



Electronic Transactions Association

**Statement of the Electronic Transactions Association on  
H.R. 2695, the “Credit Card Fair Fee Act of 2009”**

**U.S. House of Representatives  
Committee on the Judiciary  
April 28, 2010**

The Electronic Transactions Association (ETA) is pleased to submit a statement to the House Judiciary Committee on H.R. 2695, the “Credit Card Fair Fee Act of 2009.” ETA members are a diverse group of businesses, large and small, primarily involved in the distribution of payment processing services to merchants. The kinds of businesses represented by ETA include: banks that are members of payment card networks; independent sales organizations (ISOs) who work directly with merchants; payment processors; data security professionals; point of sale terminal manufacturers; and providers of infrastructure and other services to banks and sales organizations. ETA strongly recommends that the committee consider the adverse impacts H.R. 2695 will have on consumers.

The integrated system of interchange and electronic payments is a critical part of the national economy. In fact, the safe and efficient flow of electronic payments might well be considered the scaffold required to support the continued growth of commerce in the United States and around the world. Interchange networks are highly specialized and robustly developed tools that are needed to move funds from a card issuing bank to a merchant (or acquiring) bank. These networks are responsible for facilitating the rapid growth in electronic payments witnessed in just the last ten years. Recently, interest groups have focused only on the price of conducting transactions through these

networks rather than on the infrastructure required to safely and efficiently process an ever-increasing number of transactions moving through the interchange system.

Interchange and electronic payments systems provide significant benefits to consumers, merchants and the financial services industry. For the consumer, the interchange system provides a secure, cash-free way to make purchases and to receive instantaneous “credit.” For merchants and the financial services industry, the interchange system is a well-established way to facilitate business, grow sales, and mitigate certain risks. Over the past few years, as the volume of electronic payments has grown enormously, the interchange system has simultaneously grown, adapted, and continues to mitigate payment risks while increasing consumer confidence and convenience.

For instance, here is a brief and simplified description of an electronic payment transaction cycle: when a consumer makes a purchase with a payment card, usually that card is swiped through a terminal at a store. Instantaneously, a transaction “pulse” flows through the electronic payments system to the card issuing bank to seek approval of the consumer’s purchase. Immediately, another transaction flows back to the merchant’s card terminal with approval (or declination) of the purchase. Upon approval, the immediate benefits to the consumer are the speed, safety, and convenience of the process; the immediate benefit to the merchant is assurance that payment for the purchase is guaranteed by the card issuing bank.

Within the next 24 hours, another set of electronic exchanges take place for the actual settling of accounts and transfer of funds from the card issuing bank to the merchant (or acquiring) bank. (In fact, the origin of the word “interchange” is as shorthand for “the exchange of funds” between banks.) Depending on the kind of arrangement the merchant has chosen for payment processing, payment for the consumer’s purchase can be credited to the merchant’s own bank account in 24 hours or, in rare cases, 48 hours from the time the sales transactions are received by the payments processor.

The safety and efficiency of this system is so well established, and this procedure has become such a part of our daily lives, that most of us rely on it without a second thought.

Given the necessity of such transactions to most consumers, ETA strongly recommends that the committee consider the adverse impacts H.R. 2695 will have on consumers. We outline the reasons for our concern below. First, the bill seeks to interfere in the carefully calibrated risk mitigation of electronic payments systems; second, the bill seeks to have government set artificial price points in a market upon which participation is voluntary and negotiated; and last, there is no evidence that the bill's price-setting construct would produce cost savings for merchants or guarantee that merchants would pass price reductions, if any, on to consumers. As an attempt to insert the federal government into a series of business-to-business agreements, H.R. 2695 would hurt consumers, not help them.

H.R. 2695 would cause current risk calculations to become invalid. It is important to note that the bank sponsors of the card networks underwrite the risk in the payments system. Sources of that risk include merchants, ISOs, and payment processors. An acquiring (or merchant) bank's primary risks are: 1) merchants going out of business; 2) merchant fraud; 3) fraud perpetrated on merchants; 4) charge offs (uncollectable sales); and 5) data security breaches. Also, in some circumstances, the acquiring bank and/or a payment intermediary extends credit to the merchant on electronic payment receivables so that merchants can utilize their funds more quickly. For instance, the acquiring bank will credit the merchant's account for sales transactions in advance of receiving the ultimate settlement amounts from the issuing banks for those sales.

The total fee that a merchant pays for accepting credit and debit card payments for the sale of goods and services is referred to as the "discount rate" or "merchant discount". The merchant discount has several components, including:

- 1) the cost(s) to process and handle bank card sales transactions;
- 2) an interchange fee; and
- 3) the cost(s) of providing deposit credit to the retailer.

The “interchange rate” (or “interchange”) represents a wholesale, market-driven fee for credit card processing set by the card brand associations and charged to the acquiring bank. Interchange rates include the cost of keeping the interchange networks up and running, the costs associated with keeping the networks secure (and those expenses are increasing), and a payment for risk assumed by the issuing and acquiring financial institutions. While interchange is set by the card brand associations to pay for use of their payment networks, other parts of the merchant discount rate are determined by the acquiring bank. Thus, the merchant discount rate is subject to fierce negotiation and competition between different acquiring banks in the marketplace.

There are many different categories of interchange rates and they vary based on the volume of sales at the retailer, the type of business of the retailer (i.e., is the merchant an unattended gas station kiosk, a florist, a tattoo parlor, or a book binder), and the type of transaction processed. For example, a “card-not-present” transaction carries a higher risk of fraud than a “card present” transaction. A premium card transaction may have a higher interchange rate than a regular card transaction because, in the case of one of the world’s largest payment processors, the premium card average transaction size is 34% higher than those on regular cards.<sup>1</sup> Premium cards are a substantial benefit to retailers and also represent a greater expense exposure for the issuing banks. Because there are many different categories of interchange rates, the percentage of the merchant discount fee that is made up of interchange may vary from transaction to transaction. ETA members and others in the field assume the risk of payment for interchange if their pricing model incorrectly assesses the ratio of interchange cost to total merchant discount cost.

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<sup>1</sup> Moneris Solutions, Toronto, Canada, April 27, 2009.

H.R. 2695 would establish government price controls in a market where participation is voluntary and negotiated. It is important to note that merchants are not consumers of electronic payment systems. Merchants are voluntary providers of transactions to electronic payment systems. If merchants do not wish, or do not find it profitable, to provide transactions to electronic payment systems, they are not obligated to do so. If a merchant determines that the costs associated with an electronic payment system outweigh the benefits received by utilizing that system, the merchant can choose to change his level of participation in that electronic payment system. If a merchant wishes to raise or lower the number of transactions he provides to an electronic payment system, he can do so by offering a discount for cash payment or by discontinuing the availability of that electronic payment system in his business. Federal law allows merchants to offer cash discounts and card networks have clear rules stating that cash discounts are allowed. Discounts for cash are routinely seen at gasoline stations, and there are businesses around the world that do not accept certain types of electronic payments.

Merchants who offer consumers the option of electronic payment do so because of the benefits derived from the electronic payment systems. These benefits were confirmed by the U.S. General Accounting Office (GAO) in their November, 2009, report to Congress (GAO-10-45):

*“...credit cards also provide significant benefits to merchants, such as lower labor and processing costs and increased sales.”<sup>2</sup>*

*“Accepting credit cards also allows merchants to make sales on credit at a generally lower cost than operating their own credit program ... individual merchants originally offered credit cards that could be used only at their stores, but many such merchant programs have been discontinued ... [bank] credit cards allow merchants to obtain sales from customers that want to finance their*

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<sup>2</sup>United States Government Accountability Office (GAO-10-45), November 2009, page 28.

*purchases over time without the merchants having to incur the costs involved with offering credit ... merchants avoid the costs of credit losses, debt collection, credit quality assessment, card production, and statement preparation ... merchants can receive faster and more certain payment from customers using cards than from customers using other means, such as checks ...*<sup>3</sup>

H.R. 2695 would not provide financial benefit to consumers. This bill falsely presumes that interchange and merchant discount rates are not negotiated. In fact, merchants routinely negotiate for the lowest possible discount rates from the thousands of banks and card processors that offer this service. While large retailers may negotiate based on a high volume of transactions, smaller merchants have access to trade associations, professional associations, and local chambers of commerce for group-negotiated rates that offer significant savings on card acceptance. For example, the First National Bank of Omaha offers over 400 such programs to smaller merchants.

In addition, there is nothing that prevents a merchant from engaging in a negotiation directly with Visa and MasterCard. Merchants can – and do – negotiate interchange fees directly with MasterCard or Visa, based on the same factors that are used by merchants in negotiating deals with other types of vendors in markets with similar dynamics. Merchants have a much greater ability to negotiate transaction processing expenses than they do for other business services such as electricity, postage, water, or trash collection. As noted in GAO's report to Congress:

*“The competition among acquirers gives merchants the opportunity to choose among competing acquirers and negotiate lower costs. Merchants of varying sizes that we interviewed reported that they have multiple acquiring institutions and processors competing for their business and have been able to successfully*

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<sup>3</sup> Ibid., page 30.

*decrease the acquiring fee portion of their merchant discount fees in recent years.”<sup>4</sup>*

Finally, the potential for consumer harm in mandated controls on interchange was clearly noted by GAO:

*“...many industry participants and others agreed that the costs of card acceptance might shift from merchants to cardholders if interchange fees were limited, card surcharges permitted, and interchange revenues decreased ...*

*...issuers, if faced with lower interchange fee revenues, could decide that some credit card programs were too expensive to maintain and might cut credit to cardholders, including merchants that depend on credit to finance business expenses ...*

*...issuers likely would respond to their reduced interchange fee income by increasing cardholders’ annual fees and other user fees, decreasing the value of rewards points, and possibly increasing interest rates and decreasing available credit. In Australia, cardholders’ benefits as a portion of spending dropped an average of 23 percent from 2003 to 2007 following the interchange fee reforms.”<sup>5</sup>*

In conclusion, ETA requests that the committee fully consider the ill effects of H.R. 2695. The interchange and electronic payments systems provide significant benefits to consumers, retailers and the financial services industry. Each card transaction carries a carefully calibrated risk profile for the issuing and acquiring banks. Interchange and merchant discount rates exist today in a highly competitive marketplace and merchant discount packages are fiercely negotiated. The likelihood that consumers would benefit from this bill is slim, while evidence to support that consumer harm will result is great.

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<sup>4</sup> Ibid., page 36.

<sup>5</sup> Ibid., page 55.

Inserting an artificial government price control mechanism into the middle of these business-to-business contract agreements will hurt consumers, not help them.