Congress of the United States
Washington, DC 20515

Protect Main Street From Anti-Competitive Swipe Fees

November 18, 2016

Dear Colleague,

We write in response to a November 15 letter you may have received from lobbyist Molly Wilkinson, who represents a coalition of credit card companies and financial institutions that is lobbying to repeal the swipe fee reform law that Congress enacted in 2010. Repealing swipe fee reform would diminish competition and choice in electronic payments, dramatically increase debit card swipe fee rates, and force American merchants and their customers to pay an estimated $8 billion-per-year in additional fees to the nation's biggest banks--with Wells Fargo as one of the main beneficiaries. Repeal of swipe fee reform would easily be the largest legislative gift to the banking industry since the 2008 bailout, and it would come directly at the expense of Main Street merchants and consumers.

Congress enacted swipe fee reform in 2010 in order to place reasonable limits on widespread price-fixing that was occurring in the electronic debit system. This reform law, known as the Durbin Amendment, passed after years of Congressional hearings,[i] Government Accountability Office reports,[ii] Federal Reserve studies,[iii] academic articles,[iv] and press reports[v] that demonstrated that the interchange or swipe fee system was not a properly functioning market. These analyses showed that the swipe fee system was actually designed and operated by Visa, MasterCard and their card-issuing banks to avoid competition and to generate high fees that exceeded what could be sustained in a normal competitive market environment.

For years, thousands of debit card-issuing banks and credit unions had agreed to let the Visa and MasterCard networks price-fix the interchange fee amounts that all issuers in those networks charged merchants each time a debit card is swiped. This centralized fee-fixing avoided competition and diminished the issuers' incentive to manage their operational and fraud costs efficiently, because all issuers were guaranteed the same set of network-fixed swipe fees regardless of how efficient or secure their card operations were. Visa and MasterCard had incentive to constantly increase interchange fees in order to encourage issuers to issue more of their cards, and given Visa's and MasterCard's dominant market power merchants could not realistically refuse to accept these cards even as fees soared. The result was ever-rising debit interchange fees--amounting to over $16 billion in 2009--that essentially functioned as a tax on merchants to subsidize bank inefficiencies. By 2010, U.S. swipe fees had become the highest in the world--in contrast to other countries where swipe fees were minimal or even zero--and the billions charged annually through swipe fees were ultimately borne by consumers in the form of higher retail prices. In short, the system was rigged and market forces were unable to fix it.

The Durbin Amendment took on this rigged system in a careful way, providing that if a card issuer with assets of over $10 billion lets a card network fix debit swipe fees on its behalf, then the Federal Reserve must ensure that those swipe fees are reasonable and proportional to the cost of processing the transaction. The Durbin Amendment actually discourages price fixing, because if a bank is setting its own swipe fee rates, those rates are not regulated by the Durbin Amendment. Only those fees that big banks let a card network fix on their behalf are regulated.

The Federal Reserve's 2011 rule implementing the Durbin Amendment reduced the average big bank debit swipe fee from 44 cents to about 24 cents--a meaningful reduction, though 24 cents is still far higher than big banks' actual cost of conducting a debit transaction, which is just a few cents. Initially the Fed issued a proposed rule that was far lower than 24 cents, but the Fed unfortunately altered its rule and raised its cap in response to heavy lobbying by the banks and card networks.

Note that the Durbin Amendment allows small banks and credit unions to continue to price-fix debit swipe fee rates without limitation, and as a result, those institutions currently receive significantly higher debit swipe fee rates then their big bank competitors. This is a boon to small banks and credit unions, which they have used to win business away from the big banks. In fact, the Philadelphia Fed studied this question earlier this year and found that that interchange revenue "continued rising for small banks" after reform.[vi]

Swipe fee reform also put an end to Visa and MasterCard's anticompetitive habit of paying incentives to banks to block other debit card networks from handling the banks' debit transactions.[vii] Repealing this provision would likely be the death knell for smaller debit networks that are trying to compete with Visa and MasterCard, and it would create a nearly insurmountable barrier to entry for new market competitors in the debit system.

Ms. Wilkinson argues that merchants did not pass on savings from the law, but this reflects her lack of understanding about competitive markets. Cost savings are passed along from merchants to consumers to the extent that the merchant marketplace is price-competitive. Most merchant sectors are very price competitive, particularly the markets for goods that consumers rely upon the most such as gas and groceries. While it is difficult to measure consumer savings of swipe fee reform on a product-by-product basis,[viii] the aggregate savings for consumers are significant and should be preserved.[ix] And when banks and card networks bemoan that consumers have not saved enough from swipe fee reform, they never seem to mention that they aggressively lobbied the Fed to reduce the amount of savings consumers could achieve.

Ms. Wilkinson also argues that the law reduced free checking. In response, we simply point to the American Bankers Association's own figures, which show that free checking is still widely available to consumers. In fact, the ABA reported in 2015 that "the majority of Americans--61 percent--pay nothing at all for bank services"--an increase from the 53 percent the ABA reported had free checking when the legislation passed in 2010.[x]

The bottom line is this: repealing swipe fee reform is a nonstarter for Main Street merchants and consumers. It would be a massive giveaway for Wells Fargo and other big banks at the expense of local grocery stores, gas stations, retailers and the customers who support them. Congress should stand up for Main Street and reject this repeal effort--and Congress should focus instead on reining in the new schemes that banks and card networks are setting up to rig the credit and debit card systems in their favor. We encourage you to read our op-ed on these new schemes and how Ms. Wilkinson's coalition is seeking to distract your attention from them.

Thank you for your consideration.

Sincerely,

Richard J. Durbin
United States Senator

Peter Welch
Member of Congress

[i] *See, e.g., Hearing on Credit Card Interchange Rates: Antitrust Concerns? Before the S. Comm. on the Judiciary*, 109th Cong. (2006); *Hearing on Credit Card Interchange Fees Before the Antitrust Task Force, H. Comm. on the Judiciary*, 110th Cong. (2007); *Hearing on H.R. 5546, the Credit Card Fair Fee Act, Before the Antitrust Task Force, H. Comm. on the Judiciary*, 109th Cong. (2008); *Hearing on H.R. 2382, the Credit Card Interchange Fees Act of 2009 Before the H. Comm. on Financial Services*, 111th Cong. (2009); *Hearing on H.R. 2695, the Credit Card Fair Fee Act of 2009 Before the H. Comm. on the Judiciary*, 111th Cong. (2010); *Oversight of Federal Payment of Interchange Fees: How to Save Taxpayer Dollars, Before the Subcomm. on Financial Services and General Government of the S. Comm. on Appropriations*, 111th Cong. (2010).

[ii] *See, e.g.,* U.S. Gov't Accountability Office, *Credit and Debit Cards: Federal Entities Are Taking Actions to Limit Their Interchange Fees, but Additional Revenue Collection Cost Savings May Exist*, GAO-08-558 (May 2008); U.S. Gov't Accountability Office, *Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges*, GAO-10-45 (Nov. 2009).

[iii] *See, e.g.,* Terri Bradford & Fumiko Hayashi, *Developments in Interchange Fees in the United States and Abroad*, Federal Reserve Bank of Kansas City, Apr. 2008, *available at* http://www.kansascityfed.org/Publicat/PSR/Briefings/PSR-BriefingApr08.pdf (stating that "While regulation of interchange fees is still just a point of discussion in the United States, regulation abroad is a reality. In about 20 countries, public authorities have taken actions that limit the level of interchange fees or merchant discount fees. Many of these actions require interchange fees to be set according to cost-based benchmarks, although the cost categories that are eligible for the benchmarks vary by country. In several countries, interchange fees are set at zero."); Robin A. Prager et al., *Interchange Fees and Payment Card Networks: Economics, Industry Developments, and Policy Issues*, Federal Reserve Board Division of Research & Statistics and Monetary Affairs, Finance and Economics Discussion Series, 2009-23, *available at* http://www.federalreserve.gov/pubs/feds/2009/200923/200923pap.pdf (analyzing the structure and economic theory behind the interchange system and discussing various proposals for reform); James McAndrews & Zhu Wang, *The Economics of Two-Sided Payment Card Markets: Pricing, Adoption and Usage*, Federal Reserve Bank of Kansas City, Dec. 2008, http://www.kansascityfed.org/Publicat/RESWKPAP/PDF/RWP08-12.pdf (stating that "privately determined card pricing, adoption and usage tend to deviate from the social optimum, and imposing a ceiling on interchange fees may improve consumer welfare.").

[iv] *See, e.g.,* Fumiko Hayashi, *Payment Card Interchange Fees and Merchant Service Charges – An International Comparison*, Lydian Payments Journal, Jan. 2010, at 6, 11-12, *available at* http://www.pymnts.com/assets/NewFolder/Lydian-Payments-Journal-Volume-1-Issue-3.pdf (finding that "[i]n general, the United States has the highest debit card interchange fees" and that "the United States has the highest interchange fees for both credit and debit cards among the 13 countries where adoption and usage of payment cards are well advanced."); Alan S. Frankel & Allan L. Shampine, *The Economic Effects of Interchange Fees*, 73 Antitrust L.J. 627, 671 (2006) (finding that the interchange fee "acts much like a sales tax, but it is privately imposed and collected by banks, not the government. It significantly and arbitrarily raises prices based not on technologically and competitively determined costs, but through a collective process."); Dennis W. Carlton, *Externalities in Payment Card Networks: Theories and Evidence, Commentary*, The Changing Retail Payments Landscape: What Role for Central Banks, proceedings of a conference held at the Federal Reserve Bank of Kansas City, Nov. 9-10, 2009 at 125, 129, *available at* http://www.kc.frb.org/publicat/pscp/2009/PDF/A1.completeproceedings.pdf (finding that "in seven of the eight countries with the highest debit card usage per capita there is no interchange fee.").

[v] *See, e.g.,* Andrew Martin, *How Visa, Using Card Fees, Dominates a Market*, N.Y. Times, Jan. 4, 2010. ("Competition, of course, usually forces prices lower. But for payment networks like Visa and MasterCard, competition in the card business is more about winning over banks that actually issue the cards than consumers who use them. Visa and MasterCard set the fees that merchants must pay the cardholder's bank. And higher fees mean higher profits for banks, even if it means that merchants shift the cost to consumers.").

[vi] James DiSalvo and Ryan Johnston, *How Dodd-Frank Affects Small Bank Costs,* Federal Reserve Bank of Philadelphia Research Department, First Quarter 2016, at 17.

[vii] In 2010, the American Banker, citing a J.P. Morgan Securities analyst, reported that "about 40% to 50% of the debit card market in the U.S. is under exclusive routing arrangements." *See* "Fed's Plan Raises Debit Issues Galore," Andrew Johnson, American Banker, December 20, 2010.

[viii] *See* Fumiko Hayashi, "The New Debit Card Regulations: Effects on Merchants, Consumers, and Payments System Efficiency, " First Quarter 2013, at 102, available at https://www.kansascityfed.org/publicat/ econrev/pdf/ 13q1Hayashi.pdf (noting that with interchange reform "[t]he pass through of cost savings from merchants to consumers is not easy to measure, even when merchants pass on all their savings to consumers.").

[ix] *See e.g.*, Robert J. Shapiro, "The Costs and Benefits of Half a Loaf: The Economic Effects of Recent Regulation of Debit Card Interchange Fees," Oct. 1, 2013, available at http://www.sonecon.com/docs/studies/ Report_on_Interchange_Fees-RShapiro-October_2013.pdf (calculating that swipe fee reform saved consumers about $6 billion in 2012, in addition to supporting over 37,000 new jobs).

[x] American Bankers Association, "Survey: Most Americans Pay Nothing for Bank Services," August 18, 2015, available at http://www.aba.com/Press/Pages/081815SurveyonBankCosts.aspx; *see also* American Bankers Association, "ABA Survey Shows Majority of Bank Customers Pay Nothing for Monthly Bank Services," Oct. 7, 2010, available at http://www.prnewswire.com/news-releases/aba-survey-shows-majority-of-bank-customers-pay-nothing-for-monthly-bank-services-104516904.html.