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Chairman Jeb Hensarling
Chairman
House Committee on Financial Services
2228 Rayburn House Office Building
Washington, DC 20515-4305

Dear Chairman Hensarling:

On behalf of the National Association of Convenience Stores (NACS) and the Society of Independent Gasoline Marketers of America (SIGMA),[1] thank you for the opportunity to comment on the discussion draft of the Financial Choice Act. NACS and SIGMA have grave concerns about the current draft of the Act because it includes a provision to repeal debit swipe fee reform, also known as the Durbin Amendment.[2]

Debit swipe fee reform has succeeded in addressing a damaging failure in the debit card market – a lack of competition that has led to inflated prices for retailers and consumers alike. These comments will briefly walk through the problems that made reform necessary as well as the clear, unassailable benefits that reform has brought. Overall, however, we cannot overstate the importance of maintaining these reforms. The convenience store and fuel retailing industry handles approximately one of every 30 dollars spent in the United States, processing over 73 billion payment transactions per year. Debit swipe fee reform has a huge impact on many of those transactions. As such, it is the top public policy issue facing our industry and the top public policy issue we have ever faced. Our thoughts on other aspects of the draft legislation so pale in comparison to the importance of debit swipe fee reform that we will not bother to discuss them in these comments. We cannot begin to have a conversation about potential changes to the Dodd-Frank Wall Street Reform Act if there is any potential threat to debit swipe fee reform. We hope that the draft Financial Choice Act will be revised to remove any reference or changes to debit swipe fee reform so that we can engage in a constructive discussion of other public policy provisions in this area.

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[1] NACS is an international trade association representing the convenience store industry with more than 2,200 retail and 1,800 supplier companies as members, the majority of whom are based in the United States. SIGMA represents a diverse membership of approximately 260 independent chain retailers and marketers of motor fuel. The convenience store industry as a whole operates approximately 154,000 stores across the United States.

[2] Sec. 1075, Wall Street Reform and Consumer Protection Act: Reasonable Fees and Rules for Payment Card Transactions.

Background on Debit Cards

In order to discuss debit swipe fee reform, it is helpful to have some background on the history of these payment cards. The debit card had a forerunner which was known as an automated teller machine (ATM) card. Banks pioneered the ATM card in the late 1960s and early 1970s, but the cards really proliferated in the 1980s. The reason banks wanted ATMs – and the cards to operate them – was that they faced high costs when their customers wanted access to the funds they kept in their bank accounts. Prior to the ATM, there were two principal ways that consumers accessed their funds: 1) withdrawals of cash; and 2) writing a paper check. When customers withdrew cash, the banks faced high costs including having enough physical branches to meet customers' demand for access to their money and they needed to pay tellers to complete these transactions. These arrangements caused particular logistical problems on Friday afternoons and paydays when large numbers of customers would visit bank branches at the same time.[3] The result was not only that the bank had to have large numbers of tellers on duty at those times but also that customers became frustrated with the wait times. And, all of these transactions happened with paper withdrawal slips completed by customers and tellers. Processing all that paper added cost to the process as well.

Paper checks did not provide banks with the level of relief they may have hoped from the many costs of in-person withdrawals. Processing the paper was still expensive and, until the last few years, the original paper check had to be physically processed through the relevant Federal Reserve bank in order to fully complete the transaction. Paper checks were an expensive way for customers to access their funds as well.

ATMs, however, helped solve many of these cost issues. They replaced paper processes with electronic processes. The ATMs reduced the number of bank branches and tellers that banks needed to service their customers. And, ATMs could function around the clock so they reduced the Friday afternoon lines that frustrated bankers and their customers. By giving customers cards with magnetic stripes and personal identification numbers (PINs), those customers could access their funds at their convenience.

What those ATMs and cards did not do, however, was replace the need for checks. People still needed access to their funds in stores when they did not have sufficient cash (or did not want to use cash). Bankers reasoned that if people could have electronic access to their funds in stores, they would have no need to write checks. That was the origin of debit cards, which were also and continue to be referred to as "check cards." The debit card allowed customers the convenience of a check at the store (and more) and gave the banks an electronic transaction which was much cheaper for them to handle than the paper check.

[3] *See e.g.*, Bernardo Batiz-Lazo, The Atlantic, A Brief History of the ATM (Mar. 26, 2015), *available at* http://www.theatlantic.com/technology/archive/2015/03/a-brief-history-of-the-atm/388547/ (noting that "The most successful early deployments took place in Europe, where bankers responded to increasing unionization and rising labor costs by soliciting engineers to develop a solution for after-hours cash distribution… The ATM freed the average consumer from lengthy queues for services that had previously been limited to bank hours.").

This was so important as a way to help banks cut their costs that financial incentives were provided to many merchants in order to give those merchants an incentive to install the necessary hardware to be able to accept debit cards at their points of sale. For other merchants, the transactions were free. There was, in fact, vibrant debate among the banks and debit networks as to whether there should ever be any swipe fees associated with debit transactions and, if there were, whether those fees should flow from merchants to the bank issuers of cards or whether those fees should flow from the bank issuers of cards to the merchants that deployed the equipment to accept the cards (which is the direction those fees flow on ATM transactions themselves).

Ultimately, the decision was for fees (if there were any) to flow to bank issuers, but the fees were very low for many years. Into the mid-1990s, for example, the fees for most debit networks remained about five cents per transaction. At that point, however, Visa began to institute a new strategy. Visa saw debit cards as similar to its credit cards and wanted to dominate the debit business in the way it had come to dominate the credit card business. Visa executives decided the way to do that was to guarantee banks that issued cards with its logo larger revenues, through swipe fees, than those issuers would get from other debit networks. The strategy worked. Visa drove swipe fees higher and higher – and banks issued more and more debit cards with the Visa logo on them. MasterCard and other debit networks have never really recovered from the head start Visa got with this strategy. Visa dominates debit cards today far more than it dominates credit cards. But, the fees it sets for card-issuing banks were not established based on a need or a cost or fraud or any reason other than Visa saw an opportunity to grab market share and took it.

Addressing Price-Fixing and Market Failure

Visa's ability to dominate debit cards was made possible by credit cards. By the mid-1990s, credit cards had become an essential part of everyday commerce in the United States. Visa and MasterCard both had market power in the credit card market and had become well-established as household names. Visa's plan to become dominant in debit cards relied upon merchants paying large fees to bank issuers through swipe fees – and Visa had a way to do that. Visa required that any merchant that wanted to accept its credit cards was required to also accept its debit cards. Visa knew that credit cards were firmly entrenched and consumers wanted to use them. Merchants knew this as well and figured they had to go along because they could lose customers to their competitors if they didn't take the customer's preferred credit card.

In antitrust law, what Visa did was referred to as "tying." Visa tied acceptance of one product (credit cards) to acceptance of another product (debit cards). There was a lawsuit over this and it resulted in the largest antitrust settlement in U.S. history at that time ($3 billion) and an order that Visa and MasterCard could no longer tie credit and debit card acceptance. But the suit took until 2003 to conclude and, by that time, debit card usage had become so popular in it own right that not much changed. Visa and MasterCard continued to drive up debit swipe fees throughout the 2000s.

But what are these swipe fees? These are the fees that the bank that issued the card charges. Why do Visa and MasterCard have anything to do with these fees? After all, Visa and MasterCard do not coordinate what fees banks charge consumers on checking accounts or what interest rates banks pay or charge customers. On every other fee and rate, banks compete with each other. That is how a capitalist economy works. Prices get set through competitors independently determining their own prices. They have incentives to push their prices as low as they can in order to take customers (and market share) from their competitors.

Swipe fees do not operate in a competitive market. Visa and MasterCard each set the fees for their card issuing banks—and those banks all charge the schedule of fees as set by their networks. The banks do not compete with each other on price. That fixing of prices completely undercuts the way that prices are disciplined by competition in a capitalist economy. But, the dynamic of having two dominant card networks arguably makes the price fixing even worse. Visa wants banks to issue more of its cards rather than MasterCard's cards. MasterCard wants just the opposite. They each try to do this by setting their schedule of swipe fees that the banks will receive on debit transactions higher than the other network. The result is not only price-fixing but an upward spiral of price-fixing.

And, U.S. retailers are particularly vulnerable to the upward spiral of price-fixing because the U.S. retail market is so fiercely competitive. In many ways, U.S. retail is the envy of the world. Prices are transparent, and businesses compete hard for customers. In our industry, motor fuel prices are advertised on large signs that are visible to everyone as they drive past our stores. We have found that customers will turn across a busy street to save one cent per gallon on gasoline – and will drive miles out of their way to save three to five cents per gallon even though they may burn fuel driving that distance, which ultimately costs more than they will save. Because of this competitiveness, retailers will do just about anything to retain and increase their customers. This includes doing what they can to accept payment the way their customers want to pay. Economists with the Kansas City Federal Reserve have studied this dynamic and concluded that one reason Visa/MasterCard and their banks are able to fix fees at such a high level is that retailers are trying to take customers from each other all the time.[4] They know, and customers know, that customers have become conditioned to pay with their cards. So, retailers will pay supra-competitive fees that in many cases exceed their profits to try to keep their customers. As long as the fees don't actually put them out of business, retailers have to take the fees the networks fix.

That vicious dynamic has made swipe fees the second largest operating cost for U.S. retailers (second only to labor). And, for more than a decade, swipe fees have been the fastest-growing cost for U.S. retailers – growing faster than everything from health care to energy costs – and it's not even close. For the convenience store industry, we have now spent the past decade paying more in swipe fees than we have collected in pre-tax profits. The costs are staggering. In 2014, for example, the industry paid \$11.4 billion in card fees compared to \$10.4 billion in pre-tax profits.[5]

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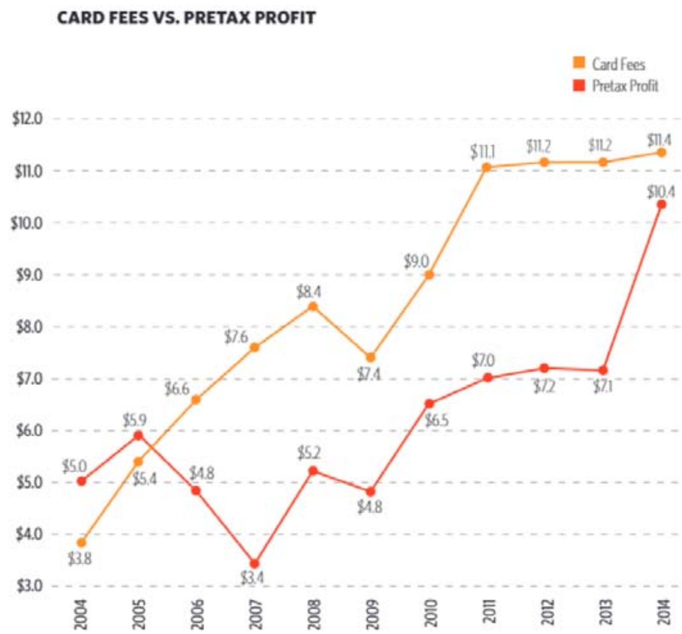
[44] *See generally* Fumiko Hayashi, Federal Reserve Bank of Kansas City, *A Puzzle of Card Payment Pricing: Why Are Merchants Still Accepting Card Payments?* (Dec. 28, 2004), *available at* https://www.kansascityfed.org/publicat/psr/rwp/WP04MerchCardAcceptance12-28-04.pdf.

[5] NACS, State of the Industry, Annual Report 2014.



That is the central problem that debit swipe fee reform addressed. Spiraling price-fixed fees undercut any semblance of a functioning market. Reform was necessary.

<u>The Reforms</u>

There were two primary changes brought about by debit swipe fee reform.[6] The first limited price-fixing to a reasonable level and the second protected competition among debit networks for handling transactions.

The changes to swipe fee pricing are often misunderstood. The law <u>only</u> applies to debit swipe fees that are centrally price-fixed by the card networks. Any bank that competes by setting its own fees rather than being part of the network price-fix is not subject to fee regulation. That means any bank can voluntarily exempt itself from the fee regulation. And, that is in addition to the vast majority of banks (more than ninety-eight percent of them) that are already exempt from fee regulation because they have less than $10 billion in assets. For those very large banks that do want to participate in the card network swipe fee price-fix, they are limited to the Federal Reserve's regulation on how much price-fixing is reasonable. One could argue that no price-fixing at all is reasonable or should be allowed, but the Federal Reserve provided far more room than that to the networks and banks. The Fed limited price-fixing to twenty one cents, plus a one cent fraud prevention adjustment plus 0.05 percent of the transaction amount to cover all of the mean bank's fraud losses.[7] That has resulted in an average debit

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[6] Sec. 1075, Wall Street Reform and Consumer Protection Act: Reasonable Fees and Rules for Payment Card Transactions.

[7] *See* 12 C.F.R. § 235.7; Federal Reserve, Final Rule, Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43394, 43467 (July 20, 2011), *available at* https://www.gpo.gov/fdsys/pkg/FR-2011-07-20/pdf/2011-16861.pdf.

swipe fee for covered issuers of twenty-four cents per transaction. Given that more than ninety percent of these transactions cost less than two cents for an issuing bank to authorize, clear and settle, they are looking at profit margins of more than one thousand percent.[8] The Fed's regulation, thereby, limits price-fixing, but it doesn't limit it much.

The second change brought by swipe fee reform is purely pro-competitive. Card networks charge their own fees to merchants on debit transactions. Those fees are over and above the swipe fees charged by card issuing banks. By the 2000s, the major card networks had worked to push their competitor debit networks like Star, Pulse, NYCE, Shazam and others out of the debit routing business. This was often done through financial deals with the largest handful of U.S. banks. Buying competition out of the market was driving small debit networks out of business. Debit reform put a brake on this trend by ensuring that there remain at least two competitive options of networks on debit transactions that the customer purchasing that service (the merchant) could choose.[9] This part of the reforms does nothing more than ensure that competition among debit networks will be protected into the future.

<u>Success of Debit Swipe Fee Reform</u>

Given the problems with debit swipe fees prior to reform, the changes predictably have been successful. Price-fixing, for example, has been a bit more limited. Unfortunately, it still goes on. Visa and MasterCard continue to price the fees that their banks charge on all debit transactions. We had hoped some banks would choose to leave the price-fixing system, but the fees that the Fed's regulations allow are still too high to give banks any real incentive to end price-fixing. But, there are at least some guardrails on price-fixing and that is an improvement.

And, there is more competition and innovation among networks. Smaller debit networks have expanded their offerings so that they can handle transactions through a variety of authentication methods. Visa and MasterCard have done the same. These innovations were long overdue and provide more competitive choices. There remain issues to be resolved as Visa and MasterCard continue to try to find ways to evade competition and constrain merchants so that they cannot make competitive choices, but we remain hopeful that the regulators and congressional oversight will ensure that, over time, competition does fully take hold among debit networks without interference by Visa and MasterCard.

All of this has meant that the amount of unnecessary friction and cost in debit transactions has been reduced. And that, after all, ought to be the goal of any payment system – reducing friction and cost so that transactions are more efficient. Economist Robert Shapiro has found that these changes resulted in consumer savings of $5.8 billion and merchant savings of $2.6 billion in the first year of debit

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[8] It is interesting to note that when forced to compete (if only a little bit) by debit reform, banks have found ways to make debit transactions more efficient, which means they pocket even more of the debit swipe fees they collect. *See* Merchant Advisory Group, Volume and Cost Trends in the Debit Card Industry (2015) (finding that between 2009 and 2013, issuers' self-reported average cost of handling debit transactions had decreased by 42%, from 7.6 cents to 4.4 cents).

[9] 12 C.F.R. § 235.7; 76 Fed. Reg. at 43468.

reform alone.[10] And, efficiency has other benefits as well. Consumers pay more when lower prices give them more purchasing power. Those benefits supported an additional 37,000 jobs in the first year of reform alone as well. Moody's has found that these savings have helped shield consumers from the higher prices they would have paid from other business costs going up – and that merchants were not pocketing savings from reform.[11] In our industry, gas prices provide a clear lesson of how consumers benefit when retailers' costs are reduced. Over the last few years, gas prices have fallen dramatically from as much as $4 per gallon to, at times, about half that amount. Lower business costs for retailers help consumers save throughout the economy.

Debit card issuing and usage has continued to flourish. While some banks had argued that debit cards would not be offered anymore, that has proven false. And, of course, that false criticism flies in the face of the history of debit cards which were (and remain) a cost saving benefit for banks even if no swipe fee revenue had ever been associated with them. The Philadelphia Federal Reserve found that banks with less than $10 billion in assets had benefitted from reform by increasing their market share and continuing to charge about the same rates for debit transactions that they did prior to reform.[12] The GAO and Federal Reserve Board made similar findings.[13]

One additional note is that some falsely claimed that swipe fee reform could reduce consumer access to free checking. Such a claim is nonsensical as free checking has its own market dynamics based on banks competing for individual customers. That is why, for example, free checking fell dramatically from 2009 to 2010 – the financial crisis upended the market dynamics in that market. Nonetheless, some made that silly claim and it has proved false – though some critics still try to point to the 2009 number for free checking (one year before reform was passed and two years before it went into effect) to show a false premise that cannot be shown by real facts. The simple fact is that more consumers have access to free checking today than did when debit reform was passed. For 2010, when reform became

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[10] Robert J. Shapiro, Sonecon, LLC, *The Costs and Benefits of Half a Loaf: The Economic Effects of Recent Regulation of Debit Card Interchange Fees* (Oct.1, 2013).

[11] Moody's Investors Service, *New Debit Rules Hurt Banks and Reshape the Payment Processor Market* (June 20, 2012) at 10.

[12] James DiSalvo and Ryan Johnston, Federal Reserve Bank of Philadelphia Research Department, Banking Trends: How Dodd–Frank Affects Small Bank Costs (1st Quarter 2016).

[13] *See e.g.*, Government Accountability Office, Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings, GAO-12-881 (Sept. 2012); Board of Governors of the Federal Reserve System Report, *Average Debit Card Interchange Fee by Payment Card Network* (May 1, 2012).

law, the American Bankers Association found that 53 percent of Americans had free checking.[14] For 2015, the American Bankers Association found that 61 percent of Americans had free checking.[15]

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The bottom line is that debit swipe fee reform was and remains desperately needed.[16] This sensible reform, which merely limited price-fixing and increased competition, has been a clear success. Repealing it would only take the country backwards. It would leave Visa and MasterCard free to price-fix fees that banks charge without limitation. It would dramatically curtail competition among debit networks. And, repeal would increase costs for everyday consumers and merchants thereby depressing sales and hurting the economy. In short, repeal would be a lose-lose-lose proposition. Only the largest 20 or so debit-issuing banks along with Visa and MasterCard would really benefit. Everyone else, including small banks, would be worse off after repeal.

NACS and SIGMA urge you in the strongest terms to remove the repeal of debit swipe fee reform from the Financial Choice Act before it is introduced as a bill.

Best Regards,

Douglas S. Kantor

Cc: Members, House Financial Services Committee

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[14] ABA Survey Shows Majority of Bank Customers Pay Nothing for Monthly Bank Services (Oct. 7, 2010), http://www.prnewswire.com/news-releases/aba-survey-shows-majority-of-bank-customers-pay-nothing-for-monthly-bank-services-104516904.html.

[15] American Bankers Association, Survey: Most Americans Pay Nothing for Bank Services (Aug. 18, 2015), *available at* http://www.aba.com/Press/Pages/081815SurveyonBankCosts.aspx.

[16] Notwithstanding the success of debit swipe fee reform, U.S. merchants continue to pay some of the highest debit swipe fees across the globe. For example, in 2015, U.S. merchants paid almost 4 times more per debit card transaction than merchants in Belgium, Hungary, Iceland, Poland, and Spain—and 3.5 times more than merchants in the U.K. *See* Federal Reserve Bank of Kansas City, *Credit and Debit Card Interchange Fees in Various Countries August 2015 Update, available at* https://www.kansascityfed.org/~/media/files/publicat/psr/dataset/intl_if_august2015.pdf; The Cost of Accepting Credit Card Payments: NA vs EU, *available at* http://www.valuepenguin.com/interchange-fees-na-vs-eu (last visited July 9, 2016).