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**WRITTEN TESTIMONY
OF
MARK CAVERLY
EXECUTIVE VICE PRESIDENT
LOCAL GOVERNMENT FEDERAL CREDIT UNION
RALEIGH, NC**

**ON BEHALF OF
CREDIT UNION NATIONAL ASSOCIATION (CUNA) AND
ELECTRONIC PAYMENTS COALITION (EPC)**

**BEFORE THE COMMITTEE ON FINANCIAL SERVICES
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“H.R. 2382, the Credit Card Interchange Fees Act of 2009”

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Chairman Frank, Ranking Member Bachus, Members of the Committee, thank you for the opportunity to testify at today’s hearing on H.R. 2382, the Credit Card Interchange Fees Act of 2009. My name is Mark Caverly and I serve as Executive Vice President of Local Government Federal Credit Union¹ in Raleigh, North Carolina, where I am responsible for oversight of the credit union’s marketing, human resources, and information technology departments. I am testifying on behalf of the Credit Union National Association² and the Electronic Payments Coalition.³

At LGFCU, we put member needs first. Over the years we have stayed the course amid a whirlwind of changes in society, to the economy and among financial institutions, all to fulfill our original purpose of improving members’ lives. We remain committed to helping our members prosper by offering affordable, safe and comprehensive financial services through good times and bad. LGFCU has \$957 million in assets and 178,000 members. We are the issuers of 173,000 debit cards and 16,000 credit cards. Interchange from debit card usage represents 14.4 % of LGFCU’s monthly income.

¹ Local Government Federal Credit Union (LGFCU) is a not-for-profit, member-owned financial cooperative established to serve the financial needs of local government employees, elected officials, volunteers and their families. With the support of the N.C. League of Municipalities and the N.C. Association of County Commissioners, LGFCU received its federal charter on March 24, 1983 from the National Credit Union Administration (NCUA).

² Credit Union National Association (CUNA) is the largest credit union advocacy organization in the United States, representing approximately 90% of America’s 8,000 credit unions and 92 million credit union members.

³ The Electronic Payments Coalition (EPC) includes credit unions, banks, and payment card networks that move electronic payments quickly and securely between millions of merchants and millions of consumers across the globe. EPC’s goal is to protect the value, innovation, convenience and competition in today’s growing electronic payments system. EPC educates policymakers, consumers, and the media on the system’s role economic growth, and the importance of protecting consumer choice and stability for the continued growth of global commerce.

The Truth about Interchange

To begin, let me cover some basic facts about interchange. First, interchange is one part of what is referred to as the “merchant discount fee,” which has been described by the Government Accountability Office (GAO) in the following manner:

“The majority of the costs associated with accepting cards are the ‘merchant discount fees’ paid to the banks that merchants use to process their transactions. Generally, for each Visa or MasterCard transaction, a portion of the merchant discount fee is paid from the merchant’s bank—called the acquiring bank—to the bank that issued the card. This portion, called the interchange fee, reimburses card issuers for a portion of the costs they incur in providing card services.”⁴

Many wonder who is responsible for interchange and who receives it. Interchange is the responsibility of the merchant and the merchant’s bank. Card issuers, like my credit union, which assume the risks of fraud, nonpayment and the administration of the card program, receive interchange.

The merchants like to describe interchange as a fee on consumers; however, interchange represents the merchants’ assumption of their fair share of the financial responsibility for the card payment system. Merchants receive many benefits as a result of their participation in the payment system. In short, interchange is a ‘cost of doing business’ for a merchant which chooses to accept this valuable form of payment.

Interchange is important to credit unions and their members because it helps support the card program. It helps to cover some of the costs associated with the risk of non-payment that the card issuers assume, the risk of fraud and other data breaches that occur at merchants, and the administrative costs of the program. And, as the GAO notes, it only covers a portion of those costs. In short, the benefits merchants receive from accepting our cards far exceeds any interchange fees we receive.

Card Issuers Oppose H.R. 2382

As debit and credit card issuers, credit unions oppose H.R. 2382. The bill aims to disrupt the functional debit and credit card marketplace to the detriment of consumers. Credit unions are particularly concerned that this legislation would permit merchants to refuse to accept credit union cards, creating a strategic

⁴ Government Accountability Office. “Credit and Debit Cards: Federal Entities Are Taking Actions to Limit Their Interchange Fees, but Additional Revenue Collection Cost Savings May Exist.” GAO-08-558. May 15, 2008. 1.

advantage for cards issued by other institutions. In addition to H.R. 2382, credit unions also oppose H.R. 2695, a bill to give merchants an anti-trust advantage in negotiations to reduce the amount of interchange received by issuing institutions.

I would also like to point out that it appears to be the objective of at least some merchant organizations to drive credit unions like LGFCU out of the payment card business. In 2007, the National Retail Federation (NRF) testified in the House Committee on the Judiciary that interchange is, "so high that even small banks can make a profit."⁵ I would like to confirm that interchange supports our ability to make payment cards available to our members. I would also like to confirm if the big retailers are successful at having Congress reduce interchange, LGFCU may not be able to offer payment cards to its members. With respect to NRF's statement, the only disagreement between the retailers' statement and our view is whether putting credit unions and community banks out of the payment card business is a good result. NRF apparently believes it is. We strongly disagree.

Today's Card Payment System Provides Value to Credit Unions, Consumers, and Merchants

To credit unions and their members, interchange and the card payment system are important elements of the successful, competitive banking experience. It happens every day: a member makes a purchase with a debit or credit card, the merchant is paid immediately, and the credit union that issued the card receives interchange from the merchant's bank. Interchange reflects a merchant's fair share of the costs of this convenient system and helps the credit union address the costs of maintaining a card program. Of the 92 million credit union members nationwide, 98% belong to a credit union that issues debit cards and 84% belong to a credit union that issues credit cards. Of credit unions nationwide, 71% issue debit cards and 51% issue credit cards. Consumer-friendly and cost-effective card programs are vital for a credit union's ability to attract, serve, and retain members. Card programs allow credit unions to compete with the largest of financial institutions.

For our consumer members, the card payment system ensures competitive rates and programs and consumer-friendly terms. The consumer benefits when credit unions serve as card-issuing institutions. The payment system is a highly competitive market, evidenced by the fact that consumers have thousands of payment card options available to them, and they can use their payment cards with merchants across the country and around the world. H.R. 2382 would result in cost-shifting from the merchants to the

⁵ Committee on the Judiciary. United States House of Representatives. Hearing on "Credit Card Interchange Fees." July 19, 2007. <http://judiciary.house.gov/hearings/printers/110th/36785.PDF>. 48.

consumers, and increased fees for consumers to obtain debit and credit cards. The strongest evidence of this is the fact that the merchants are not willing to warrant that any savings they realize from a proposed reduction in their interchange expense would be passed on to consumers in the form of lower prices. If issuing institutions terminated their card programs due to a decrease in interchange, consumers would have fewer choices in providers. Those of us who work in smaller financial institutions believe that more choices lead to lower costs for consumers.

For merchants, the payment card networks provide value in immediate payment and increased customer satisfaction. Merchants which accept payment cards benefit through reduced risk and immediate payment on debit and credit transactions. Merchants get paid immediately for purchases even when consumers do not pay their credit card bills; they also enjoy reduced costs associated with accepting checks and cash, the ability to do business on-line, and increased sales volume and expedited sales. These benefits are possible because the card-issuing credit union assumes the credit risk for the transaction. There are costs to receiving the value of the payment processing system and interchange represents the merchant's fair share of these costs.

H.R. 2382 Would Fundamentally Change the Payment System, Adversely Affecting Consumers and Credit Unions

H.R. 2382 attacks many of the essential characteristics of the payment card system upon which consumers depend every day. This legislation would disenfranchise consumers and increase their costs of debit cards and credit cards. For example, as I explain in more detail below, H.R. 2382 would reduce consumer choice for payment options, allow merchants to discriminate against credit unions and other small issuers, and facilitate deceptive (and sometimes illegal) surcharging by merchants.

Reducing Consumer Choice

Consumers appreciate that they can travel virtually anywhere in the world and use one of our payment cards to make a purchase. They see the network logo displayed by a merchant, such as a Visa credit card logo, and our members know they can use their LGFCU Visa credit card—or any other Visa credit card—to pay for a purchase with that merchant. The member could choose to use our Visa credit card, and I hope they would. But our member may also choose to use a Visa credit card issued by another financial institution. The choice is the cardholder's—not ours, and not the merchant's. Cardholders' ability to choose which Visa credit card to use benefits not only our members, but also merchants because

it gives consumers peace of mind that they can shop at the merchant and have a convenient and safe way to pay for their purchase.

H.R. 2382 would eliminate this peace of mind for our members and reduce their payment choices. The legislation would allow a merchant to reject the consumer's choice of Visa credit card and force the cardholder to use only certain kinds of Visa credit cards (*e.g.*, those that do not have rewards available, or that do not provide benefits to charities). Not only would this rob consumers of their ability to choose how to make a payment, but it would also force consumers to carry more payment cards in their wallet. If this legislation were enacted, consumers would need to carry several credit and debit cards even just for emergencies because consumers will no longer have confidence that their LGFCU Visa credit card will be accepted by merchants, even those which purport to accept Visa credit cards!

Discriminating Against Credit Unions

Today, the payment card networks allow smaller institutions, such as LGFCU and other credit unions, to compete on a level playing field against larger payment card issuers. A credit card issued by LGFCU is just as functional as one issued by our competitors and is accepted at the same locations. This allows LGFCU to compete for cardholders based on service level, price, and other factors.

H.R. 2382 would make it much more difficult for us to compete against the larger credit card issuers. The legislation, for example, would allow a large big-box merchant to team with a large card issuer to enter into an exclusive payment card acceptance arrangement and allow the merchant to reject all other issuers' cards on "cost" grounds. There is simply no way that a community bank or credit union would be able to enter into such an acceptance deal with a large big-box retailer. Similarly, even if the big-box retailer did not sign an exclusive acceptance arrangement with a large bank, the legislation would allow the merchant to coerce cardholders into choosing the payment cards issued by the large banks that are willing to share revenue with that merchant. Again, the ability to enter into such an agreement is not a luxury my credit union would have.

Deceptive (and Sometimes Illegal) Surcharging

Generally speaking, merchants cannot impose a surcharge in connection with the acceptance of a LGFCU Visa credit card. Not only is this good economic news for consumers, but it is also an important consumer protection. Surcharges for payment card usage are oftentimes unpleasant surprises to cardholders who feel as though they have been the victim of a bait and switch. In fact, surcharges are

illegal in many states as a matter of consumer protection. Yet, H.R. 2382 is designed to facilitate deceptive surcharging by merchants. The legislation would prohibit payment card networks from ensuring that consumers are not victimized by merchants imposing deceptive surcharges on them. It is unclear to me why Congress would want to prevent Visa, MasterCard, or anyone else for that matter from protecting consumers from these circumstances.

It is my understanding that merchants believe the payment card networks have interfered with merchants' legitimate rights to offer cash discounts. To do so would be illegal under federal law. Despite merchants' complaints, I am not aware of any serious allegation of such a violation, nor am I aware of any law enforcement action in this regard. However, I do know that law enforcement authorities have shown plenty of interest in cracking down on merchants' deceptive surcharging.⁶

Other Concerns Regarding H.R. 2382

The following is a discussion of additional serious concerns we have with the specific provisions of H.R. 2382:

Honor All Cards Rule

H.R. 2382 proposes to abolish the "honor all cards" rule that applies to all merchants which accept cards within a card network's brand (Section 193(b)). This means that, under H.R. 2382, a big-box retailer could tell a customer that they do not accept my credit union's Visa card, but that they do accept Visa cards issued by the top three financial institutions. Our card program is only valuable if our credit union cards are honored across the country and around the world, as any other Visa card issued by another institution. This proposed change would make it impossible for my credit union to provide a competitive card program to consumers, which would result in the inability to attract or retain members.

Chargebacks

H.R. 2382 would absolve merchants from all responsibility when they process a consumer's purchase in violation of the amount that was actually pre-authorized for the merchant's terminal (Section 193(e)). The proposed merchant "free pass" would protect them from repercussions when they exceed the dollar limit established to protect against fraud. We see no justification for rewarding a merchant that chooses to neglect an important fraud protection. Moreover, if the merchants get a free pass for their risky business, consumers will pay the price.

⁶ http://www.oag.state.ny.us/media_center/2008/aug/aug28a_08.html

Premium Cards

H.R. 2382 would give merchants the ability to refuse to pay a different interchange rate for a premium card, resulting in merchants refusing to accept a consumer's premium card at the point of sale (Section 192). This provision gives merchants control over the consumer's choice. Many consumers choose to use premium cards because they want the services and benefits that accompany such cards.

Pricing Displays

Without any oversight from the card network or the consumer's issuing bank, H.R. 2382 would give the merchant sole discretion in displaying and advertising different acceptance terms for different cards (Section 193(a)), thereby causing customer confusion in the face of the merchant's possibly misleading and deceptive communications. In fact, the legislation specifically states the merchants can "steer a consumer" to a merchant's preferred form of payment, with no oversight or regard for the consumer's best interests. Most concerning, however, is the bill's language that would give merchants the ability to mislead consumers with regard to surcharging.

Regulation by the Federal Trade Commission (FTC) and the Federal Reserve Board

H.R. 2382 would direct the FTC to promulgate and enforce rules to ensure that the card payment system rules, terms and conditions are not unfair, deceptive, or anti-competitive to consumers and merchants (Section 194(b)). It also calls upon the Federal Reserve Board to issue regulations and orders.

While the bill talks about regulation by the Federal Trade Commission (FTC) and the Federal Reserve Board for everyone except the merchants, it never addresses the "elephant in the room." Quite simply, the data security breaches involving consumers' debit cards and credit cards have one trait in common: The breaches occurred on the merchant side of the transaction. Consumers are outraged whenever we have to tell them their card was compromised in a breach. As a card-issuer, we do everything we can to protect our customers, but there is nothing we can do to protect them from the negligence or recklessness of a merchant's data security practices.

In 2009, Heartland Payment Systems, a processor for merchants, announced that *100 million* accounts may have been compromised in a breach. What impact did that have on my credit union? More than 45,000 debit cards and 2,000 credit cards were affected. Because the credit union wanted to protect its members against unwanted charges on their accounts and the confusion that could occur, we reissued

cards totaling nearly \$150,000 in added expense for this one breach. This was just part of our costs for addressing the breach—a breach we did not cause.

Interchange Fee Disclosure to Consumer at Time of Card Issuance

H.R. 2382 would require card issuers to disclose the amount of interchange fees, as well as any other “fees,” to consumers when they apply for a credit card or are issued a debit card. As noted above, consumers do not pay interchange or merchant fees. Disclosing to consumers a fee they do not pay will only lead to confusion. Also it is important to note that merchants already have the right to disclose these fees. Any merchant that believes these disclosures are important should provide them to their customers. If merchants fail to make these disclosures, they do so by choice. Federal legislation on this point is unnecessary.

Conclusion

In conclusion, CUNA and the EPC strongly oppose H.R. 2382. The card payment system provides my credit union with interchange to address the expenses and responsibilities of our card program, including functions such as reissuing cards, staffing call centers, investigating fraud, and covering the risk of nonpayment. Issuing debit and credit cards allows my credit union to compete with the largest financial institutions and gives my credit union the ability to offer cards to build relationships with my members. This provides my members the opportunity to deal with a local institution they know and trust while at the same time gaining access to a global payments system. But most importantly, from the perspective of our consumer-members, the card payment system and interchange work because:

- More competition in the issuing market, specifically from credit unions, will ensure consumers will have access to cards with more consumer-friendly terms and conditions;
- If merchants do not pay their fair share for the benefits they receive from the card payment system (as compared to their operating losses with cash and checks), consumers will either pay more for cards and banking services or, even worse, have fewer options for cards; and
- If the merchants' financial responsibility for the card system is reduced unreasonably by legislative interference, that amount will be padded to the merchants' earnings and not experienced as savings by consumers.

As long as merchants pursue reducing their obligation to support the card payment system, credit unions will stand up for their members nationwide who carry a credit union-issued debit card or credit card in their wallet. We will continue to reach out to our policymakers to share the credit union perspective

regarding interchange. Mr. Chairman, on behalf of the Credit Union National Association, and the Electronic Payments Coalition, thank you very much for the opportunity to testify today. I would be happy to answer any questions from the Committee.