

STATEMENT FOR THE RECORD

OF THE

NATIONAL ASSOCIATION OF CONVENIENCE STORES

AND THE

SOCIETY OF INDEPENDENT GASOLINE MARKETERS OF AMERICA

FOR THE

HEARING OF THE HOUSE ENERGY AND COMMERCE
SUBCOMMITTEE ON COMMERCE, MANUFACTURING, AND TRADE

DECEMBER 1, 2015

“THE DISRUPTER SERIES: MOBILE PAYMENTS”

This statement is submitted on behalf of the National Association of Convenience Stores (NACS) and the Society of Independent Gasoline Marketers of America (SIGMA). We appreciate this opportunity to present our views regarding the mobile payments marketplace.

NACS is an international trade association representing more than 2,200 retail and 1,800 supplier company members in the convenience and petroleum retailing industry. NACS member companies do business in nearly 50 countries worldwide, with the majority of members based in the United States. In 2014, the industry employed more than two million workers and generated \$696.1 billion in total sales, representing approximately 4.0 percent of the United States' GDP—or one of every 25 dollars spent.

SIGMA represents a diverse membership of approximately 260 independent chain retailers and marketers of motor fuel that sell more than 50 percent of the motor fuel sold in the United States. Most SIGMA members are involved in gasoline retailing, approximately two-thirds are involved in wholesaling, 36 percent transport product, 25 percent have bulk plant operations, and 15 percent operate terminals. Member retail outlets come in many forms, including travel plazas, traditional “gas stations,” convenience stores with gas pumps, cardlocks, and unattended public fueling locations. Some members sell gasoline over the Internet and a few are leaders in mobile refueling.

Despite the fact that our members' channel of trade conducts more than 160 million transactions per day, we are an industry of small businesses. Less than five percent of the retail motor fuel outlets in the United States are owned or operated by integrated oil companies. The vast majority of branded outlets are locally owned and more than 70 percent of retail motor fuel and/or convenience store companies operate ten stores or less. In fact, more than 60 percent of businesses that sell motor fuels at retail operate just one store.

Mobile payments offer a unique avenue and opportunity to disrupt many problems and inefficiencies in the current payments marketplace. Today's payments ecosystem, which is dominated by Visa and MasterCard is inefficient, opaque, and excessively costly. This is not surprising. Insulated from competition, the card networks have stifled innovation and have had no incentive to innovate or make the system more efficient. Our system is way behind where it should be. Nowhere is this more evident than the fact that the U.S. has only recently begun to transition away from fraud-prone magnetic stripe cards, twenty years after much of the rest of the world began this transition. The mobile payments market has the potential to be an open, transparent, and competitive environment that creates a level playing field for all players. Without proper oversight from policymakers, however, it is possible that Visa and MasterCard will leverage the market power and antitrust problems they have used to dominate payment cards into a dominant position in mobile payments. If that occurs, it risks stifling innovative new competitors and reducing the options of U.S. consumers long into the future. Thus, we encourage lawmakers to closely monitor developments in this field to ensure that innovators have the opportunity to flourish in the mobile payments space so that the best new technologies have a chance to win and consumers have the chance to benefit from that innovation.

I. The current payments ecosystem is not competitive or efficient and has stifled innovation.

The current payment cards ecosystem is marked by inefficiencies that are the direct result of an anti-competitive environment. Visa and MasterCard, which, along with the major banks, pushed electronic banking and the use of payments cards beginning in the late 1970s dominate the payment card marketplace. In fact, the monopolistic nature of the payment card market has stifled innovation. The card networks are insulated from competition and have no incentive to innovate and make the system more efficient.

A. Costs and rules underlying the payment card market have promoted inefficiency.

The lack of competition in the payment card space has disincentivized the adoption of effective data security standards and has imposed unnecessarily high fraud costs on merchants. Despite retailers spending over \$6.5 billion each year trying to protect against card fraud, fraud rates continue to rise in the United States because of our long-time reliance on outdated payment card technology.¹ Merchants pay the brunt of those costs.²

The Payment Card Industry (PCI) Data Security Standards Council, which is run by the card networks, has established requirements regarding the security of credit and debit card transaction data that retailers must implement. Generally, these requirements cost retailers tens of thousands of dollars per location, and do not ultimately lead to secure systems. Moreover, these requirements do not provide the retailer with any liability protection in the event data is breached and stolen. Despite banks' false claims that they provide merchants with a "payment guarantee," merchants are constantly hit with "chargebacks." These chargebacks are the euphemism the payment industry uses when they do not give the merchant any of the purchase price on a fraudulent payment card transaction. In other words, for charged back transactions, the merchant absorbs the full cost of the fraud.

The card networks' market dominance has given them the power to force retailers to comply with second-rate security that preserves the networks' marketplace advantage. Under the card companies' operating rules, for example, retailers are prohibited from requiring customers to enter a PIN when accepting debit cards. This is astounding, since PIN authentication is *six times more secure* than signature authentication.³ It is not, however, surprising. By prohibiting

¹ The card networks finally mandated a transition to "chip" cards that went into effect on October 1, 2015. However, these EMV cards are already old technology—Europe has been using "chip-and-PIN" cards since the 1990s.

² According to an annual report by LexisNexis and Javelin Strategy & Research on the "True Cost of Fraud," in 2009, retailers suffered fraud losses 10 times higher than financial institutions. The report found that half of retailers' fraud losses came from unauthorized transactions and card chargebacks. The 2013 report found that merchants are "paying more per dollar of fraud than in 2012, the most since 2010." And according to the most recent data from the 2015 report, merchants incur a \$223 loss for every \$100 of fraud losses. See <https://www.lexisnexis.com/risk/insights/true-cost-fraud-infographic.aspx>. In addition, card-issuer losses are dwarfed by merchant fraud losses, which the Mercator report has estimated to be tens of billions of dollars a year. Cited in "House of Cards: Why your accounts are vulnerable to thieves," Consumer Reports, June 2011.

³ Federal Reserve Board, Debit Card Interchange Fees and Routing, 77 Fed. Reg. at 46,261 (Aug. 3, 2010), available at <http://www.gpo.gov/fdsys/pkg/FR-2012-08-03/pdf/2012-18726.pdf>.

PIN authentication, Visa and MasterCard are able to drive traffic to their signature networks where they are able to collect much higher swipe fees. This is also what has motivated the card companies to push "Chip-without-PIN" in the United States rather than "Chip-and-PIN," which they have used in other parts of the world.⁴ And, of course, when banks act like merchants by accepting payment cards for something of value (cash) at ATMs, those banks universally require the use of PINs. The card networks do not interfere with banks' security at ATMs. Unfortunately, they do interfere with merchants' efforts to require PIN entry.

Focused on profits and insulated from competition, the card networks have no reason to improve efficiency, cut costs, and enhance security. They make more money with the status quo. Thus, merchants remain at the mercy of the card companies' policies, which, as we are seeing with the EMV transition, are not designed to maximize consumer protection, card transaction security, or efficiency.

B. The payment cards marketplace is opaque and rife with exorbitant costs that have negatively impacted consumers and merchants.

The dominant card networks set the swipe fees that the banks that issue payment cards charge merchants each time a merchant accepts a card. These swipe fees have grown dramatically over time as Visa and MasterCard have increased their stranglehold on the market. Because these fees are centrally set, banks which should be competing against each other agree to charge the same fees. This results in a significantly over-inflated fee. Despite the fact that banks compete on other business costs – from loan and fee rates to consumers' checking account interest – they do not compete on swipe fees. As a result of this price-fixing and Visa and MasterCard's market power, there has been no meaningful competition to push swipe fee costs down. Rather, the system encourages and perpetuates inflated swipe fee revenue that has enabled issuers to collect excessive profits well above what it would take to cover card program costs.

Not surprisingly, swipe fees have been increasing at an alarming rate. In the last fifteen years, the fees have increased from \$12 billion to over \$60 billion per year. This has made swipe fees the fastest-growing cost retailers in the United States have. In fact, the average U.S. swipe fee (more than 2%) is the highest of any industrialized country.⁵ For most retailers, swipe fees are their second highest operating cost – less than labor but more than items like rent and utilities.⁶

⁴ Visa advertises PIN benefits on its own website, noting that in the United Kingdom, fraud related to lost and stolen payment cards has decreased by more than half since chip-and-PIN was adopted there in 2004. *See The Benefits of Chip and PIN for Merchants*, available at <http://www.visa.ca/chip/merchants/benefitsofchippin/index.jsp> (last visited Nov. 25, 2015). Similarly, in their 2013 petition to the Australian Competition and Consumer Commission for authorization to *require* PIN authentication on transactions involving their cards, Visa and MasterCard made numerous pro-PIN statements, including: "*The Applicants' view is that chip and PIN is a significantly more secure form of [customer verification method] than signature.*" *See generally*, Visa & MasterCard – Authorisations – A91379 & A91380, available at <http://registers.acc.gov.au/content/index.phtml?itemId=1120516>.

⁵ According to the Nilson Report, the U.S. spends more on swipe fees than the rest of the world combined.

⁶ The convenience store industry paid over \$11 billion in swipe fees last year. *See* NACS, State of the Industry Annual Report for 2014.

Problematically, most companies have no way to plan for or deal with rising swipe fees. While businesses can make cost-cutting decisions, including changing suppliers or installing more energy-efficient equipment, they cannot do the same when it comes to swipe fees. Thousands of banks such as Bank of America, Wells Fargo, Chase and others that operate under either the Visa or MasterCard umbrella charge precisely the same schedule of fees. There is no price competition to push the price down. Companies do not know when or by how much fees will increase—and because the card networks have made swipe fee rate schedules more and more complex, even after a new rate is announced, it is nearly impossible to understand how those rates will impact a merchant’s fees. These uncontrollable and unpredictable costs have a far-reaching negative impact, not only do they lead to higher costs for consumers, they prevent merchants from hiring new employees and opening new locations.

II. Mobile payments innovation presents a unique opportunity to disrupt and overcome problems in the current payments marketplace.

Innovation in mobile commerce has the potential to address the inefficiencies that currently plague the U.S. payments marketplace. To succeed as a “disruptive technology,” however, mobile payments must be truly innovative in how they process and effectuate transactions. Just transferring the current payment cards system onto a cell phone is not innovation. This, for example, is the reason that merchants were not particularly enthusiastic when Apple came out with its mobile payments platform. Apple Pay is not truly innovative because it merely links existing credit- or debit-card accounts to mobile phones—it does not actually address the payment system’s fundamental problems. Other than allowing consumers to leave their wallets at home, Apple Pay does not provide consumers (or merchants) with added value.

Mobile technologies like Apple Pay that simply graft existing payment cards miss the opportunity to change the economics of payments. If extra, anti-competitive costs are taken out of payments, consumers and merchants can reap the benefits. That would spur economic activity and efficiency.

For a payment technology to be truly innovative and disruptive, it must actually take costs out of the current payment ecosystem and make transactions more efficient. When paper money was invented, it disrupted a traditional system of barter and trade precisely because it made it cheaper and faster to purchase goods. Mobile payments innovations can and should do the same. A classic example of a wildly successful and disruptive mobile technology is the Starbucks App. The App saves Starbucks money that it was paying in swipe fees. To incentivize its use, Starbucks gives its customers large discounts on purchases. That has resulted in a large, loyal group of users of the Starbucks App, has saved users money and has saved Starbucks money. That is a win all the way around. And, by the way, it is by far the most used and most successful mobile payments system in the nation.

In order to achieve similar success to the Starbucks App, mobile payments innovation must be driven and shaped by true competition that consistently encourages greater efficiency.

The rules underlying any particular mobile payments technology must be transparent so that consumers and merchants understand the costs involved and can make informed business decisions.

III. Policymakers have an important role to play in the nascent mobile payments space.

Mobile payments present a unique opportunity to resolve serious problems in the U.S. payments ecosystem and enhance U.S. dominance in the payments field. Innovation properly grounded in competition will enhance efficiency, lower transaction costs, and lead to stronger consumer protection and security. Merchants remain concerned, however, that without lawmaker vigilance, Visa and MasterCard may move their dominance in payment cards into the mobile space and stifle innovation.

One potential example of Visa and MasterCard abusing their market position may be occurring right before our eyes. Merchants are being pushed by the threat of more fraud liability to use EMV card readers in their stores. EMV is a technology that is proprietary to MasterCard and Visa. And, those two card networks have been engaged in a campaign to ensure that the near field communication (NFC) technology in those card readers is turned on. The mobile payments technologies that use Visa and MasterCard products (like Apple Pay) rely on NFC technology. There are, however, many other technologies that are being used and developed by competitors. In England, Visa has just announced they will require merchants to accept NFC payments. This is the type of antitrust violation, referred to as “tying,” that American merchants fear. If Visa and MasterCard require the acceptance of their mobile payments technology for a merchant to be able to accept their traditional payment cards, then they may kill-off the other innovators trying to get a foothold in the mobile payments world. This Committee should not allow that to happen.

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Merchants, including our members in the convenience store industry, are extremely excited by mobile technology’s “disruptive” potential. But we are also very nervous that the incredible innovation we anticipate could be squashed by the currently dominant payment networks. Therefore, we ask lawmakers to closely monitor the major players in the payments ecosystem to ensure that they are prevented from using market power to dominate this nascent field.