TESTIMONY OF

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BEFORE THE

U.S. SENATE COMMITTEE ON THE JUDICIARY

HEARING ON

"EXCESSIVE SWIPE FEES AND BARRIERS TO COMPETITION IN THE CREDIT AND DEBIT CARD SYSTEMS"

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Thank you for providing me with the opportunity to testify on the swipe fees that are imposed by the credit card industry on merchants. Most consumers are not aware of these fees and do not see the effects they create on the cost of goods and services and the U.S. economy, but those effects are dramatic. For merchants, the fees are a constant source of stress and financial difficulty, while for the economy the fees reduce economic efficiency and contribute significantly to inflation.

I am testifying today on behalf of my association, the National Association of Convenience Stores (NACS), as well as a coalition that we helped found to try to address these issues, the Merchants Payments Coalition (MPC). NACS is an international trade association representing the interests of the convenience industry. In the United States, the industry includes more than 148,000 stores employing 2.3 million people. It is truly an industry of small business with a full 60 percent of the industry comprised of single-store operators. The industry handles about 165 million transactions each day – a number equivalent to about half of the U.S. population. An efficient and competitive payment system is critical to the health of the industry and its employees.

The MPC is a group of retailers, supermarkets, restaurants, drug stores, convenience stores, gas stations, online merchants, and other businesses focused on reforming the U.S. payment system to make it more transparent and competitive.

I. Executive Summary

The credit and debit card systems in the United States are burdened by anti-competitive conduct that makes the systems less efficient and effective than they should be. Two payment card networks, Visa and Mastercard, dominate the market and bring together thousands of banks across the nation to wield market power in ways that harm competition in the marketplace. Merchants have no realistic options to the dominant networks. With very few exceptions, merchants must accept all credit and debit cards that run over those two networks no matter how high the fees the networks charge and no matter how onerous the rules and conditions they impose. The high fees that result from this exercise in market power inflate the costs of goods and services across the nation in a way that harms consumers.

Visa and Mastercard each separately set the fee rates for the swipe, or interchange, fees that all the banks that issue cards with those networks charge to merchants. Because the swipe fees are centrally set in this way, the banks don't compete on price. That leads to problems that are common for anti-competitive arrangements – high and escalating prices and neglect of key aspects of the service (such as protection against fraud). Visa and Mastercard also dictate a complex set of terms or rules that govern how credit card transactions happen. These terms further insulate swipe fees from competitive market pressures and, in most cases, keep the fees confusing for merchants and hidden from consumers.

In particular, by imposing a rule that requires a merchant to accept all cards issued with a Visa (or Mastercard) logo if the merchant wants to accept any cards carrying those networks, the two largest networks remove the incentives for banks to negotiate with merchants on price or acceptance of their cards – and remove almost all bargaining power that merchants otherwise might have had. This is a central element of the credit and debit card systems in the United States today and creates additional competition policy problems.

The problems caused by all this for consumers, merchants and the economy are immense. Total card fees imposed on merchants were $138 billion last year – up from $64 billion in 2010. Of that total, $77.5 billion are fees for Visa and Mastercard branded credit cards and $28 billion are fees for Visa and Mastercard branded debit cards - $105.5 billion on just those two networks. The size of the fees and the fact that they are set largely as a percentage of transaction amounts means that they are an inflation multiplier. The United States already pays the highest swipe fees in the industrialized world. The roles played by the two dominant card networks and the fees and terms they set cause other problems as well by reducing incentives for innovation in new payment products and improvements in services such as fraud protection. The United States should have the most efficient, effective and innovative payment system in the world, but we don't. This market desperately needs changes so that there are competitive market forces that improve payments for everyone.

This testimony will cover a few topics relating to swipe fees. First, it will lay out some background on how credit and debit card payments work. Second, it will address the competition policy problems created by those payment systems. Third, the testimony will discuss the negative impact these fees have on merchants. Fourth, the testimony will note the negative impact of the fees on consumers. Fifth, it will describe the negative impact of swipe fees on the U.S. economy. Sixth, it will walk through a number of the myths that the credit card industry regularly espouses in order to distract from the problems with these payments.

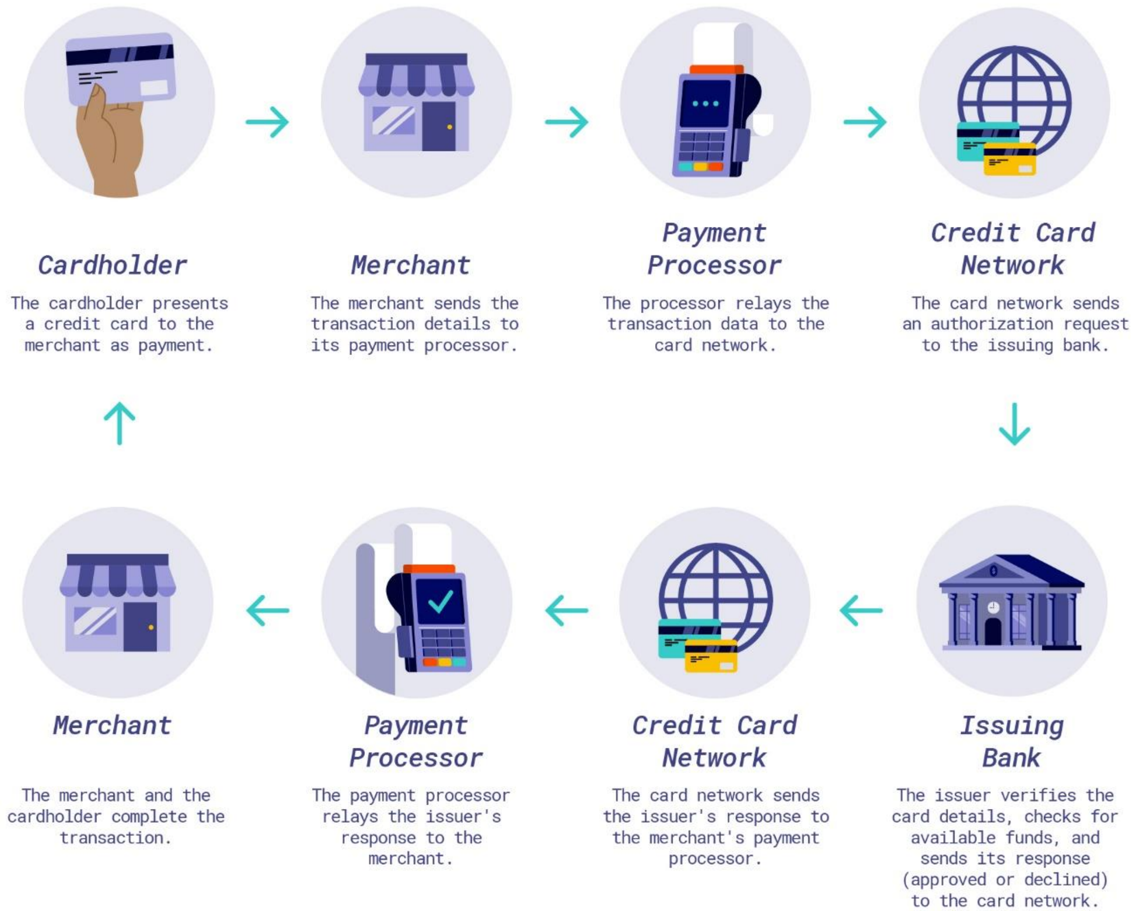
II. How Card Payments Work

In order to understand the competition problems with the credit and debit card markets, it helps to have some background on how these payments work. Neither Visa nor Mastercard, the two largest card networks, has a direct relationship with individual cardholders. Financial institutions such as banks and credit unions actually enter into agreements with individuals and issue cards to them. The structure is similar with merchants. The merchants contract with banks or payment processors to handle the merchants' acceptance of payment cards.

Visa and Mastercard actually started as associations of their bank members.[1] They do a few things to make card payments happen. They maintain data lines that connect the banks that issue cards to consumers with the banks that work with merchants. They also advertise their brands to make the cards more appealing to consumers and businesses. And, they set the prices that the card issuers charge to merchants as well as the rules that govern how cards are issued and processed. It is this price- and rule-setting role that raises antitrust issues to be addressed below.

[1] Both companies changed their structures in the 2000s in order to try to insulate themselves from antitrust liability after a court of appeals held in 2003 that Visa and Mastercard "are not single entities; they are consortiums of competitors" and that the rule then challenged by the DOJ was "a horizontal restraint adopted by 20,000 competitors." *United States v. Visa U.S.A. Inc.*, 344 F.3d 229, 242 (2d Cir. 2003). Some major banks still own billions in restricted shares in the companies that they cannot sell pending final outcomes of antitrust litigation.

A good explanation of the process of a card payment can be found at knowyourpayments.com.[2] In the simplest terms, when an individual dips or swipes a payment card at a store, the information necessary to process that payment goes to the merchant's bank (or processor) who sends the information to a card network (e.g., Visa or Mastercard) and that network sends the information to the card issuer (the bank that gave the consumer that card), then a message authorizing the transaction (or declining it) goes back through each of those entities to the merchant's payment terminal allowing the transaction to take place. The clearance and settlement of the funds takes place later through a similar process. The graphic below depicting this basic process can be found at corporatetools.com.



According to the Federal Reserve Bank of San Francisco's Diary of Consumer Payment Choice, credit cards accounted for 27 percent of consumer transactions in 2020, debit cards

[2] *See* Know Your Payments » Transaction Basics.

accounted for 28 percent, and cash was 19 percent.[3] This represented a large jump in credit card payments, which had been 24 percent of payments in 2019.

There are fees that each player involved in the processing of the card takes out of the amount that the merchant gets paid in the transaction. By far the largest fee is the swipe fee, or interchange fee, which goes to the bank that issued the consumer the card. That fee alone can account for about 80-85 percent of all of the fees involved in the transaction. The networks, such as Visa and Mastercard, impose their own separate fees, called network fees, in addition to the swipe fees. And, the merchant's processor or bank receives a fee for its services. Processing is a reasonably competitive market. Merchants don't always like how much they pay in those processor fees, but they have options to do business with different processors (or negotiate new agreements) and that helps discipline that cost. Merchant concerns about network fees are different than concerns about swipe fees. Networks set their own fee amounts, which is appropriate. Unfortunately, the two major networks have structured and applied their network fees to have certain anti-competitive effects to protect and grow their market power. The networks' market share and the way the networks bring together the card-issuing banks has enabled them to do this. Those concerns are related to, but different than, the problem created by anti-competitive behavior in the setting of swipe fees by the two major networks on behalf of card-issuing banks, which is discussed below.

Credit card issuing is very concentrated among a small number of very large banks. The ten largest credit card issuers in the United States collectively have about 80 percent of the credit card issuance market.[4] Those issuers compete to get consumers to get and use their cards. They do this through a complex set of pricing mechanisms that include interest rates, a variety of rewards offerings, and a number of potential penalty fees and related terms. These complex pricing mechanisms can be difficult for consumers to evaluate and may lead them to choose offers that are less favorable than other offers.[5] And, the enticement of credit card offers can lead consumers to create financial problems for themselves that are challenging to fix.

Because credit card issuers receive fees from merchants every time one of their cards is used, they have a strong incentive to push for those cards to be used as many times as possible. They have been particularly aggressive in trying to get consumers to use their cards for small, everyday purchases. Using credit for everyday purchases, of course, can create financial problems for consumers if they are not careful. Unfortunately, card issuers can be less concerned about individuals' financial problems due to the revenue those issuers earn from merchants.

[3] Kelsey Coyle, Laura Kim and Shaun O'Brien, "2021 Findings from the Diary of Consumer Payment Choice," Federal Reserve Bank of San Francisco (May 5, 2011) available at 2021 Findings from the Diary of Consumer Payment Choice – Cash (frbsf.org). Credit cards make up a larger percentage of payments in e-commerce.

[4] Bianca Peter, "Credit Card Market Share by Issuer," (Feb. 24, 2022) available at https://wallethub.com/edu/cc/market-share-by-credit-card-issuer/25530.

[5] For an explanation of some of these confusing prices and terms, *see* Consumer Reports, "What Credit Card Offers and Rewards are Best for you?" (November 2012) available at https://www.consumerreports.org/cro/magazine/2012/11/the-best-credit-card-for-you/index.htm; and Adam Levitin, "Testimony Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs," (July 19, 2011) available at https://www.banking.senate.gov/imo/media/doc/LevitinTestimony71911.pdf.

Though there are problems, consumers at least have the benefit of competition among different credit card issuers that try to get their business. That can lead to helpful offers. Merchants, however, do not have that benefit due to the way that the two dominant card networks bring together card issuers from across the country into their two networks.

III. The Credit Card Industry's Anti-Competitive Activity

The central problem with credit cards in the United States is that the two largest networks, Visa and Mastercard, set the amounts of the swipe fees that the card-issuing banks charge for each transaction and they set the terms governing how these transactions happen. All of those card-issuing banks – particularly the largest ones which have the vast majority of credit card market share – could set their own prices and compete with each other for merchants' business. Those card issuers all compete that way for consumers' business. But, they refuse to compete for merchants' business. One hundred percent of the banks that issue cards with Visa logos agree to charge merchants the same schedule of network-fixed fees. The same is true for the banks that issue cards with Mastercard logos on them.

There is no avoiding the destructiveness of these agreements not to compete on price. Merchants have no ability to refuse accepting payment from virtually all the banking institutions across the nation. That is in part because retail is incredibly competitive in the United States. There are many different types of merchants trying to out-compete each other on price and service for the business of the American consumer. If one of them stops taking these credit cards, the competitor across the street will take some of their business. So, merchants take the cards and the fees increase at dramatic rates. In fact, economists with the Kansas City Federal Reserve Bank have studied these fees and found that, in light of the central fee-setting structure and the competitiveness of U.S. retail, swipe fees will increase to the point that retailers may go out of business.[6] That is the only effective brake on the steep rise on these fees.

It is also important to note that the swipe fees banks charge merchants to accept their cards (the ones set by Visa and Mastercard) are not the same every time. In fact, they can vary dramatically. Visa and Mastercard set complex schedules of fee rates, and the fees vary based on the level of rewards associated with the card, the type of merchant accepting the card, the manner in which the card is accepted (online versus in-person and other aspects of acceptance) as well as, in some sectors, the card network's view of the merchant's level of security.[7] The fees for the most expensive cards can be about triple the amount of the fees for the least expensive cards for some merchants.

In addition to the fee-setting, however, Visa and Mastercard impose a set of terms that further insulate those prices from the possibility of any competitive market forces keeping the fees in check. There are hundreds of pages of these terms and problems with them are detailed

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[6] Fumiko Hayashi, "A Puzzle of Card Payment Pricing: Why Are Merchants Still Accepting Card Payments?" Federal Reserve Bank of Kansas City (2004) available at https://ideas.repec.org/p/fip/fedkpw/psrwp04-02.html.

[7] There are other factors that can change the economics as well such as other services (including tokenization, fraud detection, and other services) that the networks have tried to control.

well in ongoing antitrust litigation that is pending in the U.S. District Court for the Eastern District of New York.[8]

There are a few of these terms that merit particular attention. One, of course, is the central price-setting engaged in by Visa and Mastercard noted above. Another is the so-called "honor all cards rule." This "rule" is imposed by both Visa and Mastercard on merchants. It creates an all-or-nothing proposition for every merchant across the country and says that if a merchant wants to accept any Visa- (or Mastercard-) branded credit card, that merchant must take every credit card with that brand (and the same with debit cards). "Honor all cards" completely removes any possibility for a merchant to negotiate prices or terms with any bank – and completely removes the incentive for any bank to try to negotiate prices or terms with any merchant.

Removing those normal market incentives for price competition and negotiated deals is very significant. Because the fees are so much higher for some cards than for others, merchants very sensibly might want to accept some of them but not others (for fear of going out of business). But, they can't make that choice. If they could, of course, banks issuing the most expensive cards might be inclined to cut their prices, but they don't need to worry about that because Visa and Mastercard have removed the normal market dynamics from the playing field.

Visa and Mastercard also put restrictions on banks to stop competition from creeping into the picture. They both prohibit banks from making any network that competes with them active on those banks' credit cards.[9] That way, one hundred percent of the transactions on credit cards that have Visa enabled on them go through the Visa network (and the same is true for Mastercard).

These prohibitions are very similar to rules that were the subject of litigation the U.S. Department of Justice filed against Visa and Mastercard in 1998. The rule in question was known as the exclusionary rule. It prohibited banks that issued cards under Visa's or Mastercard's brands from issuing cards from any of their competitors (including companies such as American Express and Discover). The U.S. Circuit Court of Appeals for the Second Circuit ruled in favor of the Department of Justice in that case and the exclusionary rule is no longer permitted.[10] NACS filed comments with the Federal Trade Commission last fall discussing how Visa and Mastercard's prohibitions against banks issuing credit cards with other networks on them violates the antitrust laws and harms competition.[11]

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[8] A redacted version of the complaint filed in the case by NACS and others can be found at: https://constantinecannon.com/wp-content/uploads/2022/04/13-cv-5746-Doc.-183-6th-Amd.-Complaint-Redacted.pdf.

[9] Federal Reserve Regulation II prohibits these types of exclusivity requirements on debit cards.

[10] *United States v. Visa* U.S.A., Inc., 344 F.3d 229 (2d Cir. 2003), cert denied, 543 U.S. 811 (2004), available at Second Circuit Decision in U.S. v. Visa (02-6074) | ATR | Department of Justice. American Express and Discover each sued for the damages they suffered due to the rule and reached settlements with Visa and Mastercard. Discover, Visa and MasterCard settle antitrust suit | Reuters.

[11] NACS-Comments-to-FTC-on-Unfair-Contract-Clauses-Fi.pdf (convenience.org).

Visa and Mastercard also have a long history of restricting how merchants price their products to their customers. These restrictions formed a veil of secrecy around swipe fees that further insulated the fees from competitive market pressures. Some of those restrictive terms have been eroded through legal challenges over time. For example, the Department of Justice and seventeen states entered into a consent decree with Visa and Mastercard that became final in 2011 which prohibited those two networks from preventing merchants from offering their customers discounts for using less expensive payments.[12] Prohibiting merchants from giving American customers discounts strikes directly at the heart of how competitive markets should work. But, that is just one in the long line of actions the two largest networks have taken to undercut competition in the credit card market.

In fact, Visa and Mastercard's fee- and term-setting have turned competition on its head. While competition normally causes businesses to try to keep prices low in order to attract market share, Visa and Mastercard don't compete for merchants' business. The honor all cards rule and lock-up of all the banks takes care of that. Instead, Visa and Mastercard only compete to attract banks to issue more of their cards. They do that by trying to push the swipe fees they set on behalf of those banks higher and higher.[13] It is the opposite of what real competition does and demonstrates how the market is broken.

The major card networks have also taken actions that erode competition from smaller networks. One recent example of these anti-competitive activities was the subject of an opinion by the U.S. Fifth Circuit Court of Appeals in litigation brought by Pulse, a debit network, against Visa. In that case, the Fifth Circuit found that Pulse's claims that Visa had violated antitrust laws to squeeze Pulse out of the debit market should be decided by a jury, "And a reasonable jury could find that some of Visa's volume-based agreements amount to exclusive-dealing contracts designed to squeeze Pulse out of the PIN-less transaction market."[14] That was just the latest legal action raising troubling concerns about what the largest payment networks do to harm competition.

Visa has also sought to bolster its hold on the market and keep out innovative competitors through acquisition. Its attempt to acquire Plaid – a potential competitor in the debit market – led to a lawsuit from the Department of Justice to block the deal.[15] Plaid offers a potential alternative technology for consumers to access funds in their bank accounts to pay for things which "likely would drive down prices for online debit transactions, chipping away at Visa's monopoly and

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[12] Final Judgment as to Defendants Mastercard International Incorporated and Visa Inc. | ATR | Department of Justice. The states that joined the action and consent decree were: Arizona, Connecticut, Idaho, Illinois, Iowa, Maryland, Michigan, Missouri, Montana, Nebraska, New Hampshire, Ohio, Rhode Island, Tennessee, Texas, Utah, and Vermont.

[13] Andrew Martin, "How Visa, Using Card Fees, Dominates a Market," New York Times (Jan. 4, 2010) available at https://www.nytimes.com/2010/01/05/your-money/credit-and-debit-cards/05visa.html ("Competition, of course, usually forces prices lower. But for payment networks like Visa and MasterCard, competition in the card business is more about winning over banks that actually issue the cards than consumers who use them. Visa and MasterCard set the fees that merchants must pay the cardholder's bank. And higher fees mean higher profits for banks, even if it means that merchants shift the cost to consumers.")

[14] *Pulse Network, LLC v. Visa, Inc.*, No. 18-20669, 18 (5th Cir. Apr. 5, 2022).

[15] Complaint, *U.S. v. Visa, Inc. and Plaid, Inc*. (Nov. 5, 2020).

resulting in substantial savings to consumers."[16] Visa wanted to block the innovation and cost savings that Plaid could bring to the market by acquiring it – similar to Visa's past pattern of trying to block competition.[17] Acquisitions, exclusivity contracts and other moves have been used by Visa to protect its market power and block potential competition. All of this, of course, has been a detriment to the market, merchants, consumers, and the economy.

IV. Swipe Fees Hurt Merchants

Credit and debit card swipe fees are huge business and are growing at an alarming rate. Collectively, U.S. merchants paid $138 billion in fees to accept card payments last year.[18] That was a huge jump from the $110 billion that merchants paid in 2020.[19] That is on top of the fees nearly doubling in the decade between 2010 (when the fees were $64 billion) and 2020.[20] And, it followed the decade between 2001 and 2010 when the fees more than tripled from $16 billion to $64 billion.[21] The huge multiples by which the fees have grown seem impossible, but that is what happens when there is price-fixing in place of competition.

In the convenience industry, recent fee increases have been even more dramatic. In 2021, the fees paid by convenience retailers to accept payment cards jumped by 26.5 percent.[22] Not only that, but the rate of increase has been even higher thus far in 2022 – and that was even before Visa and Mastercard moved forward with rate increases in April that, combined with the rate increases that Visa publicly said it would delay last year amount to an additional $1.2 billion per year in additional fees.[23] These increases are completely unsustainable.

Even before these dramatic jumps, swipe fees, on average, were convenience retailers' second-largest operating cost after labor. In fact, that is true for retailers in every sector. That means swipe fees are more than the average retailer pays for rent or utilities or for any other operating cost. Some convenience retailers have even reported that the fees are approaching their labor costs.

One reason for these dramatic increases is the destructive interaction between swipe fees and inflation. The majority of the amount of credit card swipe fees are set as a percentage of the total amount of each transaction. That means swipe fees increase along with every dollar of

[16] *Id*. at ¶ 8.
[17] *Id*. at ¶¶ 44-45.
[18] Nilson Report (March 2022) available at Nilson Report | News and Statistics for Card and Mobile Payment Executives. As noted, $77.5 billion of the total are Visa and Mastercard credit card fees and $28 billion are Visa and Mastercard debit card fees.
[19] Nilson Report (July 2021) available at Nilson Report – Merchant Processing Fees in the United States—2020.
[20] Stephen Mott, "Industry Facts Concerning Debit Card Regulation Under Section 920," (Oct. 27, 2010) at 14, available at http://www.federalreserve.gov/newsevents/files/merchants_payment_coalition_meeting_20101102.pdf.
[21] *Id*.
[22] NACS State of the Industry (April 2022).
[23] Lynne Marek, "There was no stopping credit card fee hikes this year," Payments Dive (April 7, 2022) available at https://www.paymentsdive.com/news/there-was-no-stopping-credit-card-fee-hikes-this-year/621741/.

inflation. And, those swipe fees act as an inflation multiplier forcing retailers to try to increase their revenues to keep up with the spiraling fees.

During its last two earnings calls, in fact, Visa made clear that it is "a beneficiary of inflation," and that inflation is "a positive for us."[24] Most Americans and American businesses would not say the same of themselves.

An area that has among the largest impacts for the convenience industry and for American consumers are gas prices. This industry sells about 80 percent of the gasoline used across the nation. Retailers, similar to their customers, like an ample supply of gasoline and low prices. That is because as gas prices rise, the margins retailers make actually get smaller. Competition in the market means that retailers cannot pass along their own increased wholesale costs as quickly as they pay those costs. At the same time that retailers' margins are getting squeezed, however, their credit card fees are rising because they are a percentage of the total transaction amount. That means there have been many times during the past few months when retailers were paying more in swipe fees (often about 10 cents per gallon) than they were ultimately making on those sales. That makes no sense given the costs retailers incur and risks they take to maintain a site with underground storage tanks, transport fuel, and sell it to customers (often staying open 24 hours per day in the midst of a labor shortage and, in the past two years, a pandemic). Processing those transactions should not cost more than the profits that can be made after all of that effort.

What is particularly troubling for many businesses, however, is that they are powerless to plan for or deal with these rising costs. They can take measures to keep other costs in check – installing more energy-efficient equipment, using a different supplier, and the like. But there is no dealing with swipe fees because of the competition problem noted above and the unpredictability of the increases. Businesses just don't know how much the fees will go up. Even after new rates are announced it is difficult to predict how those rates will impact a merchant's fees because the card networks have made the system so complex. GAO reported that Visa and MasterCard each had four credit card rate categories in 1991, but by 2009 Visa had 60 rate categories and MasterCard had 243.[25] The numbers have grown since that time and that complexity helps obscure the consistent, large fee increases that merchants must bear.

It is worth noting that the fees increase even when Visa and Mastercard do not "raise" them. As noted, inflation is one reason that happens. Another reason is that the banks issuing cards simply push higher fee cards into the market. That is true for their new and existing customers. Many cardholders receive notification from their bank that they now have a different level of rewards or other perks. It might not be clear to the cardholder why that is, but it is not a

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[24] *See* Logan Kane, "Visa: A Great Business, But Wait for a Pullback," Seeking Alpha (April 26, 2022) available at https://seekingalpha.com/article/4503588-visa-great-business-wait-for-pullback; "Visa (V) Q2 Earnings Call Transcript," Motley Fool Transcribing (April 27, 2022) available at https://www.fool.com/earnings/call-transcripts/2022/04/27/visa-v-q2-2022-earnings-call-transcript/.

[25] Government Accountability Office, "Credit Cards: Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges," (2009) at Credit Cards: Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges | U.S. GAO.

mystery to merchants – it means the merchant must pay higher swipe fees. By systematically moving cardholders to more expensive cards, banks can drive up swipe fees without Visa and Mastercard changing their rate schedules at all.

Of course, merchants do not have visibility into the card issuing decisions that drive up their fees. Frankly, merchants have very little visibility into the price-setting engaged in by Visa and Mastercard. Merchants don't receive direct communications of these changes from Visa and Mastercard. Those notifications go to banks and processors. Typically, when sent, those notifications are confidential so that they cannot be passed along to merchants. The price changes that can so dramatically impact merchants' bottom lines become rumors in the marketplace until they are sprung on merchants with very little notice. The price increases that both Visa and Mastercard instituted just a couple of weeks ago followed this pattern of poor communication and notice. The lack of clarity is just another sign of how broken this market is.

V. Swipe Fees Hurt Consumers

Ultimately, of course, all of us pay for these overinflated swipe fees in the prices of the goods and services we buy. The fierce price competition in retail ensures this. Retail profit margins are notoriously low. As of January of this year, for example, net profit margins for general retailers were 2.65 percent.[26] For convenience stores, those margins were 2.47 percent.[27] For grocers and other food retailers, those margins were even narrower – 1.11 percent.[28] With those margins, which are around or below the level of swipe fees these businesses pay, those fees must be passed on to consumers or retailers would go out of business.

It is worth noting that while retailers' margins are notoriously thin, banks' and credit card networks' margins are very large. The money center banks that dominate credit card issuing have net margins of 32.61 percent.[29] Visa's net profit margin as of the end of 2021 was 51.59 percent and Mastercard's was 46 percent.[30] All of those margins are instructive as to the relative competitiveness of these sectors. No other industry sector reported on by NYU had net profit margins as large as the money center banks, and it is likely that none would dare dream of margins at the level of Visa's and Mastercard's.

The current system fools consumers by hiding the large interchange fees that are built into the cost of their purchases. To quote one of my fellow witnesses today, Ed Mierzwinski of U.S. PIRG, "Interchange fees are hidden charges paid by all Americans, regardless of whether they use credit, debit, checks or cash. These fees impose the greatest hardship on the most vulnerable consumers – the millions of American consumers without credit cards or banking relationships. These consumers basically subsidize credit card usage by paying inflated prices – prices inflated by the billions of dollars of anticompetitive interchange fees. And unfortunately,

[26] New York University, "Margins by Sector (US)," at Operating and Net Margins (nyu.edu).
[27] NACS State of the Industry (April 2022).
[28] *Id*.
[29] *Id*.
[30] *See* Visa Profit Margin 2010-2021 | V | MacroTrends and Mastercard Profit Margin 2010-2021 | MA | MacroTrends.

those credit card interchange fees continue to accelerate, because there is nothing to restrain Visa and MasterCard from charging consumers and merchants more."[31] In addition, over the years, consumer groups including the Consumer Federation of America, Consumer's Union, and Consumer Action have all submitted Congressional testimony criticizing the current system of swipe fees because it is not fair to consumers.

In addition, the European Commission has found that interchange fees harm consumers. In December 2007, the Commission found MasterCard's multilateral interchange fee illegal and Competition Commissioner Neelie Kroes said that interchange "inflated the cost of card acceptance by retailers without leading to any advantage for consumers or retailers. On the contrary, consumers foot the bill, as they risk paying twice for payment cards. Once through annual fees to their bank. And a second time through inflated retail prices . . ."[32] 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."

One of the most troubling aspects of the high swipe fees imposed by the broken credit card market is the way they impact low-income Americans. The fees get baked into the prices of goods and services with very few exceptions in part due to the longtime pricing constraints imposed by Visa and Mastercard. So, those who do not have or cannot qualify for credit cards pay the cost of these fees as well – as do cardholders with basic cards that don't carry rewards. In 2009, the Hispanic Institute published a paper showing how payment card swipe fees and rewards systematically transferred wealth from low income to high income individuals.[33]

A working paper published by Boston Federal Reserve economists came to the same conclusion: that swipe fees combined with rewards programs amount to a regressive system in which low-income Americans subsidize high-income Americans.[34] This disproportionate negative effect on low-income consumers is particularly unfair.

An updated study was just released by the Hispanic Leadership Fund. That study found:[35]

1) "Lower income Americans are losing money to higher income individuals.
    - American families earning less than $75,000 per year send a total of $3.5 billion to families earning more than $75,000 per year

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[31] "Testimony of Ed Mierzwinski before the House Judiciary Committee Antitrust Task Force," (May 15, 2008).

[32] "Commission Prohibits MasterCard's intra-EEA Multilateral Interchange Fees: Introductory remarks at press conference," available at https://www.parlement.com/id/vhqtky3qp9z8/nieuws/toespraak_eurocommissaris_kroes_over.

[33] Hispanic Institute, "Trickle-Up Wealth Transfer: Cross-subsidization in the payment card market," by Efraim Berkovich (Nov. 2009) available at Trickle-Up Wealth Transfer: (thehispanicinstitute.net).

[34] Marie-Helene Felt, Fumiko Hayashi, Joanna Stavins, and Angelika Welte, "Distributional Effects of Payment Card Pricing and Merchant Cost Pass-through in the United States and Canada," Federal Reserve Bank of Boston (Dec. 2020) at 4, available at https://www.bostonfed.org/publications/research-department-working-paper/2020/distributional-effects-payment-card-pricing-merchant-cost-pass-through-united-states-canada.aspx.

[35] Efraim Berkovich and Zheli He, "Rewarding the Rich: Cross-Subsidies from Interchange Fees," Hispanic Leadership Fund (May 2022) available at https://hispanicleadershipfund.org/.

- More than $1.9 billion of that money goes into the pockets of those making more than $150,000 per year.
- Families making less than $20,000 per year pay more than $1.2 billion of the $3.5 billion that gets transferred to higher income people"

2) "Black families are disproportionately harmed by today's credit card schemes.
   - The average American Black family pays nearly $60 per year to subsidize higher income people's rewards through these fees
   - Black families in the United States lose more than $1 billion each year from these transfers"

3) "The current swipe fee structure drives up shelf prices for all Americans regardless of how you pay.
   - The study found that swipe fees cost some retailers between 17 and 19 percent of annual profit.
   - Annual variation in interchange costs drives profit up and down by about 4.5 percent for smaller stores. This added risk generates economic inefficiency, and the entire economy suffers from this unneeded risk."

Those findings are staggering. Low income Americans should not be forced to pay for their wealthy neighbors' airline tickets, but that is precisely what Visa and Mastercard's anti-competitive practices cause.

Not only have fees increased dramatically and moved money from low-income to high-income Americans, but these fees change the nature of the credit card business in a way that hurts consumers. As Georgetown Law professor Adam Levitin observed in testimony before the House Judiciary Committee, the huge fee revenue the banks earn from credit card transactions taking place has created bad incentives. He testified, "The card industry's business model is the heart of the problem and needs to change. Just as with subprime mortgages, the credit card business model creates a perverse incentive to lend indiscriminately and let people get into so much debt they can't pay it back."[36]

Others have clearly observed this trend as well. For example, Acting Comptroller of the Currency Julie Williams said in March 2005, "Today the focus for lenders is not so much on consumer loans being repaid, but on the loan as a perpetual earning asset . . . it's not repayment of the amount of the debt that is the focus, but rather the income the credit relationship generates through periodic payments on the loan, associated fees, and cross-selling opportunities."[37] These changes mean that banks are less worried than they should be about consumers' welfare. It should be in the interest of banks for consumers to do well and be able to pay back credit card loans. But the huge fee income the banks generate through interchange and other means gives

[36] Adam J. Levitin, Testimony before the House Judiciary Subcommittee on Commercial and Administrative Law, "Consumer Debt – Are Credit Cards Bankrupting Americans?" (April 2, 2009).
[37] Remarks by Julie L. Williams, Acting Comptroller of the Currency, Before the BAI National Loan Review Conference, New Orleans, LA, (March 21, 2005) available at http://www.occ.treas.gov/ftp/release/2005-34a.pdf.

them another incentive – milk consumers for all they are worth and don't worry about the money getting paid back.

The bottom line is that abuse of consumers by banks will continue as long as they have the incentive to treat people that way. Interchange fees are the key incentive with which Congress has not yet dealt. The abuses of consumers and using credit cards as predatory lending vehicles will continue until something is done about interchange fees.

The credit card industry strenuously argues that if anything at all happens to reduce swipe fees, then other fees paid by consumers will increase and consumers will be in a worse position than they are today. This is false. In fact, the European Commission's Directorates for Competition and Financial Services jointly conducted a comprehensive study into the European payment card industry in general, and Visa and MasterCard in particular. The Commission found no evidence to support the card systems' arguments that the high fee levels associated with the existing interchange system benefit consumers. In particular, the Commission rejected arguments that lower interchange fees to merchants would result in higher fees to consumers:

> "There is no economic evidence for such a claim. Firstly, the inquiry's data suggests that in most cases card issuers would remain profitable with very low levels of interchange fees or even without any interchange fees at all. Secondly, the international card networks have failed to substantiate the argument that lower interchange fee would have to be compensated with higher cardholder fees. The evidence gathered during the inquiry rather suggests that the pass-through of higher interchange fees to lower cardholder fees is small. Consumers already pay the cost of the interchange fee without knowing it. This cost is now hidden in the final retail price and is therefore non-transparent."[38]

VI. Swipe Fees Hurt the U.S. Economy

Payments should not cause all of these negative outcomes. The purpose of having money is to reduce transaction costs and make buying and selling things more efficient. Our credit card system does the opposite. The comparison to our hundred-year-old system of paper checks is instructive. It was not that long ago that the originals of those checks had to be transported around the country to the proper banking institutions in order to clear payments. That was an expensive way to do things. But, remarkably, the Federal Reserve had prohibited the equivalent of swipe fees (known as exchange fees) from being charged on checks. There were (and are) still costs to processing checks, but the system works efficiently and those who accept and handle checks are able to make decisions about how to conduct business and how best to keep their costs under control.

[38] European Commission, Directorates on Competition and Financial Services, *Competition: Final report on retail banking inquiry – frequently asked questions*, Jan. 31, 2007, *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/07/40&format=HTML&aged=0&language=EN&guiLanguage=en.

Electronic payments should be much more efficient than paper payments. The actual costs of handling electronic payments are indeed lower. But, the prices paid by all of society are much, much higher due to competition problems inflating the associated fees.

The United States is an outlier in the world in this area – and not in a good way. Swipe fee rates are higher in the United States than anywhere in the industrialized world.[39] This harms American retailers and consumers – disadvantaging them compared to the rest of the world. Just to take one example, merchants and consumers in China pay much lower rates than their American counterparts.[40]

These fees are stunting business growth and hurting efforts to hire more workers and expand operations. One study of this impact in 2010 concluded that without the higher prices caused by fees above and beyond costs plus a reasonable rate of return, consumers would have an additional $26.9 billion to spend and the economy could add 242,000 jobs.[41] Of course, the fees have nearly tripled since that report was written. The lost economic growth during that time period is immense.

The overinflated swipe fee rates cause other economic problems as well. The U.S. credit card system has the most fraud in the world.[42] These problems are related. The high fees reduce the economic incentives for the credit card industry to fight fraud – because they make money even with relatively high fraud rates and would have to spend money to make the system safer for all of us. And, not incidentally, much of the fraud on credit cards gets charged back to merchants so the credit card industry does not lose those funds – the merchants do.

Rather than taking straightforward actions that have proven to be effective in fighting fraud, like requiring the entry of personal identification numbers (PINs) or using other means of authenticating the person making the transaction, the card networks have pushed most of the costs of fighting fraud onto merchants. The switch to chip cards in the United States is a primary example. While the vast majority of the world required PINs as part of that switch, Visa and Mastercard not only did not do that, but they threatened retailers that tried to require PINs with fines.[43] Instead of the common-sense measure that had been successful around the world, merchants were forced to spend $30 billion to upgrade their point-of-sale equipment and software to make the transition to chips without the protection of PIN usage. And, for their trouble, many merchants were still required to pay more to cover fraud.

In fact, a 2019 report found that the card networks use their positions in setting card security standards to entrench their own market share at the expense of focusing on card security

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[39] *See* Kansas City Federal Reserve, "Credit and Debit Interchange Rates in Various Countries August 2021 Update," CreditDebitCardInterchangeFeesVariousCountries_August2021Update.pdf (kansascityfed.org).
[40] *Id*.
[41] Robert J. Shapiro and Jiwon Vellucci, *The Costs of Charging It in America: Assessing the Economic Impact of Interchange Fees for Credit Card and Debit Card Transactions*, Feb. 2010, at 2.
[42] "Credit Card Fraud Statistics," Shift Processing (Sept. 2021) available at Credit Card Fraud Statistics [Updated September 2021] Shift Processing.
[43] Robin Sidel, "Kroger Sues Visa Over PIN Debit Transactions," Wall Street Journal (June 27, 2016) at Kroger Sues Visa Over PIN Debit Transactions - WSJ.

and fraud protection. They do this through their control of a standard-setting body called EMVCo.[44] According to the report, "Our research reveals an insidious pattern in which the card companies use EMVCo as a tool to maximize their share of transaction volumes: when the card companies feel threatened by competitive pressures or economic challenges, they — or EMVCo supporting their strategies — assume responsibility for the definition of a standard, which results in technical specifications that only benefit the card companies, not the U.S. payments industry at large."[45] Security standards should be made to protect against fraud, not to secure market share for already-dominant companies.

The large amounts of fraud on U.S. credit cards add costs to the economy. All of us must pay for that as well as swipe fees. The collective price tag for all of these inefficiencies is far higher than it should be. The United States has the largest economy in the world and should have the most effective and cost-efficient payment system. It doesn't. That should change.

VII. Dispelling Myths the Card Industry Uses to Distract From Its Anti-Competitive Behavior

As noted, anti-competitive behavior on the part of the major card networks causes serious problems for merchants, consumers, and the U.S. economy. Because the card networks cannot justify their actions and do not want to defend them, they typically try to distract any focus on their activities with complaints about the reforms Congress and the Federal Reserve put in place more than a decade ago to deal with anti-competitive activity in the debit card market. These arguments are a distraction, as well as factually wrong, and the Committee should not let the card networks try to distract its attention with those points – particularly when legislative attempts to derail those reforms have repeatedly failed over many years.

Nonetheless, the section below addresses many of the most often repeated myths that the credit card industry raises in order to ensure that you actually have the facts before you on these claims.

- Consumers and Businesses Have Benefitted from Debit Reform

Debit reform authored by Senator Durbin, which was enacted in 2010 and took effect in 2011, has been helpful in curtailing debit swipe fee rates and providing competition among networks.[46] One report showed that debit reform saved consumers $5.86 billion in 2012 alone - the first year the reforms were in effect.[47] That was nearly 70 percent of the overall savings from

[44] RPCG Group, "Payment Insecurity: How Visa and Mastercard use standard setting to restrict competition and thwart payments innovation," (Dec. 2019) available at https://securepaymentspartnership.com/paper.pdf. EMVCo was started by Visa, Mastercard and Europay but the governing body now includes American Express, Discover, Japan's JCB and China's Union Pay.
[45] *Id*. at 8.
[46] While reform has been beneficial, the rates paid by merchants remain higher than they should be. Costs have declined over the past decade and the rates are not proportional to costs.
[47] Robert Shapiro, "The Costs and Benefits of Half a Loaf: The Economic Effects of Recent Regulation of Debit Card Interchange Fees," (Oct. 2013) available here.

debit reform that year with merchants saving an additional $2.64 billion.[48] Collectively, these savings supported more than 37,000 jobs[49] – a significant economic stimulus.

In addition, *Moody's Investor Service* has reported that debit reform savings have shielded consumers from higher prices that would have resulted from increases in other operating costs for businesses such as transportation and fuel costs. The report says, "As merchant acquirers pass on debit fee savings to retailers, we believe retailers will use them to help shield customers from the impact of these other rising costs."[50] The report also noted, "While on the surface it would be easy to presume that retailers would benefit from a reduced debit interchange fee, we do not expect retailers to see a material improvement in their earnings due to the Durbin Amendment."

The Moody's report is supported by analysis of how pricing moved following the implementation of debit reform. The data shows that there was inflation in the U.S. economy in the years after debit reform was implemented. Cost increases, as reflected in the Producer Price Index for retail trade industries, rose 9.4 percent from the time reform went into effect in October 2011 through the end of 2016, while price increases to consumers, reflected in the Consumer Price Index, increased only 4.3 percent.[51] That is a large spread between the higher costs that merchants had to pay for the goods they sold and the prices that they charged consumers. Those numbers demonstrate clearly that merchants shielded their customers from the majority of the cost increases the merchants themselves faced. And, that experience has held true even during the past year with increased inflation. During 2021, the Producer Price Index rose by 9.7 percent while the Consumer Price Index rose by 7 percent.[52]

Retail profit margins show the same pattern. Those margins did not grow following debit reform. In fact, in the grocery industry, pretax profit margins in the two years prior to debit reform were 2.3 percent – and following debit reform those margins fell to 2.1 percent (in 2012) and 1.9 percent (in 2013).[53]

This data reconfirms the intensely competitive nature of U.S. retail. It is very clear that savings from debit reform (and more) have been consistently passed along from merchants to consumers in the form of prices that are significantly lower than what consumers would have been forced to pay in the absence of those reforms.

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[48] *Id*. at

[49] *Id*. at

[50] "New Debit Rules Hurt Banks and Reshape the Payment Processor Market," Moody's Investor Service (June 20, 2012) at 10.

[51] Producer price index figures from the St. Louis Fed can be found here: https://fred.stlouisfed.org/series/PCUARETTRARETTR and consumer price index figures from the Minneapolis Fed can be found here: https://www.minneapolisfed.org/community/teaching-aids/cpi-calculator-information/consumer-price-index-and-inflation-rates-1913.

[52] The U.S. Bureau of Labor Statistics' release on the producer price index can be found here: Producer Price Index News Release summary - 2021 M12 Results (bls.gov) and the 2021 increase in the consumer price index can be found here: CPI Home : U.S. Bureau of Labor Statistics (bls.gov).

[53] "Grocery Store Chains Net Profit," FMI available at FMI | Grocery Store Chains Net Profit.

Anyone who believes free markets work would need to recognize that cost savings to retail businesses help hold down prices to consumers – unless they believe that there is a market failure in the retail sector of the economy. Of course, there is not. Retail is one of the most competitive sectors of the U.S. economy and has been for decades. Without a market failure, there is no question that reduced costs pass-through into lower prices. By arguing otherwise, it makes it sound as though the credit card industry has lived with centralized price-setting so long that they have forgotten how real competitive markets work.

The credit card industry likes to point to a report released by the Richmond Federal Reserve to try to disprove consumers' clear benefits from debit reform. The problem is that, in talking about that report, they never mention the cautionary notes that the study's authors themselves included in the report – which make clear it should not be used to prove the point for which the credit card industry tried to use it. First, the report made clear they did not look at actual costs and prices - it was just an opinion survey.[54] Second, the survey sample was small and could have been biased by getting responses primarily from those dissatisfied with the way the Fed wrote its regulation. Finally, it is worth noting what may be obvious given today's economic environment. Inflation is always present and matters. The actual data shows that merchants held prices down as their costs increased. That is real consumer savings. But a survey that asks whether prices were reduced would not get that information.

- Free Checking Increased Following Debit Reform

The credit card industry like to claim that consumers had fewer options for free checking accounts following debit reform, but their claims are demonstrably wrong. At the outset, it should be noted that the banking industry has admitted that "free" checking is a fallacy, "Customers never had free checking accounts. They always paid for it in other ways, sometimes with penalty fees."[55]

In addition to Bank of America's doubts about free checking ever having existed, it should be noted that the banking industry rapidly got rid of many free checking account offerings in the years *before* debit reform ever took effect. First, the banking industry blamed the financial crisis as the reason why they had to take away free checking and charge consumers higher fees.[56]

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[54] Renee Haltom and Zhu Wang, "Did the Durbin Amendment Reduce Merchant Costs?" (Dec. 2015) at 4, available here.

[55] Bank of America spokeswoman, Anne Pace, quoted in "Bank Accounts: Free Checking Fading Fast," The Christian Science Monitor (Oct. 19, 2010), available at http://www.csmonitor.com/Business/Latest-News-Wires/2010/1019/Bank-accounts-Free-checking-fading-fast

[56] *Rising Bank Fees are Setting Records,* USA Today (Oct. 27, 2008), available at http://www.usatoday.com/money/industries/banking/2008-10-26-atms-fees-checks-banks_N.htm ("The high fees come at a time when banks are struggling to unload bad mortgage loans."); *Banks Boost Customer Fees to Record Highs,* Wall Street Journal (Nov. 12, 2008), available at http://online.wsj.com/article/SB122645109077719219.html ("Banks are responding to the troubled economy by jacking up fees on their checking accounts to record amounts."); *Banks Find Ways to Boost Fees; Checking Accounts Latest Target,* USA Today (May 28, 2009), available at http://www.usatoday.com/money/industries/banking/2009-05-27-checks-fees-banks_N.htm ("Banks defend their policies, saying that as unemployment rises, consumers have become riskier, and the higher fees reflect that risk. Banks may also be raising some account fees to compensate for higher borrowing

Then, the industry pivoted and started blaming overdraft regulations for their decisions to increase checking account fees.[57] In fact, some even had the temerity to suggest that they had to increase checking fees because they couldn't make the same money from risky mortgages anymore.[58]

All of these various excuses for the steep drop in free checking offerings were made long before debit reform came into being. The litany of excuses was summed up well in a 2011 article written when banks were blaming debit reform for their increases in checking fees – remarkably, doing this even before debit reform had ever taken effect – "The pattern is getting old and weary.

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costs and to keep prices in line with other financial institutions, says Scott Talbott of the Financial Services Roundtable, which represents the nation's largest banks."); *Bank Fees Rise as Lenders Try to Offset Losses*, New York Times (July 2, 2009), available at http://www.nytimes.com/2009/07/02/business/02fees.html?_r=1 ("Scott E. Talbott, a lobbyist for the Financial Services Roundtable, said that the banks' fees reflect the cost of providing those services and the rise in overdraft charges reflects increased risk. 'There is an increased riskiness around repayment because of the recession, he added.'").

[57] *Is Free Checking on its Way Out?* CNNMoney.com (July 2, 2009), available at http://moremoney.blogs.money.cnn.com/2009/07/02/is-free-checking-on-its-way-out/ ("Bank customers used to the perks of free checking accounts -- unlimited check writing, online banking, debit card use and ATM access, to name a few -- might have to recalibrate their expectations soon. That's because overdraft fees, which banks use to subsidize the expense of free checking accounts, have been under fire by consumer advocacy groups."); *Banking Expert: Free Checking Accounts aren't Long for this World,* WalletPop.com (Aug. 31, 2009), available at http://www.walletpop.com/2009/08/31/banking-expert-free-checking-accounts-arent-long-for-this-worl/ (Following the Credit Card Accountability Responsibility and Disclosure Act and overdraft regulations, "banks are already trying to think of new ways to make their profits."); *Banks' Struggle May Mean End of Free Checking,* msnbc.com (Nov. 10, 2009), available at http://www.msnbc.msn.com/id/33840681/ns/business-consumer_news/ ("The change by Citi comes as Congress considers legislation that would limit banks' ability to levy overdraft fees on checking accounts."); *The End of Free Checking?* MoneyTalksNews.com (Dec. 30, 2009), available at http://www.moneytalksnews.com/2009/12/30/the-end-of-free-checking/ ("[N]ew Congressional regulations like the CARD Act have limited the amount of money banks can make from credit cards. The Federal Reserve also has plans to address the highly lucrative "overdraft fee industry", estimated to be worth $38.5 billion in 2009 by industry consultants Moebs Services. In other words, free checking accounts may soon be going the way of the dinosaur."); *The End of Free Checking,* NPR Planet Money (June 17, 2010), available at http://www.npr.org/blogs/money/2010/06/17/127899418/you-may-have-to-pay-for-that-checking-account ("It costs banks a few hundred bucks a year to maintain a customer's checking account. Banks have been able to make that up (and more) largely by charging overdraft fees. But new federal rules mean banks can only charge those fees to customers who sign up for overdraft protection."); *The End of Free Checking,* The Atlantic (June 21, 2010), available at http://www.theatlantic.com/business/archive/2010/06/the-end-of-free-checking/58444/ ("Free checking is on life support. . . . The main reason why, of course, is the imminent prohibition of overdraft fees, which had been a boon for banks."); *End of Free Checking a Financial Squeeze: How Employers Can Help*, The Huffington Post (June 28, 2010), available at http://www.huffingtonpost.com/clare-j-morgan/end-of-free-checking-a-fi_b_627540.html ("The free checking accounts many Americans enjoy will soon be a thing of the past as banks scramble to find new ways to recoup overdraft charges and other fees they're no longer allowed to impose.").

[58] *The End of Free Checking? Not at Credit Unions!* Credit Unions Online (June 17, 2010), available at http://www.creditunionsonline.com/news/2010/The-End-of-Free-Checking-Not-at-Credit-Unions.html ("Since banks can no longer charge many credit card fees of the past and high risk (high fee) mortgages are gone, banks are finding themselves short of revenue. . . . Now the banks are coming after your checking account to make up the difference.")

Banks will raise checking fees whenever and wherever they think they can get away with it. And they will blame any convenient development for their choices."[59]

This background matters because the credit card industry typically relies on two fatally flawed studies to try to show that reductions in free checking that came before debit reform – reductions they blamed on the financial crisis and limits on overdraft fees – were actually caused by debit reform. These studies take January 2009 as the measuring point for free checking prior to debit reform even though those reforms did not come into effect until October 2011, nearly two full years later. And, they pushed these studies onto the Government Accountability Office which cited them in a recent report without recognizing that the timing of the studies meant that the studies were blaming debit reform for things that happened prior to reform coming into effect.[60]

The number of checking accounts without monthly fees fell by 11 percentage points just from 2009 to 2010 – still a year before debit reform.[61] But, by counting the remarkably swift and steep reduction in the number of free checking accounts that occurred during the financial crisis and blaming that on debit reform (which came later), these studies magically find that debit reform reduced free checking. It didn't.

Banking industry data demonstrates that free checking increased from the time debit reform went into effect at least for its first few years in operation. The ABA reported that 61 percent of banks had free checking in 2014 which compares favorably to the 50 percent of banks with free checking that the ABA reported in 2010 and the 39 percent of large banks that Moebs Services reported offered free checking two months prior to debit reform taking effect.[62]

- Rewards Will Not End (and the Sky Will Not Fall) if Competition Comes to Credit Cards

The credit card industry consistently argues that any reforms to the current credit card market will end credit card rewards. In fact, they have spread advertisements all over the Internet

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[59] David Balto "The Bankers' New Goat," HuffPost (May 25, 2011) available at https://www.huffpost.com/entry/the-bankers-new-goat_b_834615.

[60] *See* "Banking Services," Government Accountability Office (Feb. 2022) available at https://www.gao.gov/assets/gao-22-104468.pdf.

[61] *Region Banks Refrain from Raising Checking Account Fees,* Nwi.com (Nov. 9, 2010), available at http://www.nwitimes.com/business/local/article_337b378b-3f74-5a00-9d86-b9e6b3d58799.html ("Bucking a national trend, the region's community banks aren't raising fees or putting the breaks on free, non-minimum-balance checking accounts, yet. A recent Bankrate.com national survey on checking accounts indicates the percentage of checking accounts with no monthly service charges and no minimum balance fell to 65 percent in 2010 from 76 percent in the 2009 study.")

[62] Cadence Bank, "ABA: Most Americans Pay Nothing for Bank Services," available at https://cadencebank.com/about/resources/aba-survey---most-americans-pay-nothing-for-bank-services; American Bankers Association, "ABA Survey Shows Majority of Bank Customers Pay Nothing for Monthly Bank Services," available at http://www.prnewswire.com/news-releases/aba-survey-shows-majority-of-bank-customers-pay-nothing-for-monthly-bank-services-104516904.html; Ismat Sarah Mangla and Tali Yahalom "Bank Accounts: Get a Fair Shake, not a Shake-Down," CNN Money (Aug. 31, 2011) available at https://money.cnn.com/2011/08/31/pf/bank_accounts.moneymag/index.htm ("This was backed by data from Moebs Services, which found that 39% of big banks offered free checking in 2011, down from 64% in 2010").

depicting Senator Durbin as a cartoonish figure and alleging that he wants to end credit card rewards. That is remarkable given that neither Senator Durbin nor any other Senator has to date proposed legislation to reform the competition problems with credit cards. You might think that the credit card industry would want to review any such proposal and analyze its effects before giving a reasoned evaluation of its impact – but you would be wrong. The industry clearly prefers insult to reasoned debate. And, of course, the credit card industry wants to warn other Senators that they could be the subject of its ridicule if they have the temerity to support potential reforms.

The credit card industry resorts to these tactics because the facts are not on its side. The nation with the longest track record of credit card fee reforms is Australia. After more than a decade under reforms there, the Reserve Bank of Australia has found, "The existence of significant credit card rewards programs suggests that credit card interchange fees are currently materially higher than is necessary for banks to provide payment cards with credit functionality. The Bank's 2013 Payments Cost Study shows that – for the average-size transaction for each payment method – the existence of the interest-free period and rewards means that the effective price paid by a cardholder to use a credit card is lower than that for a debit card, even though the resource costs are substantially higher."[63]

When Australia acted, MasterCard said it would mean the end of the credit card system in that nation – arguing that there would be a "death spiral."[64] They were wrong. More consumers use more cards for less than ever before in Australia. In fact, rather than Visa and MasterCard competing to raise interchange fees so that banks will issue more of their cards, they have had to give consumers what they really wanted – lower interest rates on their cards. This interest rate competition has benefitted consumers immensely. The only ones who don't like it are Visa and MasterCard (and their member banks) because they don't make as much on interchange fees and must now compete more thoroughly on the value they deliver to consumers. The Reserve Bank of Australia reviewed the interchange reforms instituted there and concluded, "Overall, consumers are benefiting from this greater competition and lower merchant costs . . . one group of consumers clearly better off are those who regularly borrow on their credit cards. They are now able to obtain a card with an interest rate of 10 to 13 per cent, rather than the 16 to 18 per cent payable on traditional cards. For many consumers the resulting savings can run into hundreds of dollars per year . . . Consumers who do not use credit cards at all are also benefiting from the reforms as they are paying lower prices for goods and services than would otherwise have been the case. For many years, these consumers have helped subsidise the generous reward points of the credit card issuers through paying higher prices for goods and services. The reforms have helped unwind some of this subsidy."[65]

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[63] Reserve Bank of Australia, "Review of Card Payments Regulation," at sec. 3, available at https://www.rba.gov.au/payments-and-infrastructure/review-of-card-payments-regulation/conclusions-paper-may2016/interchange-fees-and-transparency-of-card-payments.html.

[64] *See* Alan S. Frankel, "Toward a Competitive Card Payments Marketplace," at 40, available at https://www.rba.gov.au/payments-and-infrastructure/resources/publications/payments-au/paymts-sys-rev-conf/2007/5-compet-card-payment.pdf.

[65] Payments System Board Annual Report, *Reserve Bank of Australia*, 2005 at 14.

Lower fees, competition, and other reforms in other countries have not stopped Visa and Mastercard from aggressively marketing their networks to banks around the world. It is clear that there is plenty of revenue in nations with far lower fees for the credit card business to be very profitable.

- Visa and Mastercard Do Not Provide a Meaningful Break on Swipe Fees at Gas Pumps

Swipe fees have jumped by enormous amounts on motor fuel purchases during the past year. As noted, the convenience industry saw its fees rise by 26.5 percent in 2021 and are seeing more rapid increases this year. These large increases add a significant economic pressure to increase gas prices at the worst possible time. The card industry has tried to defend themselves from criticism for these rapidly rising fees by saying that they have capped swipe fees at $1.10 per fill-up. But they know that cap is largely ineffectual. The average amount of gas put in a car during a fill-up is 11.7 gallons.[66] So, using the average credit card interchange rate of 2.22 percent, a cap of $1.10 does not impact what the merchant pays for that fill up until gas costs about $4.25 per gallon. Other than in California, even recent gas prices have only rarely reached that number.

Swipe fees are often near 10 cents per gallon on a fill-up today. That is simply too much for local retailers or their customers to bear.

- Visa and Mastercard Do Not Need to Set Prices for Large Banks

One of the few ways that the credit card industry has tried to justify the centralized setting of prices by the networks for the banks that issue cards is by citing the large number of banks on each side of a credit card transaction. With thousands of banks issuing cards and thousands of banks and processors handling the merchant side of processing, they argue that it is too complicated and difficult for the prices of all those combinations to be negotiated in a free market.

But, the research has found that the card industry's protestations don't fit the facts. Nicholas Economides of New York University has studied this and found that credit card issuing and, on the other side, acquiring/processing of credit card transactions is very concentrated among small numbers of banks and processors with large market shares. As a result, in 2009, he found that a mere 90 negotiated agreements would cover a full 72 percent of all Visa and Mastercard transaction volume.[67] That, of course, is very doable – and there has been significant additional concentration in both markets since then.[68] There is no reason why the largest banks

[66] https://www.statista.com/statistics/1143194/average-fuel-transaction-volume-us-gas-stations/#:~:text=Average%20quantity%20of%20fuel%20purchased%20per%20transaction%20in%20the%20U.S.%202019%2D2020&text=Americans%20bought%2011.7%20gallons%20of,the%20gas%20pump%20in%202020.

[67] Nicholas Economides, "Competition Policy Issues in the Consumer Payments Industry," at 122 In R. Litan & M. Baily, Moving Money: The Future of Consumer Payment, Brookings Institution (2009) available at 06-0277-1 CH 06 (nyu.edu).

[68] The top 5 Visa/Mastercard issuing banks accounted for more than 70% of purchase volume in 2021, and the top 10 banks comprised more than 80%. *See* Nilson Report, Issue No. 1214 at 8-9 (Feb. 2022).

couldn't do business like other companies operating throughout the economy and negotiate their own pricing.

- The Combination of Thousands of Banks Under the Visa and Mastercard Umbrellas Means that Merchants Can't Just Stop Taking Credit Cards

Economists have found that due to the market power of Visa and MasterCard, merchants have no real choice but to accept credit cards. While the credit card industry likes to say merchants have a choice, this argument would be like AT&T claiming in the 1980s that no one should worry about its monopoly because people could choose not to have a telephone. Accepting cards is essential for most businesses – as the U.S. Department of Justice has concluded.[69]

In fact, the Kansas City Federal Reserve studied this and concluded, "Only monopoly merchants who are facing an inelastic consumer demand may deny cards when the fee exceeds its transactional benefit. . . Merchant competition allows the network to set higher merchant fees. The network can always set higher merchant fees in more competitive markets. Moreover, in competitive markets the merchant fees in the long run may exceed the sum of the merchant's initial margin and the merchant's transactional benefit. . . . As long as the merchant fee does not exceed the level that gives merchants negative profits, merchants may have no choice but to continue accepting cards."[70] The courts also agree that Visa and MasterCard both have market power which means they have the ability to raise their prices above what would be sustained in a competitive market.[71]

- Debit Reform Has Helped Small Banks and Credit Unions Compete

Currently, the way that credit card swipe fees are fixed disadvantages small banks and credit unions. Those institutions typically have higher costs than do large institutions (which, unlike small banks, often pay nothing to the credit card networks). Credit union representative John Blum, for example, testified on behalf of the National Association of Federal Credit Unions in 2010 and told the House Judiciary Committee: "Credit unions have a higher per-transaction cost for processing card payments."[72] Community banks have similar disadvantages because of their relatively small size resulting, in many instances, in the need to outsource card operations.[73] By fixing fees for all banks at the same level, however, large banks have for years been guaranteed higher profit margins than their smaller competitors. Those large banks have used their advantage to aggressively market themselves to consumers. That is one of the reasons why the credit card market is more concentrated than the debit card market. Many consumers who

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[69] *See* Complaint, U.S. v. Visa, Inc. and Plaid, Inc. (Nov. 5, 2020) at ¶3.

[70] Fumiko Hayashi, "A Puzzle of Card Payment Pricing: Why Are Merchants Still Accepting Card Payments?" Federal Reserve Bank of Kansas City (2004) available at https://ideas.repec.org/p/fip/fedkpw/psrwp04-02.html.

[71] *U.S. v. Visa U.S.A., Inc.*, 344 F. 3d 229 (2d Cir. 2003).

[72] John Blum, Hearing before the Task Force on Competition Policy and Antitrust Laws, House Judiciary Committee, May 15, 2008, House Report No. 110-179, at 80.

[73] Dave Carpenter, Hearing before the House Judiciary Committee on the Credit Card Fair Fee Act of 2009, Apr. 28, 2010.

have accounts and debit cards at small banks and credit unions receive credit card and other offers from large banks. The large banks take the small banks' customers in this way on a regular basis – paid for by their excess interchange earnings. The result is that large banks have a bigger share of both the credit and debit card markets than their share of deposits.[74]

Debit reforms have helped to level the playing field. The Philadelphia Federal Reserve published a study on the impact of debit reform on small financial institutions in February 2016. The study found that after reform, "the volume of transactions conducted with cards issued by exempt banks *grew faster* than it did for large banks."[75] The study concluded that "the evidence does not support the claim that competitive forces have effectively imposed the interchange fee ceiling on small banks."[76]

The Credit Union Times has reported that debit reform created "a powerful way for credit unions to accumulate market share" and "what some say is a huge opportunity for credit unions."[77] According to Texas Trust President and CEO Jim Minge, debit reforms created "…a huge opportunity for credit unions like the Mansfield, Texas Trust Credit Union and everybody else below the $10 billion threshold…" Debit swipe fee reform "applies only to financial institutions with more than $10 billion in assets, which has created a huge opportunity for credit unions – especially those that want to attract millennials."[78]

Centralized price-setting of credit card swipe fees harms smaller financial institutions. More competition in the market would help give them additional levers to try to compete with the largest banks including by allowing them to negotiate among the different networks.[79]

- Debit Reform and Network Competition Enhanced Fraud Protection

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[74] *See* Adam J. Levitin, *Interchange Regulation: Implications for Credit Unions*, 2010, at 39 (noting that 10 banks alone account for almost 90 percent of the credit card market and 51 percent of the debit card market, even though those 10 banks hold only 36 percent of insured deposits), *available at* http://www.federalreserve.gov/newsevents/files/levitin_filene_paper.pdf.

[75] James Disalvo and Ryan Johnston, "How Dodd-Frank Affects Small Bank Costs," Economic Insights: Federal Reserve Bank of Philadelphia (Feb. 2016) available at https://www.philadelphiafed.org/-/media/frbp/assets/economy/articles/economic-insights/2016/q1/eiq116.pdf.

[76] *Id*.

[77] "Credit Unions Revive Debit Rewards" (Jan. 22, 2016) available at http://www.cutimes.com/2016/01/22/credit-unions-revive-debit-rewards; "Credit Unions Pile Into Debit Rewards" (Jan. 20, 2016) available at http://www.cutimes.com/2016/01/20/credit-unions-pile-into-debit-rewards?page=1&slreturn=1453333652.

[78] "6 Winning Credit Union Payments Strategies" (Apr. 15, 2016) available at http://www.cutimes.com/2016/04/15/6-winning-credit-union-payments-strategies?slreturn=1487974414&page=2.

[79] The two largest networks favor larger financial institutions in the terms of their deals. *See* "2019 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions," Board of Governors of the Federal Reserve System (May 2021) at 15, available at https://www.federalreserve.gov/paymentsystems/files/debitfees_costs_2019.pdf.

Competition pushes businesses to provide lower prices and better service. That has been the impact that debit reform brought to payments a decade ago. By prohibiting exclusivity arrangements so that more than one network had to be available to handle debit card transactions, the market changed so that networks needed to find a way to improve their offerings. One way they did that was with enhanced protections against fraud. As soon as the debit reforms came into effect, the networks started introducing full end-to-end encryption of data.[80] They also accelerated the transition to chip cards in the United States.[81]

The credit card industry sometimes argues that high swipe fees are needed to cover fraud costs, but this is not the case – as is clear from the fact that fraud is much lower in nations with much lower swipe fee rates. Economists with the Federal Reserve Bank of Kansas City have found that fraud costs are not a justification for over-inflated interchange fees. They wrote, "Card organizations have often argued that the reason why they impose proportional fees stems from the cost they bear from their 'payment guarantee' service which insures merchants against customers who pay with cards without having sufficient funds. We argue that the cost of fraud and insufficient funding is negligible compared with fees at the range of 1% to 3% commonly imposed by brand name cards. For example, industry studies show that the average net fraud losses are around 0.05% for signature debit cards, which do not extend credit to card users."[82] And, as noted above, the majority of fraud is paid by merchants, not banks.

The swipe fee system on debit cards prior to reforms created disincentives to the card industry taking fraud protection more seriously. Because the fees were much higher than losses from fraud, financial institutions were not highly motivated to make changes to cut down that fraud. A June 2011 Consumer Reports article pointed out these problems. It noted that thieves could "easily and cheaply" copy U.S. debit card data that is usually stored unencrypted in a magnetic stripe on the back of the card. According to the article, "The U.S. and some non-industrialized countries in Africa are among the only nations still relying on magstripe payment cards, which came into wide use in the 1970's."[83]

A representative from the New York Police Department explained in the Consumer Reports piece that the NYPD had "recommended to several of the large financial institutions that the biggest deterrent to skimming would be using the kind of cards that are issued in Europe and Canada with a chip that makes them pretty much impossible to skim."[84] The article noted that financial institutions had been reluctant to do that due to their large card revenues. After debit

[80] *See*, e.g., Tracy Kitten, "Visa's New End-to-End Encryption Service," Bankinfo Security (Sept. 12, 2012) available at https://www.bankinfosecurity.com/interviews/visas-new-end-to-end-encryption-service-i-1650.
[81] *See* Visa presentation to Federal Reserve (Jan. 8, 2014) at 2, available at http://www.federalreserve.gov/newsevents/rr-commpublic/visa-meeting-20140108.pdf.
[82] Oz Shy and Zhu Wang, "Why Do Card Issuers Charge Proportional Fees?" The Federal Reserve Bank of Kansas City Economic Research Department, (December 2008) at 3 available at https://www.kansascityfed.org/documents/5325/pdf-rwp08-13.pdf.
[83] "House of cards: Why your accounts are vulnerable to thieves," Consumer Reports Magazine (June 2011).
[84] *Id*.

reform, however, the card industry had newfound motivation to reduce fraud and pushed the transition to chip cards – though, unfortunately, they failed to push PIN usage as they had in other parts of the world.

- <u>Merchants Absorb More Card Fraud Than Banks</u>

While the card industry often talks about a "payment guarantee," merchants are not guaranteed payment on credit or debit card transactions. In fact, merchants are forced to absorb the majority of the cost of fraudulent card transactions. When the merchant is forced to pay for the fraud, this is called a "chargeback." It means that the money the merchant was supposed to receive on the transaction is taken away (in other words, charged back). This can happen to a merchant without notice even months after the transaction takes place.

The Federal Reserve has collected data on debit card fraud every two years since debit reform was passed. Its 2019 data shows that merchants covered 56.3 percent of debit card fraud while card issuing banks only covered 35.4 percent.[85] The picture is similar for credit cards as merchants absorb most fraud losses – particularly since Visa and Mastercard implemented a liability shift to push chip card usage which pushed a significant share of fraud onto merchants. In fact, the Federal Reserve has reported that the merchant share of fraud on dual message debit cards (processed in similar fashion to credit cards) is more than 60 percent.[86]

Of course, all of the fraud chargebacks merchants must pay are on top of the swipe fees they pay. Those swipe fees amount to a prepayment of all fraud charges (and much more) to card-issuing banks. Merchants should not have to prepay for fraud and they should not have to pay when the fraud happens in addition to prepaying for it. They also shouldn't have to hear about the great "payment guarantee" they receive on credit and debit cards when the merchants pay for fraud multiple times.

It is worth noting that even with debit reform, merchants prepay all the fraud that banks otherwise cover. Federal Reserve Regulation II, which implements debit reform, includes 5 basis points as part of the regulated debit swipe fee to cover fraud losses by banks. That number was pegged to 100 percent of the fraud losses on debit cards paid by the average bank covered by the regulation. Of course, that means that fraud is a guaranteed profit center for many of the banks covered by the regulation (those with below average fraud losses). And, the vast majority of banks across the nation are not subject to the Fed's fee regulation. They charge even higher fees that exceed their fraud losses on debit cards. Why merchants must pay chargebacks to cover the majority of fraud that they have already prepaid (and then some) to the banks is inexplicable.

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[85] "2019 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions," Board of Governors of the Federal Reserve System (May 2021) at 4, available at https://www.federalreserve.gov/paymentsystems/files/debitfees_costs_2019.pdf.
[86] *Id*.

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The harm done to merchants, consumers and the U.S. economy due to the anti-competitive actions of the card industry is far too large and should end. Market competition improves economic efficiency, innovation, and price competition. Bringing competition to the credit card market would produce real economic benefits across the spectrum. It is time for that to happen.