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Thank you for providing me with the opportunity to testify on the swipe fees that are imposed by the credit card industry on merchants and HB 2089, the Consumer Inflation Reduction and Tax Fairness Act. Most consumers are not aware of swipe fees and do not see the inflationary effects they create on the cost of goods and services and the U.S. economy, but those effects are dramatic. For merchants, these excessive and ever-increasing fees are a constant source of stress and financial difficulty, and for consumers these fees contribute significantly to inflation. In fact, swipe fees reduce efficiency across the economy.

I am testifying today on behalf of my association, the National Association of Convenience Stores (NACS). NACS is an international trade association representing the interests of the convenience industry. In Kansas, the industry includes more than 1,500 stores employing 25,000+ people and collects more than $2.1 billion in taxes.

Throughout the nation, the industry includes more than 150,000 stores employing 2.44 million people. It is truly an industry of small business with a full 60 percent of the industry comprised of single-store operators. The industry handles about 165 million transactions in total each day – a number equivalent to about half of the U.S. population. An efficient and competitive payment system is critical to the health of the industry, its employees, and its customers.

<u>The Problems with the Credit Card Industry's Swipe Fees</u>

The credit and debit card systems in the United States are burdened by anti-competitive conduct that makes the systems less efficient and effective than they should be. Two payment card networks, Visa and Mastercard, dominate the market and bring together thousands of card-issuing banks across the nation to wield market power in ways that harm competition in the marketplace. Merchants have no realistic options to refuse to take cards controlled by the dominant networks and virtually all the banks that are their members. With very few exceptions, merchants must accept all credit and debit cards that run over those two networks no matter how high the fees the networks charge and no matter how onerous the rules and conditions they impose. The high fees that result from this exercise in market power inflate the costs of goods and services across the nation in a way that harms consumers.

It does not have to be this way. The rates that Americans pay on credit card swipe fees are the highest in the industrialized world – and it's not close. The U.S. Congress has a potential answer to the industry's lack of competition in the Credit Card Competition Act (CCCA), sponsored by Kansas Senator Roger Marshall. The Kansas legislature, however, can act to fix another harmful aspect of swipe fees by passing HB 2089. To understand the harm created by swipe fees and how Kansas can help deal with it, it helps to understand the current problems.

The problems in this market have developed because Visa and Mastercard centrally set the fee rates for the largest portion of swipe fees, known as interchange fees. These are fees typically ranging from 2 to 3 percent of the transaction amount that card-issuing banks charge to merchants each time a Visa or Mastercard card is used. But the banks that receive the fees don't set the fees - they let Visa and Mastercard fix fee rates on their behalf. Because the banks' fees are centrally set in this way, the banks don't compete on price. That leads to problems that are common for anti-competitive arrangements – high and escalating prices and neglect of key aspects of the service (such as protection against fraud). Visa and Mastercard also dictate a complex set of terms (called network rules) that govern how credit card transactions happen. These terms further insulate swipe fees from competitive market pressures and, in most cases, keep the fees confusing for merchants and hidden from consumers.

In particular, by imposing an "honor all cards" rule that requires a merchant to accept all cards issued with a Visa (or Mastercard) logo if the merchant wants to accept any cards carrying those networks' logos, the two largest networks remove the incentives for banks to negotiate with merchants on price or acceptance of their cards – and remove almost all bargaining power that merchants otherwise might have had. This is a central element of the credit and debit card systems in the United States today. In effect, Visa and Mastercard have created cartels that control prices and terms to the detriment of merchants and consumers.

The extent of the anticompetitive problems created by this structure was recently highlighted by the U.S. Department of Justice (DOJ) in the lawsuit it filed against Visa.[1] While that case only covered debit cards, a story in the Wall Street Journal made clear that Visa's anticompetitive actions also negatively impacted the credit card market.[2]

The problems caused by all this for consumers, merchants and the economy are immense. Total card swipe fees imposed on merchants were $172 billion in 2023[3]– up from $64 billion in 2010. Of that total, $100.77 billion were interchange fees for Visa and Mastercard branded credit cards and $31.3 billion were interchange fees for Visa and Mastercard branded debit cards.[4] Visa and Mastercard also collected swipe fees called network fees for themselves that totaled $10.9 billion on credit cards and $8.3 billion on debit cards.[5] The size of swipe fees and the fact that they are set largely as a percentage of transaction amounts means that they are an inflation multiplier; as inflation goes up the amount of fees collected goes up with it, which forces retailers to further raise prices to cover the increased fees. This inflates what all consumers pay.

The roles played by the two dominant card networks and the fees and terms they set cause other problems as well by reducing incentives for innovation in new payment products and improvements in services such as fraud protection. The United States should have the most

[1] U.S. v. Visa, Complaint (Sept. 24, 2024) (available at dl).
[2] "Visa Wanted a Vast Empire. First, It Had to Beat Back Its Foes." By Annamaria Andriotis, The Wall Street Journal (Oct. 19, 2024) (available at Visa Wanted a Vast Empire. First, It Had to Beat Back Its Foes. - WSJ).
[3] The Nilson Report, March 2024 (available at 1259 - Nilson Report).
[4] The Nilson Report, March 2024 (available at 1259 - Nilson Report).
[5] CMSPI-IAC State of the Industry Report (Sept. 2024) at 19 (available at State of the Industry Report | CMSPI Global).

efficient, effective and innovative payment system in the world, but we don't. Instead, as revealed by the Justice Department and the Wall Street Journal, we actually have a dominant payment network -Visa- actively holding back innovation in the market through pay-offs and manipulative fee practices. This market desperately needs changes so that there are competitive market forces that improve payments for everyone.

The Benefits of HB 2089

Because the largest part of swipe fees are charged as a percentage of the transaction amount, swipe fees are especially problematic for the portions of transactions that merchants do not keep – taxes and tips. For both taxes and tips, merchants are obligated to give those funds to someone else, either the state/local government or the tipped worker. But, the credit card industry swipes a big chunk of that money before the merchant can give it to anyone. That means merchants must go into their own pockets to make up the shortfall to make the government or their employees whole. That simply is not fair.

HB 2089 would address precisely this injustice. It would simply prohibit the credit card industry from taking swipe fees out of the tax or tip portion of a transaction. That is all. It would not solve the entire problem with anticompetitive swipe fees. That is up to Congress. But, it would deal with one of the most egregious swipe fee injustices that Main Street merchants face – the financial penalty they take simply by doing a service for the government or their employees through collecting taxes or tips on their behalf. Main Street did not ask to be the tax collector for the state. They are required to do that. They should not face a financial penalty from the credit card industry for performing that service.

An analogy may be helpful here. The Kansas Department of Revenue employs people to do the job of collecting taxes for the state. This is a necessary function and similar to what merchants do for the state on taxes they collect. If the credit card industry imposed a special fee that took away part of the salaries of Kansas Department of Revenue employees, we would all be outraged that they would penalize those employees for doing their duty. We would expect legislation to quickly prohibit such a fee. We expect it would pass overwhelmingly.

That is effectively what happens with the credit card industry's swipe fees on the tax amount of transactions in Kansas. It hits stores that collect taxes for the state and hits them harder if they collect more taxes for the state. This needs to stop, as does the similar penalty that swipe fees impose on tips that merchants collect for their workers.

Objections to the Bill Are Misleading

The credit card industry's objections to HB 2089 deny reality. While the industry claims that they must charge swipe fees on taxes and tips, that is not the case. The tax and tip amounts are both part of the data flow in card transactions. The tax amount is included in what is referred to as "level 2" or "track 2" data. In fact, for many transaction flows, card processors must add the sales tax amount to the amount of the underlying good or service in order to arrive at the total and apply the swipe fee formula to it. HB 2089 would actually save them that step. The tip amount is also part of the transaction data flow, as the underlying amount is communicated in an

initial authorization and then the amount plus the tip is communicated through the settlement process.

The clearest giveaway of the fact that the card industry is not telling the whole story on this point is that the card networks collect sales tax data and then try to sell the data back to merchants (Visa has called this service "IntelliLink" and now refers to it as "Visa Spend Clarity").[6] This service includes "Local tax support including VAT and GST". And when Visa tried to sell merchants this data, they have claimed that there was "no special hardware or software required." So, the bottom line is that if handling sales tax data drives revenue for Visa, distinguishing this data is easy to do. But, if it gives merchants a break, the card industry suddenly claims that it becomes impossible. Obviously, that isn't credible.

The other reason that these card industry objections aren't credible is the flexibility built into HB 2089. The bill provides that if the data communicated at the time of sale cannot allow the interchange fees to be applied only to the underlying amount, and not taxes or tips, then the merchant can provide the tax and tip information later and get a reimbursement.

An after-the-fact reimbursement is not difficult. In fact, the credit card companies facilitate a number of after-the-fact processes to change figures on the final settlement. The largest of those processes is referred to as a chargeback and that allows the card companies to take away 100% of the sale amount from a merchant based on fraud or another transaction-related dispute. Chargebacks can take funds from a merchant several months after the transaction and have become so common that merchants actually pay for more card fraud today than the credit card companies or banks.

With billions of dollars currently flowing out of merchants' bank accounts weeks or months after the transaction as chargebacks, it is clear that the card industry could allow merchant reimbursement of fees charged on taxes and tips as well. Apparently, their only real objection to doing that isn't that it would be hard to do (because it would simply mirror what they already do today), but that doing so would benefit merchants rather than themselves.

And, those fraud chargebacks demonstrate the emptiness of the other primary objection from the card industry. The industry claims that they must charge fees on tax and tip amounts because they say that banks bear the fraud risk on those amounts. The reality is that merchants shoulder more of the fraud risk than banks. The Federal Reserve collects data on debit card fraud every two years, and in its most recent data, the Fed determined that merchants covered 47 percent of debit card fraud and card issuing banks covered 33.5 percent.[7] The numbers show that the card industry does not need fees on taxes and tips to cover fraud. If fraud were the primary issue, they should be sending fees to merchants, not the other way around.

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[6]The former web address for it was at: https://usa.visa.com/run-your-business/commercial-solutions/solutions/intellilink.html. Since this service was referenced in previous hearings, Visa has changed the page to remove specific references to the tax data they provide.

[7] "2021 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions," Board of Governors of the Federal Reserve System (Oct. 2023) at 3, available at Federal Reserve Board Publication. The remaining fraud was covered by cardholders.

The card industry also frequently points to a court case in Illinois in which the banking industry has challenged a similar law passed in that state. While the card industry is fond of claiming that the case shows the Illinois law is preempted by federal law, that is incorrect.

The Illinois court has only dealt with the question of whether it should pause application of the state law while the case is going forward to ensure that full consideration and a decision happen in the case before any business might be impacted. What the court has said so far is that Visa and Mastercard and Illinois banks and credit unions are all fully subject to the law and there is no need even to pause things for the court to hear the case with respect to those businesses. So, the Illinois law is going forward in July of this year – exactly the timeframe specified in its law.

The court did say that for national banks and out-of-state banks it would pause the law's application while the case is litigated. That part of the decision, however, is form over substance. Because Visa and Mastercard control every aspect of the system – from banks' pricing of interchange fees to the terms under which cards are processed – they are the only entities needed to ensure the law goes forward with respect to all transactions on Visa and Mastercard cards.

Both Visa and Mastercard regularly dictate each small detail of how these transactions happen and regularly maintain different rules for different states and regions. They do things that are much more detailed and complex than what HB 2089 or the Illinois law would require. They are so detailed that Visa's "Core" rules run 939 pages[8] and Mastercard's transaction processing rules run 397 pages.[9] And, those are not their only requirements for how card transactions must happen today.[10] HB 2089 would add relatively small details to the system Visa and Mastercard have already created. Given that Visa and Mastercard are not banks and will be subject to the Illinois law and HB 2089, all they need to do is say that taxes and tips will no longer be charged – and that's what will happen. It would be hard for any reasonable person to read their mountain of rules and conclude that the bill's changes are more complicated than what they already dictate.

The bottom line is that banks hide behind Visa and Mastercard by handing them the power to set banks' prices and the terms of card transactions. Visa and Mastercard should not be able to hide behind banks when it comes to the application of the law, yet that is just what they are trying to do. We ask you not to let them get away with that.

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The credit card industry swiping part of the tax and tip amounts from Main Street businesses before they have a chance to give those funds to state and local governments or employees is unfair and wrong. Main Street should not be penalized for performing those services, but they are today. It is as simple as that. We urge you to pass HB 2089 and correct that injustice.

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[8] Visa Core Rules and Visa Product and Service Rules

[9] Transaction Processing Rules

[10] Visa also has a merchant data handbook, separate rules for debit transactions using Interlink and more. Visa Rules and Policy | Visa. Mastercard has separate security rules, a chargeback guide, and more. Mastercard Rules for Merchants | Customer Compliance Program