Testimony of Patrick Dwyer,
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Before the Maryland House Economic Matters Committee

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Background

Mastercard operates a global payment card network that processes credit, debit and prepaid card transactions initiated by cardholders to purchase goods and services from Mastercard-accepting merchants. Mastercard contracts with banks that issue Mastercard-branded credit, debit or prepaid cards to consumers, businesses and others ("issuers") and with financial institutions that contract with merchants to accept Mastercard-branded payment cards ("acquirers"). In the Mastercard network, Mastercard sets default interchange rates to maximize the value that merchants receive when they accept Mastercard-branded cards while adequately compensating card issuers for the value they create and the risks they take. Interchange enables the card payment system and thus creates tremendous value for merchants.

House Bill 29 (the "Bill") broadly prohibits the charging of interchange fees on the tax and gratuity portion of any electronic payment transaction (the "Interchange Prohibition"), §§ (B)(1)-(2), and establishes an obligation for refunding the portion of interchange fees applied to tax and gratuity (the "Interchange Rebate"). §§ (B)(3)(I)-(II).

Harm Created by the Bill

Issuers earn interchange on payment card transactions at Maryland merchants by virtue of the costs and risks they incur for the benefit of such Maryland merchants. The Bill would undermine the fundamental fairness of the interchange structure and ultimately disincentivize the issuance of payment cards or increase the fees that issuers charge for payment card services. If there are concerns about merchants deducting interchange fees from employee gratuities, upending the entire electronic payment system is not the way to resolve it. This will cause merchants to weigh the value and cost of payment card transactions and decide whether to allow customers to include gratuities as part of a payment card transaction. Also, with respect to taxes, payment cards provide an enormous benefit to Maryland in the form of tax collection on the sale of goods and services and it would be unfair to deny issuers interchange on this portion of an electronic payment transaction. If merchants view the cost of receiving tax amounts in the form of payment card transactions as outweighing the benefits of this incredible convenience to them, then merchants can collect taxes from customers in cash. These solutions to the gratuity and tax issues clearly are fairer than the Interchange Prohibition because they match costs to benefits, so that the party that gets a benefit bears the cost of the benefit.

The Bill is likely to have unintended adverse consequences for Maryland employees, merchants and the State. For example, requiring issuers to go uncompensated by merchants for gratuity and tax portions of a payment card transaction could result in separate payment card transactions being required for gratuities and taxes or payment cards could be an unavailable payment method for such amounts. Either of these unintended consequences would inconvenience merchants and consumers, likely result in lower gratuities, likely result in lower tax collections and generally make Maryland a less favorable shopping environment for consumers to the ultimate detriment of Maryland merchants and State tax revenues. Also, we expect that merchants would incur material technology costs to avail themselves of the Interchange Prohibition and that these costs will be passed on to customers. We believe that these harms to consumers and other payment network participants more than outweigh the purported benefits to Maryland merchants.

Impediments to Implementation of the Bill for Network Operators

Mastercard's payment card network does not differentiate between the tax and gratuity amounts and other amounts that make up the whole amount of the transaction. When Mastercard processes a payment transaction, it only receives a single transaction amount from the acquirer. Interchange applies to this undivided amount. To comply with the Interchange Prohibition, Mastercard would have to incur significant costs to parse out and exclude tax and gratuity from the total transaction amount for transactions at Maryland merchants and also adopt new technical standards and rules for transmission of transaction data across its network. These will need to be adopted by acquirers and merchants at their cost. Moreover, to ensure uniformity and interoperability of the card acceptance process for Maryland merchants, Mastercard would need to agree with other U.S. and non-U.S. networks the technical standards and rules to be used by Mastercard. This process will be expensive and complex and ultimately have adverse consequences for Marylanders.

The Interchange Rebate provision contemplates that Maryland merchants may claim a rebate on interchange by merely delivering tax and gratuity documentation. The Bill creates an extraordinary operational problem. The acquirers will receive the tax documentation, but will not owe the rebate. The issuers will owe the rebate, but will not receive the tax documentation. As a practical matter, because Mastercard is the only intermediary, it will likely be called upon to stand in the gap to facilitate the Interchange Rebate. How it will do this is not clear, but it is a certainty that the expense of converting piles of unstandardized tax documents of various types into interchange rebates would be colossal.

Conclusion

If passed, the Bill would unfairly allow Maryland merchants to reap the benefits of accepting payment cards for gratuities and taxes while shifting the cost of those benefits to issuers, the network and other payment network participants. We strongly urge the Maryland House not to pass the Bill.

Sincerely,

Patrick Dwyer
VP, Head of State Government Affairs Mastercard