Testimony of Ed Mierzwinski
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at a Hearing

of the

U.S. Senate Judiciary Committee

on

Excessive Swipe Fees and Barriers to Competition in the Credit and Debit Card Systems

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The Honorable Richard J. Durbin
Chair

May 4, 2022

Testimony of U.S. PIRG at a Senate Judiciary Committee Hearing on Excessive Swipe Fees and Barriers to Competition in the Credit and Debit Card Systems 4 May 2022

Thank you, Chair Durbin, Senator Grassley and members of the Judiciary Committee.

My name is Ed Mierzwinski. I am senior director for federal consumer programs at the U.S. Public Interest Research Group. U.S. PIRG is an advocate for the public interest. We speak out for a healthier, safer world in which we're freer to pursue our own individual well-being and the common good. U.S. PIRG serves as the national office of the nonprofit state Public Interest Research Groups.

As a consumer advocacy group, we have long supported credit and debit interchange (or swipe) fee reform and the Durbin amendment, which made debit interchange markets fairer.[1]

All consumers pay more at the store and more at the pump because of unfair, nonnegotiable, nontransparent merchant interchange fees imposed by the card networks.

These fees impose the greatest hardship on the most vulnerable consumers—the millions of American consumers without credit cards or banking relationships. These consumers, as cash customers, subsidize card usage by paying inflated prices for many goods and services. These prices are inflated by the billions of dollars of anticompetitive interchange fees, which are used to subsidize rewards programs, promotions, and riskier credit underwriting for credit card users.

And unfortunately, credit card interchange fees continue to accelerate, because there is nothing to restrain Visa and Mastercard from charging merchants, and their customers, even more.[2] Just a few days ago, Visa and Mastercard raised interchange rates, despite the economic uncertainty

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[1] Here are some examples of U.S. PIRG's support for interchange fee reform: For example, see my testimony (page 44) before the Senate Appropriations Committee's subcommittee on Financial Services and General Government, at a hearing on "Oversight of Federal Payment of Interchange Fees: How to Save Taxpayer Dollars," 16 June 2010, available at https://www.appropriations.senate.gov/imo/media/doc/hearings/06_16_10%20FSGG%20Oversight%20Interchange%20Fees%20GPO%20Record.pdf. Also see my testimony before the House Judiciary Committee's Hearing on HR2695, the Credit Card Fair Fee Act of 2009, 28 April 2010, available at https://republicans-judiciary.house.gov/wp-content/uploads/2010/04/Mierzwinski100428.pdf. Also see my testimony before the Antitrust Task Force of the House Judiciary Committee on Credit Card Interchange Fees, 17 July 2007, available at https://babel.hathitrust.org/cgi/pt?id=pst.000063525090&view=1up&seq=1. See my testimony at a hearing of the House Small Business Committee, "The EMV Deadline and What it Means for Small Businesses: Part II," 21 October 2015, https://republicans-smallbusiness.house.gov/uploadedfiles/10-21-2015_mierzwinski_testimony.pdf.

[2] The United States appears to one of the few countries in which interchange fees are increasing and it has far higher fees that almost any other industrialized country. See Fact sheet, "Credit and Debit Card Interchange Fees in Various Countries August 2021 Update," Federal Reserve Bank of Kansas City, August 2021, https://www.kansascityfed.org/documents/8288/CreditDebitCardInterchangeFeesVariousCountries_August2021Update.pdf.

caused by the pandemic and inflation.[3] I believe that the big banks are happy with inflation -- when gas prices double, their percentage-based interchange revenue doubles -- without the banks making anything or doing anything.

We commend this committee for its series of hearings and actions on making markets more competitive. Visa and Mastercard are classic examples of anti-competitive platforms that control two-sided markets.

The interchange "market" represents a market failure. Merchants pay too much and cannot negotiate. Interchange rates are set, not by the banks that profit, but by Visa and Mastercard. Consumers bear the brunt of the higher prices as merchants are forced by payment networks rules to bake the swipe fee costs into the prices of the products they sell, yet are forbidden by card network rules from offering price signals to consumers to choose lower cost options for payment. Other jurisdictions, including Canada and the European Union, have imposed much more significant restrictions on interchange practices to correct the market failure.

Of course, ever-rising swipe fees that defy gravity act as a form of reverse competition to convince more banks to join the payment networks that set them. A rising interchange tide raises all bank boats, but it drowns merchants and consumers.

We present the following main points:

I. The Durbin amendment was a well-thought-out approach to the payment networks' market failure but the Federal Reserve must act to improve compliance:

The Durbin amendment provided the Federal Reserve Board with the authority to cap certain, but not all, fees for debit interchange under rules that require the fees be "reasonable and proportional" to the cost of conducting the transaction, rather than based on what the card networks call ''value'' which really means ''whatever they want and they can get.''

The Durbin amendment also took steps to improve competition in debit card network routing. More needs to be done to improve this provision, especially since the bulk of innovation in this space is in those networks not controlled by Visa and Mastercard. Merchants would like to choose from these other innovative networks, which Federal Reserve Board action could enable.

Much of the bank, credit union and card network complaining about the Durbin amendment, especially during the implementation of Regulation II, had focused on its supposed government

[3] Andriotis, AnnaMaria, "Visa, Mastercard Prepare to Raise Credit-Card Fees: The increases, delayed during the pandemic, mean many merchants will pay more when shoppers use credit cards," the Wall Street Journal, 8 March 2022, https://www.wsj.com/articles/visa-mastercard-prepare-to-raise-credit-card-fees-11646743166

price-fixing – its cap on certain debit card swipe fees. Now, they defend their defiance of the Durbin amendment's also- important routing requirements.

The Durbin amendment was always about more than stopping excessive rent-seeking. It was also designed to promote the development of a competitive payment network marketplace. The Fed's recent Notice of Proposed Rulemaking on debit routing sends an important signal that conduct inconsistent with the Durbin amendment will not be tolerated. The Federal Reserve's NPR makes simple clarifications that protect the Section 920 routing provisions required by the Durbin amendment that promote competition.

In particular, the NPR would make clearer that EFTA[4] Section 920 and its regulations:

1) "forbid issuers and payment card networks from restricting the number of such networks to fewer than two unaffiliated networks ("prohibition on network exclusivity")" and
2) "forbid issuers and payment card networks from directly or indirectly inhibiting any person that accepts debit cards for payment from directing the routing of an electronic debit transaction over any network that may process that transaction ("prohibition on routing restrictions").

Importantly, in its comments on these draft rules, the U.S. DOJ said:

> "**Consumers of financial services, like all consumers, benefit from competition.** […] Increasing the competitiveness of the debit payment market is particularly important given that competition in the debit market is very limited today. The debit payment market is highly concentrated—over 75% of transactions are processed by two firms, Visa and Mastercard. The online debit payment market is even more concentrated with Visa and Mastercard collectively accounting for over 90%, and Visa alone accounting for approximately 70%. This gives incumbent debit networks a significant amount of leverage when negotiating with merchants over the price charged to merchants for the use of their respective debit networks. **Lacking competitive alternatives, merchants must pay higher transaction fees that are passed on to consumers in the price of goods and services.**"[5] [**emphasis added**]

We support the rules under consideration at the Federal Reserve to improve debit card routing choices for merchants as required by the Durbin amendment.[6] We note that the Department of

[4] The Electronic Funds Transfer Act.
[5] Comments to the Federal Reserve Board by Department of Justice staff on debit card routing, 11 August 2011, https://www.federalreserve.gov/SECRS/2022/January/20220110/R-1748/R-1748_081121_140725_318718138961_1.pdf
[6] Comments of U.S. PIRG to the Federal Reserve Board on debit card routing, 11 August 2021, https://www.federalreserve.gov/SECRS/2022/February/20220215/R-1748/R-1748_081121_140702_384455847906_1.pdf

Justice[7] and the FTC,[8] our two government competition cops, have also offered supportive comments to the Fed.

II. The banks have spent years developing and promoting false counter-factual narratives about the impacts of consumer protection rules and the Durbin amendment specifically on both the declining number of banks and the fees bank customers pay:

The decline in the number of financial institutions began many years ago. The reason is two-fold, according to a study by the St. Louis Fed: there are fewer "*de novo*" banks and there are more bank mergers.[9] Also, according to this study, "A large number of banks failed during the 1980s and early 1990s, and again during and after the 2007-09 financial crisis."[10] The Durbin amendment, which was enacted in 2010 and didn't take effect until 2011, should not be blamed for a trend that largely predated it.

The Durbin amendment has neither forced nor caused banks to raise other consumer fees. The reality is that banks raise fees whenever they can and often cite the latest regulation, especially the Durbin amendment, as their excuse.[11] Banks raised consumer fees whenever they could before the Durbin amendment and they raised fees whenever they could after the Durbin amendment. High bank fees remain a problem; we strongly support the Consumer Financial Protection Bureau's inquiry[12] into "junk fees.[13] The banks, in their propaganda to the Congress, cite a recent GAO study that is largely based on anecdotal votes of a few bank stakeholders to impugn the Durbin amendment.[14]

Along with other consumer groups, U.S. PIRG has long been concerned that despite all the taxpayer benefits provided to the insured banking system—from taxpayer-guaranteed deposit insurance to the Federal Reserve discount window and even to bailouts—banks have either

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[7] Comments to the Federal Reserve Board by Department of Justice staff on debit card routing, 11 August 2011, https://www.federalreserve.gov/SECRS/2022/January/20220110/R-1748/R-1748_081121_140725_318718138961_1.pdf

[8] Comments to the Federal Reserve Board by the FTC staff on debit card routing, 11 August 2021, https://www.federalreserve.gov/SECRS/2022/February/20220215/R-1748/R-1748_081121_140730_316414853046_1.pdf

[9] "The long-term decline in the number of commercial banks shows no signs of ending. Bank failures have become much less common, but the rate of new-bank chartering also has declined to insignificance. Meanwhile, bank mergers continue at a historically high rate on a percentage basis," in Emmons, William, "Slow, Steady Decline in the Number of U.S. Banks Continues, St. Louis Fed, 9 December 2021, https://www.stlouisfed.org/on-the-economy/2021/december/steady-decline-number-us-banks

[10] Id.

[11] Balto, David, "The Bankers' New Goat, HuffPost, 11 March 2011, https://www.huffpost.com/entry/the-bankers-new-goat_b_834615.

[12] "Request for Information: Fees Imposed by Providers of Consumer Financial Products or Services," CFPB, 2 February 2022, https://www.regulations.gov/document/CFPB-2022-0003-0001

[13] Comment on CFPB Request for Junk Fees Information from U.S. PIRG Education Fund, 12 April 2022, https://www.regulations.gov/comment/CFPB-2022-0003-2551

[14] Report, "Regulators Have Taken Actions to Increase Access, but Measurement of Actions' Effectiveness Could Be Improved," U.S. Government Accountability Office, 14 February 2022, https://www.gao.gov/products/gao-22-104468

chosen to ignore or been unwilling to provide the un- and under-banked with reasonably-priced accounts. Consequently, many have become victims of the fringe banking system—payday lenders, rent-to-own stores, check cashers, etc. But this was true both before and after the Durbin Amendment took effect. While the FDIC notes that the number of unbanked households has dropped in recent years, it finds that "An estimated 5.4 percent of U.S. households (approximately 7.1 million) were "unbanked" in 2019, meaning that no one in the household had a checking or savings account at a bank or credit union (i.e., bank)."[15] As mentioned earlier, cash customers, such as unbanked consumers, are hurt the most by the inflated retail prices that result from high interchange fees.

III. Interchange fees represent a broken market, and all consumers, even those who pay with cash and checks, pay more at the store and more at the pump when interchange fees go up.

The significant increases in interchange fees signal a broken market. Courts have held that Visa and Mastercard have 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.[16] In the absence of broader regulation, including on credit interchange, interchange fees have increased significantly and are much higher in the United States than other countries.

In 2021, according to the Nilson Report, Visa and Mastercard charged merchants a total of $105.54 billion in credit and debit card fees. U.S. merchants paid out a staggering $77.48 billion in credit card fees and $28.06 billion in debit card fees imposed by Visa and Mastercard.[17] And just last week, Visa and Mastercard further increased many of their interchange fee rates. I am sure that the merchant witnesses today will offer details on how the purported accompanying "decreases" in some fees are largely illusory.

The card associations' rules prevent merchants from informing consumers on the costs of payment and limit the ability of merchants to direct consumers to the safest, lowest cost and most efficient forms of payment. If markets are non-transparent and consumers cannot receive price signals, then they cannot take actions to restrain unfair practices.

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[15] Survey, How America Banks: Household Use of Banking and Financial Services, Federal Deposit Insurance Corporation, 17 December 2021, https://www.fdic.gov/analysis/household-survey/index.html

[16] There are 4 credit card networks, also including Discover and American Express, but Visa and Mastercard dominate. "The general-purpose bank credit card market in the United States is dominated by cards issued on the Visa and Mastercard networks, which, combined, accounted for nearly 576 million cards, or about 83 percent of general-purpose credit cards, in 2019. In addition, American Express and Discover networks accounted for another 115 million general purpose cards in 2019." in "Report to the Congress on the Profitability of Credit Card Operations of Depository Institutions," Federal Reserve Board, November 2020, https://www.federalreserve.gov/publications/files/ccprofit2020.pdf

[17] "Merchant Processing Fees in the United States—2021," *The Nilson Report*, Issue 1216, March 2022.

IV. The interchange market has prices that are set not by the acquiring or issuing banks, but by the card networks. Neither the card-issuance or card network markets are competitive.

The card-issuance market is highly concentrated. The Top Ten card issuers "controlled 81% of the credit card market based on receivables and 85% based on purchase transactions in 2019.[18]" This oligopolistic concentration has allowed issuers to engage in a variety of unfair and anti-consumer practices.

For example, the "honor all cards" rule means what it says. U.S. merchants (but not European merchants) must accept all cards branded Visa or Mastercard, despite wide ranges of interchange (unknown to the merchant or consumer).[19]

Further, merchants cannot signal consumers to pay with cards that carry lower interchange fee rates, and as the network offers more and more rewards cards with higher and higher interchange fees, the merchants are compelled to raise overall prices to pay for the fees associated with the cards.

The enormity of the interchange fee competition problems is perhaps best shown by the massive antitrust lawsuit that Visa and Mastercard have offered to settle with thousands of merchants for over $6 billion dollars, said to be the largest antitrust settlement ever.[20] Why would they offer to settle for such a sum?

In fact, most merchants, large and small, have opted out and objected to the settlement and it is still not decided. Other than the cash to merchants, the settlement's terms do little to end the unfair conduct that the networks are accused of. In fact, the settlement would bar any merchants, including future merchants, from suing Visa or Mastercard, even for future illegal payment network practices. Such a settlement does not protect merchants or consumers, nor does it promote innovation or choice.

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[18] Geffner, Marcie, "Credit Card Issuer Market Share: Top 25 Issuers," in CardRates.com based on Nilson data, 1 September 2020, https://www.cardrates.com/advice/credit-card-issuer-market-share/
[19] Riley, Brian, "Credit Card Rewards: Honoring or Dishonoring All Cards," Payments Journal, 71 October 2018, https://www.paymentsjournal.com/credit-card-rewards-honoring-or-dishonoring-all-cards/
[20] Sweet, Ken, "Visa, Mastercard in new settlement of credit card fee suit," Associated Press, 18 September 2018, https://apnews.com/article/a51be2dbfe7a4503bef1d08ccde2f1a9

V. Other jurisdictions have done far more to rein in the debit and credit card market failures.

Canada's non-profit Interac system sets low fixed prices for certain debit fees and no fee for debit interchange.[21]

The European Union's Interchange Fee Regulation (IFR) is an exemplar of government action. A study looking at the results of this regulation found the following:

> Overall, it can be concluded that major positive results have been achieved through the implementation of the IFR (Cf. Part A), including but not limited to reduced merchants' charges resulting ultimately in improved services to consumers or lower consumer prices and enhanced market integration.[22]

U.S. interchange fees have a complex schedule set by Visa and Mastercard but merchants indicate that they generally pay 2-3% in interchange.[23] European fees, then, are only 10% of those U.S. interchange fees. As the EU announced upon implementing this regulation:

> "As a general rule, the Regulation will cap interchange fees at 0.2% of the transaction value for consumer debit cards and at 0.3% for consumer credit cards. […] Furthermore, the Regulation removes major obstacles to technological innovation in payment options. Technologies that allow consumers to pay with their debit or credit cards online or using their mobile phones (with apps, fingerprints, contactless "swipes", etc.), are readily available. However, uncertainty on the rules regarding interchange fees has been one of the factors holding up the use of these technologies. Commissioner Margrethe Vestager, in charge of competition policy, said: "*For too long, uncompetitive and hidden bank interchange fees have increased costs of merchants and consumers. Today's vote has brought us another step closer to putting an end to this. This legislation will put a cap on interchange fees, make them more transparent and remove a hurdle to rolling out innovative payment technologies. It is good for consumers, good for business and good for innovation and growth in Europe. As cards are the most widely used means of online*

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[21] Fact Sheet, "Understanding Business Fees, Interac Canada, April 2022, https://www.interac.ca/en/business/support/understanding-fees/

[22] Report on the application of Regulation (EU) 2015/751 on interchange fees for card based payment transactions, European Commission Staff Working Document, 29 June 2020, https://ec.europa.eu/competition-policy/system/files/2021-10/IFR_report_card_payment.pdf

[23] Interchange is the amount paid to the acquiring (merchant's) bank that is passed through to the issuing (consumer's) bank. The acquiring bank also keeps a small fee, the card network keeps a small fee, and a payment processor also collects a fee. But the bulk of the "merchant discount" is the interchange fee paid to the consumer's bank.

> *payment, this Regulation is also an important building block to complete the European Digital Single Market.*"[24]

VI. Actions by the FTC and DOJ over the last decade have also helped improve competition.

For example, a 2016 FTC investigation forced Visa to improve merchants' ability to offer price signals to consumers.[25] The market is still non-transparent. Consumers need to see their choices to act on them.

The Department of Justice filed a lawsuit to block Visa from acquiring nascent competitor Plaid and the merger was later dropped. From the DOJ release:

> "Millions of American consumers and merchants depend on debit services to transact business online. The complaint alleges that Visa has dominated online debit for years and has protected its monopoly with exclusionary tactics that have prevented rivals, including Mastercard, from expanding or entering. The lawsuit alleges that Visa's proposed acquisition of Plaid is a violation of both Section 2 of the Sherman Act and Section 7 of the Clayton Act."[26]

VII. Other Marketplace Problems Are Enabled by the Lack of Competition in Interchange

Most importantly, the most vulnerable consumers, those without credit cards, receive nothing from interchange, and subsidize the supposedly ''free gift'' of rewards programs for more affluent consumers.

Further, any system that allows sellers to control the terms of trade in anti-competitive ways—prohibiting discounts or prohibiting advising customers so that they can understand the differences between the costs of a rewards credit, plain old classic credit, debit, check or cash transaction—is a non-transparent system. Consumers always benefit from transparency. Is there a situation where they have not?

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[24] Release, "Commission welcomes European Parliament vote to cap interchange fees and improve competition for card-based payments, European Commission, 10 March 2015, https://ec.europa.eu/commission/presscorner/detail/hr/IP_15_4585.

[25] "As we have discussed, Visa's existing rules told merchants to present a selection screen to customers paying with a debit card. This screen asked customers to select which application would process their transaction, but only one of these applications permitted merchants to access every competing payment card network enabled on the card." in Letter to Visa from FTC, 22 November 2016, https://www.ftc.gov/system/files/documents/closing_letters/nid/closing_letter_from_james_frost_to_visa_-_11-22-16.pdf

[26] Release, "Justice Department Sues to Block Visa's Proposed Acquisition of Plaid: Acquisition Would Eliminate Nascent Competitor Plaid and Prevent Disruption of Visa's Monopoly in Online Debit," Department of Justice, 5 November 2020, https://www.justice.gov/opa/pr/justice-department-sues-block-visas-proposed-acquisition-plaid

Since interchange is highest for rewards cards, especially rewards credit cards, that means cash customers and checking account customers with low-cost debit cards are subsidizing the most affluent credit card customers.

Recommendations:

Urge the FRB to complete the debit card routing rule discussed in Section I above.

Expand the Durbin amendment – both its placing of reasonable limits on network-established interchange fees and its other pro-competition improvements to marketplace practices - to credit cards.

Conclusion

Despite the successes of the Durbin amendment, swipe or interchange fees are non-negotiable, rising in the U.S. and harming consumers as well as merchants. Merchants and consumers are angry. And as we found out in 2010 at your previous hearing, Chair Durbin, even the U.S. government cannot negotiate its interchange fees.[27] It is not just consumers. It is not just merchants. It is also the Federal Government that pays too much in nonnegotiable, nontransparent interchange fees. It is time for more to be done. I look forward to working with you and the committee on solutions to the broken card network market.

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[27] Hearing of the subcommittee on Financial Services and General Government of the Senate Appropriations Committee, "Oversight of Federal Payment of Interchange Fees: How to Save Taxpayer Dollars," 16 June 2010, https://www.appropriations.senate.gov/imo/media/doc/hearings/06_16_10%20FSGG%20Oversight%20Interchange%20Fees%20GPO%20Record.pdf