18 July 2006

The Honorable Senator Arlen Specter
The Honorable Pat Leahy, Ranking Member
Senate Judiciary Committee
224 Dirksen Building
Washington, DC 20510

RE: Credit Card Interchange Rates: Antitrust Concerns

Dear Chairman Specter and Senator Leahy,

As non-profit and non-partisan consumer and public interest advocates, U.S. Public Interest Research Group, Consumer Federation of America and Consumer Action strongly encourage the Senate Judiciary Committee's investigation into credit card interchange rates. We would be happy to come in and brief you or your staff at your convenience on this important matter affecting consumer prices.

Credit card associations' deceptive and anticompetitive practices have injured both consumers and merchants for many years. 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.

The purpose of our three organizations is to advocate on behalf of all consumers for a fair and competitive marketplace. We regularly advocate before state and federal regulators and legislators on competition policy issues.[1] We recognize that financial service markets work best where there is vigorous competition protected from anticompetitive practices. The work of your Committee in overseeing enforcement of the antitrust laws plays a vital role in this important goal.

Based on our experience in these and other markets we believe there are two essential elements to a competitive marketplace: information and choice. Accurate and transparent information is necessary for consumers to make accurate choices. When information is readily available consumers can make choices, effectively compelling firms to compete for their purchases. And choice is a necessary element too. Absent choice, the discipline of the market will be lost.

Unfortunately, the credit card market lacks both choice and adequate information. It lacks choice because merchants have no choice but to accept the card associations' cards even when the associations significantly increase prices. It lacks adequate information because the

[1] For example, see also see the joint testimony of U.S. PIRG and the Consumer Federation of America, by Edmund Mierzwinski, Consumer Program Director, U.S. PIRG, before the House Committee on Energy and Commerce, Hearing on The Law and Economics of Interchange Fees, Subcommittee on Commerce, Trade, and Consumer Protection, February 15, 2006.

associations prevent merchants from accurately informing consumers of the costs of credit card acceptance or attempting to direct them to more efficient and lower priced payment mechanisms. Moreover, the banks and associations engage in other deceptive practices to increase the interchange problem. Since the costs of accepting cards are passed on in the overall costs of goods, all consumers – affluent, working-class, and poor – ultimately pay these hidden charges. Low-income Americans, most without bank affiliations, are paying more for goods and services to fund credit card company programs for which they are not even eligible.

We present four main points. First, all consumers, even those who pay with cash and checks, pay more at the store because these interchange fees are passed on in the overall cost of goods sold. Second, the significant increases in interchange fees signal a broken market. Visa and MasterCard have tremendous market power, which allows them to dictate the terms of trade: merchants have no choice but to accept Visa and MasterCard products on the sellers' terms. Third, there is a lack of information for consumers because the associations' rules limit the ability of merchants to direct consumers to the safest, lowest cost, and most efficient forms of payment. In addition, both the associations and banks engage in a variety of deceptive practices to drive consumers to higher-cost forms of payment. Finally, interchange and consumer fee increases have occurred as banks have merged and industry concentration has increased to alarming levels.

Interchange Fees Force Consumers to Pay Higher Prices

The interchange fee system is hidden from consumers and the public. The card associations do not disclose publicly their fees or the basis for these fees. Some public reports maintain that, on average, interchange fees cost merchants 1.6 percent or more of each transaction on a credit or signature debit card. In 2004, credit card interchange fees alone cost merchants and consumers an estimated $27.6 billion.[2]

Like all other costs incurred by merchants, interchange fees are included – at least in part – when pricing goods and services. Card associations may suggest that interchange fees fund attractive rewards programs. Setting aside the question of the value of these programs, many consumers with credit cards do not use them and those without credit cards receive no benefits.[3] Over 27 percent of Americans do not have credit cards. For these consumers, interchange fees are an especially pernicious and regressive cost.[4] These low-income Americans subsidize interchange fees for "services" that they are not eligible to use. No charge could be as regressive as one in which low income consumers receive no benefits.

The regressive nature of this charge is exacerbated because interchange fees are assessed as a proportion of overall sales. For example, when gas prices averaged $1.87 per gallon in 2004, interchange fees totaled about $12.5 million per day. In 2005, gas prices averaged about

[2] Food Marketing Institute. "*Hidden Credit Card Fees: The True Cost of a Plastic Marketplace*" (February, 2006).
[3] We seriously doubt consumers receive anything close to $27 billion in benefits through rewards programs. Some of the interchange fees undoubtedly fund industry marketing efforts, such as the more than 5 billion annual mail solicitations consumers receive for credit cards. Moreover, credit card issuance is a tremendously profitable line of business.
[4] U.S. Census Bureau, *Statistical Abstract 2006*, Table 1176.

$2.75 per gallon nationally: credit card companies then made $18.4 million a day. These companies made an additional $2.2 billion dollars per year simply because of rising gas prices.[5] This problem will skyrocket as gas prices continue to increase. It is difficult enough for low and moderate income consumers to afford skyrocketing gasoline prices without having to pay additional fees that are passed on to them.

Increases in Interchange Fees Signal a Broken Market

Credit card interchange fees were intended to compensate card-issuers for certain costs, such as the costs of issuance, fraud, risk of loss, float and processing. Yet as all these costs have decreased in the past decade credit card interchange fees have increased. According to the Food Marketing Institute (FMI), these fees have increased over 20 percent in the past few years even though all the costs of card processing and issuance have fallen. The United States appears to be the only country in which credit card interchange fees are increasing and it has far higher fees that almost any other industrialized country. FMI projects that these fees will increase 22 percent annually.[6]

In a competitive market, prices would fall when costs decrease. In the credit card market, the opposite happens. The card associations may say that they need to increase interchange fees to compete for the loyalty of card issuers. But what about merchants and consumers? Merchants certainly have no choice but to accept Visa or MasterCards.

In the Justice Department case against Visa and MasterCard, the Court determined that both associations had market power because merchants were compelled to accept these cards even in the face of a significant price increase. Almost all merchants are forced to accept Visa and MasterCard's terms, no matter what the interchange rates or contractual terms. Armed with this advantage, credit card companies can, and do, increase interchange fees without suffering any repercussions.

Are these substantial interchange fees necessary? Examples outside the United States suggest this is not the case. In other countries, interchange rates are about one-third less than they are in the United States. In the United Kingdom, merchants pay about 0.7 percent. After a government mandated reduction in interchange fees in Australia from 0.95 to 0.55 percent, Australians saved over $300 million US per year.[7] In the United States, where interchange fees are considerably higher, the potential savings for each consumer would be far greater.

Another example is the debit market in Canada. In that market, there are no interchange fees. Even without interchange, there is higher debit card usage and merchant acceptance than in the United States. Some consumers pay direct fees for debit card use but because those fees are

[5] Margaret Webb Pressler, "Card Companies Are Filling Up at the Station," in Washington Post. September 25, 2005: pg. F01.
[6] Food Marketing Institute, "Hidden Credit Card Fees: The True Cost of a Plastic Marketplace" (February, 2006).
[7] "An Interchange Tussle With a Twist: Retailers Against Zero Pricing," *Digital Transactions*, September 10, 2004.

transparent there is active competition to reduce those fees. Ultimately everyone in Canada pays less for the cost of payment services.[8]

Deceptive Practices Increase Prices for Consumers

As we suggested earlier, accurate and complete information serves a critical role in making sure the forces of competition work. As the government does not regulate or compel disclosure of credit card interchange fee, most consumers have no idea that they exist and that they are paying for services that they may not even use. In fact, Visa, MasterCard and the card issuing banks engage in a variety of practices to prevent well-informed consumers from exercising their choices.

First, Visa and MasterCard rules prevent merchants from disclosing fees to their customers or attempting to steer consumers to lower-priced payment options, such as cash or online debit cards. They cannot charge a distinctive price or surcharge based on payment options. They cannot attempt to direct consumers to lower cost options such as cash, checks and online debit.

Second, card associations and banks use misleading marketing to encourage consumers to use their credit cards or signature debit cards as frequently as possible. Reward incentives, such as frequent flier miles, are designed to seem as though customers are paid to use these cards. In reality, these consumers and other consumers are simply paying for those rewards.

This lack of disclosure is especially problematic with the recent efforts of the card associations to “convert” cardholders from regular credit cards to so-called “premium cards” such as the Visa “Signature” or the MasterCard “World” cards. These cards have a significantly higher interchange fee than traditional cards, among the highest of all interchange fees. For example, a premium card may cost merchants over 1.8 percent compared to 1.6 percent for a traditional card. These premium cards focus only on the highest-income consumers. However, they offer minimal additional benefits. Consumers do not realize they pay higher prices on goods and services with a premium card and are wholly unaware of how converting to a premium card will ultimately cost all consumers more. Nor, as stated above, can merchants refuse to accept these cards or attempt to direct consumers to lower priced cards through differential pricing. These premium cards are simply a scheme to substantially increase hidden interchange fees.

Third, although merchants can’t surcharge or use differential prices to direct consumers to the most efficient and lowest priced payment options, banks do have that power. Not surprisingly, they use it to direct consumers to less efficient, higher cost options. The debit card market illustrates this problem. Signature based debit is more expensive and less secure than online debit because online debit transactions are instantaneous. Online debit has a far lower rate of fraud. Online debit transaction interchange fees are capped at fixed levels; they only cost

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

merchants $0.17 and $0.50 per transaction.[9] Conversely, credit and signature debit cards cost merchants up to 2% of the entire transaction, no matter how large. Instead of promoting online debit, banks often surcharge these transactions as much as 50 cents a transaction. These penalties effectively steer consumers to the less efficient, less secure, more costly signature debit product. While the use of online debit cards is the best option for both consumers and merchants, deceptive and manipulative tactics ensure the most expensive payment possible is used.

Not surprisingly, outside the United States, where these anticompetitive practices are not permissible, online debit is the most preferred form of debit. Online debit is a far safer and more secure product. Where market forces are not restrained and consumers can make fully informed choices, the lower priced more efficient product prevails.

.Increased Consolidation of Card-issuing Harms Consumers

The credit card issuing market has become significantly more concentrated over the past few years as numerous card issuers have merged. For example in the past few years we have seen mega-mergers such as BankAmerica's acquisitions of Fleet and MBNA. The top ten card issuers now have over 90% of the market, and the level of concentration has increased from an HHI of about 1100 in 1998 to an HHI of about 1800 today, a level that the Department of Justice Merger Guidelines define as highly concentrated.

Of course, we expect the card associations and their members to suggest that the market is unconcentrated and vigorously competitive.[10] But the facts are to the contrary. While concentration has increased dramatically over the past seven years, interchange fees, other fees charged to consumers, and interest rates have increased significantly. Although the parties to these mergers suggested that there would be significant efficiencies from these mergers, consumers have seen few, if any, benefits.

Conclusion

In his testimony in February on behalf of the Electronic Payments Coalition, Timothy Muris alleged that "[i]f consumers understood the threat that the merchants' campaign [against interchange] poses to the plastic in their wallets, I suspect that we would see nothing less than a revolt." He could not have been more wrong. If consumers understood the existence or the dimensions of the hidden fees assessed by the banks and associations, they would truly rebel. Credit card companies make billions of dollars each year through interchange fees, which ultimately consumers must pay, including the millions of Americans without credit cards. The

[9] November 2004, Federal Reserve Board, Report to the Congress on Disclosure of Point-of-Sale Debit Card Fees, page 11 See http://www.federalreserve.gov/boarddocs/rptcongress/posdebit2004.pdf (last visited 14 February 2006).

[10] In his testimony from February, former FTC Chairman Timothy Muris testified that "[n]o [card] issuer has market power, and issuers respond to increases in interchange fees by enhancing card benefits to consumers." We doubt that Visa and MasterCard or card-issuers act as benevolent monopolists, but in any case there is no systematic study to suggest that increased interchange is passed on to consumers in greater benefits. Even if this allegation was substantiated, it would still be true that all consumers, including those who do not use credit cards pay for those "increased benefits."

credit card market lacks the critical foundations of healthy competition – choice and adequate information. As consumer advocates, we are gravely concerned about the fairness and legality of bank schemes to increase credit and debit card fee income. We urge your Committee to suggest that we follow in the steps of the Australian government and the European Union in carefully investigating interchange fees. We look forward to working with you in protecting consumers from anticompetitive tactics in this vital market.

Thank you for considering these remarks. If you have any questions, please contact us.

Sincerely,

Edmund Mierzwinski
Consumer Program Director
U.S. PIRG

Travis Plunkett
Legislative Director
Consumer Federation of America

Linda Sherry
Director, National Priorities
Consumer-Action

APPENDIX

US PIRG

The United States Public Interest Research Group (U.S. PIRG) serves as the federal lobbying office for the state PIRGs. State PIRGs are non-profit, non-partisan consumer, environmental and good government watchdog groups with over 500,000 members around the United States. U.S. PIRG places a special emphasis on predatory financial practices and financial education and maintains a website at www.truthaboutcredit.org for consumers to obtain non-partisan information and fact sheets about credit card company practices. U.S. PIRG has recently testified on credit card interchange fees (House Energy and Commerce, February 2006) and credit card company practices (Senate Banking, May 2005). Recent major PIRG reports on credit card practices include the following: Graduating Into Debt: A Survey of On-Campus Credit Card Marketing In Maryland (2004); Deflate Your Rate: How To Lower Your Credit Card APR (2002) and The Credit Card Trap: How To Spot It, How To Avoid It (2001).

Consumer Federation of America

The Consumer Federation of America is non-profit organization of approximately 300 organizations (representing 50 million individuals) that, since 1968, has advanced the consumer interest through research, advocacy, and education. Comprised of approximately 300 nonprofit organizations from across the nation and more than 50 million individuals, CFA has been the voice of consumers since 1968. CFA is particularly concerned about issues affecting low and moderate income consumers.

Consumer Action

Consumer Action is a national non-profit advocacy and education organization designed to serve consumers through the advancement of consumer rights. Founded in 1971, Consumer Action has built its reputation based on its multilingual education and advocacy efforts, particularly in the fields of credit, banking, privacy, insurance, and utilities. Along with its advocacy programs, Consumer Action provides educational and technical assistance to more than 6,500 community-based and government agencies in order to ensure access to consumer education. Staff and leaders of Consumer Action are often called upon by the media to provide expert commentary on consumer-based issues. Consumer Action also operates The National Consumer Resource Center (NCRC), which educates and informs clients about current consumer issues.