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“THE LAW AND ECONOMICS OF INTERCHANGE FEES”

THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON ENERGY AND COMMERCE
SUBCOMMITTEE ON COMMERCE, TRADE AND
CONSUMER PROTECTION
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YOUR NEIGHBORHOOD SUPERMARKETS

The Food Marketing Institute (FMI), on behalf of the nation's supermarkets and grocery stores, appreciates the opportunity to submit testimony to the House Energy and Commerce Subcommittee on Commerce, Trade and Consumer Protection on "The Law and Economics of Interchange fees" and their impact on our business.

By way of background, FMI is a national trade association that conducts programs in research, education, industry relations and public affairs on behalf of its 1,500 member companies — food retailers and wholesalers — in the United States and around the world. FMI's members operate approximately 26,000 retail food stores with combined annual sales of \$340 billion — three quarters of all retail food store sales in the United States. FMI's retail membership is composed of large multi-state chains, regional companies and independent grocery stores. Our international membership includes some 200 companies from 50 countries.

Our business model has changed dramatically in the last 25 years. Shopping patterns have changed and so have how our customers pay for their purchases. The majority of our customers now choose to pay for their purchases using credit or debit cards. Our industry has responded to our customers with over 95% of our members now accepting credit and debit for payment.

By way of reference, the industry profit margin in our business last year was 1.16%. Our industry is intensely competitive and demonstrates how well consumers are served when the normal competitive model works in the marketplace. But in the plastic card world, that competitive model does not work. In that world, as costs go down, fees are driven relentlessly and inexplicably upward.

Let's look at just a few elements of cost to card issuers. The volume of transactions has grown dramatically providing economies of scale; interest rates continue at historically low levels providing lower operating costs; and technology continues to improve, also lowering operating costs. But at the same time we have seen the rates fees charged by credit card companies explode. Fees paid by FMI members to the card companies have increased roughly 700% over the past 10 years as a result of this combined growth in rates and volume.

By comparison, even the cost of a gallon of gasoline at the pump, where consumer outrage is palpable, has increased "only" 100% since February 12, 1996. We say "only" because that's a huge increase, but it's not 700%. If consumers had full information on the rates and fees associated with their plastic cards, we would see the same level of outrage we now see over gasoline prices.

Consumers already have some experience with this. They know and resent the fees they *are aware of* that credit card companies are charging them such as late fees, over-the-limit fees, zero balance fees, and inactivity fees. There is a whole class of fees that consumers *don't know* about. These include interchange fees, dues and assessments, risk fees, access fees, base rate settlement fees, surcharge fees, switch fees and transaction fees. Interchange fees are the most costly: In 2004 alone, Visa, MasterCard and their member banks collected \$27.6 billion in interchange fees.

Consumers don't know about these fees because merchants are *prohibited* from disclosing them. These hidden fees are ultimately reflected in the retail price of every product consumers buy.

Consumer anger would increase even more if they learned that this prohibition against disclosing the fees is included in a 1,200-page book of Visa operating rules that merchants must abide by but can't even have a copy for themselves! This lack of disclosure and lack of competition in these fees are contrary to everything this committee has worked to achieve.

The solution to this complex problem is relatively simple.

- First, shine some light!

Require the card companies to disclose their operating rules on a web site and file a copy with the Federal Trade Commission. Small businesses should no longer have to guess the fees they are being charged or the rules they have to follow — rules that can seemingly be changed at a whim.

- Second, card companies should be required to charge a fair price that reflects the actual cost of their services, but should not be allowed to subsidize the expensive marketing programs and promotional schemes that benefit only the most privileged few.

Consumers know nothing about the costs of these costly extras and the majority do not benefit from them. These include gold-plated reward programs that only the elite consumers qualify for, a blizzard of direct mail offers pushing cards on those who already have them or those who do not want them, and multi-million-dollar event sponsorships designed to push consumers into using the most expensive forms of plastic payment.

- Third, allow competition to develop within the system.

The days of *price increases* in a business where operating costs are falling should be over. High fees and charges to both merchants and consumers have subsidized the excessive promotional and direct marketing programs that erect prohibitively high entry barriers for new competitors.

Interchange fees constitute a powerful anti-competitive force driving up consumer prices and yet consumers aren't allowed to know about them. As a result, they do not have the full disclosure they need to make rational decisions about the payment choices they must make. This violates the most basic principle of the free competition model.

Congratulations to this Subcommittee for giving consumers their first look at interchange fees and the impact they have on the prices shoppers pay every day.