15 percent over the last 5 years. Note that these statistics do not include the U.S. Postal Service and non-appropriated Federal instrumentalities that manage their banking relationships outside of the Treasury.

COST OF PROCESSING FEDERAL COLLECTIONS

The Treasury pays for the Federal government's collections infrastructure and bears the costs of processing transactions on behalf of Federal agencies, in part because only the Treasury or its designated agent banks, and not Federal agencies or their contractors, may legally hold public money. This centralized model ensures that the Federal government has the most efficient systems to take advantage of economies of scale, helps the Treasury enforce government-wide standards for financial transactions, and allows the Treasury to better manage the revenue side of government's daily cash position. In fiscal year 2009, the Treasury spent $561 million on the Federal government's collection and deposit infrastructure, which includes expenditures to pay for transaction and service fees to process collections received or authorized by mail, by phone, over-the-counter, over the Internet, and through banking networks.

Credit and debit cards represent the most expensive component of the infrastructure, costing $116 million in interchange and card network fees, with an average transaction cost of $1.45, in fiscal year 2009. By contrast, EFTPS cost the Treasury $65.7 million to process 101 million income tax transactions, for an average transaction cost of $0.65, and the Treasury's general lockbox network, which processes paper check collections for all Federal agencies, cost $22.4 million to process 37 million items, for an average transaction cost of $0.60. Card collections represent only 0.31 percent of total Federal revenue, but 20 percent of total collections costs. Interchange fees charged by card networks are the largest component of these card costs, with an average rate of 1.9 percent across all Federal credit card collections transactions in fiscal year 2009. In contrast to a continuing decline in the unit cost of other collection mechanisms, moreover, this credit card interchange rate has remained relatively constant for many years.

As stated earlier, the Treasury and not each Federal agency pays for credit and debit card fees. Because these costs are borne centrally by the Treasury, the mechanism for paying them differs from the commercial model. Normally, a commercial merchant pays its card fees by means of a discount to its transactions. For example, if a merchant is charged card fees of 2 percent, a sales transaction of $100 would result in a deposit of $98 to the merchant when the card transaction settles, with $2 withheld to cover the fees. When a Federal agency accepts a card payment for a $100 transaction with a 2 percent card fee, however, the agency will receive a deposit at par of $100 and the Treasury will be separately billed for a $2 fee. Card fees for agencies across the Federal government are borne by the general fund of the Treasury, and any reductions to card costs would go directly to reducing the Federal deficit.

As a steward of taxpayer money, the Treasury has for some time been concerned about the relatively high cost of the Federal government's card transactions, and has taken several actions in recent years to help manage these costs. In fiscal year 2006, when the Treasury solicited re-bids for government-wide card acquiring services, overall cost was the most important factor in selecting an acquiring bank. In 2005, the Treasury issued a bulletin to Federal agencies instructing them to limit their card collections to cashflows that consisted only of individual transactions less than $100,000, since several agencies were accepting cards under programs with individual transactions that could range in size from under $100 to over $1 million. The Treasury has also entered into agreements with Federal agency Chief Financial Officers to establish goals and metrics for reducing an agency's collections costs by moving transactions to more efficient mechanisms, such as ACH, when it can be done without impairing the agency's ability to deliver services under a program. In some cases, moreover, the Treasury will not offer the option of card collections to an agency implementing a new Federal program when the average transaction amount is too high and would result in exorbitant costs to the Treasury. Last, for PIN-based debit card transactions, the Treasury minimizes costs through technology that ensures transactions are routed through the processing network with the lowest effective rate for a transaction.

THE ISSUE OF CARD COSTS

These actions, while prudent and helpful in containing costs, do not address the core issues of the level of interchange rates and other mandatory fees paid by the Federal government, and how the card networks establish these charges. While the Treasury does benefit, relative to some commercial merchants, from special interchange rates offered only to governmental entities in some instances, these rates are established unilaterally and are not applied consistently across transactions and payment networks. And although the Treasury has held direct and indirect discussions with the card networks over the years in attempts to reduce the Federal government's card acquiring costs, rates have never been open to negotiation. Thus the Treasury, acting strictly as an acceptor of payment cards and not as a regulator or public policy maker, has been unable to realize acceptable reductions in its interchange rates and must choose between accepting cards at the prescribed rates or not accepting cards as a payment mechanism for a given Federal program.

Denying the public the option of making payment by card, however, is not viable in most cases, since it would mean turning away citizens and businesses that have tendered a card and instructing them to return with cash or check to pay for sensitive or essential government services, such as a small business paying a fee to the Patent and Trademark Office, a veteran making an insurance co-payment to a VA Medical Center, or a medical clinic paying the Department of Health and Human Services to research a physician in the National Practitioner Data Bank. Moreover, card transactions are crucial to the delivery of many government services on-line, where other payment mechanisms may not be feasible. As a matter of both public policy and customer convenience, citizens are, of course, increasingly interacting with their government over the Internet, with on-line card transactions growing 22 percent in fiscal year 2009.

NEGOTIATING NEW RATES AND TERMS

The Conference Report to the fiscal year 2010 Consolidated Appropriations Act directed the Treasury "to report to the House and Senate Appropriations Committees . . . on the potential cost savings and other benefits to the Federal Government if [the Treasury] were able to effectively negotiate (1) changes in the rates and fees assessed by card networks and (2) modifications to the rules and regulations of the card networks which restrict the Federal Government's ability to determine the types of card payments it accepts and the methods by which its transactions are processed." If we accept the premise in the Conference Report—that the current structure of the payment card system has not afforded the Treasury an opportunity to negotiate appropriate prices—then one potential solution to consider is providing the Treasury with a mechanism to restrict or opt out of accepting cards for particular transactions, without incurring a penalty from a card network for violating the rule to accept all cards, if processing the transactions would be contrary to the public interest due to unduly high cost. For example, one mechanism may include granting the Treasury legal authority to establish new standards for processing public financial transactions, similar to the authority the Treasury currently holds to establish standards for depositories that hold public money.

Any such mechanism should not permit the Treasury to compel a card network or member institution to reduce fees, to make special changes in rules or fee structures, to provide any services to the government, or to enter into any agreements with the government. Such a mechanism, including any new legal authority, would only apply prospectively and could be targeted to simply allow the Treasury to establish standards for removing transactions from the cross restrictions in card network rules and to process them through another payment mechanism without enjoining any parties. The widespread restriction of card transactions would be neither the likely nor the desired result from such authority, since the Federal government would still have every incentive from other quarters to let citizens pay by card. However, having the ability to opt out of certain transactions based on cost, which may include options provided under new legal authority, would allow the Treasury to negotiate pricing terms on behalf of the taxpayer from a more equitable position, since the Treasury would have the credible option of avoiding card transactions where the expense to the taxpayer clearly outweighs any benefits. Any such negotiations for new pricing terms would be conducted separately with each card network on a bilateral basis.

POTENTIAL COST SAVINGS

As we consider potential solutions, there are difficult legal and business questions that must be carefully assessed. Nevertheless, I can provide an outline of several goals the Treasury may seek to achieve if the Treasury could reasonably negotiate costs and certain processing rules with card payment providers. We believe that significant cost savings could be achieved, but also underscore that we are mindful of the complex issues associated with the Treasury's conduct in the payments marketplace. The following terms represent the types of approaches the Treasury could pursue.

First, the Treasury could negotiate to establish a simplified framework for interchange rates. For example, the Treasury might negotiate to create one interchange rate that the government would pay to card networks for all credit transactions, and a separate single interchange rate the government would pay to networks for all debit transactions. The rates would apply regardless of how a transaction is tendered (e.g., card present versus card not present), the type of card used (e.g., rewards versus non-rewards), or the type of Federal collection (e.g., sale of goods, loan repayment, fine, etc.). These uniform rates would displace the current complex of rate categories applied to Federal agency transactions.

Second, the Treasury could seek to have the option of establishing a maximum transaction amount above which an individual credit card transaction would not be allowed. Above certain dollar amounts, credit cards are simply not an appropriate payment mechanism under most Federal programs, especially when the Treasury can process the transaction at considerably less expense with any other paper or electronic payment mechanism.

Third, Treasury could attempt to negotiate reasonable limits or mutually acceptable rules on the card networks' unilateral right to raise or institute new fees. Such reasonable limits are important not only for reasons of equity, but also to ensure that any reductions that the Federal government may realize in total interchange costs are not offset by increases in other mandatory card network fees.

Fourth, Treasury could pursue the right to establish and collect a processing fee from an individual card holder to defray the Treasury's cost of processing a particular transaction. Such a fee would not be used in most cases or with Federal programs with broad public participation, but might be charged in those cases where the cost of unique transactions should be reasonably borne by the individual card holder receiving some special benefit and not by the general taxpayer. The amount of the fee would be limited to the cost to the Treasury imposed by a card network for the transaction, and would be deposited into the Treasury as a miscellaneous receipt.

These types of changes in the rate structure and processing rules could be implemented within the current card processing infrastructure, in a manner that is straightforward for issuers, acquirers, and card networks. Although cards would still be the Treasury's highest cost collection mechanism, we believe changes like these could allow the Treasury to reduce the Federal government's per transaction card cost by an estimated $0.45 to $0.49, which would equate to $36 million to $39 million in reduced annual interchange fees based on fiscal year 2009 transaction volume.

CONCLUSION

Mr. Chairman, these remarks are offered from the perspective of the Federal government acting in the role of a service provider that accepts cards, and in response to the direction from the House and Senate Appropriations Committees in the fiscal year 2010 Conference Report. They are not offered from the perspective of a policy maker or regulator with responsibility for the commercial payments system. Moreover, I wish to highlight the difference between a Federal agency accepting cards and a commercial merchant accepting cards. With few exceptions, Federal agencies that accept cards are not engaged in sales for profit, in competitive or market based activities, or even in traditional non-profit activities, but are delivering inherently governmental services to execute Federal law. The strategy I have outlined to reduce the Federal government's card costs is based on this unique role and applies to the interest of the general taxpayer, and not necessarily to merchant interests or any other special interest. While currently there is a larger public policy debate on interchange fees in the broader economy, with many competing interests among banks, merchants, and payment companies, the Treasury's financial managers have a responsibility to conduct fiscal operations as efficiently as possible and to pursue arrangements that afford the lowest costs to the general taxpayer. Toward this end, we welcome dialogue with all users and providers of payment card services.

I thank you for allowing this discussion on the Federal government's cost of accepting credit and debit cards, and look forward to taking your questions.

Senator DURBIN. Thanks a lot, Mr. Grippo.

Well, the bad news is that while you were testifying and elucidating us on this particular subject, the bells were going off to announce two rollcalls, which Senator Collins and I have to answer. So I think I am going to stick around and try to make sure that all three of you get a chance to testify, if I can, at least Ms. Cackley, and then we are going to take a recess because we will have to both go to the floor and vote and return. I cannot predict how long the recess will be, but in the range of 20 to 30 minutes I guess is pretty reasonable. So that is the circumstance and forgive us for this, but it was not our doing. Some higher-ups.

Senator COLLINS. Wait a minute. Are you not in the leadership?

Senator DURBIN. Well, now wait a minute. Do not get carried away.

Ms. Cackley.

STATEMENT OF DR. ALICIA PUENTE CACKLEY, DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, GOVERNMENT ACCOUNTABILITY OFFICE

Dr. CACKLEY. Mr. Chairman, Ranking Member Collins, I am pleased to be with you today as you examine issues related to the interchange fees that Federal entities pay for accepting credit and debit cards. As credit and debit card use have become more popular, the costs of accepting these cards have been rising. In particular, the level and growth of interchange fees has become a growing concern.

My comments this afternoon are based on findings from two GAO reports. The first, issued in 2008, examined the impact on Federal entities of accepting and using credit and debit cards, and the second, issued in 2009, dealt with the issue of interchange fees for all merchants.

My remarks will cover three key areas discussed in those reports: first, the amounts of revenue that Federal entities have collected using credit and debit cards and the costs of such acceptance; second, efforts such entities have made to reduce their interchange fee costs, including negotiations; and third, the extent to which certain card network rules affect card acceptors' ability to reduce interchange fee costs.

In summary, as the volume of Federal entities' card payment revenues have increased, so have their associated costs. In fiscal year 2007, Federal entities collected a total of more than $27 billion in revenues through credit and debit card transactions and reported paying at least $433 million in merchant discount fees, the majority of which was the interchange fee associated with Visa and MasterCard transactions. More recently, total card acceptance costs grew from $182 million in 2007 to $204 million in fiscal year 2009 for the U.S. Postal Service and Amtrak and from $101 million in 2007 to $116 million in 2009 for the Department of the Treasury's Financial Management Service. Federal entity officials told us that they were concerned about these rising costs, but that there were also benefits to accepting credit and debit cards, including more satisfied customers, fewer bad checks and cash thefts, and improved operational efficiency.

At the same time that they are acting as cards acceptors, Federal entities also use credit and debit cards to purchase supplies and pay for employee travel and transportation expenses. In fiscal year

2009, card purchases by Federal entities totaled more than $30 billion. Federal entity officials told us that benefits of card use include lower administrative costs compared to previous purchasing methods, as well as the potential for rebates of a small percentage of the purchase price. Such rebates totaled approximately $255 million in fiscal year 2009.

As card acceptance has become more common, Federal entities have worked to control their associated fees. The card networks offer interchange fees for Government transactions that are lower than those for many other merchants, and FMS requires the banks processing these transactions to monitor them to ensure they receive the lowest interchange fee for which they are eligible. In addition, some Federal entities have attempted to negotiate directly with the card networks to lower interchange rates for their transactions with limited success. However, officials at some of the entities with whom we spoke said that they did not believe they could negotiate effectively with the largest card networks, MasterCard and Visa, for lower interchange fees, partly because they felt that they could not refuse to accept cards from these networks. Similarly, our more recent work has indicated that non-Federal merchants also have had little success in negotiating lower fees with the card networks.

Certain card network rules, generally known as anti-steering rules, are a major factor in limiting these negotiations. These rules include honoring all cards, no surcharging, and no discrimination, which means Federal entities and merchants cannot turn away or charge more for more costly types of credit and debit cards. Without the leverage of being able to differentiate between cards or take other actions to steer customers toward lower-cost forms of payment, Federal entities and merchants are unable to use their influence with the networks to encourage them to lower interchange and other fees or to offer more lower-fee cards. In contrast, representatives of issuers and card networks told us the network rules are designed to promote the wide acceptance of their cards and ensure that their cardholders have a positive experience with the card.

Based on our 2008 and 2009 work, the increasing level of interchange fees appears to be a significant concern for both Federal entities and merchants in general. Although various options have been debated for lowering interchange fees, removing the anti-steering rules could allow Federal entities and merchants to send signals to cardholders about which cards increase merchant acceptance costs, which could improve leverage in negotiating their payment costs with the networks. If interchange fees for merchants were lowered, consumers might benefit from lower prices for goods and services, but proving such an effect is difficult.

In addition, lower interchange fee revenues for card issuers could prompt them to increase cardholder costs, offer less generous rewards, or curtail cardholder credit availability, although card use would continue to have various benefits to Federal entities and consumers even if such changes occurred.

Mr. Chairman, this concludes my prepared statement. I would be happy to respond to questions.

[The statement follows:]

PREPARED STATEMENT OF ALICIA PUENTE CACKLEY

CREDIT AND DEBIT CARDS: FEDERAL AGENCIES BENEFIT FROM CARD ACCEPTANCE, BUT HAVE LIMITED ABILITY TO CONTROL INTERCHANGE FEE COSTS

GAO HIGHLIGHTS

Why GAO Did This Study

Federal entities-agencies, corporations, and others-are growing users of credit and debit cards, as both "merchants" (receiving payments) and purchasers. Federal entities, like other merchants that accept cards, incur fees—called merchant discount fees—to process card transactions. For Visa and MasterCard transactions, a large portion of these fees—referred to as interchange fees—goes to the card-issuing banks. This statement addresses (1) the amounts of revenue that Federal entities have collected using credit and debit cards and the costs of such acceptance, (2) these entities' efforts to reduce their interchange fee costs, including negotiations, and (3) the extent to which card network rules affect these entities and other card accepters' ability to reduce interchange fee costs. The information for this statement was drawn from 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) and Credit Cards: Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges (GAO–10–45). GAO analyzed data on accepting and using cards from the Department of the Treasury (Treasury), Amtrak, the Postal Service, and General Services Administration (GSA); and interviewed non-Federal merchants, card networks, banks, academics, and others. GAO also obtained updated 2009 revenues and costs from Treasury, Amtrak, and the Postal Service, and purchases from GSA.

What GAO Found

As Federal entities' card revenues have increased, so have their associated costs. In fiscal year 2007, Federal entities collected more than $27 billion in revenues through credit and debit card transactions and reported paying at least $433 million in merchant discount fees, which include the interchange fees associated with Visa and MasterCard transactions. Since GAO originally reported in 2008, total card acceptance costs for the U.S. Postal Service and Amtrak grew from $182 million in 2007 to $204 million in fiscal year 2009. Card costs for Treasury's Financial Management Service (FMS) grew from $101 million to $116 million during this same period. Federal entity officials told us that the benefits of accepting cards include more satisfied customers, fewer bad checks and cash thefts, and improved operational efficiency. In addition to accepting cards, Federal entities also use cards to make purchases for supplies or employee travel expenses, and these purchases totaled about $30 billion in fiscal year 2009. Federal entity officials noted that using cards provides a variety of benefits, including lower administrative costs and rebates of a small percentage of the card purchases that they make, which totaled about $255 million in 2009.

Federal entities have worked to control the costs associated with card acceptance fees. Card networks already offer interchange rates for government transactions that are lower than those for many other merchants' transactions, but Treasury also requires the banks that process Federal entities' card transactions to ensure that these receive the lowest interchange rates for which they are eligible. Some Federal entities have attempted to negotiate with the card networks to lower interchange rates applicable to their transactions, but with limited success. Similarly, GAO's more recent work indicated that non-Federal merchants have also experienced little success in negotiating with card networks to lower these fees.

Various card network rules have been a major factor limiting Federal entities' and merchants' ability to negotiate lower interchange fees. Each of the major card networks—Visa, MasterCard, American Express, and Discover—have various card acceptance rules that prohibit card accepters from imposing surcharges on cards, refusing to accept certain cards—such as rewards cards with higher associated interchange fees, or establishing minimum or maximum charges. Although various options have been debated for lowering interchange fees, merchants and others GAO interviewed most supported removing certain card network rules. If interchange fees were lowered, card users might benefit from lower prices for goods and services, but lower interchange revenues for card issuers could prompt them to increase cardholder costs, offer less generous rewards, or curtail cardholder credit availability—although consumers and Federal entities could still enjoy various other benefits of using cards, such as convenience and efficiency.

Mr. Chairman and Members of the Committee: I am pleased to be here today to discuss issues relating to the extent to which Federal entities accept payments from credit and debit cards and the associated costs, including interchange fees. Each time a consumer uses a credit card to make a purchase, a portion of the sale—known as the merchant discount fee—is deducted and distributed among the merchant or Federal entity's financial institution, the financial institution that issued the card, and the card network that processed the transaction. The majority of this amount generally is called the interchange fee and goes to the financial institution that issued the card, which reported using the revenues from these fees to cover their costs of maintaining card programs. More specifically, I will discuss recent work we have conducted related to these fees, including (1) the amounts of revenue that Federal entities have collected using credit and debit cards and the costs of such acceptance, (2) efforts such entities have made to reduce their interchange fee costs, including negotiations, and (3) the extent to which card network rules affect card accepters' ability to reduce interchange fee costs.[1]

In summary, we reported in 2008 that as the volume of Federal entities' card payment revenues have increased, so have their associated costs. In fiscal year 2007, Federal entities collected a total of more than $27 billion in revenues through credit and debit card transactions and reported paying at least $433 million in merchant discount fees, which include the interchange fees associated with Visa and MasterCard transactions.[2] Federal entity officials told us that the benefits of accepting cards include more satisfied customers, fewer bad checks and cash thefts, and improved operational efficiency. In addition to accepting cards, Federal entities use cards to purchase supplies and pay for employee travel and transportation expenses. Card purchases by Federal entities totaled more than $27 billion in fiscal year 2007. Since we originally reported, total card acceptance costs for the U.S. Postal Service and Amtrak grew from $182 million in 2007 to $204 million in fiscal year 2009. Card costs for the Department of the Treasury's Financial Management Service (FMS) grew from $101 million to $116 million during this same period. Federal entity officials told us that benefits of card use include lower administrative costs when compared with the slower, more labor-intensive purchasing methods previously used. Furthermore, Federal entities obtain rebates of a small percentage of the card purchases that they make, which totaled approximately $175 million in fiscal year 2007, and grew to $255 million in fiscal year 2009. Although receiving various benefits, Federal entities using cards to make purchases have had to implement controls and procedures to prevent misuse.

As card acceptance has become more common, Federal entities worked to control the associated fees. The card networks already offer interchange rates for government transactions that are lower than those for many other merchants' transactions. Additionally, FMS, which processes the card transactions for numerous Federal executive, legislative, and judicial branch agencies and other Federal entities, requires the banks that process its card transactions—known as acquiring banks—to monitor how transactions are processed to ensure that these transactions receive the lowest interchange rates for which they are eligible. Some Federal entities have attempted to negotiate with the card networks to lower interchange rates for their transactions, with varying success. Similarly, our more recent work indicated that non-Federal merchants also have experienced little success in negotiating lower fees with card networks.

Card network rules restrict their abilities to differentiate among the cards they accept or take other actions and are a major factor limiting the leverage that Federal entities and merchants have to negotiate lower interchange fees. Each of the major card networks—Visa, MasterCard, American Express, and Discover—have card acceptance rules—generally known as anti-steering rules—that limit the options that Federal entities and merchants have for accepting or denying cards, including prohibiting them from: imposing surcharges on cards; refusing to accept certain cards—such as rewards cards with higher associated interchange fees; or establishing minimum or maximum charges.

According to merchants and some academic researchers, these rules constrain the ability of Federal entities and merchants to limit the costs of credit card acceptance. For example, by not being able to charge more for credit cards generally, for a particular network's cards, or for higher interchange fee cards, these entities are unable to steer customers towards lower-cost forms of payment or recoup some of their

[1] See *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 (Washington, D.C.; May. 15, 2008), and *Credit Cards: Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges*, GAO–10–45 (Washington, D.C.; Nov. 19, 2009).

[2] Dollar values on the costs and revenues associated with card acceptance for fiscal years 2005 through fiscal year 2007 are current values and have not been adjusted for inflation.

costs for higher-cost cards. In addition, without the ability to influence customers' payment choices, these entities are unable to use their influence with the networks to encourage them to lower interchange and other fees in general, or offer more lower-fee cards. In contrast, representatives of issuers and card networks told us that the network rules are designed to promote the wide acceptance of their cards and ensure that their cardholders have a positive experience with the card.

Although various options have been debated for lowering interchange fees, removing the anti-steering rules appeared to receive the most support from the large and small merchants and merchant trade associations with whom we spoke.[3] Removing these rules could allow merchants to send signals to cardholders about which cards increase merchant acceptance costs, which also could improve merchants' leverage in negotiating their payment costs. The ability to charge more for or refuse certain cards also could cause cardholders using rewards cards to be more aware of and to bear more of the cost of the rewards from which they benefit. If interchange fees for merchants were lowered, consumers could benefit from lower prices for goods and services, but proving such an effect is difficult. Lower interchange fee revenues for card issuers could prompt them to increase cardholder costs, offer less generous rewards, or curtail cardholder credit availability.

SCOPE AND METHODOLOGY

To examine the benefits and costs associated with Federal entities' acceptance of cards, we analyzed data for executive, legislative, and judicial branch agencies; government corporations; and other Federal instrumentalities that accept credit and debit cards for payment. FMS processes the card transactions for the majority of executive, judicial, and legislative branch agencies and Federal commissions, boards, and other entities and pays the associated fees for these entities. We also reviewed data from several Federal entities for which FMS does not settle transactions: Amtrak, the U.S. Postal Service, and others.[4] To determine the impact on Federal entities of using cards to make purchases, we reviewed policies and procedures developed for the General Services Agency (GSA) card program that Federal entities can use to make purchases (known as the SmartPay program), collected and analyzed data on card use from GSA, and reviewed our prior reports and interviewed officials from five entities that were among those with the highest volume of card use in fiscal year 2006. To learn about the impact of interchange fees on other merchants, we conducted interviews with more than 80 organizations, including U.S. Federal banking and other regulators, academic researchers, and industry participants. We also interviewed and obtained information from regulatory officials in Australia. For this statement, we also obtained updated 2009 revenues and costs from FMS, Amtrak, and the Postal Service, and purchases from GSA. We conducted the work on which this statement is based from June 2007 to May 2008, from May 2009 to November 2009, and in June 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

FEDERAL ENTITIES RECEIVE NUMEROUS BENEFITS ASSOCIATED WITH CARD ACCEPTANCE, BUT ALSO PAY INTERCHANGE FEES AND OTHER COSTS

The volume of revenues accepted through credit and debit card payments was growing for the group of Federal entities we reviewed. Data on revenues that Treasury's FMS collects show that while credit and debit card transactions accounted for 0.23 percent of the total Federal government revenues FMS collected in fiscal year 2007, its card collections had grown by almost 28 percent in 2 years—from approximately $5.5 billion in fiscal year 2005 to almost $7.1 billion in fiscal year 2007 (in current dollars). Revenues that the U.S. Postal Service and Amtrak—which have their own arrangements for processing their transactions—collected on credit and

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[3] See GAO–10–45. The merchants and associations also supported restricting interchange fees with a cap or other limit.

[4] These other entities included nonappropriated fund instrumentalities (NAFI) of the Department of Defense and Department of Homeland Security which operate retail stores or recreational facilities for the military. The data we collected from Federal entities were the best data available; however, because of limitations in and differences among the record keeping of the entities, the data may not be complete for all years, may treat some costs inconsistently, and in one case contain estimated, rather than actual, values. We reviewed the data for completeness and accuracy and determined that none of these limitations materially affect the findings we report.

debit cards grew from $9.3 billion in 2005 to $11.5 billion by 2007. As shown in table 1, the card revenues from these organizations and various other Federal entities from which we collected data grew from $22.3 billion in 2005 to $27.1 billion by 2007.

TABLE 1.—CREDIT AND DEBIT CARD REVENUES COLLECTED AND MERCHANT DISCOUNT FEES PAID BY FEDERAL ENTITIES, FISCAL YEARS 2005–2007

[In current dollars]

Fiscal year	Entity	Credit and debit card revenues collected (dollars in billions)	Merchant discount fees paid (dollars in millions) [1]	Average merchant discount rate (percent)
2005	FMS	$5.5	$70	1.26
	NAFIs (all)	7.5	128	1.72
	U.S. Postal Service and Amtrak	9.3	143	1.54
	Total	22.3	341	1.53
2006	FMS	6.3	89	1.41
	NAFIs (all)	8.3	139	1.67
	U.S. Postal Service and Amtrak	10.4	160	1.54
	Total	25.0	387	1.55
2007	FMS	7.1	101	1.43
	NAFIs (all)	8.5	150	1.75
	U.S. Postal Service and Amtrak	11.5	182	1.58
	Total	27.1	433	1.60

[1] We use the term "merchant discount fee" throughout this report to refer to the card acceptance fees paid by Federal entities. For FMS, the merchant discount fees are not "discounted" from the amount of the card payment. Instead, FMS settles card transactions "at par," and all costs associated with card acceptance are paid separately.

Source: GAO analysis of Federal entity data.

Note: Not all entities from which we collected data operate on the Federal fiscal year of October 1-September 30; therefore, the data presented for fiscal years represent some costs associated with dates that fall outside of the Federal fiscal year.

As the volume of revenues from card payments have increased, so have the total amounts of merchant discount fees paid by the Federal entities from which we collected data. These Federal entities reported paying almost $433 million in merchant discount fees in fiscal year 2007 (see table 1). This figure represents an almost 12 percent increase over the amount paid in fiscal year 2006 and an almost 27 percent increase over fiscal year 2005. The average merchant discount rate increased about 4 percent from fiscal year 2005 to fiscal year 2007. Since we originally reported, total card revenues for the U.S. Postal Service and Amtrak rose to $12.4 billion and those for FMS rose to $8.6 billion in fiscal year 2009; the card acceptance costs for the Postal Service and Amtrak grew to $203.7 million and for FMS to $116 million.

Among the entities included in our review, Amtrak, FMS, and the Postal Service provided data specifically showing the amount of interchange fees associated with their Visa and MasterCard transactions (their acquiring banks provide them with these data).[5] The three entities paid approximately $205 million in interchange fees during fiscal year 2007, out of a total of $218 million in merchant discount fees specifically for MasterCard and Visa transactions.[6] These interchange fees accounted for the majority of total merchant discount fees these entities paid for accepting all card types. As card revenues and merchant discount fees increased for the three entities, so did the interchange fees they paid. Interchange fees increased by almost

[5] Merchants (or Federal entities) enter into relationships with acquiring banks to provide card processing services for Visa or MasterCard (or both).

[6] This estimate for interchange fees paid includes fees associated with debit transactions using personal identification numbers (PIN) as well as MasterCard and Visa credit and signature debit transactions. We were not able to determine the portion of the PIN debit interchange fees that were specifically paid for Visa and MasterCard PIN debit transactions. It is possible that some of the PIN debit transactions reported by these entities were routed through other debit networks and, therefore, are not necessarily Visa and MasterCard transactions. Also, some Federal entities included quarterly fees paid to Visa and MasterCard in the interchange fees figures they reported; therefore, our estimated interchange fee amount includes these fees.

36 percent, from almost $151 million in fiscal year 2005 to $205 million in fiscal year 2007 (in fiscal year 2006, they were $179 million).

In our most recent report on interchange fees issues, we reported that non-Federal merchants also were experiencing increasing card acceptance costs, which they largely attributed to increased volumes of payments being made by consumers with cards, but also as a result of customers' increased use of rewards cards. Staff from these merchants expressed concerns that the increasing use of rewards cards was increasing merchants' costs without providing the commensurate benefits of increased sales.

For some payments made using cards, the government does not bear merchant discount costs.[7] For example, consumers can pay their income and business taxes to the Internal Revenue Service (IRS) using cards. IRS has agreements with two private third-party entities to process payments for individuals or businesses that choose to use a credit or debit card to make a tax payment. The private entities charge a convenience fee of 2.49 percent of the total tax payment, a portion of which covers the merchant discount fees the entities pay to their acquiring banks. In fiscal year 2007, these merchant discount fees totaled about $47.5 million for approximately $2.4 billion in tax payments, an 85 percent increase in tax payments made with credit and debit cards from fiscal year 2005.

In addition to the interchange and processing fees that make up the merchant discount fee, Federal entities face other costs associated with the acceptance of credit and debit cards. While FMS pays the merchant discount fees associated with card transactions for entities for which it settles transactions, it does not pay for the costs associated with equipment and software; these costs are the responsibility of the entities. For example, entities must pay for point-of-sale terminals, keypads for PIN debit card transactions, computers, modems, and printers, and pay for their installation and maintenance. Other costs of accepting cards include complying with industry security standards, training employees to process and reconcile card transactions, and experiencing losses associated with fraudulent use of cards. However, some entities provided information that indicated these additional costs were not significant compared to merchant discount fees.

FEDERAL ENTITY OFFICIALS CITED VARIOUS BENEFITS FROM ACCEPTING CARDS

The ability to accept credit and debit cards provides a variety of benefits to Federal entities, including greater customer satisfaction and improved internal operations. Officials at several Federal entities noted that card acceptance helped to ensure that the Federal entities would remain competitive with private-sector organizations. Federal officials with whom we spoke mentioned benefits such as improved customer satisfaction with their organizations because consumers liked to use their cards for convenience, credit card reward programs, and security reasons. Accepting cards also has enabled entities to conduct business through 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 their Web site. Some entities also stated that the ability to accept cards has increased their sales volume.

Federal entity officials also noted that accepting cards reduced the amount spent on processing other forms of payment. 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 could 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 were deposited in accounts faster when customers use credit or debit cards than when they used checks. Additionally, Amtrak officials told us that accepting cards on trains for ticket, food, and beverage sales resulted in fewer instances of employee theft of cash.

Finally, many officials cited that card acceptance improved internal operations. 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 involved less paperwork (for reconciliation) than other payment forms. Defense Commissary Agency (DeCA) officials also stated that they believed that the labor associated with reconciling sales declined as a result of the reduced cash volume. The officials mentioned additional operational efficiencies, including reductions in

[7] We did not include such transactions in compiling the total merchant discount fees paid by Federal entities for card acceptance. Instead, we provide this information as an example of additional fees that are paid by consumers for card acceptance associated with government payments.

costs and exposure to fraud and errors from misplacing or miscounting cash and checks. Some officials stated that the efficiencies gained as a result of card acceptance allowed them to reallocate staff to different and more productive uses. For example, officials at the Department of the Interior explained that accepting cards at automated kiosks allowed them to reallocate some staff that used to collect entrance fees. Amtrak officials also stated that customers' ability to purchase tickets using cards, especially through the Amtrak Web site, has reduced their labor costs.

The Federal entities we contacted were not able to provide comprehensive data on any cost savings from accepting cards. We identified various government, academic, and industry studies that compared the cost of processing for different forms of payment; however, many of these studies found that precise estimates were difficult to calculate. Additionally, while most of the studies we reviewed found cash to be the least expensive payment form to process, the methodologies used in the studies were not consistent and the data contained in many of them were outdated.[8]

CARD USAGE BY FEDERAL ENTITIES PROVIDES NUMEROUS BENEFITS, BUT CREATES CONTROL CHALLENGES

In addition to accepting cards as payment, Federal entities are also users of credit cards. More than 350 Federal entities participate in GSA's SmartPay program—which provides purchase, travel, and fleet cards for these entities to use. Federal entities pay no direct costs for the general use of cards. According to card network officials, the banks that issue cards to Federal entities are compensated in part by the interchange fees they receive when a government entity or employee uses a card to make a purchase. In fiscal year 2007, Federal entities used cards to purchase more than $27 billion in goods and services, and since we originally reported this amount has grown to $30 billion as of fiscal year 2009. Most of this spending occurred using purchase cards, which account for nearly 70 percent of total Federal entity card spending, while travel card use accounts for about one-quarter of card spending, and fleet card use about 5 percent.

Card use by Federal entities is expected to continue growing as the entities identify additional ways of using cards and use new payment technologies. For example, officials from the Department of Veterans Affairs (VA) told us that they have been working with the bank that issues the department's purchase cards to find new ways to increase card usage. For example, in 2003 they developed a process for making payments through the card system to non-VA medical providers for services to veterans who were unable to visit a VA center for medical care, reducing the number of checks they issued and increasing the number of electronic payments they made and the rebates they received for using their cards. Additionally, officials stated that VA has been reviewing its purchase records to attempt to shift more purchasing to vendors that accept cards. Similarly, the U.S. Army has developed an automated payment system that uses purchase cards for most of the $400 million per year it pays schools and other institutions for soldiers' tuition assistance. GSA officials also expect the new products and services that will be available under the SmartPay 2 program—the follow-on to SmartPay—will lead to increases in overall card spending. These products include prepaid cards, contactless cards, and cards in foreign currencies.[9]

According to Federal entity officials with whom we spoke, administrative cost savings are one of the primary benefits associated with card usage—compared with procurement methods that cards partially replaced, such as purchase orders, imprest funds, and blanket purchase agreements. For example, obtaining goods or services under a purchase order system requires that a purchase request be filled out and approved, then sent to a procurement office, which issues it to a vendor. However, when government entities use a card, cardholders can purchase goods or services directly, review their statements at the end of the billing cycle, and forward the statements to approving officials. Officials from the Department of Agriculture said that if cards were not used, staff would need to complete purchase orders for the

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[8] David B. Humphrey and Allen N. Berger. "Market Failure and Resource Use: Economic Incentives to Use Different Payment Instruments," in *The U.S. Payment System: Efficiency, Risk and the Role of the Federal Reserve: Proceedings of a Symposium on the U.S. Payment System Sponsored by the Federal Reserve Bank of Richmond*, ed. David B. Humphrey, (Boston: Kluwer Academic Publishers, 1990). D.D. Garcia-Swartz, R.W. Hahn, and A. Layne-Farrar, "The Move toward a Cashless Society: Calculating the Costs and Benefits," *Review of Network Economics*, 5, no. 2 (2006). D. Humphrey, M. Willesson, T. Lindblom, and G. Bergendahl, "What Does It Cost to Make a Payment," Review of Network Economics, 2, no. 2, (2003).

[9] A prepaid card is one that is programmed to have a monetary value, and charges to that card cannot exceed the balance. Contactless cards store data on a microchip embedded in the card, which can be read by passing the card in front of a special card reader.

1.5 million transactions per year that currently are made using purchase cards. Officials from the Department of Homeland Security estimated that the department would require from four to five times the current number of staff to operate its travel card program if the agency paid for travel expenses without cards. In addition, officials at the Department of Agriculture stated that new tools, such as an automated process to reset charge card passwords, might further reduce the costs of administering their program.

Federal entities receive another benefit of card use through rebates from the banks that issue their cards. Rebate amounts, after adjusting for inflation, had almost doubled since fiscal year 2002 to $175 million in fiscal year 2007, and were $255 million in fiscal year 2009. Rebate amounts to Federal entities are based on a number of factors, mainly the volume of net spending on cards and how quickly balances on the cards are paid. GSA establishes a minimum rebate rate that Federal entities should receive, but entities can negotiate with their issuing banks for additional amounts. From 1998 through 2007, the minimum rate was 6 basis points of the net volume of spending on the cards, while under SmartPay 2, the minimum rebate rate increased to 8 basis points. A GSA official stated that typically in Federal entities' negotiations with issuing banks, the rebate rate is increased as an incentive for an entity to choose a particular bank to issue its cards. According to the GSA official, some entities have negotiated for specialized services rather than increased rebate amounts, and GSA encourages entities to examine their programs holistically when negotiating terms. Federal entities differ in how they use their rebates. Two of the Federal entities we spoke with return the rebates directly to the location that originated the relevant transaction, one adds the rebates into general income for the entity, and one other allocates rebates to a working capital fund for initiatives of general benefit to the entity.

Officials at the Federal entities with whom we met cited only a few drawbacks associated with the use of cards, although officials from some entities mentioned the risk of fraud and misuse. These officials told us that the risk of fraud or abuse was less than or equal to that under previously used procurement systems. Although instances of fraud and misuse on cards may be infrequent, we and several inspectors general have reported internal control weaknesses in charge card programs at Federal entities and instances of fraud and abuse. For the most part, fraud and misuse can be limited through strong internal controls in card programs of Federal entities. GSA and the Office of Management and Budget (OMB) have issued guidance on internal controls intended to reduce the risk of misuse of cards. For example, GSA develops guidance through training courses for Federal entities and publishes guidelines for oversight and information on detecting misuse and fraud. Additionally, OMB has issued several memorandums related to oversight of card programs. Finally, officials from some of the Federal entities told us that the tools and data that their card-issuing banks provided helped them reduce the risk of misuse of cards by enabling them to track and limit the types of purchases made on the cards.

FEDERAL ENTITIES HAVE WORKED TO REDUCE CARD ACCEPTANCE COSTS, BUT EFFORTS TO NEGOTIATE LOWER INTERCHANGE FEES HAVE HAD LIMITED SUCCESS

As card acceptance has grown, Federal entities have used several methods to manage their costs and reduce the fees associated with card transactions. First, both Visa and MasterCard have a designated merchant category for Federal entities, in which the interchange rates are lower than those for many other merchant categories. As long as Federal entities' transactions meet all applicable processing requirements—for example, they must be submitted for final settlement in a timely manner—the entities are charged the interchange rate applicable to those merchant categories. For example, as of April 2008, if transactions met all applicable processing requirements, government entities accepting a MasterCard consumer credit card as payment would pay an interchange fee of 1.55 percent of the transaction amount plus $0.10, and for a Visa consumer credit card, 1.43 percent plus $0.05. (In comparison, the interchange rate for a MasterCard general purpose consumer credit card transaction at some fast food stores is 1.90 percent.) In some cases, card transactions at Federal entities can be assessed a lower rate. For example, FMS officials told us that DeCA transactions qualify to be processed using the interchange rate for the supermarket merchant category, which can range from 1.27 percent to 1.48 percent plus $0.05 for MasterCard general purpose consumer credit card transactions, depending on the volume of card transactions processed.

Because the method in which the card is accepted, transaction volume, and other factors can affect interchange rates, many Federal entities have taken steps to ensure that the acceptance and processing procedures they follow result in the most advantageous interchange rates applying to their transactions. For example, Amtrak officials explained that by replacing card machines (which embossed paper receipts) with wireless card terminals on trains, they were able to significantly reduce the interchange rates that applied to transactions made on trains, because the electronic transaction qualified for a lower interchange rate than the paper transactions. Moreover, FMS officials explained that their acquiring bank was responsible for monitoring how card transactions were processed and the interchange rates assessed. The bank provides FMS with daily and monthly reports that provide various levels of detail on the interchange fees paid. Both the bank and FMS officials review these reports to identify instances in which transactions may have been charged a higher interchange rate—known as a downgrade—because they were not processed under the requirements necessary to qualify for a lower rate.

Several Federal entities have attempted to control fees associated with card acceptance by expanding their ability to accept PIN debit card payments. PIN debit transactions generally are assessed lower interchange rates than "signature" debits, and therefore some Federal entities are beginning to put in place the technology necessary to accept these transactions. While Federal entities would have to purchase the equipment needed to process PIN debit transactions (for example, PIN pads), one entity told us that the much lower interchange rates associated with PIN debit transactions justified the investment. An FMS official stated that the only entity for which it processes card transactions that currently can accept PIN debit cards is DeCA; however, as entities undergo equipment upgrades, FMS works with them to identify equipment that may lower overall collection costs. For example, one Federal entity has been developing a new terminal system for card collections, and as part of this process, FMS has encouraged the entity to implement a system that can process PIN debit transactions. Additionally, some of the military NAFIs with which we spoke adopted technologies for accepting PIN debit cards, stating that they too recognized the cost savings associated with these transactions.

FEDERAL ENTITIES HAVE HAD LIMITED SUCCESS IN NEGOTIATING LOWER INTERCHANGE FEE COSTS

Federal entities have acted to reduce card acceptance costs by negotiating with their acquiring banks for lower merchant discount rates or with card networks for lower interchange rates. Some of the Federal entities we reviewed have realized card acceptance savings by negotiating new acquiring bank services contracts. These entities were able to negotiate lower rates for the processing component of the merchant discount rate applied to their transactions. For example, by signing a new acquiring bank agreement, one Federal entity received a substantial reduction in the processing fee component of its merchant discount rate. Also, to obtain a more favorable merchant discount rate for their transactions, officials from some of the military service NAFIs have been working together to try to negotiate a lower merchant discount rate with American Express on the basis of the volume of transactions they provide to that company.

Officials at some of the entities with whom we spoke stated that they did not believe they could negotiate effectively with the largest card networks—MasterCard and Visa—for lower interchange rates. One of the primary ways of negotiating lower rates would be to refuse to take a particular network's card. However, many of the Federal entity officials told us that consumers expect to be able to use cards to make payments, and some stated that they did not think they could stop accepting cards. For example, Amtrak officials stated that customers paying with cards accounted for about 85 percent of their sales and that if they did not accept cards, ridership would decline significantly. Some Federal entities stated that they have attempted to negotiate, but have had varying levels of success:

—FMS officials told us that they tried to negotiate lower interchange rates with both Visa and MasterCard by stating that some factors that were included in rate determinations did not necessarily apply to Federal government transactions. For example, FMS officials argued that the Federal entities that participate in the Card Acquiring Service pose less risk than other merchant types and that there is no risk of delinquency on the part of the Treasury. FMS officials stated that their negotiations were not successful and that they were not able to negotiate lower interchange rates.

—Officials from the Postal Service also explained their attempts to negotiate with the card networks. They stated that they believed lower interchange rates should be applied to their transactions for the following reasons. First, the Postal Service estimated that it has been one of the top U.S. merchants in terms of card transaction volume. Second, it poses less risk of fraud than some other merchants because most of its transactions are face-to-face. Third, the Postal Service operates a large retail network with 35,000 offices, self-service terminals, mail and phone orders, and a Web site that receives approximately 30 million hits per month and provides a great amount of visibility for the networks. Fourth, the Postal Service has its own law enforcement agency that investigates instances of fraud, including fraudulent use of cards where merchandise travels through the mail. These investigations result in the recovery of merchandise as well as stolen card data and in some cases the arrest of international criminals to the benefit of the credit card industry. They noted that the benefit of such services to the card networks were not reflected in the interchange rates for Postal Service transactions. The officials did state that they have had some limited success in negotiations, resulting in some small cost savings.

—Officials from another Federal entity told us that they have had some success in receiving funds from one of the networks as a result of a joint marketing program. The funds could be used to reduce interchange costs or for additional marketing efforts; however, confidentiality agreements bind the details of the negotiations, which are considered proprietary information. The officials explained that negotiations of this type are not typical of Federal entities because of the limited marketing opportunities available to most government entities.

Although some Federal entities have had some success in negotiating lower interchange rates for their transactions, whether additional opportunities exist for further reductions in interchange rates is unclear. According to officials of MasterCard and Visa, factors they consider when setting interchange rates include whether the industry or sector represents a new market for credit and debit cards. According to these officials, government payments are a market in which they hope to increase card acceptance and transaction volumes; thus, the interchange rates that they set for government transactions are lower than those of many other merchant categories. Additionally, officials at MasterCard and Visa told us that opportunities exist for merchants, including Federal entities, to negotiate for lower interchange rates. For example, the MasterCard officials cited an instance in which, in response to rapidly rising gasoline prices, they worked with gasoline merchants to develop a cap on the interchange fees for petroleum purchases. Officials from both networks explained that they have staff dedicated to developing customized arrangements with merchants and that these negotiations involve identifying mutually beneficial arrangements. We found it difficult to assess whether Federal entities could negotiate rate reductions based on their relative transaction volume or aggregate card revenues, because we could not identify any publicly available data we could use to determine how the Federal government's total transaction volume or aggregate card revenues compared with other large merchants.

MERCHANTS SIMILARLY HAVE HAD LIMITED SUCCESS IN REDUCING THEIR INTERCHANGE FEE COSTS

In our most recent report on interchange fee issues, we reported that merchants had had similar difficulties in negotiating lower interchange fee rates. We found that merchants did have greater ability to lower the processing fee portions of their merchant discount fee as the result of greater competition among banks offering such services. Increased competition for acquiring services provides merchants with considerable choice and opportunities to negotiate and lower some card acceptance costs. Hundreds of financial institutions and other firms compete as acquirers to provide card processing services. Merchants of varying sizes that we interviewed reported that they have multiple acquiring banks and processors competing for their business and have been able to lower the acquiring fee portion of their merchant discount fees in recent years.

Although merchants have reported success in negotiating their acquiring costs, several of the merchants we interviewed told us that their ability to lower their interchange fee costs—which represents the bulk of their card acceptance costs—was limited. These merchants generally paid the rates listed in the Visa and MasterCard networks' default interchange fee schedules. Although the ability to refuse to accept Visa and MasterCard should provide merchants with the leverage to negotiate lower interchange fees, merchants reported that they could not refuse to take such cards because of customer demand. For example, some merchants told us that if they did not accept credit cards from Visa or MasterCard, their sales would decrease and they would lose business to competitors that did accept those cards. Without this ability, merchants told us that they generally have not been very successful in obtaining meaningful reductions in Visa and MasterCard interchange fees. According to staff from Visa and MasterCard, their networks are willing to negotiate with merchants. For example, officials from one network told us that their network has negotiated with merchants with sales that represented 26 percent of their overall processing volume. Only one of the large merchants we interviewed told us that their company had received a limited and temporary reduction in their interchange fee costs as a result of negotiations with Visa or MasterCard following the settlement of a lawsuit.

CARD NETWORK RULES ARE A MAJOR FACTOR LIMITING CARD ACCEPTERS' ABILITY TO NEGOTIATE LOWER INTERCHANGE FEES

Card network rules also limit the leverage that Federal entities and merchants have to negotiate lower interchange fees. Each of the major card networks—Visa, MasterCard, American Express, and Discover—has various card acceptance rules—generally known as anti-steering rules—that limit the options that card accepters have for accepting or denying cards.[10] These rules include:

—no surcharges—card accepters may not impose a surcharge on consumers for the use of credit cards or cards with higher interchange fees;

—honor all cards—card accepters are required to accept all credit cards within a network's brand;

—no discrimination/differentiation—card accepters may not differentiate between credit cards within a network nor discourage the use of cards within a network;

—no minimum or maximum charges—card accepters may not impose a price floor or price ceiling on credit card transactions; and

—preferred treatment—card accepters may not direct consumers away from or to a certain network's cards.

Some academic researchers and merchant representatives argue that these rules constrain card accepters' ability to limit the costs of credit card acceptance. For example, without the ability to surcharge for credit cards generally, for a particular network's cards, or for higher interchange fee cards, card accepters, including Federal entities, are unable to steer customers towards lower-cost forms of payment or recoup some of their costs for higher-cost cards. In addition, without the ability to influence customers' payment choices, card accepters are unable to use their influence with the networks to encourage them to lower interchange and other fees in general, or offer more lower-fee cards. In contrast, representatives of issuers and card networks told us that the network rules are designed to promote the wide acceptance of their cards and ensure that their cardholders have a positive experience with the card.

REMOVAL OF ANTI-STEERING RULES SEEN AS IMPROVING MERCHANTS' ABILITY TO NEGOTIATE WITH CARD NETWORKS, BUT IMPACT OF LOWER INTERCHANGE RATES ON CONSUMERS IS UNCLEAR

Although various options have been debated for seeking to lower interchange fees, removing the networks' anti-steering rules was one of the options that appeared to receive the most support from the large and small merchants and merchant trade associations with whom we spoke.[11] Removing the anti-steering rules appears to have various advantages, including providing merchants with the ability to send signals to cardholders about which cards increase merchant acceptance costs, a change that could improve merchants' leverage in negotiating their payment costs. Merchants' ability to surcharge or refuse certain cards also could cause cardholders using rewards cards to be more aware of and to bear more of the cost of the rewards from which they currently benefit. This option also may require the least intervention, as merchants could decide whether to add surcharges or refuse certain cards based on their customer mix.

Merchants told us that they have faced increased costs from accepting credit cards in recent years, partly because of the increasing number of customers using credit cards and partly because of the increase in average interchange fees, particularly for higher-fee rewards cards. With lower card acceptance costs, merchants may pass on their interchange fee savings through lower prices to consumers; however, the extent to which they would do so is unclear.[12] Representatives of merchants we interviewed told us that they generally passed any increased costs—including the costs of accepting credit cards—to their consumers through higher retail prices.

[10] Not all of the networks have each of these rules, but if a merchant accepts cards from each of these networks, they are subject to all of them. Visa, MasterCard, and American Express have posted some of their rules on their Web sites; Discover's rules are not available online.

[11] See GAO–10–45. The other option that was most supported was restricting interchange fees with a cap or other limit.

[12] For example, Federal Reserve economists told us that the extent to which merchants would pass on their interchange fee savings likely would depend on the competitiveness of the markets in which the merchants operate.

Thus, all their customers may be paying higher prices for goods and services, whether using a credit card or not.

If interchange fees were lowered for merchants, consumers could benefit from lower prices for goods and services, but proving such an effect is difficult. For example, Australian regulators estimated that capping interchange fees in their country resulted in lower interchange fees for their merchants by about 1.1 billion Australian dollars for the period of March 2007 through February 2008. They acknowledged that providing conclusive evidence of the extent to which these savings have resulted in lower retail prices was difficult because so many factors affect prices at any one time. Moreover, the degree of savings depended on whether or not merchants were increasing their prices because of higher interchange fee costs. Some merchant representatives we interviewed told us that merchants would take different steps to improve customer service if interchange fees were lowered, such as hiring more employees. Customers also might not experience lower prices if merchants' overall costs did not decrease. Several industry participants speculated that if merchants were allowed to refuse higher-cost cards, merchants would lose sales from customers using premium credit cards. Network and issuer officials told us such customers spend more than customers using basic credit cards. A study of the Australian reforms by several economists reported that because the actual decrease in merchant costs was very small, merchants may have hesitated to lower prices, especially when their other costs might have been changing.[13]

Lowering interchange fee revenues for issuers could prompt issuers to increase cardholder costs or curtail cardholder credit availability. In Australia, issuers reduced rewards and raised annual fees following that country's interchange fee cap. In addition, with less interchange fee income, representatives of smaller issuers such as community banks and credit unions told us that they likely would not offer rewards cards and therefore would be unable to compete with larger issuers. One credit union official told us that the credit union could not offer credit cards because of the expense involved with running such a program. In addition, representatives of credit unions and community banks we interviewed said that they benefited from a network system that developed interchange rates to attract both merchants and issuers. Allowing merchants to refuse certain cards or negotiate rates directly with the issuers would eliminate smaller institutions from the process. Representatives of larger issuers told us that with less revenue from interchange fees, they would consider reducing the amount of credit they make available to cardholders. Australian officials reported that since their reforms were instituted, the number of credit card accounts in Australia has continued to increase and smaller credit unions have remained in the credit card business, albeit with some of their operations outsourced.

Banks' lower interchange fee revenue and the removal of certain anti-steering rules could also negatively affect Federal entities. For instance, a GSA official told us that banks facing reduced interchange fee revenue might reduce the amount of rebates Federal entities receive for using purchase cards. In addition, he said that the "honor all cards" rule ensures universal acceptance of GSA purchase cards—an important consideration for timely purchase of goods for first responders.

Although interchange fees are not regulated at the Federal level in the United States, these fees and card network rules, including the anti-steering rules, have been the subject of various actions by foreign regulators, the Department of Justice (DOJ), and private litigation. The Federal Reserve, under the Truth in Lending Act, is responsible for creating and enforcing requirements relating to the disclosure of terms and conditions of consumer credit, including credit cards, but because interchange fees are paid by merchants' banks and not directly assessed to consumers, such fees are not required to be disclosed to consumers. Although not specifically regulating credit card interchange fees, DOJ and the Federal Trade Commission have jurisdiction over credit card networks and issuers as part of enforcing U.S. antitrust laws or the Federal Trade Commission Act. In 1998, DOJ sued Visa and MasterCard for alleged antitrust violations regarding, among other things, how these networks' rules in effect prevented issuers from issuing cards on competitors' networks.[14] DOJ officials reported that they currently have another investigation under way involving potentially anti-competitive network rules such as those that prevent merchants from steering customers to other forms of payment, levying surcharges for card transactions, or discriminating against cards by type. DOJ staff

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[13] See Howard Chang, David S. Evans, and Daniel D. Garcia-Swartz, "The Effect of Regulatory Intervention in Two-Sided Markets: An Assessment of Interchange-Fee Capping in Australia," Review of Network Economics, 4, no. 4 (December 2005).

[14] See *United States* v. *Visa U.S.A., Inc.*, 344 F.3d 229 (2d Cir. 2003), aff'g, 163 F. Supp. 2d. 322 (S.D.N.Y. 2001), Cert. Denied, 543 U.S. 811 (2004).

told us they have requested information from American Express, Discover, MasterCard, and Visa as part of this investigation. They were not able to provide an estimate for when any formal action resulting from the investigation, if any, might occur. Interchange fees and other card network practices also have been the subject of private lawsuits. Since the mid-1980s, various lawsuits alleging problems with interchange fees and other card network practices have been litigated or remain pending.

In addition, as of September 2009, more than 30 countries have acted or are considering acting to address competition or card cost concerns involving payment cards.[15] Some actions taken by these countries include:

—regulating relationships between merchants, issuers, and card networks, such as prohibiting card networks from imposing certain rules on merchants;
—establishing maximum interchange fees or capping average interchange fees;
—allowing more institutions to enter the credit card market by changing the requirements to allow more institutions to qualify to act as an issuer or acquirer; and
—conducting investigations into the functioning of the payment card market, including legal antitrust proceedings.

Federal agencies accept cards and pay the associated costs. They also use cards and obtain various benefits as a result. Efforts to reduce interchange fees by addressing anti-steering rules could lower Federal entities' interchange fee costs. If interchange fees were lowered, consumers and Federal entities might benefit from lower prices for goods and services, but lower interchange revenues for card issuers could prompt them to increase cardholder costs, offer less generous rewards, or curtail cardholder credit availability, although consumers and Federal entities could still enjoy various other benefits of using cards, such as convenience and efficiency.

Mr. Chairman and Members of the Committee, I appreciate the opportunity to discuss these critically important issues and would be happy to answer any questions that you may have. Thank you.

Senator DURBIN. Well, thanks. We are going to have some questions, but it is going to be a little while.

Ms. Langenderfer, if I can beg your indulgence here, I am going to run off to vote and then return and hold this subcommittee in recess for approximately 20 minutes. So I thank you all for your understanding.

Well, the subcommittee will resume now that Senator Collins and I have returned from casting our votes, another pair of identical votes I am sure. Right.

Senator COLLINS. It was. This is scary.

Senator DURBIN. It is scary.

So, Ms. Langenderfer, thanks for waiting. The floor is yours.

STATEMENT OF JANET LANGENDERFER, SENIOR DIRECTOR OF CREDIT CARDS, FINANCE DEPARTMENT, NATIONAL RAILROAD PASSENGER CORPORATION (AMTRAK)

Ms. LANGENDERFER. Thank you. Good afternoon. Thank you for the opportunity to present this testimony.

My name is Janet Langenderfer. I am the Senior Director of Credit Cards in the Finance Department at Amtrak. I work for the treasurer and have responsibility for everything having to do with customer payments made by credit and debit cards. I am here today to discuss how the proposed financial reform legislation may benefit Amtrak and its customers.

[15] Federal Reserve economists and others report that these countries include Argentina, Australia, Austria, Brazil, Canada, Chile, Colombia, Denmark, Finland, France, Germany, Hungary, Israel, Italy, Mexico, New Zealand, Norway, Panama, People's Republic of China, Poland, Portugal, Romania, Singapore, South Africa, South Korea, Spain, Sweden, Switzerland, Turkey, and the United Kingdom, as well as the European Commission. See Terri Bradford and Fumiko Hayashi, "Developments in Interchange Fees in the U.S. and Abroad," Payment System Research Briefing (Federal Reserve Bank of Kansas City: April 2008); and GAO–08–558.

Amtrak sold more than $1.8 billion worth of tickets, food, and beverages to customers traveling between 500 stations located in 46 States in fiscal year 2009. Our customers used credit or debit cards for more than 90 percent of those purchases. As a result, our systems processed approximately 30 million transactions.

Clearly, Amtrak customers want to pay with cards, and therefore it is critical that Amtrak continue to offer as many payment choices as possible.

A customer swipes his card, and like magic it is supposed to work, but it is not magic. It is a financial transaction created by Amtrak to be entered into the banking system, bringing with it all of the rules and regulations of any other banking transaction.

My job at Amtrak is to make sure that every customer's credit or debit card transaction is processed quickly, accurately, securely, and cost effectively.

The legislation proposed by Senator Durbin addresses certain direct costs for payment card acceptance that will benefit Amtrak and its customers. However, the total cost of accepting payment cards results from a complex structure of both direct and indirect costs.

In fiscal year 2009, Amtrak paid more than $33 million to outside companies to process $1.6 billion worth of card transactions. This calculates to 2.27 percent and is 0.11 percent more than what we paid in 2008.

As you may know, every credit and debit card transaction is priced independently based upon the type of card used, the sales channel used, and the technical properties associated with the transaction. Our April 2010 statements for the four major credit card brands contained more than 200 different rates. We work aggressively to analyze our monthly statements, looking for opportunities to cut our costs, and you can see that our fees are based on a really complicated rates matrix.

We have also worked with each of the payment card brands, to the extent possible, to qualify for the best category of rates. We have been more successful with some brands than with others. Under the proposed legislation, we will have the opportunity to encourage a customer to use our lowest-cost card, thereby lowering our overall costs. This would likely create an environment that would encourage competition among the various brands to negotiate rates that are more favorable. I would see this as a benefit to Amtrak, to its customers, and to the taxpayer at the end of the day.

As customers ourselves, we can all appreciate what it means to have a purchase processed quickly and accurately. In order to have a consistent process, the payment card companies establish card processing rules, including requirements for technology, how to issue receipts, how to handle returns and refunds, how to prevent fraud, and many more.

It is the responsibility of Amtrak's management team to make sure that our front-line employees and our electronic systems incorporate all of these rules into our own policies and procedures so that each purchase is seamless to the customer. But following the rules is not easy and the transactions do not always get processed quickly and accurately.

Security has always been a high priority at Amtrak. Everyone understands that payment transactions must be handled carefully and theft of payment card information is scary. From our perspective, payment card security is viewed in two general categories: fraud prevention and compliance with the payment card industry (PCI) data security standards, often called PCI. Amtrak has spent close to $4 million on IT projects specifically to meet PCI compliance so far. However, there is no separate financial accounting for the significant amount of staff time spent on PCI-related issues such as contracts, policies, and procedures.

Amtrak works to prevent fraud through a series of industry best practices. As a result of recent efforts, we have reduced losses from 0.5 percent in 2001 to 0.04 percent in 2007. It has remained at 0.04 percent through 2009 even though sales on payment cards have increased by 50 percent during the same period. These are laudable numbers, but they come with hidden costs, increased interchange fees, more customer service costs, and potentially lost revenue from customers who do not want to be inconvenienced.

In conclusion, Amtrak accepts debit and credit cards from customers for almost all of our sales. The cost of accepting these cards are difficult to manage due to the complexity of the rate structure and the rules established by the payment card companies.

The legislation proposed by Senator Durbin puts us in the position to offer our customers the choice to use a payment type that provides them and Amtrak with the best combination of service and cost. With that opportunity, Amtrak will be able to negotiate with each payment card company on an equal footing for pricing that is appropriate for selling train tickets, food, and beverages and for rules that are geared to our organization and our customers.

Thank you for the opportunity to testify today. I will be happy to entertain any questions.

[The statement follows:]

Prepared Statement of Janet Langenderfer

Good afternoon and thank you for the opportunity to provide this testimony. My name is Janet Langenderfer. I am the Senior Director of Credit Cards in the Finance Department at Amtrak. I work for the Treasurer and have responsibility for everything having to do with customer payments made by credit and debit cards.

INTRODUCTION

I am here today to discuss how we believe the proposed financial reform legislation may benefit Amtrak and its customers. Amtrak sold more than $1.8 billion worth of tickets, food, and beverages to customers traveling between 500 stations located in 46 States in fiscal year 2009. Our customers use a credit or debit card for more than 90 percent of those purchases; and as a result, our systems process approximately 30 million authorization requests, sales and refund transactions each year. Clearly, Amtrak's customers want to pay with a credit or debit card, and therefore it is critical that Amtrak continue to offer them as many payment choices as possible.

Customers expect their card to simply work when using it at Amtrak; they do not realize that Amtrak is actually creating a financial transaction that will be entered into the banking system—bringing with it all of the rules and regulations of any other banking transaction. Controls and consistency are necessary to protect the security and integrity of the system. However, it is challenging to understand the rules established for the financial transactions we are trying to support.

The total cost of accepting payment cards results from a complex structure of direct and indirect costs. The Amendment proposed by Senator Durbin incorporates language that addresses certain direct costs for payment card acceptance that will reduce the cost of these transactions and therefore benefit Amtrak and its customers. The remainder of my testimony will demonstrate some ways that payment card transaction rules impact Amtrak and its customers today.

THE DIRECT AND INDIRECT COSTS OF ACCEPTANCE

In fiscal year 2009, Amtrak paid more than $33 million to outside companies to process $1.6 billion worth of payment card transactions. To provide a frame of reference, this is a "blended rate" of 2.27 percent and is 0.11 percent more than what we paid in fiscal year 2008.

As you may know, every single transaction is priced independently based upon the type of card used, the sales channel used, and the technical properties associated with the transaction. Our April 2010 statements for the four major card brands contained more than 200 line items. We work aggressively to analyze our monthly statements, looking for opportunities to cut our costs. But the savings do not show big returns; one effort in fiscal year 2009 saved us about $2,500; another one $200. On the other hand, as customers have moved (with society as a whole) from traditional travel agencies to the Internet, sales on Amtrak.com have saved us more than $50,000 each year just in payment card fees.

You can see that a company like Amtrak pays its payment card fees based on a complicated rates matrix applied to each transaction. We have worked with the payment card brands to the extent possible to qualify for the best category of rates. We have been more successful with some brands on this than with others. Under the proposed legislation, we have the option to encourage a customer to use our lowest-cost card, thereby lowering our overall costs significantly. This would likely create an environment that would encourage competition among the various brands to negotiate more favorable rates. I would see this as a benefit to Amtrak, to its customers, and to the taxpayer at the end of the day.

Example of Debit Card Customer Challenge

Here is an example of indirect costs we incur related to the application of the payment card contractual rules rather than the direct costs we pay. A customer makes a reservation and offers a debit card to pay for it. For one reason or another, the transaction is not completed. It could be because there were not enough funds available in the account, or because the transaction did not pass the Amtrak fraud prevention screens, or because the customer changed his or her mind about which train to take. In any event, Amtrak will work with the customer to either use another form of payment or hold the reservation until the customer is able to complete the payment. When this occurs, Amtrak sends an automated payment reversal transaction to the payment card company so that the customer's money is not held by the bank and unavailable for his or her use.

However, banks do not always apply the reversal transaction to the account immediately and the customer does not have access to his or her funds. The customer will request our help, but only the bank can release the money. As you can imagine, this is a significant inconvenience for our customer and it is very costly for Amtrak.

FAST AND ACCURATE TRANSACTIONS

My job at Amtrak is to make sure that every customer's credit or debit card transaction is processed quickly, accurately, securely, and cost-effectively. I think as consumers ourselves we can all appreciate what it means to have our purchase processed quickly and accurately. The payment card company rules also include technology requirements (hardware, software, and telecommunications), and regulations regarding how to issue receipts, how to handle returns and refunds, how to prevent fraud, and many more. And by the way, each company generally sends out its own update every 6 months. It is the responsibility of Amtrak's management team to make sure that our front-line employees and our electronic systems incorporate all of these rules into our own policies and procedures so that each purchase feels seamless to the customer. But following the rules isn't easy and transactions don't always get processed quickly and accurately.

I'd like to provide a specific example on this topic that may not be familiar to everyone. Amtrak has some large corporate customers who use one credit card for many employees traveling on the trains. During the course of a month, there are many sales, refunds, and exchanges for travel between the same two cities—the train number and the price are the same. In an effort to improve data sharing between travel companies and their customers, the payment card companies began requiring that additional data regarding each transaction be submitted within the payment transaction record—every time. The concept is great; however, the implementation is very difficult, and the transaction fees are some of the highest. In the past, inconsistent application of the rules has led to challenges where customers are not receiving the information that Amtrak has sent; creating some of the problems the program was designed to fix. This demonstrates the need for full life-cycle data accuracy and prompt delivery to all transaction participants.

SECURITY COSTS AND CONSIDERATIONS

When it comes to security, everyone understands that payment transactions must be handled carefully and theft of payment card information is scary to everyone. While we focus a great deal on prevention, the Amtrak Police Department, a nationally recognized agency, has a dedicated fraud investigation unit focused solely on credit card fraud. Together our company does everything we can to keep all of Amtrak's and our customer's data secure. This involves a major ongoing investment in information technology which is neither simple nor inexpensive—but security has always been a high priority at Amtrak.

We look at security in two general categories: fraud prevention and compliance with the Payment Card Industry Data Security Standards, often called "PCI".

Fraud Prevention

At the macro level, fraud prevention is managed through a payment card company process where a bank may reverse a customer's purchase after Amtrak has already been paid for it. For example, if you report your card stolen and it is later fraudulently used to purchase a ticket on Amtrak.com with a valid approval by the credit card issuer, you would not be charged for the ticket but Amtrak would! According to payment card company rules for a "Card Not Present" environment, Amtrak is held responsible because as "the merchant", we cannot prove who was using the card at the time of the transaction.

More than 70 percent of Amtrak passengers now elect to purchase their tickets through Amtrak's card-not-present sales channels (rather than going to the ticket counter). Today Amtrak has few options for avoiding a fraudulent transaction at one of its card-not-present sales channels and therefore, if the bank will not guarantee a card's validity, we do not accept it. We require that the customer come to the station and complete the transaction there. This is much more costly for Amtrak, and very inconvenient for the customer.

Amtrak works to prevent fraud through a series of industry best practices. As a result of recent efforts, we have reduced chargeback losses from 0.5 percent in fiscal year 2001 to 0.04 percent in fiscal year 2007. It remained at 0.04 percent through fiscal year 2009 even though sales on payment cards have increased by 50 percent during that same period and despite the fact that more customers are using card-not-present channels. These are laudable numbers—but they come with hidden costs, increased interchange fees, more customer service costs, and potentially lost revenue from customers who do not want to be inconvenienced in this manner.

Payment Card Industry Data Security Standards—"PCI"

The PCI standards, for anyone familiar with them, are like many other standards—continually evolving. Formal changes are announced every 2 or 3 years and interpretations are published more often. To date, Amtrak has spent close to $4 million on IT projects specifically to meet PCI compliance; however, there is no separate financial accounting for the significant amount of staff time spent on PCI-related issues such as revising contracts, policies, and procedures.

I offer one final example to demonstrate the issue. As you can imagine, Amtrak has contracts with tens of thousands of vendors. This includes vendors who build train engines, those who process card payments, and those who write software. According to the PCI standards, Amtrak is required to re-negotiate its contracts to include new language regarding PCI security, where the vendor is responsible for any violation of the PCI standard whether they are aware of it in their own system or not. Needless to say, the investment in the process to modify these contracts has not been easy—and yet it is part of our jobs and we haven't tracked the costs separately.

CONCLUSION

In conclusion, Amtrak accepts debit and credit cards from customers for almost all of our sales. The costs of accepting these cards are difficult to manage due to the complexity of the rate structure and the rules established by the payment card companies. The amendment proposed by Senator Durbin addresses certain direct costs for payment card acceptance. It puts us in the position to offer our customers the choice to use a payment type that provides them and Amtrak with the best service and cost combination. With that opportunity, Amtrak will be able to negotiate on an even basis with each payment card company for pricing that is appropriate for selling train tickets, food and beverages. It will also allow us to negotiate on the topic of rules that will help our customers.

We believe that the provisions of Senator Durbin's Amendment are reasonable, and we support it.

Thank you.

Senator DURBIN. Well, thanks for your testimony.

Let me digress before I get into the substance of this and say that as I listened to Mr. Grippo and Ms. Langenderfer and Ms. Cackley as well talk about the refusal of Visa and MasterCard to negotiate with our Federal Government, for some reason I remembered a scene from my favorite movie, "Dr. Strangelove", when Lionel Mandrake needed some change to make a long distance call because they thought there was going to be a nuclear war and he didn't have change. And it was suggested that he shoot up the Coca Cola machine and take the change and use it to avoid a nuclear war. And Keenan Wynn, who was playing Colonel Bat Guano, said to him, you're going to have to answer to Coca Cola if you do that.

It seems like things are similarly upside down here where we have the Federal Government with literally millions, if not billions, of dollars in transactions unable to negotiate when it comes to the fees that they are going to pay on credit cards? Stick with me for a minute, Mr. Grippo. It seems like we have some bargaining power under most circumstances here to make sure that taxpayers get a break. What is missing?

Mr. GRIPPO. I think under many circumstances, the Federal Government has lots of purchasing power as a consumer in the marketplace. But if you look at the overall numbers, which total to, let us say, $3.5 trillion of credit and debit card collections in this economy, our $8.6 billion may not be enough to exercise any purchasing power here. And in fact, the Federal Government card volume really is not enough when it is considered in the larger context of the economy.

Senator DURBIN. So what chance do the Qik-n-EZ convenience stores in central Illinois have if $8 billion does not get you to the table with Visa and MasterCard?

Mr. GRIPPO. Well, I think they are in the same boat as all other merchants, which is, by and large, they are presented terms through their acquiring banks from the card associations and they do their best in accepting those terms.

Senator DURBIN. Our research says that Visa has 122 different interchange fee arrangements. So it is not as if they do not look around and shop around.

Is there any indication—do any of you have any indication that the amount that is being charged to the Federal Government reflects the reasonable cost of collection, fraud, default? Is there anything that you can point to, for example, at Amtrak where you can say, well, there is a reason why we pay? What is the number that you gave us here? 2.27 percent on every transaction with a credit card and debit card. Is there anything that you can point to that says, well, that is because of default or fraud or something?

Ms. LANGENDERFER. Senator, I cannot give you an exact answer. There is a big range of rates. I will give you one example. I have looked at our most recent statement, and I have debit card transactions that range from 0.97 percent to almost 5 percent for debit cards.

Senator DURBIN. On the interchange fees.

Ms. LANGENDERFER. Interchange fees.

Senator DURBIN. So they range from less than 1 percent to 5 percent.

Ms. LANGENDERFER. Yes.

Senator DURBIN. And the reason?

Ms. LANGENDERFER. I do not know.

Senator DURBIN. It is just an arbitrary decision by the credit card company?

Ms. LANGENDERFER. I would imagine there are transaction details that are different, and I would imagine that the type of debit card that was used would be different, but I cannot tell on the face of it.

Senator DURBIN. So it appears that some card networks in other countries have been more successful than the United States of America. On April 27, the Wall Street Journal reported that Visa Europe agreed to lower the debit card fees it would charge in nine European countries, as well as for cross-border European Union transactions. MasterCard had reached a similar agreement last year.

Also, according to the April 2008 report issued by the Federal Reserve Bank of Kansas City, banks have reached agreement with foreign governments to reduce interchange fees in Israel, Mexico, and Switzerland.

Mr. Grippo, why is it that other governments can negotiate with Visa and MasterCard but the Government of the United States of America, where they are nominally part of, cannot negotiate?

Mr. GRIPPO. Well, I think in most, perhaps all, of the examples you mentioned, those countries were acting as regulators through their competition authorities' negotiating agreements to reduce rates across the general economy. I do not believe they were governments acting as purchasers of banking services to negotiate lower rates for the government itself.

Senator DURBIN. So the plot thickens. It appears that our failure to assume a power or responsibility when it comes to these fees ties our hands with these two giants, Visa and MasterCard. And in other countries where they have assumed a regulatory relationship—incidentally, for the record, who regulates interchange fees in the United States?

Mr. GRIPPO. To my knowledge, there is no Federal regulatory power over interchange rates. It is a matter of contract among the parties.

Senator DURBIN. I think you are right.

Senator Collins.

Senator COLLINS. Thank you, Mr. Chairman.

Mr. Grippo, I want to follow up by getting a better understanding of whether Federal agencies try to negotiate the interchange rates that they are paying. Does Treasury try to negotiate the rates?

Mr. GRIPPO. The Treasury negotiates the rates on behalf of all the agencies for a variety of reasons, including the fact that the Treasury is the one legally that is processing the collection and taking the deposit. And we do try to negotiate, as best we can, with the card associations primarily through our acquiring bank, although directly with the card networks in some cases. And there are cases where we may be successful in negotiating a lower charge for a particular type of transaction or categorization, or in the definition of an interchange category, but in directly negotiating the rates, the level of rates, and the manner in which they are set, we really have not had much success in realizing any reductions.

Senator COLLINS. That surprises me, given the amount of transactions that the Federal Government is doing. If it were individual agencies trying to negotiate the rate, I could understand that they might not have sufficient clout to do so, but if Treasury is negotiating the rates across the board, why are you not having more success, for lack of a better word? You could go through different banks. Correct?

Mr. GRIPPO. We could go through different banks, but any bank we went through would be subject to the same card association rules.

Senator COLLINS. So does this get back to the point that the chairman made that you have two big issuers who control 80 percent of the market?

Mr. GRIPPO. It does get back to the fact that there is one set of rules, and while we very aggressively compete to select an acquiring bank, and the fees that we pay that particular bank for their particular services are very competitive, as good as anyone can get, the interchange fees and other card network fees that are established by the associations and merely passed through the bank we happen to be dealing with are not something that the acquiring bank controls and not something we negotiate directly with the acquiring bank.

Senator COLLINS. Your report, which came out earlier this week, notes that the Treasury could seek to negotiate a maximum rate that would be a flat, fixed percentage of all transaction dollars. First of all, is that being done now, or is that a recommendation?

Mr. GRIPPO. This is a recommendation. One of the themes of the report is that if the Treasury were able to change the status quo—and what we recommend is some mechanism, perhaps new legal authority, that allows us to opt out of certain transactions that may be cost prohibitive. If we have such a mechanism, that would put us on a more equal negotiating footing to directly negotiate what those rates were. Then we would pursue this concept of a uniform rate or a flat rate that would apply to all credit or all debit transactions. This would help simply by eliminating the complexity of dozens of categories which, frankly, we have to aggressively monitor to make sure that they are applied correctly to our transactions.

Senator COLLINS. Ms. Cackley, I can see why Treasury would like the simplicity of one fixed rate for all transactions, regardless of whether it's a personal identification number (PIN) or a signature debit, for example. But do different transactions not have different costs?

Dr. CACKLEY. Different transactions could have different costs definitely, depending on whether they are transactions with a card that is presented or a transaction over the Internet. There could be different processing costs. But the interchange fees, as they are currently set, are not directly connected to the cost of the transaction itself, although they can vary by the perceived risk of the merchant.

Senator COLLINS. Which has been the chairman's point and why he wants the Federal Reserve to look at setting reasonable and proportional rates.

But I am wondering—and my time has expired. So just quickly, what do you think of the Treasury's recommendation that there should be a flat, fixed rate? The reason I am somewhat concerned about that is it seems to me with a debit card, you have less of a chance of a default because the money is presumably taken immediately from the individual's account. Therefore, I would think debit charges should be lower than if someone is using a credit card.

Dr. CACKLEY. The idea of having a different rate for a debit card versus a credit card is something that has already been suggested and actually is already true.

But when we did our work on interchange fees, looking at the different kinds of ways to try to lower interchange fees for all merchants, capping the fees was certainly one of the options that we considered and that has some merit.

Senator COLLINS. Thank you, Mr. Chairman.

Mr. GRIPPO. If I could just comment, Senator Collins. In our report, we do in fact make that distinction, and when we talk about a flat rate or a uniform rate, there would be one for credit and a separate for debit to reflect those different risks and costs.

Senator COLLINS. Right, though you treat different kinds of debit cards alike, whether they are a PIN card or a signature card.

Mr. GRIPPO. That is right.

Senator DURBIN. I have asked Senator Nelson if I could ask a couple questions before I give the floor to him.

Ms. Cackley, in your testimony you say that MasterCard has set a Government interchange rate of 1.55 percent plus 10 cents per transaction. You also note that MasterCard gives supermarkets a 1.27 percent interchange rate. Your testimony says that most Government transactions do not qualify for the lower rate given to supermarkets, even though Federal Government transactions have far less risk than a merchant transaction. Can you explain why supermarkets are getting a better deal than Federal agencies and Federal taxpayers on interchange rates?

Dr. CACKLEY. Senator, I believe that the interchange rate for supermarkets was set somewhat lower in order to attract supermarkets and persuade them to start accepting credit and debit cards because that was not something that supermarkets did originally, and so having a lower rate was a way to bring them into the market.

Senator DURBIN. But $8 billion worth of buying power in the Federal Government is not enough to entice them to give the taxpayers a similar break?

Dr. CACKLEY. Apparently not.

Senator DURBIN. So let me ask one last question. There is something called a SmartPay program, the General Service Administration's (GSA) SmartPay program. I have got one, and this is a credit card given—an official credit card for official expenses given to Members of Congress and other Federal employees. And this is interesting because in this case, the Federal Government is not accepting credit cards. The Federal Government is issuing credit cards to be used by their employees, and a different world has emerged.

As your testimony notes, Ms. Cackley, there are Federal agencies participating in the GSA SmartPay program that receive rebates from the card-issuing banks. The rebates can be substantial. GSA is able to get back these rebates because card-issuing banks are competing with one another to get GSA's card business and because GSA negotiates with banks and comparison shops to get the best deal possible. In other words, competition in a card-issuing market works to the Government's benefit in the GSA case.

So, Ms. Cackley, is there any opportunity for Government agencies to negotiate with or comparison shop between card-issuing banks with regard to the interchange rates the Government pays those banks when it accepts their credit cards?

Dr. CACKLEY. The Government does negotiate the rebates that they get for——

Senator DURBIN. This is when they issue cards. I say when they accept cards.

Dr. CACKLEY. But when they accept cards, they do not have the ability to negotiate in the same way.

Senator DURBIN. It seems that there is something missing in the equation when there is no competition.

Senator Nelson.

Senator NELSON. Thank you, Mr. Chairman.

I know that you called the hearing to discuss the Federal Government's payment of interchange fees, but I would like to turn briefly to a question about the impact of interchange fee regulation on State prepaid debit card programs.

We have heard from some States. And I would like to know how the regulation of the debit card interchange fees will impact prepaid debit card programs that are used by the States such as the State of Nebraska, my home State, to disburse Government benefits and assistance, which has apparently been happening for some period of time. I remember as Governor, when we set the program in place, we called them Smart Cards. So perhaps you can—first of all, Mr. Grippo and then Ms. Cackley.

Mr. GRIPPO. Well, it is, I know, a very important question. Any change to the balance of interests in the payment card system across merchants, banks, the associations, and users is a delicate matter. And certainly the regulation of debit card interchange rates will impact all of those participants.

At the Treasury, we have not taken a position on Senator Durbin's amendment to the regulatory reform bill that would go to directly regulating debit card fees. So I do not want to offer thoughts that would support or oppose that.

Senator NELSON. No, I understand. If you could just explain what you believe the impact would be without taking a position on it—on the States and what would happen in terms of their costs, their charges.

Mr. GRIPPO. In general terms, I would say that it would cause State governments with benefit cards to have to renegotiate the terms of their card agreements with their issuing banks. I could not comment on the extent to which they would have to do that, but clearly, if the underlying cost structure changed due to new regulation of the fees, then the end users, including State governments, would have to renegotiate some of their terms with the banks.

Senator NELSON. Do you think they gain leverage or do they lose leverage?

Mr. GRIPPO. I do not know, Senator. Frankly, I am not sure how the direct regulation of debit card fees would play out and how all of the different actors would respond. I do not know.

Senator NELSON. Thank you.

Ms. Cackley.

Dr. CACKLEY. Senator, we did not do work on the electronic benefit transfer (EBT) cards directly, but we do know a little bit about which cards are not currently impacted by interchange fees. The Supplementary Nutrition Assistance Program cards are not now affected by interchange fees. I think that we would have to do more work in order to answer the rest of your question.

Senator NELSON. Well, I think it is an important point for us to consider because raising the cost to the States is not an intended consequence. So I think it would be very helpful if we could get more information in connection with that because the last thing we need to be doing is raising their costs at a time that they are coming to us asking for more help on Medicaid.

Do you have any initial thoughts, even prior to the research, as to what the impact would be?

Dr. CACKLEY. I think, as Mr. Grippo said, there are so many actors that it would be difficult for me to speculate until I had done the research.

Senator NELSON. But do you think it would be a good idea to be able to do some research on that to give us some enlightenment?

Dr. CACKLEY. I think we could certainly look into it for you, sir.

Senator NELSON. Okay.

Senator DURBIN. Senator Nelson, thank you for raising that issue and thank you for calling me personally on this because after we passed the amendment, you brought to my attention that this was a concern based from your experience as Governor of your State and what you had heard since. And I wanted you to know that we are working on an amendment that will specifically carve out these government types of cards so that they would not be affected by anything related to the private sector. I think it is a special case situation, and I am on your side on this one. I am glad you brought it to my attention. Thank you for doing that.

Senator NELSON. Thank you, Mr. Chairman. Thank you.

Senator DURBIN. Senator Collins? Nothing further?

Thank you to this panel. Appreciate your testimony and your patience while we were in recess voting and all those things.

I would like to ask the second panel to please, if they would, come to the table.

The first witness in the second panel, who is taking a seat now, is Bruce Sullivan. He is Vice President and head of Government services for Visa, Incorporated. And prior to his tenure at Visa, Mr. Sullivan worked for the Department of Defense for 33 years and received numerous awards for his expertise and accomplishments in the Federal acquisition arena. Mr. Sullivan, thank you for being here.

Our next witness is Ed Mierzwinski. He is the Consumer Program Director of the U.S. Public Interest Research Group (PIRG), the nonpartisan and nonprofit federation of State public interest research groups. State PIRGs are nonprofit, nonpartisan, consumer, environmental, and government watchdog groups with over 500,000 members. Mr. Mierzwinski has been a consumer advocate with PIRG for over 20 years authoring major reports on a wide variety of issues relating to financial reform, identity theft, product safety issues.

And Wendy Chronister, who is the President and Chief Executive Officer of Chronister Oil Company. Her company currently owns and operates 11 Qik-n-EZ convenience stores located in central Illinois and employs approximately 150 people. She grew up in my hometown of Springfield where her father founded Chronister Oil Company. She has extensive experience in venture capital and private equity, graduated cum laude from Dartmouth and magna cum laude from the University of Illinois College of Law in Champaign. Thank you for joining us too.

Mr. Sullivan, we will make your written testimony part of the official record and we would like to give you 5 minutes to summarize it or to raise some highlights. The floor is yours.

STATEMENT OF BRUCE SULLIVAN, VICE PRESIDENT AND HEAD OF GOVERNMENT SERVICES, VISA INC.

Mr. SULLIVAN. Thank you very much. Chairman Durbin and Ranking Member Collins, 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. I am Vice President and head of Government services for Visa. In this capacity, I work with issuing banks and Federal agencies participating in GSA's SmartPay program. I also work with the FMS in introducing new payment technologies for them to use with Federal agencies on their programs.

As a former public servant, I am acutely aware of the need to both reduce costs and increase efficiencies within the Government.

As a global payments network, Visa provides a platform for business and Government efficiency. Our products provide extraordinary value to all participants in the payment chain by facilitating commerce, reducing operational costs, and expanding the availability of electronic payments to the Nation's unbanked. In return, this reduces overall costs to taxpayers.

That is why Government agencies increasingly are embracing electronic payment products. To highlight this, the GAO reported that the U.S. Government saved close to $2 billion in 2006 just from the efficiencies gained from the use of the GSA purchase cards.

Just this week, the Treasury announced plans to modernize Government and eliminated outdated wasteful processes to create savings for taxpayers, distributing most benefits from the Government to consumers via direct deposit or prepaid cards. This eliminates the need for paper checks. This change is estimated to save the Government more than $300 million in its first 5 years.

Electronic payments are also an effective tool for ensuring governments and underserved consumers have ready access to funds in moments of crisis each and every day. Following Hurricane Katrina, Louisiana used purchasing cards to purchase and pay for vital supplies, everything from generators to sun screen.

Forty-seven States use or are in the process of implementing debit and credit 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.

Interchange is what helps make these programs work. Interchange is not revenue to Visa. Rather, it is a transfer of value from the merchant's bank to the cardholder's bank. Interchange is but one component of the total cost of acceptance a Government merchant or enterprise faces when arranging with an acquiring bank to accept cards for payment.

As issuer revenue, interchange supports an issuer's significant investment in providing cardholders with access to the payment system. Issuer interchange helps many Federal and State agencies enjoy a no-cost proposition when it comes to using prepaid products to disburse benefits to beneficiaries, thereby allowing the unbanked to keep more of their wages instead of paying high check cashing fees.

Federal Government agencies have benefitted tremendously from accepting payment cards as well. It is a more efficient and less costly method of payment than cash or check. The 2008 GAO report on the cost and benefits of accepting payment cards concluded that by accepting cards, Federal entities realize benefits, including more satisfied customers, fewer bad checks and cash thefts, and improved operational efficiencies.

For more than 14 years, the majority of Government-oriented merchant category codes have qualified for one of Visa's lowest interchange rates. Visa has also created new, unique interchange rates for select types of Government transactions. Importantly, the level of Visa interchange rate applied to the Government sector transactions has remained essentially flat over the last decade.

Both Federal and State governments have decided that distributing government benefits on payment cards is an important tool to both minimize costs and expand their ability to offer a convenient and efficient method of distribution to the Nation's unbanked and underserved. And by using GSA purchasing travel cards to eliminate paper-based processes, agencies have saved billions of dollars in reduced annual expenses, and military and civilian personnel can respond faster to military deployments, natural disasters, and national emergencies.

In conclusion, electronic payments, whether used by Federal, State, or local governments for disbursing benefits, making purchases, or accepting purchases, promote efficiency, reduce costs, and save taxpayer dollars.

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. Thank you very much.

Senator DURBIN. Thanks, Mr. Sullivan.

[The statement follows:]

PREPARED STATEMENT OF BRUCE SULLIVAN

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 the Treasury's Financial Management Service on new payment technologies available for use by Federal agencies.

Prior to joining Visa 7 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 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 5 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, 47 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 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 ongoing 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 10 years. Looking at all Visa payment methods from 1999 through 2009, volume (i.e., cardholder usage) in governmental categories has increased by almost 600 percent over the past 10 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 percent is just over 3 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 10 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 timeframe, Visa volume has increased almost 2,000 percent since 1999—a remarkable growth rate reflecting the increasing adoption of electronic payments by governments as a method of ac-

[1] A second GAO report—released just about 6 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.

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

ceptance 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 percent. 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 percent. Interchange is only one component of the merchant discount fee, therefore interchange would be an amount less than the 1.35 percent 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 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 toward 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, 47 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 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."

[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."

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 percent of benefits by avoiding fees which average above 3.24 percent, 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 4 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 in postage costs and will save taxpayers approximately $303 million in the first 5 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 percent of the staff that would be necessary for a paper-based 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.

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

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

[6] Credit and Debit Cards, GAO Report 08–558, p. 42–43.

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 United States, 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 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.

Senator DURBIN. Mr. Mierzwinski.

STATEMENT OF EDMUND MIERZWINSKI, CONSUMER PROGRAM DIRECTOR, U.S. PUBLIC INTEREST RESEARCH GROUP

Mr. MIERZWINSKI. Thank you, Chairman Durbin, Senator Collins. I am Ed Mierzwinski of the U.S. Public Interest Research Group.

All consumers pay more at the store and more at the pump because of unfair, nonnegotiable, nontransparent merchant interchange fees imposed by the card networks. If you take the numbers from just a few years ago, because I can do the math in my head, just a few years ago, 50 percent of all transactions were plastic and 50 percent were cash. Now the merchant witnesses at this hearing and at other hearings will say it is much closer to 70 or 80 percent are plastic, but if you just take 50 percent of transactions have a 2 percent interchange tax, that means merchants are raising their prices an average of 1 percent across the board for all customers, including cash customers. Since interchange is highest for rewards cards, rewards credit cards in particular, that means cash customers and checking account customers with low-cost debit cards are subsidizing the most affluent credit card customers.

So the subsidies are going in the wrong direction. The fees are nonnegotiable, and the merchants are angry. And as we found out today with the reports from the Government investigators, the Government is unable to negotiate these fees as well. It is not just consumers. It is not just merchants. It is also the Federal Government that pays too much in nonnegotiable, nontransparent interchange fees.

It is my view, U.S. PIRG's view, that consumers always win with greater transparency, and the Durbin amendment accomplishes two goals.

First, I want to point out that the Durbin amendment to the Wall Street reform legislation that is currently in conference is a rifle shot approach. I think that is useful. You address part of the problem. Through a Federal Reserve reasonable proportional test, you would attempt to lower the cost of interchange on debit. Then that would be an incremental change. I see no reason for the catastrophes that the industry is claiming will occur because of your amendment. You are not going after the entire marketplace. You are going after part of it. I think that is a very smart way to go about it.

Second, you address the unfair practices that the card associations impose on the retailers who are unable to offer their customers discounts without being threatened with thousands of dollars a day in fines and penalties. I think it is very important that we have greater transparency and we improve the way the system works. The two parts of the Durbin amendment I think work very well in that regard.

I also commend you for including the provision in the amendment that says that merchant minimums do not apply to debit cards, which partly addresses the issue of an EBT customer who just needs a gallon of milk and does not need to spend $15 on other unnecessary purchases. Those minimums would only apply to cards that are credit cards.

Now, I personally feel that merchants will be careful about how they use the powers that you have given them in the amendment because they have to respond to their customers as well. So I think you are giving them the opportunity in the marketplace to advise customers on lower forms of payment that will benefit them, that will benefit cash customers, and that will ultimately result in those benefits being passed on.

I cannot tell you how much of those benefits will be passed on, but I can tell you this. Merchants are in a competitive retail marketplace. Card networks are not. The courts have found that card networks have market power. It is clear that individual merchants do not have the kind of market power that the card networks have. So I think your amendment is a very thoughtfully crafted amendment and will do a great deal to move this process forward.

The other thing is that I support your views, as in your colloquy with Senator Nelson, that there should be a carve-out for EBT programs. I do not think that the way that the banks have negotiated with governments is necessarily fair. On the one hand, governments are paying hundreds of millions, if not billions, of dollars in interchange fees. On the other hand, the banks come in as if they are white knights, which they are not, and say, we can offer you a good deal on EBT programs. Ultimately the taxpayer is paying some way or another, but the best solution in the short run is, as you have proposed, to have that carve-out.

I want to take one quick moment of personal privilege to also say that I want to commend you, Senator Durbin, on your leadership on the originally named, I believe, the Financial Credit Product Commission, which is now the Consumer Financial Protection Agency. You took Professor Warren's idea, along with Representative Delahunt. It is now in both parts of the bill. We are fighting over how strong it will be, but ultimately consumers will benefit tremendously from your leadership. We will finally have a regulator that does not advise consumers that they cannot do anything because the banks told them they could not do anything. We will have a regulator with one job, protecting consumers.

Thank you.

Senator DURBIN. Well, thank you. I appreciate your kind words.

[The statement follows:]

PREPARED STATEMENT OF EDMUND MIERZWINSKI

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.[1] 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.[2] We have also launched a major campaign on over 40 college campuses around the country against unfair credit card marketing practices.[3]

SUMMARY

The Durbin interchange amendment to the Restoring American Financial Stability Act,[4] takes important steps to end unfair and anti-competitive practices in the credit and debit card marketplace. As shown in the reports released today, exces-

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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 nonprofit, nonpartisan consumer, public health and good government watchdog groups with over 1 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 nonpartisan 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] 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; on financial regulatory reform (16 July 2009) available at 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. 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.

[3] See http://www.truthaboutcredit.org.

[4] The bill was originally S. 3217 and was re-numbered H.R. 4173 on passage and for conference consideration.

sive, non-transparent and non-negotiable interchange fees even harm the Federal government and that harms taxpayers.

For the past 3 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.

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 percent 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 anticompetitive 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 nondiscriminatory 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.[5] 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."[6]

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.

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 bil-

[5] See Mierzwinski, Edmund. 2008. The Poor Still Pay More. *Trial Magazine, Journal of the American Association for Justice, 44* (September): 40–49.

[6] 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).

lion 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 United States 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 percent 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 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.[7]

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

[7] Foer, Bert. "Our $48 Billion Credit Card Bill." New York Times. April 20, 2010.

and those without credit cards receive no benefits.[8] Over 27 percent of Americans do not have credit cards. For these consumers, interchange fees are especially pernicious and regressive.[9] 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 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.[10] 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.[11]

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 per year simply because of rising gas prices.[12] This problem will increase if gas prices continue to increase. It is difficult enough for low- and moderate-income consumers to afford skyrocketing gasoline prices without having to pay additional fees that are passed on to them.

INCREASES IN INTERCHANGE FEES SIGNAL A BROKEN MARKET

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

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 MasterCards.

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 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.[14]

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[8] 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.

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

[10] 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.

[11] 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

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

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

[14] 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

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 percent, down to just 0.2 percent—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.[15]

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.[16]

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 percent or lower for all categories of purchases.[17]

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 United States). It was recently reported that fees to merchants were 1.1 billion Australian dollars lower from March 2007 to February 2008 as a result.[18] 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.

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.[19]

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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.

[15] PaymentsSource. "Bulletin: Visa Europe Agrees To Cap Intra-regional Debit Interchange Rate." April 26, 2010.

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

[17] See "Visa New Zealand Domestic Maximum Interchange Reimbursement Fees," http://www.visa-asia.com/ap/nz/mediacenter/factsheets/interchange.shtml and "Interchange Fees: MasterCasd Domestic Purchase Transactions Interchange Fees for New Zealand," http://www.mastercard.com/nz/merchant/en/interchangefees/index.html.

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

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

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 United States, 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.

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.[20]

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 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.

[20] 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.

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 percent 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.[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. The Durbin amendment's provisions on anticompetitive 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 percent of the market, and the level of concentration has increased from an HHI of about 1,100 in 1998 to an HHI of over 1,800 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.[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

[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.

[22] A 2003 NYPIRG report found that 89 percent 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 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.

[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.

[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."

important contractual terms.[25] While concentration has increased dramatically over the past 7 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.

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.[26] 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[27], 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,"[28] 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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[25] 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.)).

[26] 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.

[27] The Credit CARD Act, H.R. 627, became Public Law 111–24.

[28] See Section 102(b) of Public 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.

Senator DURBIN. Ms. Chronister.

STATEMENT OF WENDY CHRONISTER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CHRONISTER OIL COMPANY (d/b/a/ QIK-n-EZ CONVENIENCE STORES), SPRINGFIELD, ILLINOIS

Ms. CHRONISTER. Thank you, Senator Durbin, for inviting me to speak today and share with you my views on interchange, specifically as they relate to our business and our customer.

As you already said, I am the CEO of Chronister Oil Company. It is a company founded by my father in 1967. Today we operate 11 convenience stores throughout central Illinois, Springfield and the surrounding communities, under the trade name Qik-n-EZ. We sell fast food, packaged food, beverages, other convenience store items, and we have from 4 to 13 fuel dispensers at each of our stores and sell E-85 at each of our stores.

I truly appreciate the opportunity to give this testimony and tell you the dramatic impact that interchange fees have on our business. And I will show you why Mr. Mierzwinski—pardon if I butchered your name—is correct, that this is about our customer.

We are in the business of convenience. The convenience store business is wildly competitive today. Our competitors include big boxes such as Wal-Mart or Meyer's. They include drug stores like Walgreen's and CVS. They include liquor stores, cigarette shops, grocery stores, and fast food shops like McDonald's and their 99 cent coffee. And what that means for us is that the old notion of convenience stores where you, as a consumer, would go in and be happy to pay more for the convenience or the immediate necessity of the item is not the business that we are in today.

Qik-n-EZ will survive only if we have repeat customer traffic, and the only way to have repeat customer traffic is to deliver value every day to our customers.

For the first 5 months of this year, our sales actually increased 17 percent compared to the same time last year, but do not let that fool you. That was primarily all the rise in fuel prices. Our gross profits actually declined 17 percent in the same period last year, and out of our gross profit we pay operating expenses.

So where do credit card and debit card fees fit into this scheme? They are our second largest operating expense, behind labor, in front of utilities.

I am going to take a minute to describe my stores in particular because it puts it a better perspective. Our stores average 5,000 square feet. We have at least 22 cooler doors. We have big canopies, lots of light. In other words, we have big utility bills. And we are trying to make investments to become more energy efficient. That is expensive. But our utility bills are sizeable. Our utility bills were less than 40 percent of the credit card fees we paid last year.

With respect to labor, that is our largest cost. In our industry, we are in the high end in labor. We believe people are the most important thing in our business. We pay our people well. We want it to be careers, not a job. So this is about being able to continue to do that as well. Nevertheless, our credit card fees represented anywhere from one-half to two-thirds of that cost throughout the year.

Now, everybody who is in the retail business and is still in the retail business knows that over the last couple of years, you have had to really focus on your expenses and trim costs where you could. With respect to labor, you can manage schedules and you can have predictable costs associated. With respect to utilities, you can make a decision to become more energy efficient and make the investment. With respect to other suppliers, you can go out and bid and get competitive pricing and have predictable costs. But for our second largest expense, credit card expense, we can do nothing, and in fact, we get faxed a notice of increase in price. Sometimes we get it in the mail, and we can do nothing.

So you actually stole my words, Senator Durbin, because if the Federal Government cannot negotiate against MasterCard and Visa and their member banks, how can I as the operator of 11 convenience stores in Springfield, Illinois do something about it? That is a problem and that is why I am here today.

One of the most expensive items that we sell is a full gallon of fuel. You have to understand where fuel fits into our sales to understand the whole picture as well. Fuel sales represent 63 percent of our total sales. Gas is very competitive. I said we had to deliver a value proposition every day to our customer. That means with gas the only thing I can do is sell cheaper gas. We do price surveys at every one of our stores four to five times a day and our competitors do the same on us. So, believe me, we are competitive on fuel.

Nevertheless, while the consumer thinks that as gas prices are going up on the street, maybe the retailer is making more money. In fact, when they rise rapidly, we are generally losing profit. Profit is measured in cents per gallon over the cost. It is not measured in percentages. Ironically as the price of fuel has gone up this first 5 months, our credit card fees go up while our profit goes down.

You know, I talked about the expenses and things we can manage, and it is reflected in the results. Our labor is about the same this year as it was last year overall. Our utility bills have gone up about 2 to 3 percent, and our credit card fees have increased 43 percent this year.

I have talked a lot about our business, but it is also about our customer. And you have to understand our customer today. Our customer does not impulse buy anymore. Our customer plans. They make lists. For us to be successful, they need to want to come to our store and get a good value, and we have to be able to offer it.

For our customer, debit and credit cards are a new form of currency. 70 percent of our sales were with credit cards or debit cards this year.

Now, I will say that I do not think that MasterCard and Visa and member banks should just give us credit cards or allow us to accept them for free. I just simply think that they should be subject to the same kind of competitive environment that anyone of our other suppliers is and that we are. To the extent that we can reduce any costs whatsoever, it will be felt by our customer. I agree with Mr. Mierzwinski. Our business is so competitive that that has to be the result, and frankly, I hope one of our competitors does not pass on that savings because we will get their customers.

So thank you again for inviting me to speak today. This is an issue that is extremely important to us. I thank you for and wholly support the amendment that you made to the financial reform bill that was passed by the Senate last month.

[The statement follows:]

PREPARED STATEMENT OF WENDY CHRONISTER

Chairman Durbin, Ranking Member Collins, and Members of the Subcommittee on Financial Services and General Government, thank you for inviting me to share my views on interchange fees. I am the President and CEO of Chronister Oil Company. We own and operate 11 convenience stores in Central Illinois under the trade name "Qik-n-EZ". Interchange or "swipe" fees constitute the second largest operating expense in our stores. As is the case for all of our competitors and other merchants, including the Federal government, unlike other operating expenses, we have no ability to negotiate these expenses. We operate in an extremely competitive environment. We measure our ability to make a profit by cents. Approximately 70 percent of our sales in the first 5 months of this year were credit card transactions. The interchange fees associated with accepting credit and debit cards are a significant cost of operating a convenience store. We currently cannot negotiate these costs. As a result, the real cost of the interchange fees is borne by the consumer because they inflate the prices of the products we sell. I fully support the Durbin Amendment in the financial reform bill passed by the Senate because this is legislation that truly is for the consumer and what is good for the consumer is good for retail business and ultimately for the economy.

OVERVIEW

Our company is based in Springfield, Illinois. My father founded Chronister Oil Company in 1967. Our convenience stores are located in Springfield, Illinois and surrounding towns. In addition to beverages, prepared and packaged foods and a broad range of other convenience store items, each of our locations has between 4 and 13 fuel dispensers and each location sells E-85. We purchase ethanol and store it at our bulk plant facility where we splash blend with conventional fuel before distributing to our store locations. In addition to supplying our own stores, we distribute finished product to other retail locations as well as commercial and farm distribution businesses, among others.

Today, the convenience store industry as a whole includes approximately 145,000 stores in the United States, a decline of 3–4 percent from last year. The convenience store industry 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 and one-store operators own more than 60 percent of convenience stores.

Indeed, the convenience store industry has engaged in petition efforts in convenience stores throughout the country during the past year. It is my understanding that 5.5 million consumers have signed petitions in favor of swipe fee reform, a number that exceeds the number of signatures delivered to Congress on any legislative policy proposal. The Senate paid attention to this outpouring of support when it passed Senator Durbin's Amendment to the financial reform bill with a bipartisan vote of 64–33. I am hopeful that the conference committee reconciling the House and

Senate versions of that bill will maintain Senator Durbin's language and provide some relief to my industry and our customers.

THE IMPACT OF RUNAWAY CREDIT CARD FEES ON MY CONVENIENCE STORE BUSINESS

In 2008, the total cost of credit card fees paid by our industry was reported at $8.4 billion while convenience store gross profit was reported to be $5.2 billion. Based on these statistics, credit card fees alone were responsible for the loss in the number of convenience stores across the country. However, I am here to speak to the impact which credit and debit card expense has on our business and the operations of our convenience stores. Credit and debit card fee reform is important for the consumer and therefore good for the convenience store business.

The convenience store industry is a highly competitive one. We are in the business of convenience. However, we do not compete with convenience stores alone for customers. Rather, inside our stores, we compete with big box stores such as Wal-Mart and Meijer's, quick serve restaurants including McDonald's, drug stores such as Walgreens and CVS, liquor stores and cigarette shops and other convenience store chains. Each of these retailers is competing for the same customer that we are and we overlap product offerings with each of them. Each of these retailers, like us, is in the business of convenience in one way or another. Despite the fact that we cannot obtain the same cost structure as a big box retail outlet, we have to compete with that same big box for the customer. Indeed, the notion that a consumer will accept significantly higher price point at the convenience store because it is a one-time convenience is outdated and not true. The only way we can be successful is by offering repeated value to customers who will return and will make a Qik-n-EZ store part of their destination on a routine basis. To accomplish this, we must deliver value to our customers. Providing a good experience is essential but not enough. We have to be competitive on price.

It is important to understand where credit and debit cards fit in the scheme of our store operations. For the first 5 months of this year, our total fuel sales have increased by approximately 17 percent over the first 5 months of 2009 due to the higher cost of fuel and corresponding higher prices. However, our company's overall gross profit has declined 17 percent.

Out of our gross profit we pay operating expenses—our top three expenses are labor, credit card fees and utilities, in that order. In the first 5 months of this year, our labor expense remained about the same as the same period last year, our utilities increased approximately 3 percent and our credit and debit card expense rose 43 percent.

Our only operating expense that exceeds credit card expense is the cost of labor. All but two of our stores are open 24 hours a day and, even at the slowest times, we never have fewer than two persons on duty in a store. We are proud to pay our employees well and, even at the entry level, significantly above minimum wage. We have always offered a full benefit package and 401(k) opportunities to all of our employees. Still, credit card fees are approximately two-thirds of our total store labor expense.

Our stores average 5,000 square feet and are much larger than the average size convenience store according to industry statistics. In most of our stores, we have at least 22 cooler doors per store, large canopies with many lights over our fueling stations and neon signs, we have cold winters and hot summers—in other words, we have high utility costs 24 hours a day. In fact, we are trying to make investments in our stores to make them more energy efficient—but this is an expensive proposition. Nevertheless, despite utility inefficiencies, our utility bills overall for the first 5 months of this year are less than 40 percent of our credit card expense.

During the first 5 months of this year, fuel sales accounted for approximately 63 percent of our sales. On the street, we have to be competitive. Everyone who sells fuel is measuring their gross profit by cents per gallon over cost. We check our competitor's street prices multiple times per day to ensure that we are competitive since consumers have no loyalty when it comes to purchasing fuel. Generally, during a period of rising prices, the cents per gallon profit for us is declining. Ironically, during the same time, our credit card expense per gallon is rising. On average, we estimate that we pay approximately half of our gross margin per gallon of fuel sold to credit card fees.

Consumers are using credit cards and debit cards to make purchases more and more frequently. The rising cost of fuel and the increasing number of people who use credit are the primary drivers behind this. For the first part of this year, nearly 70 percent of our sales were card purchases. Approximately one-quarter of our card use was debit cards, the remainder being credit cards. And, over the last few years alone, interchange fees have grown more rapidly and significantly than all of our other expenses. In contrast to other expenses, we have absolutely no control over interchange fees. For example, we could change employee schedules if we needed to reduce labor cost; invest in new technology to reduce utility expenses; and we put our business and health insurance needs out for competitive bid yearly to help keep those expenses at a manageable (or at least predictable) level. With respect to credit and debit card expense, we are faxed a notice of an increase in fees and it is what it is. If we didn't take credit cards, we could not compete and would certainly go out of business. We have no ability to negotiate fees and we are powerless to deal with these cost increases. Yet, given the competitive landscape we are in, we have an increasingly smaller pot out of which to pay them. Costs that cannot be controlled have a far broader, negative impact on the business than do other costs.

This rise in credit card charges does not take into account the fee increases that Visa announced effective in July. I do not know the full impact of this yet; however, one company in our association estimates that these hikes will result in a 5.9 percent increase in card fees convenience stores will pay on fuel sales alone. And these increases are not for interchange—they relate to the myriad of other fees the card companies charge merchants, such as the Assessment Transaction Fee, Partial Authorization Fee, Zero Floor Limit Fee, and various debit card fees. Depending on the market dynamics, this could wipe out the entire cents per gallon gross profit at any given time.

BACKGROUND ON THE DURBIN AMENDMENT

I understand that the Durbin Amendment will accomplish the following, each of which will benefit the consumer:

First, the Durbin Amendment will give the Federal Reserve the power to write rules ensuring that swipe fees on debit cards are "reasonable and proportional" to the cost of processing. This is, in fact, an overly generous standard for the card industry. Check transactions, for example, cost banks more to process than debit transactions but interchange fees have been completely prohibited on check transactions since the early part of the last century. The check system has been an efficient means of conducting commerce in the United States during all of that time and it is long overdue for debit transactions—which are simply electronic check transactions—to be treated in a similar way.

Second, the Durbin Amendment will allow merchants to give their customers discounts when they use cards from a network with lower fees or use forms of payment that are cheaper for the merchant. That means that I could give my customers a discount if they use a Discover Card (or Visa, MasterCard or American Express) if that card network is cheaper. Alternatively, our stores could offer customers a discount for paying by a debit card or cash, check or other means may be less expensive for our company to accept. This simply means that credit card networks will compete with one another, just like we have to compete with other retailers selling the same products that we sell.

Smaller banks have raised the concern that the cards which they issue will be treated differently than cards issued by significantly larger banks. However, it is my understanding that the Durbin Amendment will not allow a merchant to differentiate prices to the consumer based on the card-issuing bank. Therefore, the concerns raised by smaller banks are not well founded.

Third, the Durbin Amendment will allow merchants to set a minimum or maximum amount for a transaction using a credit card. This is necessary because each card transaction has a fixed fee portion in addition to a percentage fee. For many small dollar transactions, that fixed fee part of the transaction (which can be 10 to 25 cents) may be more than the profit margin I would have earned on the sale. For some products, in fact, such as newspapers, the fixed fee on the card can sometimes exceed my cost of purchasing the product (such as on papers I sell for 25 or 50 cents). While the Durbin Amendment does not prevent our company from experiencing operating losses, the amendment would allow us the basic ability to protect my business from a guaranteed loss.

As a retail marketer and operator of convenience stores, I am in favor of the Durbin Amendment and its focus on reforming credit and debit card fees so that credit card companies and their member banks are required to compete in the same way that any other supplier of services is required to compete. This is good for consumer and will ultimately benefit the economy.

CONSUMERS WILL BENEFIT FROM REFORM

Economics shows that in a functioning market, lower business costs will mean lower prices and higher costs will mean higher prices. I understand that those opposed to credit card fee reform complain that the Durbin Amendment does not include a stipulation the retailers will pass on cost savings to consumers. I can only speak to the convenience store business. I cannot imagine that the consumer would not benefit. As I previously described, our business is highly competitive and consumer habits have changed. Peoples' preconceptions about convenience stores as an expensive place to purchase products out of convenience or necessity are generally of a business model that existed long ago. Today, we are competing for the same customer that many other types of retail are seeking. This customer is no longer an impulse buyer but rather plans ahead and makes lists and doesn't spend the extra dollar if it is not necessary or the product can be purchased elsewhere at a lower cost. Already, we frequently lose money on products such as a gallon of milk, a cup of coffee, a hot dog or a case of popular beer because we have to price these products competitively in order to maintain a consistent customer count in the store. If we cannot maintain the customer traffic we cannot stay in business.

When it comes to selling fuel, we would always like to be the lowest price on the street if we can maintain a sufficient profit margin and we are always trying to be. No one wants to purchase fuel, it is a necessity and the consumer looks for a consistently low price. It is not surprising that the Department of Energy, for example, conducted a study of retail gasoline pricing and found that 100 percent of cost increases and 100 percent of cost reductions were passed through to consumers in gas prices.

The current interchange fee system in the United States fools consumers by hiding the large interchange fees that are built into their purchases. One of the other witnesses here today, Ed Mierzwinski, of U.S. PIRG, has stated: "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 interchange fees." In addition, 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 and Americans for Financial Reform, which counts these and many more consumer groups as its members, has endorsed the Durbin Amendment.

The Hispanic Institute published an economic report on interchange fees and wrote in a letter to Senators endorsing the Durbin Amendment: "[W]e found definitively through economic analysis of transaction and pricing data that consumers do currently pay interchange fees in the prices of the things they buy and when those fees are lower merchants' prices are correspondingly lower as well. This is proof, backed by economic data, that those who argue against reform by saying consumers will not benefit are wrong. Consumers will unequivocally benefit from reform."

Experience around the world demonstrates that consumer card reform ultimately results in a benefit to consumers. It is my understanding that every country in the world that has begun and completed a full review of credit and debit fees has enacted reforms designed to further regulate the card system. More than 20 countries, including, among others, Great Britain, Australia and the European Union have taken action that has benefited their consumers.

The Reserve Bank of Australia issued the following statement based on its finding that savings from card fees reform were in fact passed on to consumers:

> "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 otherwise have 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 . . . . This judgment is consistent with standard economic analysis which suggests that, ultimately, changes in business costs are reflected in the prices that businesses charge." [1]

The European Commission also found that interchange fees harm consumers. In December 2007, the Commission held 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 to 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

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

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.”

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 might work as tools that distribute income from low-income earners to high-income earners.

The Durbin Amendment allows merchants such as our company to give their customers discounts (either for using a cheaper card network or a cheaper form of payment like checks or cash). Currently our contracts with Visa and MasterCard prohibit us from giving these types of discounts to our customer. It also means that they can agree on the rules and impose them on us and prohibit us from offering discounts to our customers. As consumers have picked up the use of debit cards, Visa and MasterCard have joined together again to impose significant fees on their use, out of proportion to the costs of providing a debit card. Once again, we have no power to negotiate, as we have to accept these credit and debit cards to stay in business.

It is slightly hypocritical for these credit card companies to argue that we would not pass on a discount opportunity to our customer and it also reflects a lack of understanding of the convenience store business. As a marketer of convenience store items and fuel, we are constantly looking for opportunities to deliver value to our customers. In fact, our entire marketing plan is based on how to deliver value to the consumer, especially in this economy. We welcome the opportunity despite the complexity it brings to our marketing programs. To the extent that interchange fees are reduced as a result of competition among the credit card companies and/or the requirement of reasonableness and to the extent we can offer discount pricing to reflect those reduced fees, our customers will have increased spending capacity.

It is equally hypocritical for the card industry to suggest that the reduction in credit and debit fees due to competition or the requirement that they be reasonable must mean higher credit card fees. Credit card fees in their entirety are not a zero sum game in which the card industry has the legal or constitutional right to earn a certain total amount of revenue. The point is absurd when one considers that interchange fees in the United States have tripled since 2001. Credit card fees on cardholders were not cut by a third during that time; in fact, consumer card fees have continued to rise hand in hand with the increasing cost of interchange fees. This argument is simply a reflection of the consumer card industry’s insatiable hunger for fees aided by their unfair and deceptive practices in charging them.

Indeed, the European Commission’s Directorate of Competition reviewed this claim and found, “There is no economic evidence for such a claim. First, 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. Second, the international card networks have failed to substantiate the argument that lower interchange fees would have to be compensated with higher cardholder fees.”

THE DURBIN AMENDMENT WOULD BRING REASONABLE REFORM

As I understand it, the Durbin Amendment is not about driving credit card companies out of business. It is not about requiring credit card companies and banks to provide a service at no cost to the user of that service. I recognize the valuable service debit and credit cards provide for merchants and consumers and know that our company will continue to pay for the ability to accept credit and debit cards.

The Durbin Amendment means that the credit card companies will be subject to a little of the same competition that we are subject to. If one of them is willing to provide a more attractive rate, we can promote it. If a consumer wants to pay cash or use a debit card, we can offer that consumer a more attractive price because the costs associated with these types of payments should be less. In effect this allows the consumer to decide how to spending his or her money and know something about the cost impact of that decision. If one beer company were to offers a more competitive pricing strategy on its products than another beer company, we could pass this savings on to our consumer through a promotion and we do.

In addition to credit cards, debit cards have become the currency of our customers. The Durbin Amendment provides for Federal Reserve regulation of debit card interchange fees. Debit cards mean that a customer is spending money that he or she has in their checking account. Their use seems to have increased in popularity as people have reined in reckless credit card spending. In addition, the costs associated with processing debit cards are less than that of processing a check and must be less than a credit card since there are no credit losses associated with a debit card. While a debit card is less costly for all constituencies and encourages greater fiscal responsibility by users, the card companies and member banks have the ability and have agreed to impose significant fees on the retailer or other merchant—just because they can. A retailer can approach multiple vendors and negotiate costs when acquiring goods to offer for sale to its customers. In contrast, a convenience store operator has no choice but to accept the fees imposed by the consumer card companies and accept debit cards.

In addition to interchange fees, we pay processing fees and fees associated with maintaining accounts at local banks. And, of course, credit card companies will still charge consumers an array of interest charges and fees. While credit card companies will not like reform, they will continue to have many avenues to recover costs, compete, and make profits.

Bank and credit card companies have suggested that the Durbin Amendment will push the risk of fraud onto financial institutions. This is the first time that I have heard financial institutions admit that they don't cover the risk of fraud today. While they often talk about their "payment guarantee," the ugly truth is that financial institutions push most of the risk of fraud onto merchants—while simultaneously charging a company such as ours a huge fee. The Durbin Amendment does not change the credit card companies' rules that allow them to push most of the fraud risk onto merchants. All it does is make sure the banks cannot take the same fraud costs out of merchants twice—once through charge backs and once through interchange fees. Again, the Amendment ensures that fees on big bank debit cards will be reasonable and allows consumers to get discounts and doesn't change the treatment of fraud one way or another.

Bank and credit card companies also argue that the Durbin Amendment will shift costs from big box stores to consumers. We don't operate a big box store. I was particularly concerned when research by the GAO found that large businesses against which we now compete have an advantage over small retailers like our company in the current system. Our company pays a higher interchange fee rate now than do our big box competitors. Small business needs this reform to survive and have the same advantage and opportunity to offer value to customers as their competing big business. Reform will actually help small businesses more than large businesses because debit rates will have to be related to the banks' actual cost of issuing them—not to the size of the market.

What small business retailers are fighting for is simply to have reasonable fees and the right to give their customers a discount. The fact that credit card giants prohibit merchants from giving consumers a discount for using a cheaper card brand (such as a Discover Card rather than a Visa) and prohibit merchants from giving discounts if they use a cheaper type of payment (like checks rather than credit) cannot be defended. Discounts for consumers are good things and the card giants want to prohibit them in order to hide their fees so they can keep raising them without anyone noticing. This doesn't protect consumers at all. I am proud and appreciative to know that Senator Durbin, representing my state, has taken the lead in exposing the credit card companies unfair system and trying to change it. Reform will give real help to Main Street businesses like mine and give a boost to our economy that will help everyone.

CONCLUSION

I am speaking in support of the Durbin Amendment because it is the right answer for the consumer and the survival of retail business. I am privileged to operate a business and to serve my community in central Illinois as a retailer. We employ approximately 150 people and therefore are responsible for 2–4 times that number. I have a responsibility to our employees to stay in business and to our customers to provide exceptional value and service.

Our business is highly competitive. We focus our efforts on delivering value to a customer that will result in customer loyalty. We look at our margins in terms of penny profits, out of which we have to cover and manage operating expenses. We have no ability to negotiate credit and debit card fees that account for the second largest operating expense and far exceed every expense other than the cost of labor. Yet we are in the business of convenience and cannot stay in business unless we offer our customers the ability to use credit and debit cards—today, debit and credit cards are a form of currency with our customer. The Durbin Amendment requires the credit card companies to be competitive and allows us to deliver an option to our customers. The amendment requires interchange fees be related to the actual cost of providing them and that they are reasonable. There is no question that the consumer will benefit from this as we are in the business of providing the best value to our customers. There is no question that competition will rein in the unrestrained increases in interchange fees. There is no question that this alone will help retailers in the convenience store industry to survive because it will lower the cost for which they can deliver retail to the consumer. Accordingly, for all of the reasons set forth above, I strongly support the Durbin Amendment.

Senator DURBIN. Thank you, Ms. Chronister. Your story really tells the human side of this for us all in terms of a small business in a competitive environment and the problems faced because of these charges on credit cards.

Mr. Sullivan, if I went into McDonald's and ordered a Pepsi, I am sure the clerk has been instructed, because I have heard it over and over again, to remind me that they just sell Coca Cola. They do not sell Pepsi. And they do that, of course, to protect their own franchise and their arrangement with Coca Cola.

So under current law, could I have a business that just takes Visa cards and not MasterCards?

Mr. SULLIVAN. I am not aware of laws, sir, that would bar the issuance or acceptance of one card versus another.

Senator DURBIN. Not laws, but rules of your company.

Mr. SULLIVAN. Visa, as far as selections of lower cost card types—first of all, merchants can and do negotiate total acceptance costs——

Senator DURBIN. Good. Hold on because, Ms. Chronister, tell me about your negotiation with Visa at Qik-n-EZ. How did you negotiate your interchange fees? Did you use your lawyers, or did you do that personally?

Ms. CHRONISTER. I am not sure how I would negotiate with this.

Senator DURBIN. You have not negotiated with them?

Ms. CHRONISTER. No. I am not sure how we would do it. I do not mean to be sarcastic, but I am sure I could find an 800 number. I am not sure who I would talk to.

Senator DURBIN. So the 43 percent increase in your interchange fees this year were not negotiated increases.

Ms. CHRONISTER. No. We do not have any control over these expenses. I asked my controller to give me some background on the raises that we have incurred. I can look at some data. And her response—I am not sure I liked it, but—was I do not really keep track of this because we cannot do anything about it.

Senator DURBIN. So, Mr. Sullivan, you heard the testimony from the Department of the Treasury and now from Ms. Chronister. There is no negotiation going on.

Mr. SULLIVAN. Mr. Grippo did testify that he did negotiate total acceptance costs with the acquiring banks, and merchants can do that.

And there has been negotiations. We talked about the Defense Commissary Agency. They do, in fact, get—it is a Government agency—the grocery rate. The U.S. Postal Service does have negotiated rates with the Government as do a few other Federal agencies.

Senator DURBIN. So would you give me an idea of the volume of credit card transactions—I am talking credit and debit—through Visa with the Federal Government that you think have been subject to negotiated interchange fees?

Mr. SULLIVAN. I do not have those numbers with me, but I would be happy to submit them to you, sir.

Senator DURBIN. I wish you would.

[The information follows:]

When including all Federal Government merchant payment volume, 66 percent of payment volume and 73 percent of transactions receive a preferential Visa interchange rate. This covers all payment volume processed through Treasury's Financial Management Services (FMS) as well as other Government agency payment volume processed through non-FMS acquiring relationships. These payment volumes include the payment volumes covered under the negotiated rates listed below as well as the preferential interchange rates made available to Government merchants, i.e., Visa Government-to-Government interchange rate, Visa Emerging Segments rates for Government transactions, and other GSA-specific interchange rates applied to payment volume from Federal Government merchants.

Senator DURBIN. And I hope you will take a look at Mr. Grippo's testimony because he said—and I refer you to pages 3 and 4—"And although the Treasury has held direct and indirect discussions with the card networks over the years in attempts to reduce the Federal Government's card acquiring costs, rates have never been open to negotiation."

Mr. SULLIVAN. I will comment I have been at Visa 7 years, and when Mr. Grippo was at FMS, I do not recall him ever asking Visa to negotiate rates. Now, not to say he had not talked to other people, but the Government has negotiated rates and for the benefit of the Government.

In addition, we talked about—you talked about the SmartPay program, sir. When a bank competes for that contract with the General Services Administration, there are two important evaluation criteria which determine who wins that contract. The first one is price. By law, rightfully so, Government agencies have to consider price in award of contracts. The second critical component was card acceptance.

Senator DURBIN. Mr. Sullivan, I am going to draw a distinction here which I think you will accept. We were talking about those who use credit cards to pay Government expenses as opposed to those cards issued by Government agencies. It is clear that the cards issued by Government agencies like the one I showed earlier was a subject of competition, and as a result, there are rebates being paid and there are some benefits coming back to the Federal Government. But when it comes to the acceptance of cards to pay for everything from the Veterans Administration to Amtrak, I think Mr. Grippo is correct, and I am going to give you a chance, if you will, please, to provide us with information related to negotiations by your company with Federal agencies to establish interchange fees.

[The information follows:]

I can confirm that the following Government agencies receive a beneficial interchange rate on Government transactions, two of which are negotiated rates: United States Postal Service (USPS); Sallie Mae; and Defense Commissary Agency (DeCA).

Senator DURBIN. I would like to ask you this question too. Is Joseph Saunders still the CEO of Visa?

Mr. SULLIVAN. Yes, sir, he is.

Senator DURBIN. I wrote to Mr. Saunders last December and I asked him whether Visa would commit to working with U.S. regulators on ways to reduce interchange rates on transactions across the country. Mr. Saunders replied on Visa's behalf and said "We do not believe regulation is appropriate or necessary." That was his letter to me.

So, Mr. Sullivan, in November 2009, the Government Accountability Office found that "regulators in other countries have worked with Visa and MasterCard to voluntarily reduce their interchange rates. For example, on April 27, the Wall Street Journal reported that Visa Europe agreed to cut by 60 percent the debit interchange rates it charges in nine European countries and for cross-border EU transactions. The highest debit rate in those countries is now 0.2 percent. However, in April, at the same time Visa was reducing debit interchange rates in Europe, Visa raised many of the interchange rates that it charges for U.S. PIN debit transactions by approximately 30 percent. Most of these U.S. debit fee rates are significantly higher than the 0.2 percent charged in Europe."

So my question to you, why is Visa voluntarily reducing interchange rates in Europe and other countries while raising them in the United States?

Mr. SULLIVAN. Senator, those decisions are outside of my expertise. I could not comment. I do not know the decisions or the circumstances that surround that.

Senator DURBIN. I will tell you there is one circumstance that does surround it. In the European situation, there is a government regulation that brings Visa and MasterCard to the table. And as Mr. Saunders said, he does not believe that government regulation is appropriate or necessary. I would say to him it works pretty well in Europe and it is not working very well here for our businesses and for our Federal Government.

Ms. Chronister, do you think it is fair that Visa is raising the interchange rates they charge in America while voluntarily lowering the fees in Europe?

Ms. CHRONISTER. No, certainly not. I guess I am glad you asked me the question. I do not think there should be interchange fees on debit, period, for that matter. I think of debit as an electronic check, and the Federal Reserve for 80 years has said you cannot have interchange fees on checks. I certainly suspect—but I do not know for certain—that a debit card costs less to process than a check.

Now, with respect to Europe, the way I understand it, the merchants go together and they went and they talked about it, and they did not have a hard time getting them to drop it to 0.02 percent. And that is why we are here today. Right?

Senator DURBIN. That is what this Government is supposed to be about.

Mr. Mierzwinski, when you try to draw comparisons between the cost of processing of a credit card transaction and a debit card transaction, is there not an inherent difference?

Mr. MIERZWINSKI. I think you are exactly right, and that is why I think your amendment goes after the important problem that debit cards are being treated as if they are credit cards when really they are a substitute for checks, not a substitute for credit.

The banks first tried to take—and were pretty successful at taking debit and moving it from the lower-cost PIN platform owned by local banks to the higher-profit, higher-cost national Visa and MasterCard credit card networks. This is the difference between

PIN or signature, or they say credit or debit. At the register, what they mean, debit means PIN and credit means signature. They were first successful at moving debit to a higher-cost platform. Now they are moving cash to debit, and it is clearly a substitute for checks. And I agree with the merchants that it is much more like a check.

Senator DURBIN. So, Mr. Sullivan, do you disagree? Do you think that credit and debit interchange rates should be the same, or is there less of a risk to Visa from a debit card than a credit card?

Mr. SULLIVAN. Sir, I came here prepared to talk about Government acceptance and use of cards in the Government. I am unknowledgeable to answer that.

Senator DURBIN. Well, then I am going to ask you another question which probably will elicit the same answer. If Ms. Chronister wanted to put in her convenience stores that she would prefer cash transactions and would give a 2 percent discount for cash or would say no credit cards for amounts under $2—let us say that—is that prohibited by the rules of Visa today for her to do that?

Mr. SULLIVAN. She could offer a cash discount, I mean, a discount for people who want to pay with cash. She can use a terminal that steers individuals to lower-cost cards as well such as PIN. So merchants can do those. That is not against Visa operating regulations.

Senator DURBIN. Did you know that, Ms. Chronister?

Ms. CHRONISTER. No. I do not know if we have a different agreement, but I am not sure that that is actually true for us.

Also, I just want to say again that when we're talking about these debit cards and these fees, at the end of the day, these will get back—these do go back to the customer. Maybe it is just my perspective as the operator of 11 convenience stores and recognizing the competition and the competitive environment we are in, but it will go back to our customer. And the reason why that is good for me is because when our customer has more dollars to spend, that is good for our business and it enables us to survive.

Senator DURBIN. Thank you.

Mr. Sullivan, you heard the earlier question I asked of Ms. Cackley from GAO about the interchange fees charged to the Government which I believe I can find here, but I think it was $1.55. This was the MasterCard situation. So it may not be your situation.

But can you tell me if there is a difference in the charge on interchange fees by Visa to the Federal Government as opposed to the fees that are charged to supermarkets? I used the illustration of MasterCard where it is $1.55 and 10 cents for the Government, and yet supermarkets are $1.27. Do you know if the Federal Government is paying a higher interchange fee to Visa than other commercial customers?

Mr. SULLIVAN. I can tell you because I know Defense Commissary does pay the grocery rate. So they are paying the same as grocery stores. I do not know, and I believe the postal interchange rates are confidential. If I did know, I could not tell you. But I do not know really what they are.

Senator DURBIN. Are the commissary rates negotiated?

Mr. SULLIVAN. We negotiated with Defense Commissary, yes, for those rates.

Senator DURBIN. The interchange fee is negotiated with——

Mr. SULLIVAN. Yes. Yes, sir.

Senator DURBIN [continuing]. Your company. All right.

And can you tell me what that is? Do you know what the charge is, the interchange fee, for the commissaries?

Mr. SULLIVAN. What I understand is it is the grocery rate which is the commercial rate.

Senator DURBIN. And what about Amtrak? Do they negotiate their interchange fee with your company?

Mr. SULLIVAN. To my knowledge, if I do not know if they have negotiated or attempted to negotiate, sir.

Senator DURBIN. I am not sure if they have or not, but I do not think they have.

But anyway, you are going to provide me with information about the actual negotiations that are taking place——

Mr. SULLIVAN. Yes, I will.

Senator DURBIN [continuing]. In terms of these fees. All right.

[The information follows:]

I can confirm that the following Government agencies receive a beneficial interchange rate on Government transactions, two of which are negotiated rates: United States Postal Service (USPS); Sallie Mae; and Defense Commissary Agency (DeCA).

Ms. CHRONISTER. Senator Durbin.

Senator DURBIN. Yes?

Ms. CHRONISTER. There might be some confusion. You know, there are so many different fees and costs surrounded by the credit cards and debit cards that we pay. We are able to negotiate with our processor, and maybe that is some of the negotiation you are talking about. But interchange fees represent 80 to 90 percent of the total credit card and that is what we are concerned about today, not these processing fees. So just in case we were——

Senator DURBIN. That is a good point. Can we distinguish that point, Mr. Sullivan? Are you saying—I know there is a processing fee and an interchange fee. Are you saying that interchange fees are being negotiated here with the Federal Government?

Mr. SULLIVAN. Within the Government? Yes, sir.

Senator DURBIN. I see.

Mr. SULLIVAN. You know, Mr. Grippo did say he did have negotiations, in fact, very strict negotiations for his acquiring services contract, but in addition to Treasury negotiating total costs, several Federal agencies have successfully negotiated a reduction in cost of interchange with Visa.

Senator DURBIN. And you are going to provide us with some examples of that, some evidence of that, please?

Mr. SULLIVAN. Yes, sir.

Senator DURBIN. Thank you.

Mr. Mierzwinski, before I ask Ms. Chronister, I am going to ask you to kind of make a general statement looking at this from the consumers' viewpoint which your organization focuses on here. As we take a look at these increases in the charges associated with credit and debit cards and the increased incidence of the use of these cards, can you tell me what you think the impact will be if this continues unabated on consumer cost and costs of living?

Mr. MIERZWINSKI. Well, I think it is a broken market, and that is clearly the problem here. These prices are going up even though technology improvements suggest that the prices should be going down, even though there are two other competing networks that really cannot compete because these two biggest networks have so much market power they are dictating the terms of trade. So I think ultimately it is going to be bad for consumers. Prices should not go up in a competitive marketplace. They should decline. Consumers should have choices and consumers should have information.

Yet, the operating rules, as I understand them from being told by many merchants I have spoken with, when they do, in fact, try to offer legal cash discounts—under the Truth in Lending Act, cash discounts have been legal for years and years—the operating rules—they come in with a hammer and they say, oh, you are offering a discounted surcharge. We are going to charge you thousands of dollars a day.

So merchants and consumers and the Government will all benefit if we can impose some competition in this marketplace, some transparency, some information, some choice. I think that all of us will benefit with lower prices and more choices.

Senator DURBIN. Ms. Chronister, let me ask you to close on that note because I would guess, having been to your convenience stores and looked at all the different products that you offer, that there was competition for those who wanted shelf space, wanted to sell their soda pop or whatever it happened to be, and that you as a retailer picked the best value you thought for your customers and tried to get your suppliers to keep their prices as competitive as possible. So is there any other part of your store, other than this dealing with the credit cards, where you face this dearth of competition?

Ms. CHRONISTER. No. Certainly you are correct. If a beer company suggests that they have a good cost for us on something, we will put that out in front on sale and pass that directly on to the consumer because that is our value proposition to the consumer. Even if their competing brand does not offer it, we are not going to drop their price.

We are asking to do the same thing, and your amendment would allow us to do the same thing with MasterCard and Visa. We could say, if we were able to negotiate better costs with MasterCard, your price is more attractive if you use your MasterCard versus Visa, the same with cash versus credit or debit versus credit. To me, they are another supplier, and as I said, we need to pay them but they need to be held in a competitive environment.

Senator DURBIN. Well, we all are very proud of our free market economy, but at the heart of it, there is competition, and I think that is what this hearing has been about.

Mr. Sullivan, you are a brave man to come and appear before a Durbin subcommittee, and I appreciate your being here. I really do. Thank you very much for being here. I am looking forward to the follow-up information that you promised.

Mr. Mierzwinski, thank you, and to my neighbor, Wendy Chronister, thank you. Glad you are here.

Ms. CHRONISTER. Thank you, Senator.

ADDITIONAL COMMITTEE QUESTIONS

Senator DURBIN. If there are any questions that are going to be sent to the witnesses, I hope they will respond in a timely fashion.

[The following questions were not asked at the hearing, but were submitted to the witnesses for response subsequent to the hearing:]

QUESTIONS SUBMITTED TO GARY GRIPPO

QUESTIONS SUBMITTED BY SENATOR JON TESTER

Question. In Ms. Puente Cackley's testimony, she describes the substantial rebates that Federal Agencies received in return for making purchases using credit cards, totaling $255 million in fiscal year 2009. What are the rebates that Federal Agencies receive used for? Are there any regulations with respect to how these funds may be used? Is there any reason why they are not returned to the Treasury to offset the cost of interchange fees? What would the impact of higher interchange rates be on the rebates that Federal Agencies currently receive?

Answer. The GSA SmartPay program, which is not administered by the Treasury, provides charge cards to Federal agencies to purchase general supplies and services. The Treasury manages a wholly separate program that allows Federal agencies to accept cards from the public as payment for fees, fines, sales, donations, and other revenue transactions. Under the GSA contracts with GSA SmartPay card issuers, Federal agencies receive refunds based on their net charge volume, and the refunds are returned to the appropriation funds that earned them. From these appropriation funds, Federal agencies may use the refunds for activities consistent with their statutory missions, such as purchasing additional supplies or funding upgrades of administrative systems. The refunds are governed by a number of laws and regulations, including Office of Management and Budget Circular A–123, Appendix B, Chapter 7, entitled "Refund Management," and Treasury Financial Manual, Volume 1, Part 4, Section 4530, entitled "Refund of Contractual Costs," in addition to Federal appropriations law. These refunds are not unique in that Federal agencies may receive or qualify for refunds and rebates under many other types of Federal contracts.

Because the Federal card payment contract and the Federal card collection program are managed by different agencies, using different authorities, with services from different banks, and because Federal agency purchase card activity is generally legally and programmatically separate from the revenue collection programs, the Federal agency refunds generated by card payments are not transferred to the Treasury to defray the cost of card collections. Moreover, the Federal agencies that earn the majority of refunds are likely different from the agencies that incur the most interchange fees. Applying refunds earned by one agency to offset the interchange cost of another agency could reduce the use of purchase cards and therefore raise the administrative costs of the Federal procurement process.

Changes in interchange rates would not have a direct impact on the refunds that Federal agencies currently receive under the terms of existing GSA SmartPay contracts. However, lower interchange rates could result in a request from GSA SmartPay banks to renegotiate the contracts to reduce refunds paid to Federal agencies. In addition refund rates could change when the GSA SmartPay contracts are re-competed, but this is not likely to occur in the short term because the current contracts have a potential performance period of 8 years remaining.

Question. In your testimony and in Treasury's Report to the Subcommittee you discuss the importance of negotiating: "terms that are straightforward for issuers, acquirers and card networks to implement, and that do not make Federal government transactions an exception process for the global industry." Can you explain what you mean when you say "an exception" to the industry? Are you concerned about Federal government transactions being treated differently and if so, why?

Answer. In this context, "exceptions" refers to technical requirements that may necessitate systems or software changes solely to process transactions with the Federal Government. Such exceptions could not only cause operating problems for the industry, since many systems are shared by thousands of participants to process transactions in a common manner, but also could make it more difficult and more costly for the Treasury to engage a collection bank, which would not be inclined to significantly change its systems for one customer. Legislation designed to reduce the Federal Government's interchange rates should not require the card industry to make significant technology changes to process Federal Government transactions differently from other commercial transactions.

Question. In your testimony, you discuss the utility of streamlining the many different interchange rates that Federal entities pay. How would streamlining rates impact the cost of processing these transactions? What would be the impact on Federal entities of a two tiered system of interchange rates like the one included in Senator Durbin's interchange amendment where different interchange rates would apply to transactions based on the size of the issuer?

Answer. We believe that reducing the number interchange categories would serve to lower the Federal Government's costs for several reasons. Most important among these reasons is that the complexity of categories, and the multiple fee levels within those categories, frequently serves to "downgrade" transactions into higher rates based on how a transaction is identified or reported. To give a simple example, the manner in which the tax status of a transaction is identified could result in the application of a higher interchange rate, even though tax status should not be relevant to a Federal agency transaction. The multiplicity of categories also makes it more difficult to negotiate genuine rate reductions because, regardless of the best rate that may be negotiated for a transaction type, any number of variables would allow a card network to shift a specific transaction into a higher rate category.

A system of two-tiered rates, such as the one embodied in Senator Durbin's interchange amendment, should not affect the Federal Government as an acceptor of cards, since it would not change a Federal agency's internal systems or processes. Under the current model, the Federal Government already is charged different rates based on interchange categories and levels within those categories; adding tiers would be no different. The operational effect of a two-tiered model, if any, would occur in the central routing and processing systems of the card networks and the card issuers.

Question. Mr. Grippo, in your testimony, you state that "having the ability to opt out of certain transactions based on cost . . . would allow the Treasury to negotiate pricing terms on behalf of the taxpayer from a more equitable position." Under a two-tiered system of interchanges rates, would Federal entities be inclined to opt out of higher cost transaction if they could?

Answer. In deciding whether to opt out of transactions, Federal agencies would assess the overall interchange costs associated with a given program, activity, or operating location and determine whether cards were a cost effective method of collection. That is, an agency would not review its costs on a transaction-by-transaction basis and opt out of individual transactions based on the tier or rate associated with the card issuer; rather, the agency would opt out by establishing a policy not to accept cards, regardless of the card issuer, for groups or types of transactions based on the overall costs to a program, activity, or operating location. Under a two-tiered system of interchange rates, Federal agencies might be less inclined to opt out of transactions than under the existing system, because the overall interchange costs of a two-tiered model likely would be lower than the current single-tier system.

Questions Submitted to Alicia Puente Cackley

Question Submitted by Senator Ben Nelson

Question. How do you foresee the regulation of debit card interchange fees impacting prepaid debit card programs used by States to disburse government benefits and assistance?

Answer. Although various States are using prepaid Visa or MasterCard debit cards for unemployment or other State cash benefits, very few are using them for food and nutrition assistance payments because of program funding and cost considerations. The food and nutrition programs generally are excluded from the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 provisions governing Federal Reserve regulation of interchange fees for debit transactions. In addition, the Food and Nutrition Act of 2008 provides that no interchange fees shall apply to electronic benefit transfer transactions for Supplemental Nutrition Assistance Program payments. (Public Law 110–246, title IV, § 4115(a)(9) (codified at 7 U.S.C. 2016(h))). Retailers are also eligible to obtain free processing equipment and accept these payments at no cost to them.

Similarly, a provision in the Dodd-Frank Act exempts debit cards and prepaid cards[1] provided for use only in a Federal, State or local government-administered payment program from the cards that will be subject to any rules regarding the rea-

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[1] This exemption applies unless the card is a general use prepaid card for which the following fees may be charged (1) an overdraft fee, and (2) a fee for the first withdrawal of the month from an automated teller machine.

sonableness of fees that the Federal Reserve is tasked with creating under that law, which should preclude the impact of any lower interchange fees resulting from that act from affecting issuers' willingness to participate in such programs with States. However, States' use of Visa or MasterCard debit cards for these programs does not eliminate the costs associated with administering a benefits program, but instead shifts who bears some of these costs from the State to the merchants that accept the cards and pay the associated interchange fees.

QUESTIONS SUBMITTED BY SENATOR JON TESTER

Question. In your testimony, you describe the substantial rebates that Federal Agencies received in return for making purchases using credit cards, totaling $255 million in fiscal year 2009. What are the rebates that Federal Agencies receive used for? Are there any regulations with respect to how these funds may be used? Is there any reason why they are not returned to the Treasury to offset the cost of interchange fees? What would the impact of higher interchange rates be on the rebates that Federal Agencies currently receive?

Answer. According to information we collected for our 2008 report, Federal entities differ in how they use their rebates. Two of the Federal entities we spoke with return the rebates directly to the location that originated the relevant transaction, one adds the rebates into general income for the entity, and the other allocated rebates to a working capital fund for use in various initiatives.

The Office of Management and Budget and the Treasury Department issue guidance for covered agencies' use of rebates.[2] According to the manager of the General Services Administration, entities comply with the guidance by, among other things, returning their card rebates to the appropriation or account from which they were expended, and using rebates for any legitimate purchase by the appropriation or account to which they were returned. The manager of the General Services Administration stated that if Federal entities were required to remit these rebates to Treasury they might have less incentive to use purchase cards.

If interchange rates were changed, the amount of rebates that government agencies receive could also be affected. The manager of the General Services Administration purchase card program told us that banks facing reduced interchange fee revenue might reduce the amount of rebates Federal entities receive for using purchase cards. However, government agencies have identified other benefits to using cards, including estimated savings from avoiding manual and paper-based acquisition processes that exceed the total rebate amounts. As a result, potentially lower rebate amounts may not reduce the willingness of government agencies to continue to use purchase cards.

Question. In your testimony, you discuss the utility of streamlining the many different interchange rates that Federal entities pay. How would streamlining rates impact the cost of processing these transactions? What would be the impact on Federal entities of a two tiered system of interchange rates like the one included in Senator Durbin's interchange amendment where different interchange rates would apply to transactions based on the size of the issuer?

Answer. Our testimony noted that both Visa and MasterCard have a designated merchant category for Federal entities that provides for interchange rates that are lower than those for many other merchant categories. However, like other merchants that accept cards, the actual interchange rate paid can vary across this category depending on the type of card accepted or how it is processed. Our November 2009 report noted that one way to mitigate the impact of interchange fee reductions on smaller issuers was to exclude them from reductions or reduce rates on only selected types of cards that smaller issuers may not issue as frequently.[3] If the level of interchange rates were to vary by size of issuer—with cards issued by larger issuers carrying lower rates and those from smaller issuers carrying higher rates, then the costs of card acceptance by Federal entities would likely change based on the extent to which Federal entities accept cards issued by larger issuers versus smaller ones. Given that most cards are issued by larger issuers, this likely means that Federal entities would experience reductions in their card acceptance costs.

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[2] OMB Circular 123–A, Appendix B, Ch. 7, and Treasury Financial Management Manual Sec. 4530.

[3] GAO, *Credit Cards: Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges* GAO–10–45 (Washington, D.C.; Nov. 19, 2009).

QUESTION SUBMITTED TO JANET LANGENDERFER

QUESTION SUBMITTED BY SENATOR JON TESTER

Question. In your testimony, you discuss the utility of streamlining the many different interchange rates that Federal entities pay. How would streamlining rates impact the cost of processing these transactions? What would be the impact on Federal entities of a two tiered system of interchange rates like the one included in Senator Durbin's interchange amendment where different interchange rates would apply to transactions based on the size of the issuer?

Answer. In my June 16, 2010, testimony, I stated: "Our April 2010 statements for the 4 major card brands contained more than 200 different rates. We work aggressively to analyze our monthly statements, looking for opportunities to cut our costs, and you can see that our fees are based on a complicated rates matrix."

This example was used to illustrate the size of the problem. While the number of rates charged is difficult to manage, the bigger problem is the complexity of the rates. In fact, the interchange rates applied to Amtrak's transactions are ambiguous and mired in complicated technicalities. The critical issue is that the large number of different rates and the complexity of those rates—applied to approximately 15 million transactions per year at Amtrak—makes the effort to reduce interchange rates extremely difficult. Significantly fewer rates with more direct qualifications (the "streamlining" to which you refer) would make it possible—and economic—for Amtrak to determine which transactions are receiving the most favorable rates and how to get better rates for those transactions that are not.

When one looks at the rates listed on the web sites of the credit card companies, it may appear that there are only three primary factors used to determine the rates: merchant type; card product code (such as debit card, corporate card, rewards card, etc.); and method of data entry (such as Internet, automated self service, etc.).

Additionally, the sites show that in certain select categories, there are also discounts for large volumes, but this does not apply to Amtrak.

Much more difficult to discern from the published charts are the long list of technical requirements needed for each transaction to qualify for the lowest rate within its parameters. While some of the parameters (such as merchant type or product code) are determined at the time of the transaction, many of the technical details are not.

In order to be charged the lowest rate for a particular transaction, all of the data must be submitted correctly by the merchant. However, once that data is sent to the credit card company, the merchant has no ability to control the integrity of the data it has submitted.

The only indication that anything has gone wrong is when one looks at a statement (at earliest a day later) which may show that a higher rate was charged for "technical reasons." Sometimes the technical reasons can be traced back to a cause and the error can be fixed for future transactions that may contain that error. Other times, no explanation can be found.

On one occasion, after much persistence by Amtrak, the source of one such technical problem was found and corrected. The error was not made by Amtrak but by the credit card company itself. And yet, Amtrak over-paid thousands of dollars in interchange fees over a 2-year period.

The lack of clarity and trace-ability of the interchange rates is by far the most pressing challenge for Amtrak. Interchange rates that are based on ambiguous, opaque technical criteria are the true source of higher costs for Amtrak.

CONCLUSION OF HEARING

Senator DURBIN. The hearing of this subcommittee will stand recessed.

[Whereupon, at 4:35 p.m., Wednesday, June 16, the hearing was concluded, and the subcommittee was recessed, to reconvene subject to the call of the Chair.]

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