General Discussion
Session 2

Mr. Weiner: Thank you, Marc and Kylie. Marc, I will give you a chance to react to comments Kylie made.

Mr. Rysman: I agree with everything she said. I certainly think costs are important too, although I left it out of my paper.

Mr. Hunt: I was intrigued by Kylie's chart on the surcharging. Have you done any research on whether this variation in surcharging has led to consumer-sorting across merchants?

Ms. Smith: I am sorry. Could you clarify consumer-sorting?

Mr. Hunt: Once you change the price structure, you may change the kinds of customers you attract. So, is there any way you can measure that effect?

Ms. Smith: Unfortunately we are trying to get a lot more detailed information on surcharging in Australia at the moment because it has become an important issue. We haven't been able to look at that in too much detail. There was a study done by the Netherlands Bank. One of the coauthors is here—Wilko Bolt. They found consumers may, when faced with a surcharge, go to a different store. Their number was about 5 percent. They indicated if they faced a surcharge, they might actually go to a different merchant. But that is all the evidence I know of.

Mr. Gove: Just a comment on the surcharging in the Australian environment in addition to Kylie's chart there. It shows between 20 and 30 percent of merchants surcharging. That should not be confused with the percent of transactions that are being surcharged, which is about 5 percent according to Reserve Bank estimates.

The other thing that is important to realize about surcharging—I am just saying this because there seems to be a lot of misinformation about surcharging in Australia—is they may only be surcharging on one card type. It may only be

American Express. It is not surcharging on all cards necessarily. Those sorts of issues need to be kept in mind when evaluating the impact of surcharging in Australia.

Mr. Weiner: I think the surcharging issue obviously is very important and very timely right now. I don't want to put anyone on the spot, but the Dutch have some studies on this, as does the Bank of Mexico. I know Jose is with us. Any comments from either the Dutch or the Mexicans on your experience?

Mr. Bolt: In Holland, we use only cash or debit cards at the point of sale. We don't use credit cards. One in five merchants in the Netherlands—predominantly small merchants—surcharge debit cards. They do that in a specific way. They do it only for payments below €10. So below €10, if you want to use your debit card, you pay sometimes four times the fee the merchant pays. So, if the merchant pays a 5-cent flat fee for every debit card transaction, he charges 23 cents, on average, for a payment below €10. That was actually a normal situation.

The Dutch then say, "Well, I am not going to pay that if I buy something for €9.90 and then you have to pay a 23-cent extra fee."

So, what they do is use cash or they go to another merchant that doesn't surcharge. In the end what happens with regard to all this is, if you would stop surcharging, the debit card volume for those small payments would rise enormously. Then you can realize economies of scale. Promising in some sense lower debit card fees ultimately, so actually what we are now advocating at the central bank is that we have a public campaign that merchants should in some sense stop surcharging and say to consumers on a national channel on television, "You should use your debit card also for small payments."

What we have now seen in 2009 is the number of transactions by debit cards for under €10 has increased by 20 percent. Dutch people are using the debit card also for small payments, and merchants are reacting by stopping surcharging. In the end, they actually expect and banks somehow also agree to that. Of course, this is a difficult area to discuss. Yet to come are lower payment fees over time, actually decreasing the 5 cents to even lower, because the volume gets bigger and bigger and you can realize economies of scale there. That is what happens in Holland.

I have a question for Kylie on the surcharging. Do you know what types of merchants surcharge and the different rates, how much or to what extent they surcharge? Do they extend the full payment fee they face, or do they absorb some of those costs and pass on some of those costs to the consumers? Does that differ across types of merchants?

Ms. Smith: We do have some data on this. We obtain data from a consulting firm that surveys a group of merchants, and we also collect our own quarterly data from acquirers on merchant service fee income. It does seem roughly that the surcharge is in line with the merchant service fee.

Mr. Hayes: A comment on the comment, and then I also have a question for Kylie, if I can.

The comment is, in the United States clearly there is no surcharging on debit card payments. You are prohibited from saying you can't take a card for a transaction of less than x amount. We see small-value payments are the fastest growing category of debit payments in the United States. Fully 25 percent of all debit card transactions are for less than $10 here, and it is growing very, very quickly, even without this idea of lower pricing. So, it seems the value proposition has been quite strong, and it represents a big part of the market.

My question concerns your last chart. I want to try to understand the basis for the numbers. The three colored bars are meant to be financial institution cost, merchant cost, and consumer cost in each of the three payment forms. What is somewhat puzzling is when I look at the EFTPOS number, the merchant cost appears to be a bit higher than the cash cost, for example. My understanding is that with EFTPOS, the merchants are receiving typically 4 or 5 cents per transaction in revenue by the issuer and typically have fairly low processing costs. So, I am just puzzled by why that cost would be higher than what you show here for cash. So, maybe I am misreading this or there are other things embedded within these numbers.

Ms. Smith: Yes, you're right. Those three bars are the costs broken down into financial institution, merchant, and consumer. On the EFTPOS versus cash, the component there for the merchant will be the "tender times": merchants with high turnover provided data on tender times from time-and-motion studies. Cash is about 20 to 25 seconds to make a transaction, whereas EFTPOS is about 35 to 40 seconds. That is the main driver there. All the other costs are actually lower than for cash.

Mr. Negrin: On the Mexican experience of merchant surcharging, there is not really actual surcharging. What you can do is have discounts if you pay with cash, let's say. What has been happening since the interchange fees have gone down and the discount rates have come down somewhat is more merchants that used to take cards used to charge more if you paid with credit cards. That has changed quite a bit. On the other hand, larger merchants are distinguishing between paying with debit or with credit.

I have a question for Marc about education not being relevant on your regressions. Do you have an explanation for that? It seems very strange because it is highly correlated with income, and if you have high income, you would have expected that. On the PIN use for which you had strange results, can it be related to the fact of having several debit cards or several credit cards?

Mr. Rysman: The education one is tricky. I guess I don't have a good answer for you about that. People who run regressions on the *Survey of Consumer Finances* that the Fed runs, seem to find that education matters. But, for instance, we have early results from the *Survey of Consumer Payment Choice*, the new survey the Boston Fed is running that is really focused on payments. And there the result is ambiguous for education. Scott, would you agree with that? There, the result depends on how you run the regression. I don't have a great explanation, but I think, as the new versions of this dataset come out, maybe we can resolve what is going on.

The surprising result on PIN debit is the one questioning which one is easy to use. There "credit card" is ranked ahead of "signature" and "PIN" debit. I am not sure either. The difference of about 15 points means 15 percent of the people are saying credit cards are easy to use, but they are not saying that debit cards are easy to use. It is not that they can't remember their PIN number because they are saying it for both signature and PIN debit. It is not that many people, so I am not sure how big it is if we take it in terms of statistical significance.

One of the things that jumps to my mind is that with debit, you have to know how much money is in your account, and with credit, you are not running up against your limit, at least you don't have to think about how much money is in the account today. Especially if someone is maintaining separate checking and savings accounts, Are they going to move money from the savings account to cover payments as they come in? They don't have to think about that when they are using their credit card. They just have to move it in on the day they send off their credit card payment. So, that is my best guess for what is happening there.

That is the issue with these sorts of studies. You never get enough information. You always want to know why. That is one of the reasons I like that essay format, where you read the essays and see what you can learn from them.

Ms. Smith: If I may add a comment on the education and income-type variables from our empirical analysis, we find these kinds of variables might have strong explanatory power in terms of whether a consumer holds a credit card or not, but then it drops out of the use regressions once you control for credit card holding. You get very few demographics that end up left in your use regressions.

Mr. Weiner: If I can ask a quick question that is kind of related as far as determinants, I find one of the biggest puzzles—and you highlighted it, Marc—is the lack of concern over security. It doesn't seem like consumers rank it that high. Any more insight on that or thoughts on what's happening there?

Mr. Rysman: People trust the Fed to protect them, I guess.

Mr. Eckert: Perhaps it's because the consumer protection laws, either private or public, effectively push that cost away from the consumer to the issuer and/or the merchant. Therefore, the embedded cost of worrying about security is nonexistent to the consumer, so why should they care?

Then, the second thing as a follow-up on the debit side, our own observational research on why signature debit is seen as less convenient or less easy to use than PIN is because it still runs on credit rails, so the customer has to know either to hit "credit" when they are making a debit payment (which is kind of confusing) or opt out by hitting "cancel." So, it actually is less convenient for them. What is counteracted often by issuers is they offer rewards on a signature debit as opposed to PIN.

Mr. Cook: Josh, you know I couldn't let this one go. Whenever we talk about PIN, I am pretty shocked by this. I personally don't think it is an issue of consumers thinking the Fed is going to protect them; I think it is a misconception they have been told. It is kind of a George Costanza scenario, "it is not a lie if you believe it."

Here is my debit card, for example. I will trade it with anybody in this room. I have used this example before. You heard me in Chicago use this example. If you took my PIN debit card, you cannot use it. But anyone who has a scheme bug on their card, I can use your card (United States only; it is unique in Europe). The fact is that fraud is associated with it.

So, think about this for a second. Even if your fraudulent charges are waived and you are reimbursed for those, what about when your mortgage payment bounced? Who covered that late payment? Who covered that late payment for your utility bill, for example? All those other fees that go along with it, did the Fed step in and protect you there? Did your bank reimburse you for those? I don't think so. Did Visa stand in or did MasterCard give you all the reimbursement for all your late fees? No, they didn't.

When you talk about less convenience for signature-based cards, think about coming into one of our stores. If you return a piece of merchandise that you bought with a signature debit card, what is the timing of you getting reimbursed for that? It is three to four to five days later before we can get credit back to your account. You use a PIN debit card, I'll give you cash back. Those are the kind of things that make it a less-efficient product. It is fraud-prone. I'll leave it at that.

Mr. Taylor: Debit holds are a big issue within our industry because when you buy gasoline, the bank is going to put a hold against your DDA up to $75, $100, $150. It is really up to the bank. To Wal-Mart's point, that debit hold is not cleared in real time. What happens, if you are close to your DDA limit, you are down to balance $0, if you have checks presented over the next three or four days, even though the retailer has issued a finalization within five minutes of holding up that handle, that $150 is still being held. Then the whole cascade of fees comes down. Consumers are generally scared to death of the $37 overdraft fees and all the fees that come down. That is why you are seeing Congress act on overdraft fees in this case

Mr. Duncan: I wanted to comment on Marc's questioning of the Illinois toll situation, where there was a change of 40 cents. If you have pricing transparency, you can make massive changes in consumer behavior, as that example showed.

Until relatively recently, a number of banks were surcharging 50 cents to a consumer who entered a PIN. That might explain some of the same kind of behavior we saw with consumers shifting to a signature debit card.

Mr. Rysman: I think that's right. Transparency and the saliency of the charge in that case were really striking in a way that not all fees are. It's one of the reasons why the result that people with revolving credit switch away from credit cards to debit is so striking. That is not salient. I am surprised that many people get that it is going to cost them money. But it is a strong result in a couple of different studies. I agree with your point. The saliency and the immediacy of the fee and the transparency play a role in people responding to it.