

“Swipe Fee” Reform – International Lessons

Have you ever wondered why small stores beg you not to use credit cards for low-dollar purchases or hope that you'll pay with cash? It's because of the cost of swipe fees, also known as interchange fees.

Unless you're a retailer, you've probably never heard of them, but swipe fees hit your pocketbook regardless of whether you pay with plastic. These huge hidden fees are what the big banks charge small businesses every time a customer uses a credit or debit card. Interchange costs Americans an average of \$2 on every \$100 they spend on cards – a higher percentage than anywhere else in the industrialized world.

Though we live in a global marketplace, other countries and their governments have been able to negotiate with the Big Banks and credit card companies for fair rates and transparency. But, in the United States merchants and their customers are still forced to pay skyrocketing swipe fees. If we paid the same low credit and debit card swipe fees as consumers in Australia pay, then the net benefit for American consumers would have totaled \$125 billion over the last four years.

Swipe fees started out in the 1960s as a way for banks to cover the cost of processing credit card transactions. But even as technology has dropped that cost dramatically, the banks and credit card companies have pushed swipe fees higher and higher, turning it into a cash cow. For many businesses, swipe fees are now their single-highest non-labor operating cost.ⁱ

With almost any other equipment, supplier or service, a merchant can comparison-shop, negotiate or otherwise influence its final cost of doing business. Store owners can conserve on energy usage and seek out the most competitive prices for merchandise just to cite a few examples. Not so with credit card swipe fees. Visa and MasterCard control more than 80% of the marketplace. They set the swipe fees in secret, give businesses no ability to negotiate and virtually insist they be buried in the price of merchandise. Unfortunately, the card companies' hidden fees get passed on to all consumers in the form of higher prices and lower value for nearly everything they buy.

“It's bad enough that the credit card companies force these hidden fees on us and our customers when we can least afford it,” says Tom Robinson, President of Robinson Oil Corporation, which operates a chain of thirty-four convenience stores. “But when we are paying more than anywhere else in the world, and other countries have taken action to protect

their citizens from abuse, it is inconceivable that our government would turn a blind eye to the issue. It is time for Congress to step up and defend the principles of the free market economy by taking action on swipe fees.”

Though Congress and the White House have addressed other credit card reforms, any fix will be incomplete without addressing swipe fees. Consider:

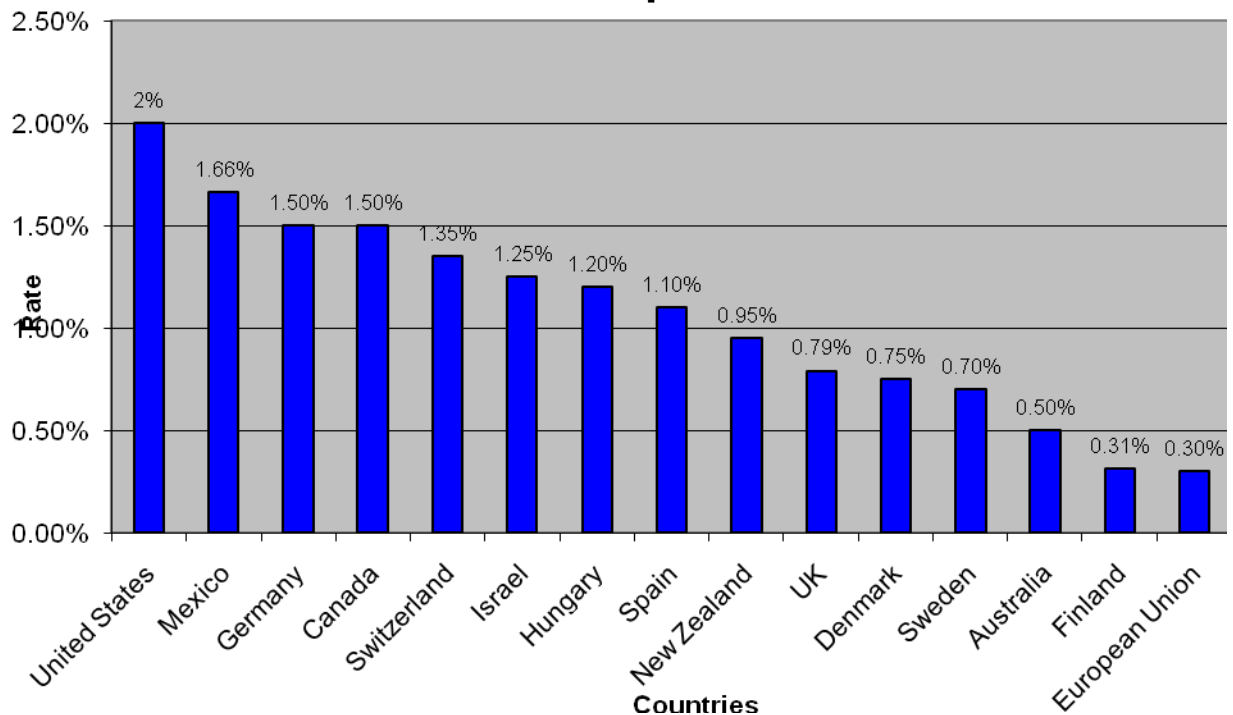
- Banks raked in an estimated \$48 billion in swipe fees in 2008 – an average of \$427 per American household in just one year.
- This \$48 billion total is more than triple the amount collected in 2001
- Hidden swipe fees cost Americans more than all credit card annual fees, cash advance fees, over-the-limit fees, and late fees combined
- U.S. swipe fees are the highest in the developed world
- The U.S. pays approximately 60% of swipe fees globally – about double the U.S. percentage share of global GDPⁱⁱ

Compared to the rest of the world, U.S. swipe fees are:

- More than two times the rates in the UK and New Zealand
- Four times the rates in Australia
- Over six times the cross border rates recently agreed upon by MasterCard and the EU

Most Americans think of the United States as a sensible place to do business compared to many European countries. But when it comes to the cost of credit cards, as the below chart highlights, citizens in EU and NAFTA countries pay a much smaller interchange rate to Visa and MasterCard banks.ⁱⁱⁱ

Credit Card Interchange Rates in Various Countries - April 2009



Not only do other nations provide lower interchange rates, but we can also learn from other countries' experiences with interchange reform. Major countries around the world have addressed interchange reform, with some already demonstrating beneficial results for their economies. In particular, lessons learned from experiences in Australia, New Zealand, Canada, and the European Union, provide instructive examples about why interchange reform makes economic sense in the U.S. – especially now.

Reforming swipe fees would be a boon to our economy and would benefit both merchants and their customers. Lower interchange rates and a more transparent and competitive process of determining these rates would lead to consumer savings and, in turn, would stimulate much needed spending.

Australia

“The competitive environment has been improved. Merchants have more choice. The veil of secrecy on interchange fees has been lifted. Access has been liberalised. And the price signals to consumers have been improved.”

— Philip Lowe, Assistant Governor (Financial Systems), Reserve Bank of Australia

In 1997, an Australian committee tasked with studying the nation’s financial and regulatory systems highlighted interchange fees as areas of “policy concern” in its final report. The Committee recommended the formation of a new Payments System Board as part of the Reserve Bank of Australia to examine interchange fee arrangements in more detail. The Board’s subsequent findings, published in October 2000, concluded that “in card networks, competition is not working as it should.”

In part because of the hidden nature of the swipe fees and the absence of informed consumer choice of payment method as a result, the Reserve Bank of Australia designated in April 2001 that the interchange rates payment systems were subject to regulation under a piece of financial legislation passed in 1998. As a result, Australia mandated a reduction in interchange fees and enacted a series of interchange reforms that “aimed to improve the efficiency of the overall payments system and to promote competition. In particular, they have sought to: increase the transparency of the system; remove or modify restrictions that hinder competitive forces; liberalize access arrangements; and promote price signals to consumers that are conducive to the efficient evolution of the payments system.”^{iv} The reforms went into effect in November 2003 and the fees have fallen by approximately .45 percentage points since that time.^v

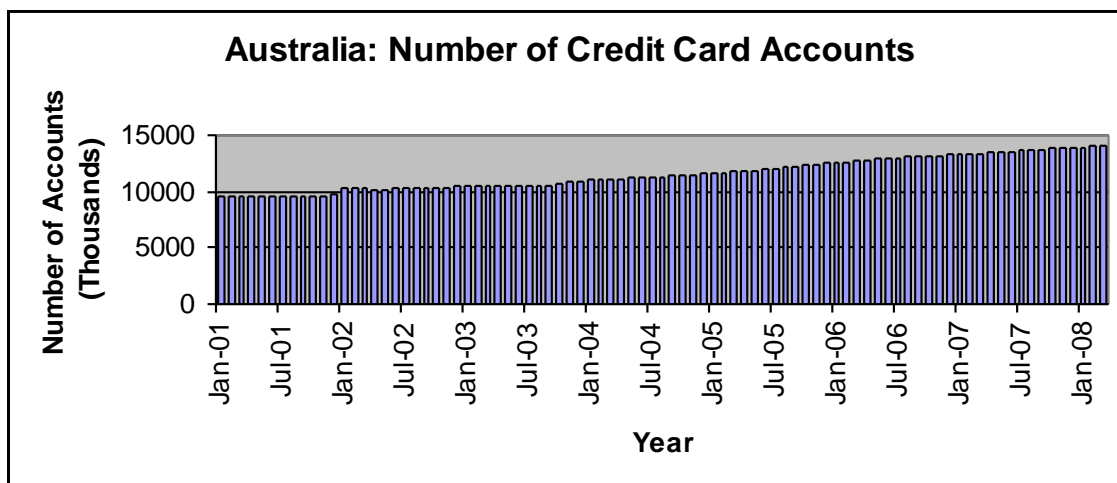
A series of subsequent analyses from the Reserve Bank of Australia and its Payments Systems Board have documented the numerous benefits that interchange reform has meant for the Australian economy.

- **Consumers save money from interchange reform:** As the Payments Systems Board stated in their 2005 Annual Report, “the most notable impact of the reforms has been a marked reduction in merchants’ costs of accepting credit cards, which in turn, is flowing through into lower prices of goods and services for all consumers.”^{vi} The Report also noted “competition means that just as the banks passed on their lower costs to merchants, so too must merchants pass on their lower costs to consumers.”^{vii} In its *Preliminary Conclusions of the 2007/2008 Review*, the Reserve Bank estimated that “over the past year, these cost savings have amounted to around [AU]\$1.1 billion” and estimated that the “bulk of these savings have been, or will eventually be, passed through into savings to consumers.”^{viii} Given the size differences between Australia and

the U.S. and their respective economies, it is safe to say that the potential size of U.S. consumers' savings due to swipe fee reform could dramatically exceed the AU\$1 billion figure from Australia. In fact, if Visa, MasterCard, and the issuing banks had charged Americans the same payment card swipe rates they charged Australians, American consumers would have saved \$125 billion over the last four years alone.

- **Reduced swipe fees benefit credit card borrowers...**: As the Payment Systems Board noted in their '05 Report, "One group of consumers clearly better off are those who regularly borrow on their credit cards. They are now able to obtain a card with an interest rate of 10 to 13 per cent, rather than the 16 to 18 per cent payable on traditional cards. For many consumers the resulting savings can run into hundreds of dollars per year."^{ix}
- **...As well as non-plastic users**: Australia found that non-credit card users benefited from swipe fee reforms as well, by paying lower prices as merchants passed along savings to all consumers. As the Payment Systems Board stated, "For many years, these consumers have helped subsidize the generous reward points of the credit card issuers through paying higher prices for goods and services. The reforms have helped unwind some of this subsidy."^x

Additionally, despite the doomsday scenarios outlined by credit card companies, the Australian example shows that credit card accounts and activity have both continued to rise since the nation enacted interchange reforms. As the below chart illustrates, reforming the interchange rate process has not dampened the marketplace for credit card accounts in Australia, where credit card issuing continues to grow at 5% per year.



Overall, Australia's swipe fee reforms provide a real-life case study that shows that interchange reform is beneficial to both consumer and merchant. This example also helps refute the dire warnings of credit card companies that swipe fee regulation will cripple their businesses.

As the *2007/2008 Review* concludes, "The reforms have met their key objectives. They have: increased transparency; improved competition by removing restrictions on merchants and liberalising access; and promoted more appropriate price signals to consumers."^{xi}

The Australian Merchants Payments Forum assessed the positive aspects of swipe fee reform as follows, "the RBA's reforms to the Australian cards market have been extremely effective in reducing merchant service fees and freeing merchants from anti-competitive restrictions imposed by card Schemes. These reforms have achieved welfare gains and improved the efficiency of Australia's payments system. Despite dire warnings from card Schemes and Issuers that their business and competitive position would be terminally damaged, key indicators such as the number of credit card accounts, the market shares of the card Schemes, and the number and value of credit card purchases indicate this has not eventuated."^{xii}

In August 2009, after reviewing the progress of interchange reforms, Australia's Payment System Board announced that it would continue to oversee and regulate the swipe fee process in the nation, while maintaining the current interchange rate. Although the Board announced that some positive steps had been made to strengthen competition and ensure that swipe fee rates would not spike in the absence of regulation, they noted that "it would not be in the public interest" to go back to pre-reform days.^{xiii}

The European Union

“The fee is passed on to retailers and, ultimately, consumers. In theory the purpose of this is to give each bank an incentive to issue and promote payment cards. However in practice these fees simply became a hidden source of revenue for the banks.”

- Neelie Kroes, European Commissioner for Competition Policy

Swipe fee reform in the E.U. is “part of a move by Brussels to stimulate economic growth by boosting the affordability of goods and services through cheaper banking and card fees.”

- *The Independent (U.K.)*, April 2, 2009

Europe has been recently cracking down on excessive interchange fees that their authorities have found to be antitrust violations.

Notably, European political leadership and market experts view the reform and reduction of hidden credit card interchange fees not only as pro-business and pro-consumer, but also as a painless way to put more money in the economy during a recession and to stimulate spending.

In December 2007, the European Commission ruled that MasterCard’s cross-border interchange fee breached EU antitrust rules and had to be changed. The Commission concluded that the fees inflated the cost of card acceptance by retailers without leading to proven efficiencies.

As Competition Commissioner Neelie Kroes stated at the time, "Multilateral interchange fee agreements such as MasterCard's inflate the cost of card acceptance by retailers. Consumers foot the bill, as they risk paying twice for payment cards: once through annual fees to their bank and a second time through inflated retail prices paid not only by card users but also by customers paying cash. The Commission will accept these fees only where they are clearly fostering innovation to the benefit of all users." ^{xiv}

After years of investigation, in April 2009, the European Commission announced an agreement with MasterCard on cross-border interchange rates. As Commissioner Kroes noted, “I am happy to announce that MasterCard has undertaken to cut its original Multilateral Interchange Fees (or MIFs) for cross-border card payments in Europe and to repeal its recent scheme fee increases for cross-border transactions. Moreover, MasterCard has also agreed to introduce certain changes to its system that increase transparency and efficiency in the payment cards markets.” ^{xv}

MasterCard agreed to reduce its cross-border interchange rates by about half, to 0.3% - less than one-sixth the average U.S. rate. Compared to the U.S., where the swipe fee means Americans pay \$2 out of every \$100 spent in stores, the MasterCard agreement “means that if you spend 100 euros with a payment card in another Member State, the merchant will be charged a fee of on average 30 cents as opposed to up to one euro and ninety cents in the past.”^{xvi}

In addition, in March 2008, the European Commission decided to open formal antitrust proceedings against Visa Europe in relation to its interchange fees associated with cross-border, point-of-sale transactions, which are currently at 0.7%. At this time, no agreement has been reached. However, given the MasterCard example, Visa and other purveyors must recognize that their “future must lie in transparent, sustainable behaviour and services that offer clear benefits to its customers.”^{xvii}

Clearly, the E.U. realizes that cutting unfair credit card fees is a smart move to encourage competition, transparency, and a fair playing field. However, cracking down on swipe fees also offers an efficient way of putting money into the economy. As *The Independent* noted in an article about the MasterCard agreement, the development, is also “part of a move by Brussels to stimulate economic growth by boosting the affordability of goods and services through cheaper banking and card fees.”^{xviii}

New Zealand

“The Commission considers that this increased transparency will assist retailers and customers in making decisions about their payment choices.”

- New Zealand Commerce Commission Chair, Dr. Mark Berry

New Zealand recently announced agreements with both Visa and MasterCard to reform the nation’s credit card swipe fee system to ensure a more transparent process and to empower small business owners with more room to negotiate swipe fees. These reforms will make the entire interchange process more equitable and accountable and will help eliminate the hidden charges that New Zealand retailers currently pass on to consumers as a result of swipe fees.

Visa and MasterCard are highly active in New Zealand. As of 2004, approximately 2.1 million Visa and 900 thousand MasterCards were in use in New Zealand, representing approximately 90% of the credit card billings in that country.^{xix} Combined Visa and MasterCard transactions in New Zealand totaled \$19 billion during ‘04.^{xx} However, in November 2006, New Zealand's Commerce Commission ruled that both card issuers' interchange fee process was in violation of the restrictive trade practices provisions of the nation's Commerce Act.

Specifically, the Commission found that Visa and MasterCard were in violation of sections of the nation’s Commerce Act that prohibited “contracts, arrangements or understandings that substantially lessen competition” and “price fixing, which is when people or businesses that are in competition with each other agree to control, fix or maintain the prices for the goods or services that they supply.”^{xxi}

Within two weeks of each other, in August 2009, Visa and MasterCard each agreed to a series of reforms designed to improve interchange process transparency, foster competition, and increase access to information for both consumers and retailers. The two companies also agreed to pay for some of the costs associated with the Commerce Commission’s actions in investigating and pursuing the cases, with Visa agreeing to pay 2.6 million NZD and MasterCard agreeing to pay 3 million NZD.^{xxii}

The agreements between the NZ government and the two companies include a number of specific changes to the swipe fee process, including: allowing credit card issuers to “individually set the interchange rates that will apply to transactions using their credit cards,” ensuring that this rate information is publicly available, and allowing merchants to apply “surcharges to payments made by credit cards or by specific types of credit cards.” Merchants are also newly able “to encourage customers to pay by other means,” meaning that discounts for cash payments are no longer prohibited.^{xxiii}

The *New Zealand Herald* editorialized in favor of the announced reforms, noting that the previous process resulted in retailers passing on their own high rates of swipe fees to all customers “regardless of the method of payment.” As the *Herald* wrote, “In theory, of course, this should mean that prices will decrease. A cost formerly attached to all goods to compensate for credit-card transaction fees can now be sheeted home to the user.”^{xxiv}

Upon announcing the agreement with Visa, New Zealand Commerce Commission Chair Dr. Mark Berry stated that the reforms will, “improve competition between companies that provide credit card services to retailers in New Zealand” and noted that the changes “are in the long-term best interests of both New Zealand consumers and retailers.”^{xxv}

After the Commission announced the agreement with MasterCard, Dr. Berry stated, “The settlement can be expected to reduce overall costs to consumers of payment systems by driving down interchange fees and facilitating merchant steering towards lower cost payment methods.”

Canada

“Small- and medium-sized businesses in Canada have not asked for government subsidies, and this is not requesting money from the government. This is only requesting action in regards to fairness in those fees for the merchant community”

- Senator Pierrette Ringuette
Member of Canada’s Senate Committee on Banking, Trade and Commerce

Like its neighbor to the South, Canada faces problems of escalating swipe fee costs combined with limited leverage for consumers and retailers to rein in these costs. Canadians paid \$4.5 billion in swipe fees last year, in part due to some of the highest interchange rates in the world (see chart on page 2).^{xxvi} The Canadian government has started to take notice.

In March 2009, the Competition Bureau of Canada announced that the bureau was exploring whether Visa and MasterCard breached the nation’s Competition Act and abused their dominant position in the Canadian marketplace.^{xxvii}

In June 2009, the Canadian Senate’s Committee on Banking, Trade and Commerce released an exhaustive report exploring the direction of the Canadian credit and debit card markets, including a detailed study on the role of swipe fees in the Canadian economy.^{xxviii} Coming after months of testimony from merchant and consumer groups, credit card companies, and Canada’s largest financial institutions, the report recommended reforming the swipe fee process to improve transparency and increase direct negotiation between merchants and Visa and MasterCard member banks.

Among its findings, the report stated, “The Committee believes that the Canadian credit card market needs improvement and clarity.”^{xxix} The report also found that “the relative power of the participants in the credit card payment system is unequal. We accept, to a great extent, the argument that most merchants lack the individual bargaining power needed to negotiate on an equal basis with other participants in the payment system... The end result of higher interchange rates is higher costs for merchants and higher retail prices for consumers.”^{xxx}

While recommending more oversight and accountability by the Canadian government over the credit and debit markets and the interchange system, the report and its findings have not yet led to legislative action. As Senator Pierrette Ringuette of the Committee on Banking, Trade and Commerce stated, “the priority right now is for the government not to sit on this report. This is not a political document; it’s an action document, and it requests action immediately from the government.”^{xxxi}

Conclusions

Lawmakers and antitrust regulators in many of the world's top economies have recognized the antitrust and other policy problems with swipe fees and have moved to curb abuse of pricing and operating rules.

As Sonja Yates Hubbard, CEO of E-Z Mart Stores, puts it, "The U.S. has the greatest, most competitive economy in the world – except when it comes to swipe fees. I cannot understand why Congress would allow small businesses in the U.S. to pay larger swipe fees than businesses anywhere else in the industrialized world when so many other countries have found that reform works for business, for consumers, and for the economy as a whole."

Governmental intervention in all countries where interchange was curbed follows the same basic economic premise. For the free market model to work, competition must exist to keep pricing in check, and consumers must have requisite "knowledge" to choose which competitor offers the best value. An absence of any of these fundamental elements creates the toxic environment of abuse, and the American credit card system is a perfect example of this because just a couple of companies dominate and keep their fees hidden.

Reforming swipe fees is broadly supported by not only small business owners, but the public at large and consumer advocates as well. A July 2008 poll by Penn, Schoen, and Berland Associates found that 3 out of 4 Americans supported legislation to reform interchange fees.^{xxxii} Edmund Mierzwinski, Consumer Program Director of the U.S. Public Interest Research Group stated the perspective of many consumer advocates in 2008 congressional testimony, "the credit card market lacks the critical foundations of healthy competition – choice and adequate information. As a consumer advocate, I am gravely concerned about the fairness and legality of bank schemes to increase credit and debit card fee income."^{xxxiii}

As the examples from international competitors demonstrate, cracking down on interchange fees is a boon to consumers, merchants, and to the establishment of a fair and competitive marketplace. Though each nation is different, the underlying problem that must be addressed is the same. U.S. small businesses and consumers should not be treated worse than citizens elsewhere in the world.

As Congress and the White House have already taken on other credit card abuses, any lasting fix will be incomplete without addressing swipe fee reform.

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- ⁱ National Association of Convenience Stores, *State of the Industry Report 2009*
- ⁱⁱ Data from Merchants Payments Coalition.
- ⁱⁱⁱ Estimates based on 2009 updates prepared by Fumiko Hayashi, Federal Reserve Bank of Kansas City.
- ^{iv} Reform of Australia's Payment System: Preliminary Conclusions of the 2007/2008 Review, Reserve Bank of Australia, at 2.
http://www.rba.gov.au/PaymentsSystem/Reforms/RevCardPaySys/Pdf/preliminary_conclusions_2007_2008_review.pdf
- ^v Press Release, Reserve Bank of Australia, Credit Card Benchmark Calculation, September 29, 2006.
- ^{vi} Payments System Board Annual Report, *Reserve Bank of Australia*, 2005 at 10.
http://www.rba.gov.au/PublicationsAndResearch/PSBAnnualReports/2005/Pdf/credit_charge_cards.pdf
- ^{vii} *Ibid* at 11.
- ^{viii} Reform of Australia's Payment System: Preliminary Conclusions of the 2007/2008 Review, *Reserve Bank of Australia*, at 23.
- ^{ix} *Ibid* at 14.
- ^x *Ibid*.
- ^{xi} Reform of Australia's Payment System: Preliminary Conclusions of the 2007/2008 Review, Reserve Bank of Australia, at 39.
- ^{xii} *Regulation of Card Payments in Australia*, Prepared by the Australian Merchant Payments Forum, August 19, 2009.
- ^{xiii} Reserve Bank of Australia Press Release, "Payments System Reform," August 26, 2009:
<http://www.rba.gov.au/MediaReleases/2009/mr-09-18.html>.
- ^{xiv} "Antitrust: Commission prohibits MasterCard's intra-EEA Multilateral Interchange Fees," Press Release from European Commission, December 19, 2007 <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/1959>
- ^{xv} Remarks of Neelie Kroes, European Commissioner for Competition Policy at Press Conference in Brussels, April 1, 2009.
- ^{xvi} *Ibid*.
- ^{xvii} *Ibid*.
- ^{xviii} *Independent*, "Mastercard agrees to cut fees it charges banks," April 2, 2009:
<http://www.independent.co.uk/news/business/news/mastercard-agrees-to-cut-fees-it-charges-banks-1660022.html>.
- ^{xix} Press Release from New Zealand Commerce Commission, "Commerce Commission and Visa reach agreement to settle credit card interchange fee proceedings," August 12, 2009:
<http://www.comcom.govt.nz/MediaCentre/MediaReleases/200910/commercecommissionandvisareachagre.aspx>
- ^{xx} *Ibid*.
- ^{xxi} Press Release from New Zealand Commerce Commission, "Commerce Commission and MasterCard agree to settle credit card interchange fee proceedings," August 24, 2009.
<http://www.comcom.govt.nz/MediaCentre/MediaReleases/200910/commercecommissionandmastercardagr.aspx>
- ^{xxii} *Ibid*.
- ^{xxiii} *Ibid*.
- ^{xxiv} *New Zealand Herald*, "Editorial: User-pays for credit cards fairer for all," August 14, 2009:
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- ^{xxvi} "Card costs: who pays what to whom," CBC News, May 21, 2009:
<http://www.cbc.ca/consumer/story/2009/04/16/f-cardfees.html>
- ^{xxvii} *Ibid*.

^{xxviii} *Transparency, Balance, and Choice: Canada's Credit Card and Debit Card Systems*. Report of Canada's Standing Senate Committee on Banking, Trade and Commerce, June 2009:

<http://www.parl.gc.ca/40/2/parlbus/commbus/senate/com-e/bank-e/rep-e/rep04Jun09-e.pdf>

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^{xxx} Ibid.

^{xxxi} "Ottawa must repair credit-card market immediately: Senate report," *Canwest News Service*, July 3, 2009:

<http://www.canada.com/news/national/Ottawa+must+repair+credit+card+market+immediately+Senate+report/1748072/story.html>

^{xxxii} Poll from Penn, Schoen, and Berland Associates, July 2008. Available at www.unfaircreditcardfees.com.

^{xxxiii} Testimony of Edmund Mierzewski, Consumer Program Director, U.S. PIRG, Before the Antitrust Task Force, House Judiciary Committee, Hearing on HR 5546, the Credit Card Fair Fee Act of 2008, 15 May 2008.