Taking a swipe at debit card fees

Retailers and banks are on opposite sides of federal legislation that could change the way debit card fees are regulated.

By Annie Johnson | BRBJ

At its core is a plastic resin called polyvinyl chloride acetate. Layers are added and laminated together to protect it from the wear and tear of rubbing against your driver's license.

It bends. It breaks. It buys you stuff.

But under legislation expected to pass this week, the way consumers use that little piece of plastic could become more important than ever to number-crunching businesses that have lost billions of dollars over the years in "swipe fees."

Specifically, the measure would provide that the fee a merchant is charged when he swipes a customer's debit card is "reasonable and proportional" but would exempt banks with less than $10 billion in assets. Right now, swipe fees are not regulated.

The language is part of a broader financial regulatory overhaul and is a landmark moment in the years-long battle between retailers and financial services firms that handle their credit and debit card processing.

Credit card companies and big banks say that they would struggle to make up the lost revenue in other areas if the fees were capped, and that their cardholders could see higher fees for other services.

And while the legislation applies only to debit card fees -- typically a flat rate plus a percentage of the sale -- credit card companies and banks fear that credit card swipe fees will be next on the chopping block.

Originally, the legislation included both types of cards, but that provision was stripped from the final version of the bill thanks to intense lobbying efforts from companies such as Visa and MasterCard. Another gutted provision would have allowed merchants to offer a discount to customers who pay with cards that carry lower transaction fees. Right now, merchants have to accept all debit or credit cards on the same terms.

The bill would allow merchants to require a $10 minimum to use a card, as well as to offer discounts to people who pay cash or who use debit instead of credit cards.

Each time a consumer pays with a card, six parties are involved in the transaction: the consumer, the consumer's bank, the network that issued the card, the merchant, the merchant's bank and the processor, which gets the authorization for the payment and processes it. The majority of the fee goes to the consumer's bank.

Moving to cashless
Danny Givens, owner of Givens Books in Lynchburg, estimated that his swipe fees have climbed to about $30,000 a year, quickly approaching the money he spends on advertising. That includes both debit and credit card transactions, he said.

The reason? "We are becoming a more cashless society," Givens said. Fifteen years ago the book store did about 75 percent of its business in the form of cash or check. That proportion is completely inverted now, with 75 percent of purchases made with a credit card.

Add to that the bombardment of calls from processing groups that all promise a lower rate, and Givens said the leg work can be overwhelming at times.

The National Retail Federation, which has run radio and TV ads in support of the legislation, estimates that swipe fees average close to 2 percent of each credit or debit card sale.

In 2008, U.S. retailers and consumers paid an estimated $48 billion in swipe fees, or triple the $16 billion charged when NRF began tracking the fee in 2001, according to the group. The $48 billion includes fees for both debit and credit card purchases.

Looking just at debit cards, $1.21 trillion in purchases last year generated $19.7 billion in fees paid by U.S. merchants through the Visa and MasterCard networks alone, according to data from The Nilson Report, a trade publication. Most of the fees went to the banks that issued the debit cards.

According to filings with the Federal Election Commission, the NRF spent more than $2 million on lobbying efforts in 2009. The filings don't break down which legislation the group spent the most money on but do illustrate the concerted effort on the part of the nonprofit to get pro-merchant legislation passed.

K.L. Crank, general manager of Backcountry Ski and Sport in Blacksburg, said his company switched card processors just this year in an effort to control costs.

"Sometimes it's a percentage point, sometimes it's a penny, sometimes it's just the ability to be able to void a transaction and not be penalized for it," he said.

Crank said that the store is charged when a customer makes a return and wants the balance added back to her card. He gets charged for the purchase, loses the sale and is charged again when he swipes the card for the return.

While most businesses have accepted the widespread use of plastic, a few have stuck to their guns, posting hand-written "cash only" signs on their registers.

Fabricare Center, a Roanoke laundromat and dry cleaner, deals in cash only to avoid the hassle of credit card machines and swipe fees, owner Les Clayton said.

But even with lower fees, Clayton said he plans to stick to the green so he doesn't have to constantly run to the bank to get change for his customers.

"People come in wanting change all the time," he said. "If everyone uses a credit card, I won't have any change."

Little Dipper in downtown Roanoke only recently began accepting plastic in an effort to gain a share of a
younger market, said Shellie Crowder, co-owner of the ice cream shop.

"I don't know why, but that's all they use anymore," she said.

Little Dipper was cash-only for more than eight years amid fears of the fees charged to process credit transactions. Still, the legislation wouldn't do much to ease the shop's financial burden: The business accepts all cards but can only run them as credit.

Crowder said that Little Dipper and other mom-and-pop shops would be in favor of lowering credit card swipe rates, but that capturing new customers has been worth the expense. The store pays anywhere between 1.5 percent and 3 percent per sale. She said the business has no intention to return to cash only.

Fee shuffling

While retailers and merchants across the country laud the legislation, banks are left wondering how they would make up the difference.

One way: pass the revenue loss on to consumers.

Consumers could expect to see new fees on services that are currently free, said Charlie Robbins, regional president of BB&T and chairman of the board of directors of the Roanoke Regional Chamber of Commerce. The chamber hasn't taken a position on the legislation because it would affect members in vastly different ways.

"It will definitely impact us in the sense it is going to negatively affect a source of revenue -- and a source of revenue that would also help offset a lot of embedded costs that we've had to bear," Robbins said.

Robbins pointed to services such as fraud protection and ATMs as places bank customers could see fee increases as a result of the legislation. The bill, he added, also would inhibit a bank's ability to raise revenue, be profitable and lend money -- all areas that regulators scrutinize when evaluating an institution's performance and potential to remain federally endorsed.

 Officials at StellarOne in Blacksburg said that while the legislation would not directly impact the bank, which has just over $2 billion in assets, it could have other effects. Joshua Gehring, director of retail banking for StellarOne, said that if larger banks are forced to lower fees it could create competition issues.

That's the thinking of other community banks and credit unions that have said they would have to lower their fees to stay competitive with larger institutions whose fees would be capped by the Federal Reserve. If larger banks offered lower rates, then some merchants might have an incentive to switch banks.

"Currently, the smallest credit union and the largest bank in the world receive the same interchange fee when their respective customer uses their debit card," Fred Becker, president and chief executive of the National Association of Federal Credit Unions, wrote in a June letter to Fed chairman Ben Bernanke. "The interchange amendment, however, destroys this equal footing."

The long battle over swipe card fees has escalated in the past decade as card companies have raised the rates, which are nearly four times what they are in Europe and other areas of the world, according to Raman Kumar, a professor of finance at Virginia Tech's Pamplin College of Business.

In 2005, retailers and their trade associations filed 41 class action suits in federal court related to swipe fees,
According to the American Banker's Association.

In April, Visa Europe agreed to cap debit card swipe rates at 0.2 percent for four years. In the United States, Visa debit card fees are 0.95 percent, Kumar said.

"The actual cost of processing is going down with all the improvements with technology," he added.

Australia cut credit and debit card fees on merchants by half, and debit card holders particularly benefited from the change, according to the Reserve Bank of Australia. But credit card holders saw an increase in bank fees and a reduction in cardholder rewards, such as fewer points or airline miles. Merchants also started imposing surcharges on some credit card transactions.

"It's becoming a huge profit for the banks rather than just a processing fee," Kumar said.