

Interchange Fees

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Interchange Fees

Interchange fees are the fees merchants pay to the banks that issue the cards customers use to make their purchases. This is our board's number one priority because it's one of our members most rapidly increasing uncontrollable costs. Interchange fees have been increased by the card networks 13 times just since April of 2003.

This is growing in importance because card transactions are growing worldwide. The difference between the US and the rest of the world is that we pay the highest interchange fees of any of the developed countries, and fees in these other countries are stable or declining because their governments have already taken action. We pay the highest fees in spite of the fact that our costs are the lowest. We have the greatest economies of scale, we have the lowest interest rates, and our fraud and bankruptcy liability has just been sharply limited. Yet the fees are being driven relentlessly higher.

In the United States, the majority of noncash transactions are now done electronically with the number of card transactions passing checks just last year. This has happened in large part because banks are relentlessly driving customers to plastic cards through aggressive advertising, an avalanche of direct mail pieces, and a variety of reward programs. This has been so successful that banks are setting record profit levels with card-based fees as their single most profitable source of income.

As a result, FMI is spearheading a drive to organize associations representing all of the merchants accepting plastic cards to move the card companies to transparent, cost-based interchange that would level the playing field for merchants. Right now the card companies are in complete control of that playing field and there is no effective competition at all. Although the coalition has not picked a name yet, my recommendation is CAUHT (pronounced "caught"): the *Coalition Against Unfair Hidden Taxes*.

Why doesn't normal competition take care of this situation? Primarily because the competitive model in the card world is upside down. Visa and MasterCard don't compete by becoming more efficient and lowering fees the way every other business competes. Their "customers" aren't really shoppers. Their "customers" are their member banks who issue their cards. Visa and MasterCard are associations, cartels if you will, who compete for banks to join their networks. They compete by raising the fees they pay to these member banks, fees that ultimately come from consumers. In this Alice In Wonderland world, competition raises prices, it doesn't lower them.

Even our supplier friends in the audience should care about this. Every extra dollar taken from consumers by the credit card companies is one less dollar they have to spend on your products. And, any of you who sell through vending machines will soon see customers using cell phones or key fobs to pay through the machine and you will be deep into the world of ever escalating interchange fees.

How big is the problem? The interchange fee a supermarket pays when a customer pays with plastic is more than the money that flows to the retailer's bottom line; it's often double. Does that seem right to you? The service provider using a computerized payment network is getting more dollars from the transaction than the net profit for the merchant who provides the labor, the land, the fixtures, the light and the heat, and the store that stocks the products.

Of course consumers can't make an informed decision about any of this. Fees are collected from the merchants, not directly from the card users. These fees will soon pass \$30 billion with contracts that actually prohibit merchants from disclosing the cost to their customers who use the cards. These fees are hidden from consumers but they do ultimately pay them because in the long run, increased costs have to be passed along in the form of higher prices.

Consumers have an intuitive feel that something is wrong in the plastic world from their own experiences with card companies. They see high school and college students who have little or no income deluged with card offers because the issuers know Mom and Dad will pay the bills the financially naïve kids run up. They see newly bankrupt households deluged with card offers because the issuers know they are prevented from declaring bankruptcy again for a long time even if they get in over their heads. They see the rules they thought they signed up for changed without notice or with notice so buried in the fine print that it isn't useful. They see card companies happy to set low balance limits and gleefully authorize over-limit payments because they trigger exorbitant penalty fees. And, they're discovering the Universal Default Rule. This means that even if you have a perfect record with your card company, your interest rate will be doubled or tripled, or worse, if you have any transaction of any kind referred to a collection agency, even a decade-old forgotten parking ticket. Consumers are not surprised that merchants suffer similar outrageous treatment at the hands of card companies.

As if this weren't bad enough, it gets even worse. Card companies have weaned consumers away from checks and they are pushing them into the highest cost, least efficient forms of plastic because that's where the highest fees are. Merchants are in much the same boat as consumers. The card associations can and do change their rules without prior notice and without recourse. For many of our members, plastic transactions are now well over half of the total sales and refusing to take whatever card the customer wants to use is just not an option.

When the competitive model drives prices higher not lower, when the information is hidden from the end user so consumers can't have the information they need to make informed choices, when merchants have no effective bargaining power for one of their most rapidly increasing costs, when the card companies have become so powerful that it's virtually impossible for a new competitor to enter the market, the only remedy is for government to step in.

So where are we? Since the credit card lobby is one of Washington's most powerful and best funded, this will be a huge uphill fight. This only way to win it is with the broadest possible coalition of merchants and the support of our customers who are ultimately bearing the burden of these unreasonably high fees. The good news is that people are increasingly outraged at the way card companies treat them and, to anyone willing to listen, common sense is on our side.

Here's the argument in a nutshell.

Financial Service Fees

In a perfect world, we would not need additional regulation. But we don't live in a perfect world. We need a way to level the playing field so that merchants can make a reasonable profit, so that credit card companies can be paid a fair fee for offering a service, and so everybody has enough information to make their decisions.

Right now, the competitive model doesn't work in the credit card world the way it works everywhere else. Merchants compete by becoming more efficient and lowering prices for consumers. Credit card companies compete by driving up merchant fees so they can pay their member banks more. This ultimately pushes up the cost of goods and that means customers who pay with cash or checks end up subsidizing the highest income consumers who have the most elite reward cards. Hidden fees are like a food tax that, in the long run, raise prices and hurt those who can afford it the least. As a matter of principle, this just isn't fair.

The reason the system needs to change can be summed up in four simple words—The Right to Know. Consumers have a right to know if their prices are being driven up by unreasonably high fees set by the credit card companies. Merchants have the right to know all the details of the agreements the card companies enforce and they need to know their agreements can't be changed without prior notice. The more information, the more knowledge people have, particularly in this day and age, the better off everyone is.

When the hurricanes hit in the Gulf and gasoline prices spiked, we found out that the group benefiting the most, the group that saw their profits soar but provided no additional service at all, were the credit card companies whose fees are based on a percentage of every transaction. When gasoline prices went up because of the natural disaster, the money generated by card fees went up right along with those higher prices with absolutely no additional work on the part of the card companies. We also learned that when the electricity went out in the Gulf forcing merchants to process card transactions through the old paper systems that we all used to use, credit card companies doubled or tripled their fees—just because stores were trying to help people begin to rebuild their lives and to cope as best they could with the disappearance of almost all of our modern conveniences. Could the credit card companies have waved these outrageous fee increases? Of course. Did they? No. In a natural disaster, we're all in the struggle together; everybody suffers—everybody except the credit card companies. They just ring the register.

I'm not for constant intervention. For the most part, the free market system works. But when credit card companies compete by raising fees paid to their banks not by lowering costs to consumers, when those fees must ultimately flow into higher prices paid by all consumers whether they use a card or not, we need to restore the balance. We need full disclosure of the information businesses and customers need to make rational choices and we need fair fees based on actual costs. To make this happen we need government action and we need it now.