

A PRACTICAL GUIDE TO REDUCING MERCHANT PAYMENT CARD PROCESSING COSTS



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I. Introduction: Merchant Concerns with Payment Card Processing Costs

Retailers have expressed concern regarding the fees they pay for the services associated with their acceptance of credit and debit cards. Much of the attention has focused on “interchange” fees which are one of the card processing cost components. Concern about interchange levels has resulted in proposals for its regulation by federal authorities. These proposals, which include creation of a new antitrust exemption for even the largest banks and retailers, are complex, misguided and would require action by both Congress and Executive Branch agencies prior to initiation of any efforts to change card processing charges. Moreover, the legislative and regulatory proposals would not control a key card processing cost component which is disproportionately burdensome on smaller businesses.

In presenting a practical guide that merchants can use to significantly lower their payment card processing costs without new federal intervention, this paper will:

1. Discuss why merchants accept payment cards;
2. Explain how card payments are processed;
3. Describe the different components of payment processing costs;
4. Detail the problems and pitfalls of interchange regulation;
5. Provide a guide for merchants to use in reducing their payment card processing costs; and
6. Include case examples of merchants who have succeeded in substantially reducing their card processing costs.

Acquirer Surcharges Hit Smaller Merchants

Initiatives to regulate interchange fees are misguided since they: 1) would hurt small businesses and consumers (see p. 9); and 2) don't address what for many smaller businesses is their largest transaction processing expense, the various fees and surcharges that are paid to the card processor and independent sales organizations (interchange goes only to the issuing bank).

CRE found that processor fees and surcharges can double a merchant's card processing costs. For example, a merchant who qualifies for a card processing rate (discount rate) of about 1.7% may end up paying between 2.5% to 4.0% after various surcharges are factored in.

Merchants seeking lower their transaction processing costs should use a “renegotiation” program as described on page 25.

II. Why Merchants Accept Payment Cards

When merchants accept payment cards, they obtain a wide range of services including transaction processing, bad debt protection and fraud protection. By accepting these cards, retailers are not only providing their customers with payment convenience and flexibility, they are also safeguarding themselves against everything from the costs and risks (thievery) of cash transactions, to insurance against bad debt, bounced checks, and identity theft by customers as well as improved cash flow.

Bad debt in particular is an increasingly costly danger. Bloomberg News reported that “U.S. credit-card defaults rose to a record in August” 2009 of almost 11.5%.¹ The news wire also noted that “more losses may lie ahead as delinquencies climbed for the first time since March, according to Moody’s Investors Service.”

Thus, the benefits for merchants from accepting payments cards can be divided into three categories:

1. Increased sales;
2. Reducing or eliminating the need to handle cash; and
3. The variety of services that are purchased through the transaction processing fee. These services include financial institutions taking over the merchant’s risks associated with partial or non-payment by consumers, countless varieties of fraud, quicker cash flow, and the provision of transaction-specific paperwork/recordkeeping/accounting services.

III. The Payment Chain: How Payment Card Transactions Are Processed

There are two types of payment card business models, the open network model used by Visa and MasterCard which allows for thousands of competing card issuing institutions, and closed network models used by American Express and Discover. Since the open network model is the most popular, it will be the primary subject of this paper.

There are five primary participants involved in the processing of bankcard payment card transactions:

1. The consumer;
2. The merchant;
3. The acquirer;
4. The card network; and
5. The card issuer.

¹ <http://www.bloomberg.com/apps/news?pid=20601087&sid=aa71n7jSFj80#>.

The Consumer

The consumer is the alpha and omega of every transaction. The process begins with the consumer choosing to initiate a transaction using a payment card and ends with the consumer paying for the goods and/or services received.

The Merchant

The merchant is the party who accepts payment cards for the goods or services they offer. While often a retailer, the “merchant” may also be a wholesaler, physician, architect, charity, licensed massage therapist or any other person or organization that accepts payments cards as a convenient way to transfer funds.

The Acquirer

Acquirers, (also known as acquiring banks, merchant acquirers, or card processors) are financial institutions that perform much of the transaction processing grunt work. There are multiple services provided by the acquirer,² some of which may be subcontracted or performed in partnership with third-parties such as speciality processing companies and independent sales organizations. The role of independent sales organization is discussed on p. 8.

Services provider by acquirers include:

- Signing up merchants. Acquirers market their services to businesses and, in doing so, encourage organizations that do not yet accept branded payment cards to do so.
- Underwriting. One of the acquirer’s functions is to ensure that the merchant meets the card network’s financial qualification requirements. As part of this underwriting function, the acquirer assumes financial responsibility for the merchant’s transactions. For example, if a customer makes a purchase from a merchant and the merchant goes out of business before delivery is made, it is the acquirer who has the responsibility for making the customer financially whole.
- Means of Transaction Authorization. When a merchant submits a payment card transaction, it is the acquirer who queries the card’s issuing institution through the card network to see if the transaction request is approved. The acquirer then informs the merchant regarding the transaction’s approval or rejection. If a transaction is approved, the merchant is guaranteed payment, even in the event of customer fraud or default, unless legitimate grievances are raised concerning the merchant’s performance.

² Ann Kjos, “The Merchant-Acquiring Side of the Payment Card Industry: Structure, Operations, and Challenges,” Discussion Paper, Payment Cards Center, Federal Reserve Bank of Philadelphia, October 2007, pp. 3-6.

- Clearing & Settlement. The acquirer uses the card network to obtain funds from the card issuing institution and credits the merchant's account for the sale, usually within a day or so, minus the fees for payment processing services. The acquirer also provides the sales transaction data to the card issuer through the card network.
- Statement Services. Merchants receive statements from their acquirer detailing sales, expenses and other relevant data concerning transactions made with payment cards. Depending on the agreement between the merchant and acquirer, the data may be automatically integrated into the merchant's accounting information systems. The acquirer may also provide analysis services regarding sales trends and other information.

The acquirer may also provide other services to the merchant in addition to those described above. For example, acquirers often arrange for the sale or lease of the customer premises equipment which accepts card "swipes."

The Card Network

The card network, usually Visa or MasterCard, is the backbone of the payment card process. In addition to establishing and maintaining the network, setting and updating the rules of the road, and making sure the whole process works seamlessly around the world, the network is responsible for ensuring the widespread acceptance by merchants and availability to consumers of their branded payment card. The importance of the acceptance/availability function cannot be underestimated. A payment card which has limited acceptance, whether geographically or by any other measure, has less appeal to consumers. Similarly, a card which is held by relatively few consumers, is less attractive to merchants. Conversely, widely held and accepted cards are more valuable to both consumer and merchants. For example, a local sandwich shop may benefit from the global availability of branded payment cards because of international tourism. Even proprietary payment cards, such as American Express, vigorously engage in the ensuring their brand's broad acceptance and availability.

The Card Issuer

The card issuer is the financial institution which provides consumers with network-branded payment cards tied to a bank account and/or a credit line. The issuer performs multiple functions including approving transactions, using the card network to pay the acquirer, providing statements to their customer, and assuming the financial risk from non-payment and fraudulent card use. It is the card issuer which faces the greatest financial exposure during the transaction process.

As illustrated in Chart 1 on the next page, the five parties form a daisy chain, exchanging value (money or goods/services) and information (transaction-related data) at each step in the process. The outer ring of blue arrows in the chart illustrate the flow of information while the inner ring of green arrows illustrate the reciprocal flow of value among the parties to the transaction.

The transaction process begins with each consumer providing the merchant with information, their card number, and receiving value, the product or service they purchased. The process concludes with customers receiving information from their card issuer, their bank or card statement, and providing value, *i.e.*, making payment.

The Payment Chain

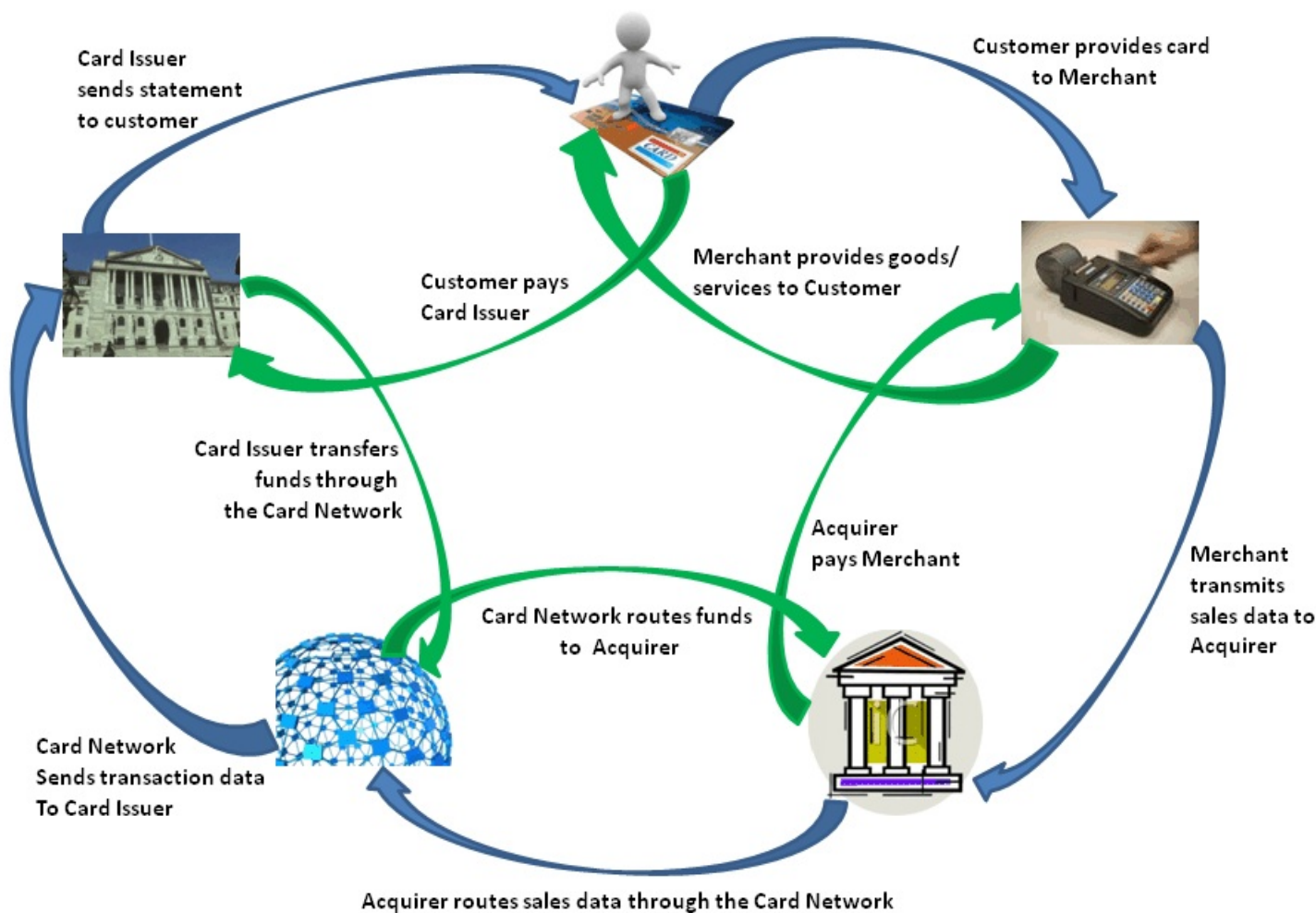


Chart 1

The division of the fee paid by the merchant for the payment card processing services among the different parties to the transaction is the subject of the next section of this paper.

IV. The Components of Payment Processing Costs

In exchange for receiving transaction processing, risk reduction and other services, the merchant pays a fee, as was noted in the previous section. This fee is deducted from the revenues remitted to the merchant by the acquirer and is divided into three portions, one for each of the three entities that are responsible for processing the transaction, the card issuing institution, the card network and the acquirer.

The three types of processing costs are:

- The interchange fee, paid to the card issuer – interchange goes only to issuing institution and, as was noted, is only one of the processing cost components.
- The “dues and assessments” fee, paid to the card network which is the smallest component of processing costs; and
- The acquirer’s fee, paid to the acquiring bank – the acquirer may include various surcharges in addition to their base rate.

The transaction processing fees, combined, are called the “discount rate” since the amount is discounted, *i.e.*, deducted, from the sum that is remitted to the merchant by their card processor.

Information on these payment card processing fees was obtained from a Discussion Paper prepared by the Federal Reserve Bank of Philadelphia’s Card Processing Center.³ This paper was based on a workshop, sponsored by the Bank, which was led by the managing partner of a firm which provides specialized advice regarding the payments industry. As part of their presentation, the official shared proprietary research regarding the payments processing industry.

Conventional wisdom holds that interchange accounts for the largest portion of the cost of accepting payment cards. On average, when all merchants are considered, even the very largest and most efficient, that is true. The equation changes dramatically, however, based on the size of the merchant. For small and medium size merchants, the acquirer’s fees, including various surcharges, can exceed interchange costs.

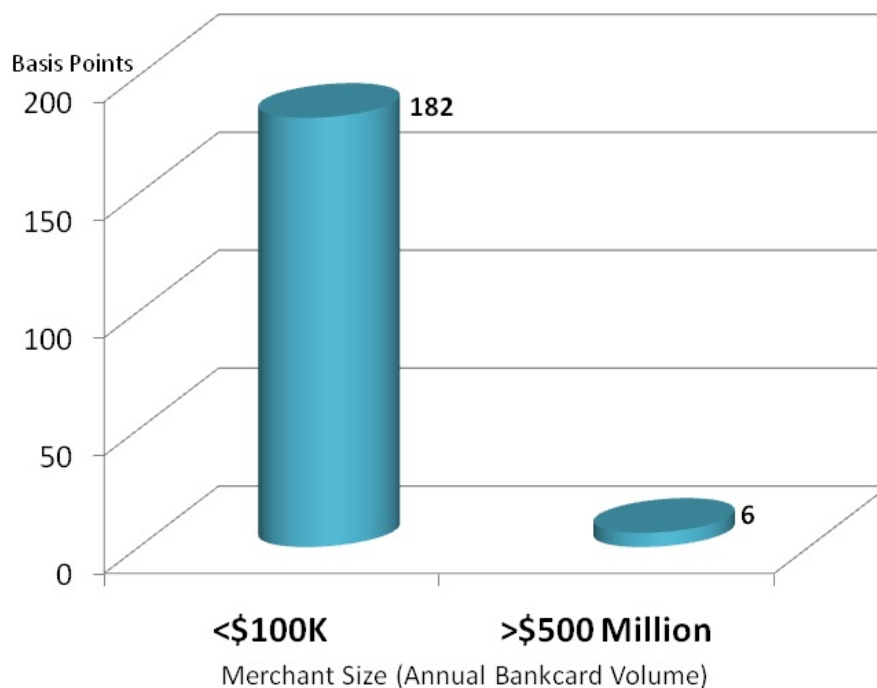
The Federal Reserve Bank’s paper provides details about the substantial disparity in the percentage of a transaction which goes to the acquirer for a transaction from a small business compared to a transaction from a large merchant. It is this variance which makes seeking and obtaining reductions in the acquirer fee an attractive opportunity for small and medium sized businesses.

Chart 2 illustrates the 30-fold difference in the percentage of a transaction charged the largest merchants versus the smallest for acquirer services. The chart shows the acquirer’s “net spread,” their net revenue

³ Ibid.

as a share of processed payment card sales volume expressed in basis points.⁴ It should be noted that almost 90% of all merchants are in the smallest category of no more than \$100,000 per year in bankcard payment card sales.

Variance in Acquirer's Net Margin



Source: Federal Reserve Bank of Philadelphia Discussion Paper

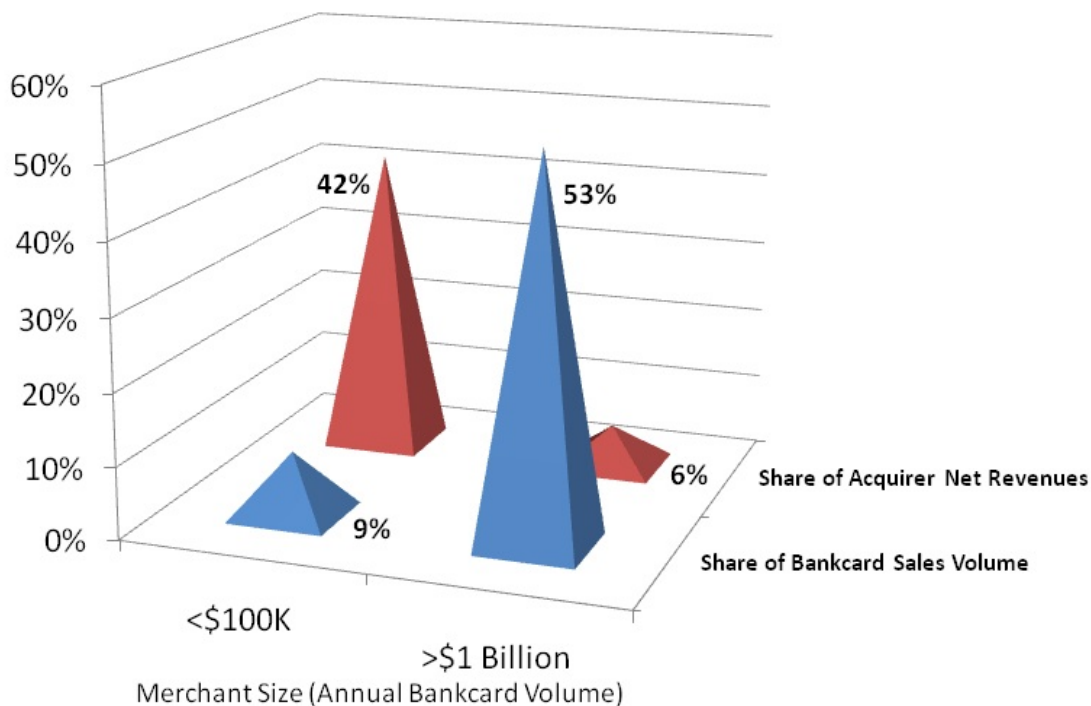
Chart 2

The Federal Reserve Bank of Philadelphia's discussion paper also explained that even though the small merchants (\$100,000 or less in annual card bankcard sales) account for less than 9% of the dollar volume of card sales processed, they contribute a significantly larger share, over 40%, of the acquirer's net revenues. By contrast, the 125 largest merchants who account for more than half of the dollar volume of payment card transactions, produced less than 6% of acquiring banks' net revenue in 2004.

Chart 3, based on 2004 data, illustrates the differences in the share of acquirer's card sales volume and net revenues that are accounted for by the smallest and largest merchants.

⁴ One basis point equals 1/100th of 1%.

Larger Merchants Have Negotiated Lower Acquirer Fees



Source: Federal Reserve Bank of Philadelphia Discussion Paper

Chart 3

Independent Sales Organizations

Acquirers often retain independent sales organizations to help market their processing services. These independent sales forces work on a commission basis. Moreover, there are no professional certifications or generally-accepted industry norms for training the individuals engaged in marketing card processing services. Thus, there is the potential for these independent agents to:

1. Not fully or appropriately represent the costs associated with a specific contract for card processing services; and
2. Try to sell merchants more expensive services/options than they need.

These higher costs will generally hit smaller merchants since larger, more experienced businesses often have the knowledge to take advantage of the competitive market for acquirer services and side-step commission-driven sales proposals.

Another area in which independent sales representatives can drive up a small merchants costs is through the leasing of customer premises equipment (swipe machines and similar) when such equipment could be purchased for a small fraction of the leasing costs. For example, CRE has received reports of \$200 machines being leased for \$50/month on 48 month leases to unsuspecting merchants. Other leasing abuses (lease of outdated and/or non-standard equipment) has also been reported.

Two key facts that need to be recognized when considering the acquirer fees paid by smaller and larger merchants:

1. There are significant economies of scale which make it less expensive on a per-dollar basis to process transactions from larger merchants; and
2. The market for acquirer services is highly competitive.

It is the second issue, the highly competitive nature of the acquirer business, that provides small and medium sized merchants the opportunity to lower their processing costs. Although the smallest merchants will not enjoy the economies of scale of their largest rivals, they are often able to significantly reduce their transaction processing costs. It is by negotiating lower acquirer fees, including surcharges, that businesses are able to reduce their payment card processing costs without any regulatory intervention by the Congress or federal agencies.

V. The Consensus Against New Regulation of Transaction Processing Services

The discussion of how payment card transactions are processed demonstrates that there is significant opportunity for merchants, particularly for small and medium sized companies, to reduce their card processing costs in the competitive marketplace for acquirer services. An explanation of how merchants would go about reducing their costs may be found in Section VI.

In contrast with negotiated solutions to reducing processing costs that have been demonstrated to save retailers money, regulation of interchange fees and other transaction processing costs is a misguided notion that would further strengthen the largest businesses while harming most merchants and the consumers who patronize them. Much of the support for federal intervention in the setting of interchange fees was based on a misunderstanding of a widely publicized study by Diamond Management & Technology Consultants (“Diamond Report”).⁵

The Diamond Report was initially cited by political leaders and business officials as providing evidence supporting legislation that would create a new antitrust exemption for banks and retailers and authorize federal intervention in setting interchange fees. After Diamond Consultants denounced the misconstruing

⁵ A. Dawson and C. Hugener, “A New Business Model for Card Payments,” Diamond Management & Technology Consultants.

of their study by proponents of interchange legislation, the Center for Regulatory Effectiveness (“CRE”) analyzed the report’s findings and is using them to demonstrate that regulation of interchange fees would be counterproductive and harm consumers. CRE’s conclusions are further supported by a more recent studies by the Congressional Research Service (“CRS”), the US General Accountability Office (“GAO”) and by a review of the relevant economic literature.

Misuse of the Diamond Report to Support Federal Regulation of Interchange

Political and business political leaders have frequently cited the Diamond Report as providing analytic support for proposed legislation that would:

1. Create a new antitrust exemption for some of the nation’s largest corporations; and
2. Authorize federal intervention in determining the fees and services exchanged between retailers and payment card systems.

Examples of key leaders who have cited the Diamond Report in support of federal intervention in setting interchange fees include:

- **United States Senator**. In a letter to the CEO of a major card network, the sponsor of the Senate version of the interchange bill stated:
 - “Interchange fees have been the subject of considerable Congressional interest in recent months. ... A recent analysis by Diamond Management and Technology Consultants estimated that only 13 percent of collected interchange fee amounts are used to pay for the costs of transaction processing...”⁶
- **Witnesses Before the House Judiciary Committee**. The Diamond Report was cited by multiple major stakeholders in their testimony before the House Judiciary Committee. These organizations explained that the Diamond Report was a key research paper for understanding interchange fees. For example, the National Grocers Association said:
 - “The recent ‘Diamond Study’ of interchange examined, among other issues, the costs presently being borne by consumers and merchants under the present interchange system.”⁷

Other major business associations who cited the Diamond Report in their testimony as justifying federal intervention in setting interchange fees included:

⁶ Sen. Dick Durbin, May 23, 2008 <http://durbin.senate.gov/showRelease.cfm?releaseId=298800>.

⁷ Prepared Statement of the National Grocers Association at the Hearing before the Antitrust Task Force of the Committee of the Judiciary, House of Representatives, July 19, 2007, p. 138.

- The National Retail Federation;⁸ and
- The National Association of Convenience Stores.⁹

Additional major business trade groups that have also specifically cited that Diamond Report as justifying the legislation authorizing federal intervention in setting interchange rates include:

- The National Restaurant Association (“NRA”), which referenced the Diamond Report and its estimate of transaction processing costs in the NRA’s list of recommended “Talking Points” for the public to include in emails to legislators in support of interchange legislation;¹⁰
- The Food Marketing Institute (“FMI”) which cited the Diamond Report in a press release supporting the House legislation;¹¹ and
- The Merchants Payments Coalition (“MPC”), a trade group representing a variety of retail trade associations such as the National Council of Chain Restaurants and the National Association of Chain Drug Stores, which included a chart from the Diamond Report on its website dedicated to passage of the proposed legislation.¹²

The Diamond Report: Competition is Transforming the Payment Card Industry

Instead of a call for legislation or regulation, the Diamond Report is just the opposite; a warning to payment card issuers and networks that competition from new payment systems and increased market power by retailers imperils their business.

The three key points made by the Diamond Report are:

1. Competition is forcing lower interchange rates, a process already underway;
2. Merchants are gaining power relative to payment card companies; and
3. Large, sophisticated retailers are poised to reshape the payments industry.

⁸ Hearing, p. 48.

⁹ Ibid., p. 134.

¹⁰ <http://capwiz.com/restaurant2/issues/alert/?alertid=11129911>.

¹¹ http://www.fmi.org/news_releases/index.cfm?fuseaction=mediatext&id=945.

¹² <http://www.unfaircreditcardfees.com/site/page/fightfees>.

A. Competition is Already Lowering Processing Fees

The Diamond Report explains that: 1) competition will significantly increase without government intervention; 2) competition is already lowering interchange rates; and, thus 3) card systems will need to adapt to maintain their business.

- “Already we have seen both Visa and MasterCard move to reconstitute their price-setting bodies in ways that are likely to be more friendly to merchants.”¹³
- “This pressure on the card associations and issuers can only intensify. Driven by investor demands for improved performance, merchants can be expected to take advantage of the low-cost alternatives to the status quo that already exist.... Innovations from other quarters can also be expected because of this market opportunity.”¹⁴
- “These disruptions will set in process other changes that cannot be foreseen. It is clear, however, that issuing banks and the associations need to prepare for a world of change.”¹⁵

B. Merchants’ Increasing Economic Power is Forcing Changes by Payment Card Systems

- “Consolidation of retailing has led to fewer, larger, more influential merchants. Not only are these companies under constant pressure to improve performance, but they are also equal partners in the payment cards equation.”¹⁶
- “Once transparency comes to credit card pricing models—as it ultimately does to virtually every industry and now may be beginning here with the recent decision by MasterCard to publish interchange tables—merchants will use the information to force an unbundling of interchange fee structures, The interchange structure as we know it will disappear, replaced by a system where merchants pay directly for value they receive.”¹⁷

Visa and MasterCard both publish their interchange tables on the internet.¹⁸

¹³ Diamond Report, p. 7.

¹⁴ Ibid., p. 6.

¹⁵ Ibid., p. 11.

¹⁶ Ibid., p. 7. [Emphasis added]

¹⁷ Ibid., p. 10. [Emphasis added]

¹⁸ <http://usa.visa.com/download/merchants/october-2009-visa-usa-interchange-rate-sheet.pdf>
http://www.mastercard.com/us/merchant/pdf/MasterCard_Interchange_Rates_and_Criteria.pdf

C. Large Retailers Are Poised to Reshape the Payments Industry

- “Large merchants will assume more of their own payment processing. Wal-Mart Stores Inc. is taking this step now....”¹⁹
- “It will eventually be a small step for one of them [large retailers] to decide they need a particular card company less than the reverse. When one or more major merchant stops accepting general purpose credit cards and signature debit, it will send a shudder through the card industry.”²⁰

Diamond Makes Explicit Their Opposition to Federal Intervention in Interchange Fees

The Diamond Report was a warning to card systems that competition and increased market power by large retailers was forcing changes to their pricing model and reducing consumer costs. The Report has been misinterpreted by supporters of legislation that would circumvent the competitively-driven process underway by creating a new antitrust exemption for merchants and payment card networks.

As a result of the misuse and out-of-context quoting from their report, Diamond Management and Technology Consultants published a document objecting to the misleading, inappropriate use of their study and explaining that it is market-based mechanisms – not government intervention – that will provide merchants and consumers with improved value:

- “For many reasons, making references to our analysis is inappropriate. ... Competition within the credit card industry will further promote innovations and this exchange of value between issuers and merchants.”²¹
- “Furthermore, the 13 percent figure (for processing) and the as much as 44 percent figure (for issuer rewards) that have been quoted from the study do not include all of the costs of the payments system, nor do the figures reflect how issuers actually spend interchange fees.... There are many costs, including credit losses, fraud losses and operating costs to pay for statements, online access and other costs that are not included in those percentages.”²²

¹⁹ Ibid., p. 11.

²⁰ Ibid., p. 7.

²¹ “Diamond’s position on news coverage about interchange fees:” found at http://www.diamondconsultants.com/PublicSite/company/press/news/Others/Interchange_6-12-08.pdf

²² Ibid. [Emphasis added]

- “In closing, we find it unfortunate that a report that was actually intended to provide valuable insights to our clients, inform their business strategies and enhance innovation could be deployed by others to stifle innovation and hamper free market forces.”²³

The Congressional Research Service Economic Analysis of Interchange Fees

In September 2008, Congressional Research Service (“CRS”) published a study, “Payment Card Interchange Fees: An Economic Assessment”²⁴ which made two key points:

1. Cost-based regulation of interchange would not yield an optimum payment fee structure; and
2. There is no evidence that retailers share interchange savings with consumer costs.

The CRS analysis also highlighted that there has been little discussion about establishing a mechanism for ensuring that at least a portion of any reductions in interchange fees are passed along to consumers.

A. Cost-Based Regulation Doesn’t Work

The Senate version of interchange intervention legislation proposed in the 111th Congress calls for cost-based regulation. Moreover, the bill calls for establishing a new kind of federal judge, “Electronic Payment System Judges,” that would be appointed by jointly by the Attorney General and the Chairman of the Federal Trade and who would not be subject to Senate confirmation.

Among the unusual powers that would be granted to the new breed of judges is that they “may issue regulations to carry out the duties of the Electronic Payment System Judges under this Act.”²⁵

While the regulations would be subject to approval by the Attorney General and FTC Chairman, it is not at all clear that they would need to be developed in accordance with public participation, small business protection and other requirements of the “good government” laws, *e.g.*, the Administrative Procedure Act, Regulatory Flexibility Act and Data Quality Act, which apply when regulations are issued by agencies, not judges.

Thus, the legislation would create antitrust exemptions that would allow even the largest businesses to cut deals while potentially bypassing the small business and consumer protection processes in the normal regulatory process.

²³ Ibid.

²⁴ <http://thecre.com/pdf/CRS%20Report%20Interchange%20Fees.pdf>.

²⁵ S. 1212, 111th Congress, 1st Session, Sec. 5(b)(4).

With respect to creating a cost-based regulatory system, the bill states that the Electronic Payment System Judges shall “consider the costs of transaction authorization, clearance, and settlement that are necessary to operate and to access an electronic payment system” as well as “normal rate of return in a hypothetical perfectly competitive marketplace....”²⁶

The legislation proposes cost-based regulation to set interchange fees even though the CRS analysis clearly stated that cost-based regulation is not only a generally inappropriate basis for price regulation but also that such regulation would be particularly inappropriate for setting interchange prices in “two-sided markets” such as exists for payment cards where, even hypothetically, there cannot be a single “perfectly competitive marketplace.” As the CRS report explains:

- “economists have pointed out that price regulations based on costs have historically been plagued with practical problems even in industries in which theory would predict that the optimal price can be based on cost. The practical reason for these theories’ failure to determine the optimal price based on costs is that a firm has little incentive to cut cost if its revenues are tied to those costs.”²⁷

The report goes on to explain that in addition to the general problem with cost-based regulation discussed above, “in the case of interchange fees, economic theory also suggests that cost-based regulation would not be expected to produce the optimal interchange fee.”²⁸

As CRS further explained:

- “Economists have shown that, because of the nature of the credit card market, it would be very unlikely that the optimal interchange fee could be reached by setting it at zero or determining it strictly on a cost-based measure.”²⁹

B. Two-Sided Markets Require Special Consideration

Key to understanding CRS’ explanation of why cost-based regulation is particularly inappropriate for interchange fees (and similar explanations by other economic authorities) is the concept of a “two-sided market.” A two-sided market is characterized by businesses which need to simultaneously appeal to two different sets of customers. For example, newspapers need to attract both advertisers and readers. Similarly, shopping malls need to obtain both retailers and customers. In two-sided markets, one type of customer (advertisers, retailers) will pay substantially more for the intermediary’s services than the other type of customer (readers, customers).

²⁶ Ibid., Sec. 3(c)(3)(C)(i)(II).

²⁷ CRS, p. CRS-6. (Emphasis added.)

²⁸ Ibid.

²⁹ Ibid., p. CRS-6.

David Evans and Richard Schmalensee (2008) point out that businesses in two-sided markets “act as intermediaries between the two groups and create efficiencies by lowering transactions costs and reducing duplication costs.”³⁰

As CRS explains, credit cards are an example of a two-sided market

- “where suppliers compete for two types of customers with different demand responses, like a newspaper that must attract both readers and advertisers. In the payment card market, banks must attract cardholders and merchants, and a transfer of revenues is usually necessary to provide card-issuing banks an incentive to issue more cards, which provide more payment card users to merchants.”³¹

CRS’ discussion of two-sided markets is crucial for understanding why the proposed interchange legislation is fundamentally flawed. CRS explains that in two-sided market there “are effectively two demand and supply curves to determine the optimal price.”³² The proposed legislation, however, does not account for these two separate supply and demand curves. Instead, the legislation calls on judges, in absence of an agreement between payment card companies and merchants, to set interchange fees that would “most closely represent the rates and terms that would be negotiated in a hypothetical perfectly competitive marketplace for access to an electronic payment system between a willing buyer with no market power and a willing seller with no market power.”³³

Thus, the proposed legislative mandate does not account for the fact that, irrespective of market power, there are two completely different types of willing buyers (consumers and retailers) with different elasticities of demand.

As CRS explains, citing a 2005 study by Evans and Schmalensee on the economics of interchange fees, the two sided nature of the payment card market means that,

“Maximizing output requires issuers and acquirers to set prices in a way that will provide proper incentives for cardholders to use and merchants to accept the payment card. Balancing costs in some fashion would achieve this result only if the elasticity of demand on both sides were equal. Furthermore, setting the fee to zero would maximize output only if on both sides of the two-sided market costs and

³⁰ David S. Evans & Richard Schmalensee, Markets with Two-Sided Platforms, in ISSUES IN COMPETITION LAW AND POLICY 667 (ABA Section of Antitrust Law 2008). [Emphasis added]

³¹ Ibid., Summary.

³² Ibid., p. CRS-6.

³³ S. 1212, Sec. 3(b).

*demand were equal. Because neither is likely to be true, one should not expect either a cost based or zero interchange fee to be optimal.*³⁴

Moreover,

- “In both the newspaper and the payment card cases, revenue transfers are necessary to maximize overall social welfare.”³⁵

In short, the proposed legislation calls on federal judges to make pricing decisions based on a theoretically inappropriate economic theory.

C. Merchants Don’t Share Interchange Savings with Consumers

A few countries including Australia and the U.K. have experimented with limiting interchange fees. As CRS explains, there is no evidence that retailers have shared any of their savings with consumers:

- “In countries where interchange fees are capped, the governments have been relying on merchants to voluntarily lower prices. Yet, there is no formal evidence that merchants have lowered their prices because of the lower interchange fee caps.”³⁶

The Implications section of the CRS analysis asks, but does not provide an answer to, the question of how to ensure consumers benefit from a reduction in interchange fees. CRS notes that there has been little discussion of this issue. CRS again explains that, in the absence of a mechanism for passing interchange savings to consumers, rate caps may well simply redistribute wealth from banks to retailers:

- “What mechanism might be used to make sure that the price of the goods and services is lowered to reflect the lower interchange fees? Although experience has shown that interchange fees can be lowered by regulatory caps and other government restrictions, there has been little discussion of how to pass the excess fees back to the cardholders. If the government just lowers the fee with the expectation that merchants will pass the savings back to cardholders, it might not occur. The government’s regulatory caps would be redistributing revenues from the issuing banks to merchants.”³⁷

³⁴ Ibid., p. CRS-6.

³⁵ Ibid. [Emphasis added]

³⁶ Ibid., Summary. [Emphasis added]

³⁷ Ibid., p. CRS-10.

A recent GAO report in interchange fees noted that consumers would “benefit if merchants reduced prices for goods and services, but identifying such savings would be difficult.”³⁸

D. Economic Basis for Opposing Interchange Fee Regulation

CRS’ report on interchange fees builds on long-standing economic analyses of two-sided markets in general and interchange fees (“IFs”) in specific as well as analysis of the problems resulting from cost-based regulation. For example, the CRS paper is in accord with an influential European study of payment card interchange fees by Jean-Charles Rochet and Jean Tirole, “An Economic Analysis of the Determination of Interchange Fees in Payment Card Systems.”³⁹

The Rochet and Tirole paper notes that in “several regions of the world (European Union, Australia, Israel), the mode of determination of IFs has come under scrutiny by competition authorities, often at the instigation of large retailers’ associations” and explains that one of the purposes of the paper is “to examine the case for a public regulation of interchange fees.”⁴⁰ The authors state,

*“In agreement with Katz (2001), we in particular explain why there is no economic rationale for cost-based regulation of IFs.”*⁴¹

No Demonstration of Market Failure

Rochet and Tirole begin with the standard model for determining if regulation is warranted.

“The standard approach to public intervention in industries involves two steps:

(1) the theoretical identification of a serious market failure and the validation of its empirical relevance,

*(2) the identification of the least distortionary way of addressing the market failure and a check that the remedy will not be worse than the illness.”*⁴²

³⁸ GAO, “CREDIT CARDS: Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges,” November, 2009, GAO-10-45, What GAO Found. (Emphasis added.)

³⁹ Jean-Charles Rochet and Jean Tirole, “An Economic Analysis of the Determination of Interchange Fees in Payment Card Systems,” Review of Network Economics, vol. 2, No. 2., June 2003, pp. 69-79.

⁴⁰ Ibid., p. 69.

⁴¹ Ibid.

⁴² Ibid., p. 70.

The 2003 Rochet-Tirole paper explains there is not even the theoretical work to demonstrate a market failure with respect to interchange fees let alone explain how it could be improved through government intervention. It is important to note that the more recent fall 2008 CRS study also did not identify any market failures. Rochet-Tirole explain that:

“Proponents of a regulation of the IF must first build a theoretical paradigm that gathers broad intellectual consensus and demonstrates a clear market failure, show that the resulting distortions have a clear sign and a sizeable impact on welfare, and propose a form of regulation that is consistent with the underlying theory and is better than nonintervention. So far, no such theoretical paradigm has been achieved. On the contrary, recent academic work concurs to establishing that there is no systematic bias in the IFs selected by cooperative networks: there is no reason to think that privately optimal IFs are higher or lower than socially optimal ones.”⁴³

Rochet and Tirole explain, even more bluntly, why the economics of the payment cards markets needs to be understood before attempts are made to impose regulatory solutions on perceived problems:

“Misunderstanding the economics of the problem and imposing cost-based regulation could impose substantial distortions in the industry.”⁴⁴

The Logical Extension of Interchange Fee Regulation

CRS’ opposition to cost-based regulation in two-sided markets was consistent with Rochet-Tirole. Rochet-Tirole explain why such cost-based regulation is inappropriate and go on to explain some of the implications of applying cost-based regulation in other two-sided markets, thus illustrating the law of unintended consequences.

“A cost-based regulation of the IF would be an unfortunate precedent for two-sided markets. The same logic would then imply that advertisers’ fees paid to TV networks, newspapers and portals should be regulated on a cost basis so as to stop the subsidization of eyeballs by advertisers...and the social gatherings should be regulated so as to prevent payments to or free entry for attractive participants (e.g., celebrities) while others pay for entry.”⁴⁵

Thus, both Rochet-Tirole and CRS make clear that the notion of cost-based regulation of interchange fees needs to be fundamentally reconsidered.

⁴³ Ibid., p. 71. [Emphasis added.]

⁴⁴ Ibid. [Emphasis added.]

⁴⁵ Ibid.

Ending the Level Playing Field Among Payment Cards

One of the issues analyzed by Rochet-Tirole is the difference in setting interchange fees between proprietary payment card systems, e.g., American Express, Discover, and cooperative payment card associations, e.g., Visa, Mastercard. The authors' discussion of the differences between proprietary and cooperative card associations is relevant to regulatory considerations since such regulation would end the level playing field for payment cards between the two types of systems.

*“To perform the balancing act in the context of the payment-card industry, proprietary systems can directly set end-user prices and use the no-discrimination rule (NDR) that prevents merchants from charging different prices for card and cash transactions. In contrast, payment card associations can use only IFs and the NDR as indirect means of bringing both sides of the market “on board”. Incidentally, it seems odd for competition conscious authorities to deprive open-access cooperatives of the ability to use the instruments (IF and NDR) that are necessary to perform the balancing act, and thereby to **destroy the level-playing field** in their competition with closed-access, for-profit platforms that do resort to an (implicit) IF and to the NDR.”⁴⁶*

It should be noted that the House version of the proposed interchange intervention legislation⁴⁷ would exempt American Express on the grounds that they are too small to be covered.⁴⁸ As the US Delegation to the OECD's Competition Committee noted in a June 2009 document for a Roundtable on Two-Sided Markets, “American Express sets the highest prices to merchants of all of the credit card networks....”⁴⁹

The official US position paper for an OECD Roundtable cites Rochet and Tirole's work on two-sided markets in its discussion of competition. The US notes that “A central question for competition policy is how competition affects prices. ... In a two-sided market, it is possible for competition between platforms to have different effects on each side of the market, making conclusions about prices less clear.”⁵⁰

⁴⁶ Ibid., p. 70. [Emphasis added.]

⁴⁷ H.R. 2695, 111th Congress, 1st Session.

⁴⁸ The House version of the proposed legislation defines a covered electronic payment system as one that was used for at least 20 percent of the combined dollar value of U.S. credit card, signature-based debit card, and PIN-based debit card payments processed in the applicable calendar year....” According to a September 25, 2008 Bloomberg News story, American Express has 17% of the market. <http://www.bloomberg.com/apps/news?pid=20601087&sid=adHxiaGa8gLS&refer=home>

⁴⁹ Organisation for Economic Co-operation and Development, DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS COMPETITION COMMITTEE, ROUNDTABLE ON TWO-SIDED MARKETS, “Note by the Delegation of the United States,” p. 5.

⁵⁰ Ibid., p. 4.

In discussing the nature and implications of a two-sided market, the government document, echoing Rochet-Tirole, explains that,

“A feature of many two-sided markets is a highly skewed pricing structure. That is, one group of customers pays a high price to use the platform, while the other group pays a very low or even negative price. For example, newspapers, web portals (e.g., Google or Yahoo.com), and websites offering information or entertainment content are often provided to readers for free, while advertisers pay the fees that cover the newspaper’s or website’s costs of production.”⁵¹

The fundamental policy conclusions about regulation and interchange fees can be found in the paper “Merchant Benefits and Public Policy towards Interchange: An Economic Assessment” by Margaret E. Guerin-Calvert and Janusz A. Ordover, available from The Federal Reserve Bank of New York. In the paper, the authors explain,

“In sum, economics theory and experience with regulatory interventions in many countries indicate that heavy-handed cost-based regulation of prices is the public policy of last resort. It should only be adopted when there is a cognized market failure of the sort that cannot be remedied by less interventionist means. There is no evidence that such market failure exists in the markets for the provision of credit or debit card network services. The most appropriate role for competition policy in the realm of payments systems is to promote and ensure market conditions that foster vigorous competition among payment networks and among different means of payment and to remove unnecessary impediments to such competition at the merchant and cardholder level. Arbitrary and artificial allocations of responsibilities for cost-recovery to merchants based on the narrow definitions of “benefits” that inure to them from credit and debit payment systems is not consistent with either economics or sound public policy. Empirical evidence on the benefits from innovation and investment in card networks shows that society, consumers, as well as merchants benefit directly and indirectly from such investments.”⁵²

Why Interchange Legislation Would Not Benefit Consumers

There are five primary reasons why legislation establishing federal intervention in interchange fees would not benefit consumers:

⁵¹ Ibid., p. 3.

⁵² Margaret E. Guerin-Calvert and Janusz A. Ordover, “Merchant Benefits and Public Policy towards Interchange: An Economic Assessment,” p. 31 (emphasis added) found at http://www.newyorkfed.org/research/conference/2005/antitrust/Guerin_Calvert_Ordover.pdf.

A. Rent Seeking Harms Consumers

“Rent seeking” is the technical term for business interests which try to use the legal/regulatory system for their own gain. As the *Economist* magazine explains, rent seeking is defined as,

*“Cutting yourself a bigger slice of the cake rather than making the cake bigger. Trying to make more money without producing more for customers.”*⁵³

The *Economist* goes on to explain that,

*“as they do not create any value, rent-seeking activities can impose large costs on an economy.”*⁵⁴

The Diamond Report indicated that reductions in interchange fees are not shared with consumers. More recently, these findings were supplemented by the Congressional Research Service which also found no evidence that interchange savings are shared with consumers. Even more significantly, CRS found that there had been “little discussion” of a mechanism that would ensure at least some interchange savings were passed back to consumers. Without an integral benefit-sharing mechanism, interchange regulation would simply transfer funds from one industry to another, *i.e.*, constitute a successful example of rent seeking by the retail industry.

B. Cost-Based Regulation Produces Unintended Consequences

The CRS study and Rochet-Tirole paper explained why cost-based regulation in a two-sided market does not produce socially optimal results. A point worth reiterating is that both papers cited the news industry, as well as payment cards, as examples of two-sided markets where such regulation would be harmful. It should also be noted that there is significant overlap between business groups supporting regulation of interchange fees and news advertisers. CRE carefully watches developments that could further harm America’s newspapers.⁵⁵ While slippery-slope arguments are often treacherous, if rent-seekers are able to gain regulation of interchange fees it is not unreasonable to consider the possibility that they may try similar tactics with the news industry’s advertising rates.

C. Antitrust Exemptions Don’t Help Consumers

The proposed interchange regulation bills would create an exemption for merchants and card issuers from:

⁵³ <http://www.economist.com/research/Economics/alphabetic.cfm?letter=R>.

⁵⁴ Ibid.

⁵⁵ <http://www.thecre.com/wdw/2006/20061023.html>.

- The Clayton Act;
- State antitrust laws; and
- Section “5 of the Federal Trade Commission Act (15 U.S.C. 45) to the extent such section 5 applies to unfair methods of competition...”⁵⁶

The exemption would be to allow the companies to “jointly negotiate and agree upon the fees and terms for access to the covered electronic payment system....”⁵⁷

While it is true that there have been distinguished free-market economists who opposed antitrust laws,⁵⁸ given the current economic situation, now is probably not the optimal time for new experiments in freeing businesses from any provisions of federal and state antitrust protections.

D. Small Merchants and the Department of Justice are Skeptical About Creating New Antitrust Exemptions

The GAO report on interchange documented serious reservations by small businesses and by the Department of Justice (“DOJ”) to legislative proposals to allow banks and merchants to bargain over interchange fees under antitrust protection.

Small merchants and small banks expressed concern that the largest companies would dominate the discussions and that interests and concerns of the smaller companies would be crowded out. GAO explained that

*“it could be difficult to ensure that small issuers and small merchants benefited from collective negotiations. Representatives of small issuers said that small issuers would not have sufficient market power to negotiate favorable interchange fees with a group of merchants. Furthermore, several of these representatives said they were concerned that merchants could come to agreements with large issuers under which the merchants would accept only the large issuers’ cards. Some merchants with whom we spoke were skeptical about the potential for small merchants to benefit from the collective negotiations with networks and issuers.”*⁵⁹

⁵⁶ H.R. 2695, 111th Congress, Sec. 2(a)(3). Similar language may be found in S. 1212, Sec 2(5).

⁵⁷ S. 1212, Sec. 3(b)(1)(A). Similar language may be found in H.R. 2695, Sec. 2(b).

⁵⁸ http://www.cato.org/pubs/policy_report/v21n2/friedman.html.

⁵⁹ GAO, p. 62. (Emphasis added.)

DOJ is also concerned about creating new antitrust exemptions. As GAO relates, the Department stated that “the granting of antitrust waivers in the United States can be justified only in very rare cases....”⁶⁰

GAO goes on to explain that DOJ is concerned about both the creation of a new antitrust exemption and the role the Department would be expected to play in discussions conducted under the antitrust umbrella.

*“DOJ officials have expressed their historical opposition to efforts to create exemptions to antitrust laws, stating that these exemptions should be used only in the rare instances in which a public policy objective compellingly outweighed free-market values. Furthermore, in response to a prior proposal that would have allowed for collective negotiations of interchange fees, DOJ officials expressed concern about the role that their agency would play in such negotiations.”*⁶¹

E. Consumers Pay More, Receive Less

GAO’s report on interchange found that the result of Australia’s decision to regulate interchange resulted in consumers paying more for payment cards and receiving lower benefits. Moreover, GAO indicated that interchange regulation may reduce competition among card issuers as credit unions and community banks can no longer compete with larger institutions. As GAO explained,

*“In Australia, issuers reduced rewards and raised annual fees following that country’s interchange fee cap. In addition, with less interchange fee income, representatives of smaller issuers such as community banks and credit unions told us that they likely would not offer rewards cards and therefore would be unable to compete with the larger issuers in the market. ... In addition, representatives of credit unions and community banks we interviewed said that they benefited from a network system that developed interchange rates to attract both merchants and issuers. Allowing merchants to refuse certain cards or negotiate rates directly with the issuers would eliminate smaller institutions from the process. Representatives of larger issuers told us that with less revenue from interchange fees, they would consider reducing the amount of credit they make available to their cardholders.”*⁶²

⁶⁰ Ibid., p. 61.

⁶¹ Ibid., 63.

⁶² Ibid., p. 46. (Emphasis added)

VI. A Practical Guide to Lowering Payment Card Processing Costs

There are two types of services to lower card processing costs. The first and most common type of service is known as a merchant credit card processing program, also sometimes called a negotiated-rate card processing program. These services act as a collective buying program and potentially allow smaller businesses to leverage their combined purchasing capability. Merchant card processing programs are often offered by business and trade associations⁶³ and are also available through some large retailers.⁶⁴

The second type of service, and the one which is the focus of this guide, is known as a “renegotiation” service. Two key attributes of this type of service:

1. The renegotiator works for the merchant, they do not have a financial relationship with a card processor, unlike virtually all merchant card processing programs; and
2. The renegotiator works with the merchant’s current card processing company, *i.e.*, their acquirer, instead of recommending a different company. Allowing the merchant to maintain his existing business relationships has multiple advantages including avoiding possible penalty fees for early termination of existing contracts as well as saving the management time it would take to integrate a new service vendor into the merchant’s business.

Renegotiation is an ongoing process by which payment card specialists, retained by the merchant, work with the acquiring bank and the merchant to reduce the bottom line cost of accepting payment cards without terminating existing contracts. Since the acquirer market is highly competitive, the card processors work with the renegotiator to ensure they retain the merchant. Moreover, the renegotiator works with the merchant to ensure that their systems and processes are efficient as possible, qualifying them for lower rates and making them more desirable clients for the processor.

As was noted above, merchants pay three fees (rolled into a single merchant discount rate) when they accept payment cards, specifically, fees to the: 1) issuing bank; 2) card network; and 3) acquirer/card processor. It was also indicated that processing costs vary substantially depending on the size of the business. One of the reasons for the large disparity in processing rates paid by smaller businesses is because of additional fees charged to these merchants by their card processor. Examples of the one-time and recurring surcharges paid by many retailers include:

- Application fee;
- Per-transaction fees;

⁶³ <http://www.nfib.com/tabid/96/tabid/56/Default.aspx?cmsid=28497&v=1>.

⁶⁴ <http://www.samsclubms.com/>

- Authorization fees;
- Batch header fees (fee paid when the merchant sends a batch of transactions to their processor, usually at the close of each business day);
- Mid-qualified and non-qualified surcharges (charges based on technical aspects of specific transactions);
- Chargeback fees;
- Monthly fees;
- Help desk fees;
- Over limit fees (charged when merchants' monthly transaction volume exceeds the amount stated in their Merchant Processing Agreement);
- Statement fees; and
- Annual charges.

Surcharges can add 50% to 100% to the total fees paid by the merchant for accepting payment cards.

CRE has received proprietary card processing cost data from Robert Livingstone, the President of Ideal Cost, a specialty firm which provides renegotiation and related consulting services to merchants.

The data indicated that merchants who qualify for a card processing rate (discount rate) of about 1.7% for face-to-face transactions may end up paying between 2.5% to 4.0% after various surcharges by the acquirer are factored in. Thus, as was mentioned on page 6, when surcharges are factored in, the processing fees that are paid to the acquirer may well exceed the interchange fee, particularly for smaller businesses.

Merchants which accept telephone and internet orders pay a higher rate for payment card services because of the increased risk associated with these transactions. As was explained above, acceptance of payment cards inoculates merchants from the fraud risks and, thus, they pay higher fees for higher risk transactions.

For merchants accepting telephone and internet orders who qualify for a rate of between 2.5% to 4.0%, the Ideal Cost data indicates that these firms often end up paying 3.75% to 6.5% because of various additional charges, again highlighting that the acquirer's fees can be the largest single component of a company's transaction processing costs.

Merchants can reduce their processing costs through the renegotiation process irrespective of whether they accept payment cards in person and/or over the phone or internet.

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The renegotiator engages in two types of tasks: 1) working with the merchant's current acquirer to lower costs; and 2) working with the merchant on issues such as equipment security to ensure that the company qualifies for as low a processing rate as possible.

The process of merchants reducing their payment card costs begins with reducing their processing surcharges. Other factors, in addition to business size, average transaction amount, and transaction risk, that will effect the costs of payment card processing services include risks associated with the specific merchant, *e.g.*, credit worthiness, the security of their payment processing and related equipment, and their efficiency in managing transactions.

Renegotiation services, such as Ideal Cost, focus on reducing card processing costs for their merchant clients through techniques including:

- Monthly renegotiation;
- Merchant risk assessment;
- Elimination of any double charges and non-justified fees;
- Equipment security analyses; and
- Improving transaction efficiency.

The following charts are based on data provided by Ideal Cost for four businesses of different sizes that have used their renegotiation services. The charts, based on actual data, examine the first six months of each business using the company's services.

The charts focus on the "effective rate" (ER) paid by the merchants on payment card transactions. ER is defined as total processing fees divided by total processing volume. For example, a firm which paid \$500 a month in card processing costs on card sales volume of \$10,000 would have an effective rate of 5.0%. Thus, the ER captures all payment card processing charges, including the interchange fee that go the issuing bank, the duties and assessments fee that goes to the card network, and the acquirer's fees and surcharges that go to the merchant's card processor.

The "Old ER" data in the charts refers to each merchant's effective rate prior to using renegotiation services while "New ER" refers to the rate when the renegotiator's services are in use. The difference between the new and old rates is the firm's savings on payment card processing costs. Since renegotiation is an ongoing process and the charts are based on actual data, the New ER will vary each month.

In Chart 4, the deli is saving about \$70/month on payment card processing costs and is expected to save over \$900 during a full year. The deli is a relatively small business with about \$130,000/year in payment card sales. As the chart shows, deli was able to reduce their total card processing costs by about 20%.

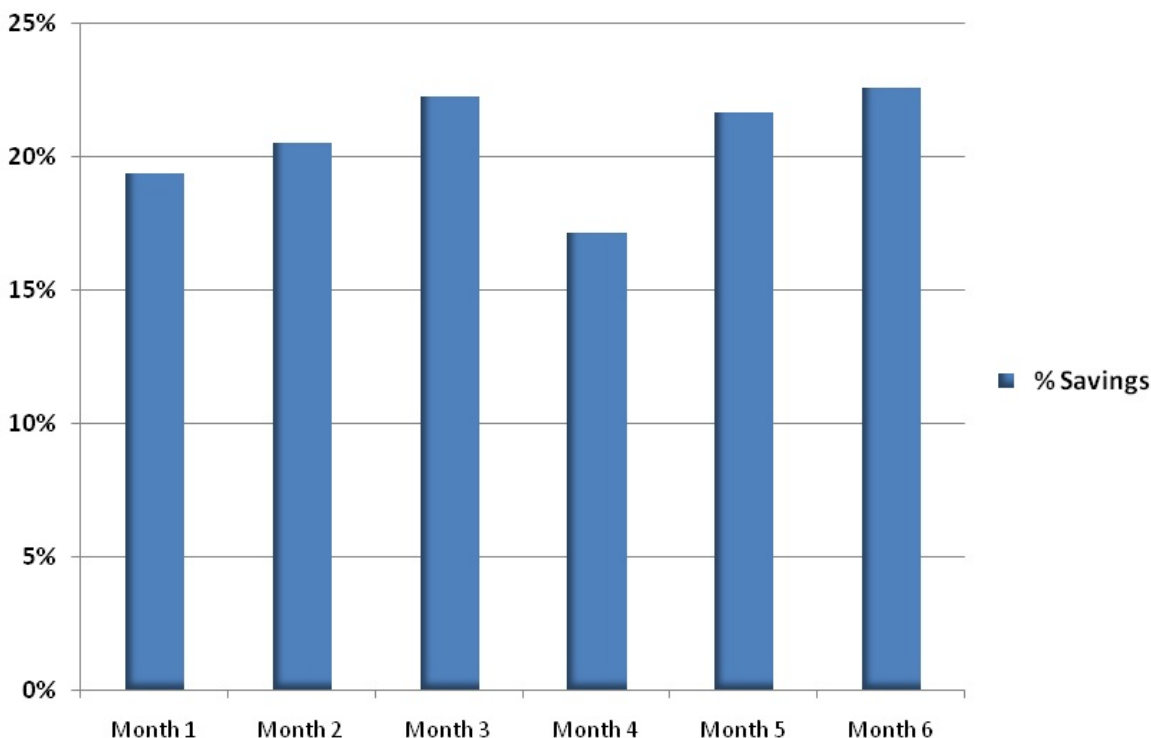
Actual monthly savings vary with sales and with small variances in the New ER. These savings are important to small business working to remain competitive.

Delicatessen: Payment Card Processing Savings

Average Sales Volume: \$11,000/month

Average Sale: \$25

Old ER (avg.): 3.51%



Source: Ideal Cost

Chart 4

Chart 5 on the next page is for an e-commerce business that sells products over the internet. Because of the higher risk of fraud, both the old and new ERs are higher than for an in-person business such the deli featured in the previous chart. Despite this, the percentage savings is actually greater than for the deli. The e-commerce retailer is saving over \$500/month and expects the combined savings over three years to approach \$20,000.

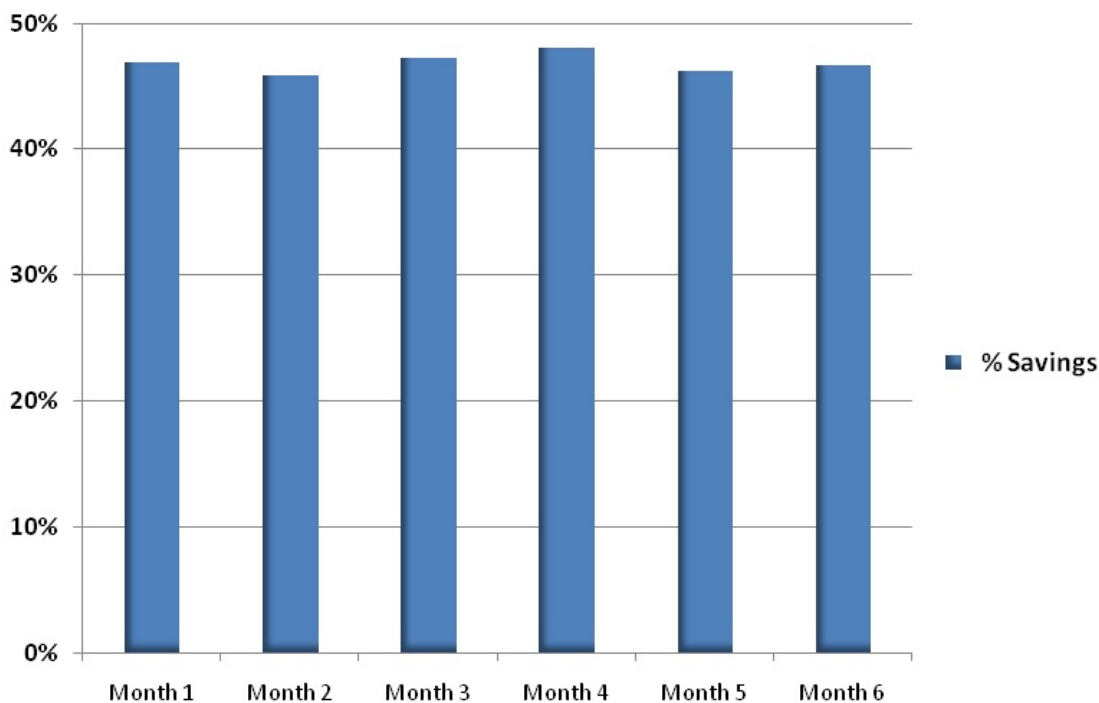
Thus, **the internet retailer was able to cut their card processing costs by almost half through the renegotiation process.** These savings were achieved through a voluntary market-based process that did not require any legislative or regulatory changes.

E-Commerce Retailer: Payment Card Processing Savings

Average Sales Volume: \$18,000/month

Average Sale: \$55

Old ER (avg.): 5.74%



Source: Ideal Cost

Chart 5

The business described in Chart 6 is an automotive transmission service shop. The company in this case study averages over \$50,000/month in payment card sales with an average ticket of about \$1,200.

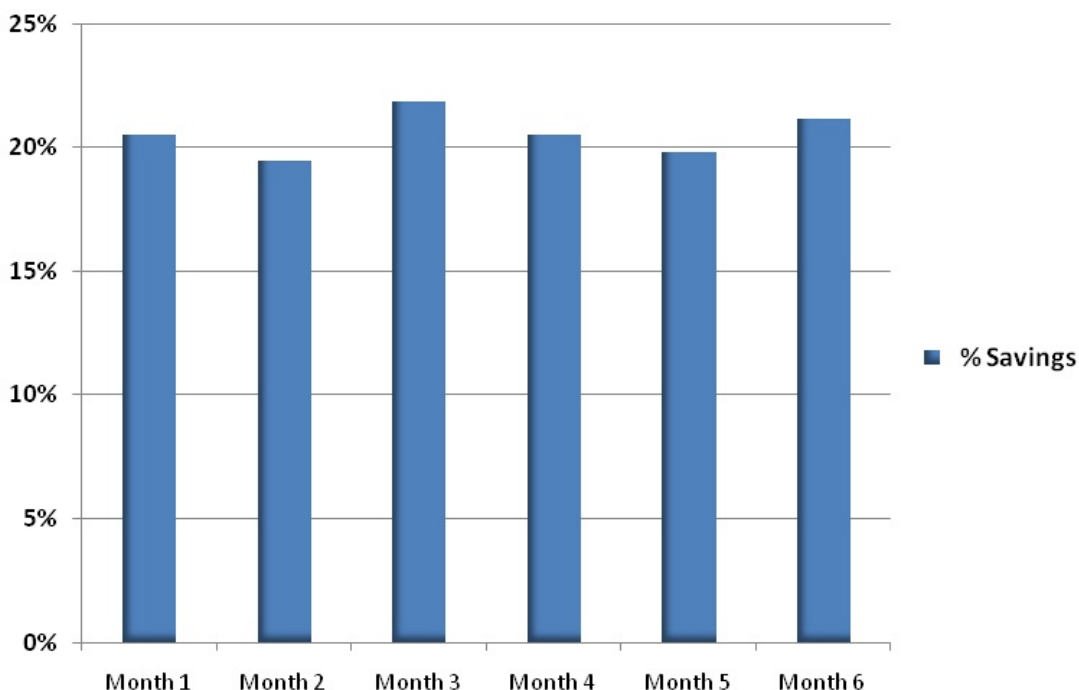
Because this company is somewhat larger than the previous examples and uses in-person card swipes for almost all of their payment card transactions, the service shop has a comparatively low starting transaction cost. Even though they started with a relatively good rate compared to companies that are smaller and process higher-risk transactions, they were still able to cut their payment card transaction costs by about 20%, saving the firm about four thousand dollars in their first year of using a renegotiation service.

Transmission Service Shop: Payment Card Processing Savings

Average Sales Volume: \$55,000/month

Average Sale: \$1200

Old ER (avg.): 2.93%



Source: Ideal Cost

Chart 6

The case study depicted on the next page in Chart 7 is for a wholesale distributor of machine parts. The company takes payment card information verbally over the telephone and then keys it into a terminal.

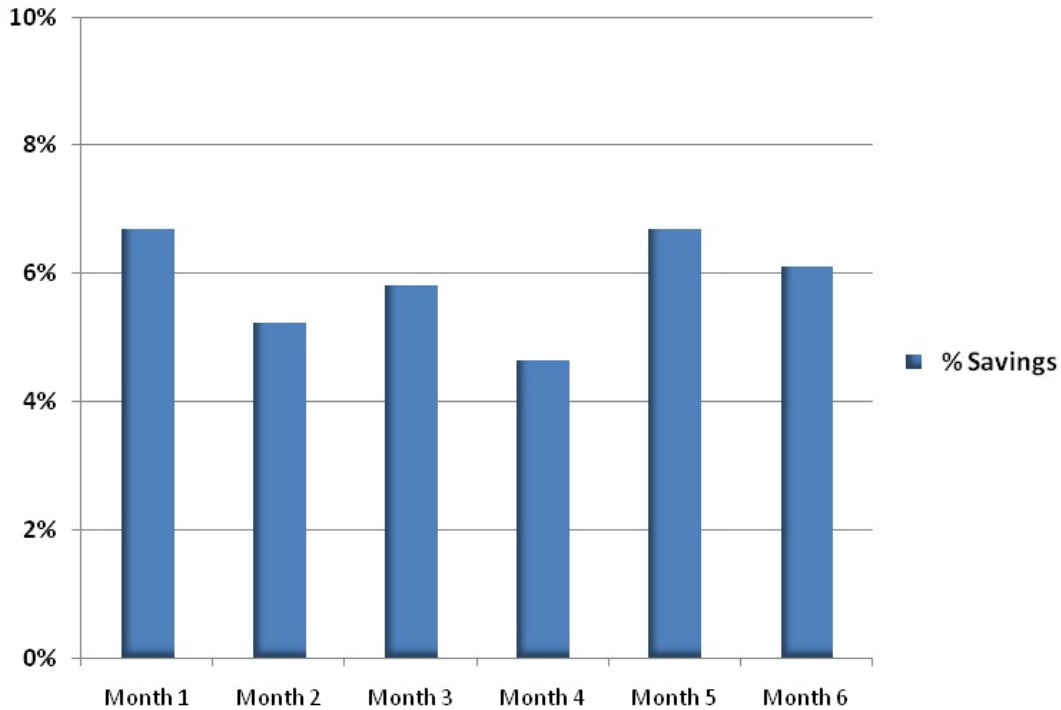
The machine parts wholesaler is the largest of the four firms examined in this paper and has annual sales of about \$4 million. The distributor achieved the smallest reduction in card processing costs of the four case studies depicted, about 6%. This reduction, however, was enough to save the firm about \$8,000 a year. Thus, savings from the renegotiation process are not limited to small non-and-pop companies and are broadly applicable to many businesses.

Wholesale Parts Distributor: Payment Card Processing Savings

Average Sales Volume: \$325,000/month

Average Sale: \$500

Old ER (avg.): 3.44%



Source: Ideal Cost

Chart 7

The four companies examined in this paper were diverse in their size, type of business, method of accepting payment cards, and savings attained by using renegotiation to reduce their card processing costs. What is consistent through all of the case study examples is that they achieved significant savings on processing payment card transactions while keeping their same processor.

It is particularly important to note that the greatest savings were experienced by the smaller businesses. Moreover, all of the savings were achieved without the costs to consumers and merchants from interchange regulation such as:

- Higher card fees;
- Less competition among card issuers; and
- Lower credit limits.

VII. Conclusions

- Interchange is only one of the three card processing costs paid by merchants along with the dues and assessments fee and the acquirer's fees and related surcharges.
- For smaller merchants, it is the acquirer's fee and surcharges, not interchange, that may be the biggest cost component associated with accepting payment cards.
- Regulation of interchange fees would harm merchants and consumers by raising card costs, reducing competition and lowering credit limits.
- Renegotiation services have demonstrated that they can substantially reduce card processing costs, particularly for small and medium size businesses, without any new legislation or regulation and the associated costs.

VIII. Recommendation

- Merchants interested in obtaining more information about use of renegotiation services **and/or** merchants willing to share information about their payment card processing experiences should contact CRE. Please call or email:

Bruce Levinson
The Center for Regulatory Effectiveness
202/265-2383
Levinson@TheCRE.com

About CRE

CRE is a regulatory watchdog established in 1996 by former senior career officials from the Office of Management and Budget ("OMB").⁶⁵

CRE has identified the interchange regulatory proposal as requiring watchdog oversight since:

- America's consumers are in crisis; and
- CRE has an extensive record in acting as a watchdog on legislative and regulatory proposals affecting payment systems.^{66, 67}

⁶⁵ http://www.thecre.com/emerging/Jim_Tozzi_Bio.html.

⁶⁶ <http://www.thecre.com/pdf/Banking%20Report.pdf>.

⁶⁷ http://www.federalreserve.gov/SECRS/2008/September/20080909/R-1298/R-1298_256_1.pdf.