

*Statement for the Record*

*On Behalf of the*

AMERICAN **BANKERS** ASSOCIATION

*Before the*

Antitrust Tax Force

Committee on the Judiciary

United States House of Representatives

May 15, 2008

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The American Bankers Association appreciates the opportunity to submit a statement for the record on the Credit Card Fair Fee Act of 2008, H.R. 5546. ABA brings together banks of all sizes and charters into one association, and works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than \$125 million in assets – represent over 95 percent of the industry's \$12.7 trillion in assets and employ over 2 million men and women.

The United States has the most innovative, efficient and cost-effective consumer credit market in the world, providing fast, safe and low-cost transactions that benefit consumers and retail merchants. Today, credit cards are responsible for more than \$2.5 trillion in transactions a year and are accepted at more than 24 million locations in more than 200 countries and territories. There are more than 6,000 U.S. credit card issuers. In the last 20 years, the number of debit cards has grown from 60 million to nearly 420 million. All payment cards rely on a processing system that handles more than 10,000 transactions *every second* and has enough communications lines to encircle the globe nearly 400 times.

***Clearly, it is a system that works and works very well.***

This highly advanced and efficient payment system is the result of a highly competitive and innovative industry that has invested heavily in its ideas and its customers. The value delivered through this payment system to consumers, merchants and financial services organizations far exceeds the costs. Merchants, in particular, receive significant benefits from accepting electronic payments, foremost the ability to maximize consumer satisfaction and company sales. These guaranteed, immediate payments

help merchants avoid bad check losses, employee theft, check float loss, costs associated with billing and collections, and managing and depositing cash. When merchants *choose to accept* payment cards, they pay a penny or two on each dollar for the ability to accept electronic payments. This is a very small price to pay for all of these benefits.

H.R. 5546 represents an effort by the merchant community to have government step in to reduce the merchants' cost of doing business, while increasing the costs and reducing the benefits of everyday consumers. The bill would impose price controls by authorizing a government bureaucracy – a panel of three government-appointed lawyers – to arbitrarily decide rates and terms for interchange fees and the electronic payments system. Substituting the judgment of three lawyers for a market that has functioned smoothly for over 50 years will destroy a smoothly functioning payment system that works to the benefit of consumers, merchants, community banks, and the local economy.

Price controls on electronic payments systems will harm banks of all sizes and, ultimately, will harm the consumers they serve. Interchange fees cover the significant risks and costs associated with providing electronic payments, including payment risk, fraud risk, and the operational costs of providing the extremely efficient and seamless payment system we have today. They also provide small community banks, particularly, with an important revenue stream that enables them to offer payment cards to their customers, allowing them to compete on a level playing field with the world's largest banks. There is significant customer demand for community banks to offer card products to complement their traditional bank offerings. Limiting the electronic payments system with government price controls would shrink the market to a much smaller number of large card issuers and would reduce choices for consumers.

Merchants, banks, and card networks have worked together for more than 50 years to build an efficient and accessible electronic payments system that is convenient, secure, reliable, and global. H.R. 5546, if enacted, would disrupt the balance established in a properly functioning and remarkably

successful marketplace in which merchants, customers, financial institutions, and networks have benefited.

There are three key points we make in this statement:

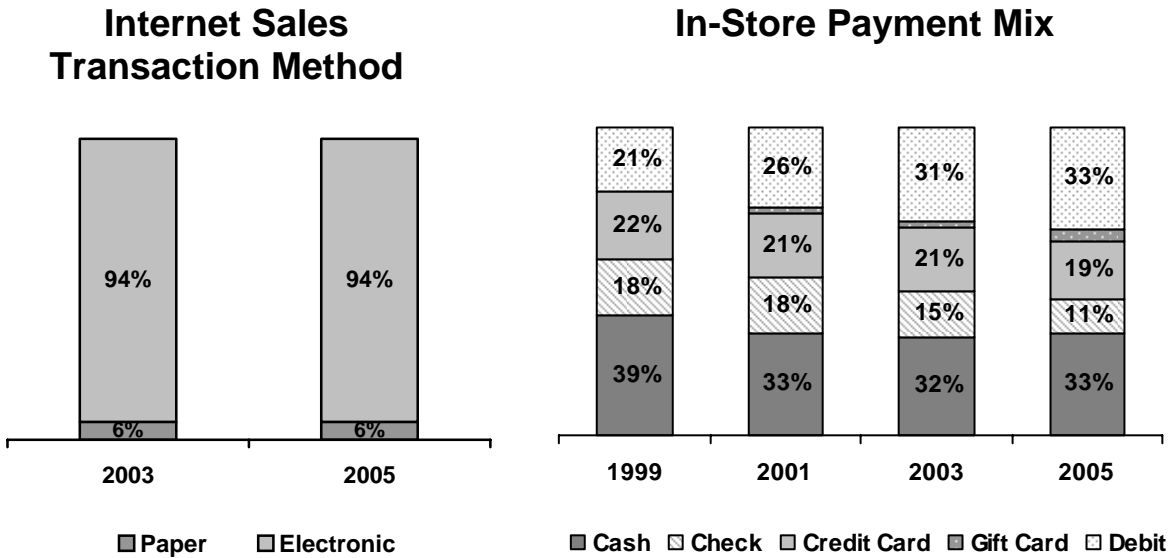
- **Payment cards play a vital role in our economy and offer many benefits to consumers, merchants, and the local financial institutions that provide services.**
- **Price controls do not work; instead of reducing costs to consumers, they shift the costs of doing business from merchants to consumers in the form of increased fees and reduced benefits.**
- **H.R. 5546 puts in place a new government bureaucracy to fix prices that will have severe unintended consequences, including reducing competition and harming consumers and the economy.**

## **I. Payment Cards Play a Vital Role in Our Economy and Offer Many Benefits to Consumers, Merchants, and Financial Institutions**

Payment cards safely connect consumers and businesses instantly to a panoply of products and services. They provide merchants of all sizes with broad access to the buying public, funding for small businesses, and billions of dollars in annual payment-processing savings. Retail commerce, in particular online shopping, would not exist as we know it today without them.

Millions of consumers and businesses have access to payment cards, and this is directly attributable to a pricing structure that has encouraged financial institutions to issue credit and debit cards, and merchants to accept them. **It is a win-win situation for everyone** involved that has resulted in an effective and reliable system for consumers and merchants that works so smoothly, they take it for granted. Further, the electronic payments system has fostered a fiercely competitive industry

that has revolutionized how Americans do business, fueled e-commerce, provided small merchants unlimited growth potential, and offered millions of consumers convenience, security, and access to money when they need it.



**Consumers have benefited tremendously from payment cards.** In the early 1970s, cards were available only to those with relatively high incomes. This is not the case today as some type of payment card is available to most people. Payment cards provide myriad benefits to consumers, most notably the everyday convenience for making purchases that is enjoyed by individuals and businesses, 24/7 around the world. Card accounts help households keep track of exactly how much and where their money is spent with the help of customized monthly statements or via up-to-the-minute account access over the Internet. Payment cards provide confidence and convenience when traveling and are a means of identification. Some cards entitle consumers to popular and valuable enhancements, such as rebates and awards tailored to their purchasing habits and special interests, which are a result of the intense competition issuers engage in as they fight for consumer loyalty. Short-term credit is also a proven means by which average consumers can weather unexpected financial disruptions or pay for unexpected expenses.

The pricing structure within this system ensures that financial institutions have incentives to offer new and innovative products, which helps fuel increased use of cards and which translates directly to greater use at merchants in the United States and world-wide. Perhaps most important of all, innovations in the payment card industry have resulted in strong protections against fraud, including state-of-the-art technology that protects consumers from unauthorized access to their accounts. For example, credit card issuers notify consumers if it seems likely their account security has been violated and can automatically suspend account access until the status of the account is verified. Consumers face little if any liability for unauthorized or unlawful use of their credit cards; rather, it is the banks that bear this cost. Generally, consumers' liability is limited to \$50 under federal law and, in many cases, cardholders pay nothing for credit card losses as issuers waive the \$50. It is hard to imagine a more powerful, flexible tool that offers so many protections against loss or fraud. Put simply, Americans participate fully in today's world economy – largely because of the access that a spectrum of card products provides – but pay nothing directly for this privilege. Importantly, it is the interchange revenue that plays a major role in being able to offer the full spectrum of card services.

**Merchants Benefit from the Payment Card System.** Payment cards of all kinds provide the passkey to new sales channels in the 21st century. Payment card acceptance gives business owners access to the broadest possible customer base. It allows merchants to sell a greater volume of products in less time and at lower cost. Payment cards are particularly helpful to smaller merchants because they give them access to a larger pool of customers that helps them compete with large chain stores at both the store front level and on the Internet. In fact, e-commerce would have been impossible without the support of the electronic payments systems. ***Whether online or in person, card transactions generate millions of customers and billions of dollars in sales for merchants every year.***

Sophisticated payment card systems provide merchants huge benefits compared with cash or checks. They are a form of guaranteed payment that protects merchants from the risk of fraud and

non-payment. This allows retail merchants to instantly confirm that a customer has enough credit to make a purchase with his payment card and to have that payment transferred electronically from the customer's bank to the merchant's account. Retailers, while fully aware of the benefits these services provide, now do not want to pay for it. Rather, they want Congress to intervene to lower a cost of doing business.

The greater the use by both consumers and merchants, the more valuable the network is to all parties. It is no wonder that even retail businesses that deal in small dollar sales, such as fast food restaurants and coffee shops, are accepting card payment services. The firms had a choice to make regarding how best to increase sales and enhance the customers' need for convenient and fast service. The businesses have realized the significant value of the service and made an economic decision that it is in their best interest to be a part of the system.

Innovations by card issuers have rapidly expanded availability of payment cards to small businesses, further driving sales for retailers. Small firms benefit from access to credit to help finance their operations. They also benefit from flexible terms and greater ability to manage monthly expenses, track purchases, and weather short-term fluctuations in cash flow. Nearly half of all the small firms in the United States depend upon credit cards for their everyday operations. For example, small businesses made more than \$100 billion in purchases using Visa Business cards last year. Again, it is a system that works very effectively.

**The Economy Benefits from Payment Cards.** No retailer acting on its own could arrange for an efficient payment system like this one, developed and paid for by the banks involved. The card payment system today has provided enormous benefits to retailers and the economy. The General Accountability Office (GAO) found that the number of credit cards in use has grown from less than 100 million in the mid-1980s, to over 690 million through 2005. Accounting for trillions of dollars in transactions every year, credit cards are responsible for a large and growing share of consumer spending

in the United States. Economic performance depends upon a stable, efficient, and secure means of exchanging value. In the United States, payment cards make this exchange possible every minute of every day. Imposing price controls on a system that has returned such significant benefits for our economy makes no sense.

**Local Community Institutions Benefit.** Community banks, and their customers, have also benefited from the growth of payment systems as it enables smaller banks to compete for customers with larger financial institutions. There is significant customer demand for community banks to offer card products to complement their traditional bank offerings. In fact, debit cards are particularly popular with bank customers and are the fastest growing segment of the payment card market. Revenue derived from interchange fees is critical to community banks' ability to provide card transaction services and helps support the provision of financial services more generally. This benefits consumers by offering more choice and allows community banks to compete with large institutions on an equal footing. Limiting the electronic payments system with government price controls would shrink the market to a much smaller number of large card issuers and would reduce choices for consumers.

## II. Price Controls Do Not Work

The electronic payments system is working for consumers, merchants, and the financial institutions that handle the transactions. Price controls or other interference by the government are unnecessary and would ultimately harm consumers by shifting the costs of maintaining the electronic payments system from merchants *directly* to consumers. In fact, a similar price control regime in Australia allowed merchants to reap a windfall of savings, at the expense of cardholders who

experienced increased fees, rates and the elimination of rewards, while prices for goods and services remained the same.

Interchange fees are not paid directly by consumers that use credit and debit cards. Rather, they are paid by merchants to the financial institutions that process these transactions as a cost of business for using an electronic payments system. The value conferred to merchants is huge and they **choose** to use these systems because they benefit from a fast and secure method of payment that customers like and are using with ever growing frequency. Merchants know that there are costs to other systems as well. Cash has to be counted, and tends to “shrink” from theft. Checks are more expensive to handle, and merchants pay extra fees for check management. In fact, the cost of returned checks was a major reason for the creation of the electronics payments system in the first place. All of this means that merchants have choices. ***Retailers can choose not to accept payment cards, but they know that they will lose customers to other retail competitors that do accept payment cards.***

Supporters of H.R. 5546 argue that interchange fees harm consumers and that regulating rates will help lower prices. Proponents of this legislation contend that regulating interchange fees will help consumers. This is simply not true. The thousands of issuers of credit cards and debit cards, in their intense competition for customers, have used the flow of interchange to lower costs to consumers and provide them more benefits and services. Consider, for example, that most card issuers no longer charge any annual fee. Government intervention to lower interchange rates will not benefit consumers. In fact, imposing artificial price controls on the free market will interfere with this efficient system and is likely to result in harm to consumers through higher fees and reduced benefits.

As noted above, recent experience in Australia shows that imposing price controls on payment card system fees is a bad idea. In 2003, the Reserve Bank of Australia (RBA) began regulating interchange fees by tying price to the costs of funding, processing and fraud and allowing merchants to assess a surcharge on credit card purchases. Comments made by the RBA itself in 2004 and 2005 note

that while merchants have saved \$500 million in Australian dollars (about \$400 million US), there is little evidence that these savings have been passed on to consumers. In fact, statistics gathered by the Prudential Equity Group in September 2004 showed that the restrictions are causing more harm than good to consumers and merchants because merchants have added surcharges to credit card and Internet purchases and because they have not passed on the savings to consumers. In short, Australia's attempt to set price controls has ended in windfall profits for retailers. Any attempt to control interchange fees in the United States would also end up in failure.

### **III. H.R. 5546 Will Reduce Competition and Harm Consumers and the Economy**

The credit and debit card system functions as a free market, with rates established between institutions within the card network. The economy has prospered because of the security and sophistication of the credit and debit card system, developed at a significant cost to banks. Subjecting interchange fees to government price controls would jeopardize the efficiency and responsiveness of the system and will end up increasing costs for consumers and harming the economy.

The bill puts in place a new government bureaucracy – a panel of three government-appointed lawyers – to arbitrarily decide rates and terms for interchange fees and the electronic payments system. This interjects government price controls and interference into a smoothly functioning payment system that works to the benefit of consumers, merchants, community banks, and the economy. Merchants already negotiate the terms of their agreements, including the fees they pay, with those providing payment acceptance services to them. Thousands of small community banks, credit unions, larger global banks, and card processing companies compete on a daily basis to offer merchants these services.

There is significant customer demand for community banks to offer card products to complement their traditional bank offerings. Regulating interchange fees would likely strain these banks' relationships with their customers. By offering credit and debit cards to customers, smaller banks are able to maintain their customer relationship while offering products that typically only larger banks would be able to offer. A reduction or cap on these fees could force many banks to curtail or eliminate benefits for cardholders and raise annual fees. This would have a disproportionate impact on community banks and would shrink the market to a much smaller number of large card issuers – further reducing choices for consumers.

## **Conclusion**

ABA strongly opposes H.R. 5546 because interchange rates and governance should be determined by the free operation of the private market rather than government fiat. H.R. 5546 would result in higher real costs to consumers and allow merchants to reap windfall profits. This is because reducing interchange fees may save merchants money, but it will be at the expense of cardholders who are likely to face increased fees, rates and the elimination of rewards. Moreover, there is no guarantee – and in fact, evidence to the contrary – that merchants will pass their savings on to customers. Establishing price controls will devastate the free functioning of an efficient market.

Each year our credit and debit card system processes millions of transactions with amazing accuracy. Merchants do not have to participate in this system and are free to accept cash and checks as payment for goods and services. Indeed, most retail transactions are made via cash and checks, but increasingly, merchants have realized that the benefits of accepting card payments – access to millions of consumers through the Internet; guaranteed immediate payment for goods and services; and fraud protection – far outweigh the costs. The greater the willingness of consumers to use cards for payments, the more valuable the system becomes to merchants.

H.R. 5546 would turn back 50 years of development that has resulted in an efficient, accessible, secure, reliable, and global electronic payments system. It will create an impractical federal bureaucracy that puts the government in charge of setting prices, undercutting a pricing system that currently benefits consumers, businesses, and the broader economy. Rather than reduce costs at the cash register, H.R. 5546 would give merchants windfall profits; rather than save money in streamlined government, H.R. 5546 would create a new bureaucracy; rather than encourage the development of new products that allow consumers to manage their money more easily, H.R. 5546 would take away options for consumers. The American Bankers Association urges Congress to oppose H.R. 5546.