FOOD MARKETING INSTITUTE

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July 23, 2004

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. OP-1196

Dear Ms. Johnson:

Thank you for the opportunity to provide comments on whether existing disclosures required by the Electronic Funds Transfer Act adequately inform consumers of fees imposed by a financial institution when a PIN debit card is used to make a purchase.

The Food Marketing Institute (FMI) commends the Congress and the Federal Reserve for initiating a study of debit card transactions and fees. The use of this form of payment by consumers is growing rapidly as consumers switch to debit from other payment types such as cash and checks that traditionally have been under the regulatory purview of the Federal Reserve. We believe it is essential that the Federal Reserve preserve its role in payments by expanding its oversight of debit (and credit) as consumers switch to those payment methods.

FMI's[1] members are accepting a rapidly growing number of debit and credit cards transactions. Indeed, the Tower Group reported in 2003 that grocery/supermarkets account for more than half of all PIN-based debit transactions and 59% of all signature-based debit transactions. At the same time, the cost of accepting these cards has been skyrocketing, often exceeding the 1% average net profit margin of a typical grocery store.

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[1] FMI conducts programs in research, education, industry relations and public affairs on behalf of its 2,300 member companies — food retailers and wholesalers — in the United States and around the world. FMI's U.S. members operate approximately 26,000 retail food stores with a combined annual sales volume of $340 billion — three-quarters of all food retail store sales in the United States. FMI's retail membership is composed of large multi-store chains, regional firms and independent supermarkets. Its international membership includes 200 companies from 60 countries.

The major bankcard associations, issuing financial institutions and networks have been raising the fees associated with accepting these cards regularly, without regulation and seemingly without regard to cost. FMI's members report the following:

- The cost of electronic payments is one of the fastest growing and least controllable costs.
- There have been 11 credit/debit rate increases in the last 12 months with still more expected this year.
- PIN debit fees are up 267% since 1999.
- Electronic payments volume has increased over 500% from 1989 to 2000, and continues to grow dramatically.
- Card association (VISA/MasterCard) operating rules and regulations prohibit merchants from passing costs directly to consumers or giving them notification of fees paid by merchants on the transaction.
- Card associations collected $29.2 billion in 2003 on interchange, which is paid directly to the issuing bank.
- Increases are just as significant, if not more significant, for debit than credit because of the proportion of the growth and lack of risk/cost to the financial institutions as available funds are simply being transferred.
- Airline miles/rewards drove credit usage; financial institutions are expanding miles/rewards to signature debit as the rates for debit increase with the goal of increasing signature debit usage.
- Debit and credit fees are now calculated using a similar pricing model, although they are very different products – both now include a percentage charge plus a flat fee.
- The current interchange fee model is inverted from normal competitive market models – more volume means more cost; volume cannot be used to lower costs; merchant fees are invisible to consumers.

Central banks, legislative bodies and regulatory agencies around the world have been examining the impact of these fees on consumers and consumer prices and exploring methods of regulating these growing fees. Several countries including the United Kingdom, Australia, Israel and the European Union have initiated actions such as caps on fees, changes in operating rules, antitrust/fair trade investigations, studies and legislation. With fees that are higher than any of these international competitors, U.S. merchants and U.S. consumers are at a competitive disadvantage unless similar actions are considered in this country. This situation requires attention by the Board.

There are two broad categories of fees that should be reviewed – transaction fees paid directly by consumers and interchange fees paid by merchants.

Transaction Fees Paid Directly By Consumers

Presently, financial institutions impose consumer fees for the use of PIN debit for the express purpose of driving customers away from using PIN debit, which is a faster, more secure and less expensive form of payment. They are intentionally trying to switch consumers to signature debit, which is slower, less secure and significantly more expensive for retailers and ultimately for consumers. We believe these fees and other incentives that switch consumers from PIN debit to signature debit are not in the best interest of consumers and should be closely reviewed and regulated by the Federal Reserve. We agree that consumers should be informed and educated about these fees. But it is just as important for consumers to understand the broader context of the issue. Signature debit is less safe, less efficient and ultimately more costly for everyone. If financial institutions are allowed to impose these fees without any oversight and consumers are made appropriately aware of the fees, consumers will switch to signature debit to their detriment. This would not be good public policy.

With regard to the Board's specific request for comment on "whether the initial disclosures, the disclosures in periodic statements, or any disclosures on receipts at electronic terminals, are effective – either separately, or cumulatively – in providing consumers with sufficient information about such point-of-sale fee practices," we offer the following comments.

Our experience has been that the initial disclosures to consumers have very limited value, so we will focus our comments on the disclosures in periodic statements and any disclosures on receipts at electronic terminals.

While statement disclosures clearly have value in outlining charges for consumers, there may need to be greater clarification regarding how that disclosure is made, particularly with regard to the proper identification of the party receiving the proceeds of the fee. For example, a statement may note a transaction like this: "ABC Supermarket, Store #1234, Convenience fee .75." The customer knows that a fee is being collected and the amount of the fee, but with this type of disclosure, the consumer might reasonably assume that ABC Supermarket is collecting the .75 fee on this transaction, rather than the financial institution issuing the statement. Financial institutions imposing a consumer fee should be required to clearly state that they are the entity imposing the fee on the consumer. This will allow the consumer the opportunity to contact the entity collecting the fee if there are any disputes, rather than the merchant. It will also eliminate the false impression that is often created that it is the merchant charging the consumer a fee.

The Board requested comments on the value of disclosures on receipts at electronic terminals. There are several issues to consider from the perspective of the supermarket owner/operator. First, every effort is made to reduce the time a customer spends in the checkout lane. Each additional second in the checkout lane represents added cost that is ultimately passed to consumers in the form of higher prices. Second, consumer surveys consistently identify time spent at checkout as the most negative portion of the shopping experience. Therefore, any activity that results in additional time at the front-end of the store must be justified either by value to the customer or by the ability to lower consumer prices. Disclosure of these financial institution imposed fees on receipts at electronic terminals of stores would have the opposite effect: disclosure would add little or no value for consumers; it would slow down checkout considerably; and would be more likely to increase consumer prices.

The retailer would not know the amount the financial institution intends to charge customer "Jane Doe" simply by swiping the card. In many cases financial institutions charge customers different fees based on the types of accounts they hold or balances maintained. A second message would have to be sent by the retailer to the financial institution (in addition to the retailer initiated authorization for payment message) that would require a response back from the financial institution to the retailer indicating the amount to be charged to the customer's account. Clearly this would increase the time in the checkout lane and would add some very significant programming costs for the retailer, assuming that this is technically possible in all instances. This is a very different situation than ATM fee disclosures. In an ATM environment, the person imposing, noticing and collecting the fee is the same. In a point-of-sale debit transaction, the financial institution would be imposing and collecting the fee, but the retailer would be providing the notice to the customer. The retailer would bear the cost of the notice while the entire fee collected would go to the financial institution.

If this type of disclosure is required, retailers should be reimbursed for all costs and expenses associated with the disclosure including time in the checkout, software/software development and hardware. And as noted, point-of-sale disclosure is likely to drive consumers to signature debit, which is a less secure, slower and more expensive form of payment than PIN debit, contributing to the growing national problem of identity theft. Thieves can use signature debit cards to empty consumer checking/saving accounts without needing a PIN. There are also serious questions about the availability of the technology needed to retrieve the necessary information from each financial institution and communicate it quickly and accurately to the point of sale terminal. It is unclear how quickly this technology can be developed and made available for all retailers. Clearly, a simpler and much better approach for consumers and retailers would be for financial institutions not to charge a consumer point of sale fee for the use of a more secure PIN number when initiating a payment with their debit card.

Interchange Fees

The Board has correctly noted in its request for comments that in addition to fees the consumer pays directly to their financial institution, there are also interchange fees imposed on a debit or credit transaction that are paid to the financial institutions by the retailer. Although these fees are currently invisible to consumers, they clearly impact consumer pricing and thus are also fees to the consumer and should also be reviewed by the Federal Reserve. These interchange fees also clearly impact the value of money. Instead of a dollar being worth a dollar, its value as a payment is discounted by more than 1% through the use of an interchange fee assessed by the card associations. Although retailers pay fees on currency and check deposits to their depository institution, those fees are competitively bid and are for services performed on behalf of the retailer. In addition to competitive bids, retailers are able to exert some control over these fees by voluntarily initiating processes such as check encoding, electronic check conversion or providing customers with cash back to reduce cash-sorting costs. Debit and credit transactions are very different. Retailers pay a small processing fee to the processor, PIN network or card association for processing the transaction. In addition to that fee, there is an additional and much larger fee that retailers must pay to the issuing bank, the so-called interchange fee. Retailers have no control over interchange fees which are assessed without regard to any market-based pricing models and without providing any service or added value to the retailer. As noted above, these fees need to be controlled.

A second and very serious concern regarding debit interchange is the price differential between the fees for the two authorization methods – PIN-based debit or signature debit. Because financial institutions are able to charge retailers so much more for signature debit, they have a perverse incentive to drive cardholders to the more costly alternative for retailers and more fraud-prone for consumers.

Since signature debit transactions have a higher fraud risk than PIN-based debit transactions, banks should encourage their customers to use the more secure PIN-based debit payment method. However, they are doing the opposite. Many charge customers for PIN-based debit, however, none charge their customers for initiating a signature debit transaction. In fact, two institutions have gone so far as to eliminate their customers' ability to initiate PIN-based debit transactions. Another financial institution not only charges customers for entering a PIN, but also provides a financial incentive to their cardholders who do not enter a PIN. Thus it is clear that financial institutions are encouraging the use of the more fraud prone option with its higher cost to the American consumer, simply because it is more profitable to them. This situation needs to be remedied.

We encourage the Federal Reserve to include all costs associated with debit (and credit) cards including interchange fees in its study of whether consumers are adequately informed of fees imposed by financial institutions when a debit card is used to make a purchase.

We look forward to working with the Federal Reserve to further develop the appropriate regulatory response to these important issues.

Sincerely,

George Green
Vice President
General Counsel