NACS

April 14, 2017

The Honorable Mike Crapo
Chairman
Committee on Banking, Housing, and Urban Affairs
239 Dirksen Senate Office Building
Washington, DC 20510-1204

The Honorable Sherrod Brown
Ranking Minority Member
Committee on Banking, Housing, and Urban Affairs
713 Hart Senate Office Building
Washington, DC 20510-3505

Dear Senators Crapo and Brown:

Thank you for providing us with the opportunity to give you our thoughts on ways that the Banking Committee could aid economic growth. One of the biggest drags on Main Street businesses over the past two decades has been the rapidly increasing swipe fees that those businesses pay in order to accept debit and credit cards. These fees, on average, are retailers' second-highest operating expense (behind labor) and retailers' fastest-growing expense (dramatically outpacing healthcare cost increases, for example). Overall, U.S. businesses pay a whopping $70 billion each year in swipe fees. These fees are higher in the United States than anywhere else in the industrialized world.

The reason these fees are so high and increasing so rapidly is that the market is not a free, competitive marketplace. While banks and credit unions compete with one another on the fees they charge and the rates they charge and pay in virtually every area of their businesses, they have abandoned that model when they present themselves to retailers that accept their debit and credit cards. Rather than compete on price, in that situation the banks and credit unions have allowed the payment card networks (of which, Visa and MasterCard are the dominant players) to set the prices that the banks and credit unions charge retailers.

With competitive pricing replaced by network price-setting, it should be no surprise that the fees have grown out of control. Competitive pricing is the most basic underpinning of our market economy for a reason.

Congress took positive steps to bring some market competition to debit cards as part of the Dodd-Frank Wall Street Reform Act in 2010. We deeply appreciate that both of you supported the amendment to that bill providing reform. Those reforms made two primary market improvements to debit pricing competition. First, the amendment instructed the Federal Reserve to limit how high the payment card networks could set prices for debit transactions on behalf of banks and credit unions. Importantly, that limitation only applies to network set prices. The limitation was established in order to create an incentive for banks and credit unions to independently set their own prices. That incentive for market competition has led at least one bank to set its own prices – and those prices face no regulatory limits.

Second, the amendment ended the practice of the dominant payment card networks incentivizing banks and credit unions to block all other network options for their debit cards. For decades, debit cards had carried multiple networks to provide some options for communicating

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transaction messages. Payments from Visa and MasterCard, however, were blocking out many smaller competitors. With reform, each card must have at least two options from which merchants can choose to handle their transactions. This change has restored market competition to the fees that networks charge (which are separate and apart from the fees that the networks set on banks' behalf).

Those reforms have been successful in creating more market competition, spurring increased economic activity, supporting jobs, reducing consumer prices and helping Main Street businesses.

Proposal: Bring Competition to Credit Card Swipe Fees

With that in mind, Congress should now consider making changes to address the problems with credit card pricing and markets. Credit cards are different than debit cards and merit different considerations. The most straightforward and first step for dealing with the lack of market competition in credit card swipe fees would be to prohibit the card networks from fixing the fees that banks and credit unions charge for credit card transactions. This would ensure that the financial institutions issuing credit cards compete on price.

The academic literature in this area demonstrates that the credit card system can work well without Visa and MasterCard fixing the fees that card-issuing banks and credit unions charge.[1] The concentration in the market on both the card-issuing and the processing/acquiring parts of the market means that it would only take a limited number of market negotiations to reach agreements on pricing that cover the vast majority of the marketplace. Removing price-fixing from the market so that there is competition would dramatically improve the credit card market.

Impact on Economic Growth

Debit reform provides a good foundation from which to view the benefits of increased market competition. Economic analysis of those reforms shows that the increased pricing competition and incentives resulted in consumer savings of $5.8 billion and merchant savings of $2.6 billion in the first year the reforms were in place.[2] The analysis found, "The savings by consumers expand their consumption and purchases, which supports the creation of new jobs. Similarly, the savings for merchants lead to more purchases, investments and hiring. The $5.86 billion in Regulation II savings for consumers in 2012 were sufficient to support 21,566 new jobs, and the savings for merchants in 2012 could support an additional 15,935 jobs."[3] Those 37,000+ jobs were a real benefit to the economy.

Reforming credit card fees could lead to much higher savings and hiring because credit fees are higher than debit fees. While debit fees were about $20 billion per year prior to reform, credit swipe fees currently run about $60 billion per year. Australia has the longest history with reforms of credit and debit card fees. The Reserve Bank of Australia has examined these reforms, which were put in place to

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[1] See Nicholas Economides, "Competition Policy Issues in the Consumer Payments Industry," in R. Litan & M. Baily, Moving Money: The Future of Consumer Payment, Brookings Institution (2009) 113, 122.
[2] "The Costs and Benefits of Half a Loaf: The Economic Effects of Recent Regulation of Debit Card Interchange Fees," by Robert Shapiro, Sonecon, Oct. 1, 2013.
[3] "The Costs and Benefits of Half a Loaf: A Visual Representation" by Robert Shapiro, Sonecon, Oct. 1, 2013 at 2.

bring swipe fees into line with competitive markets, and has consistently concluded that those reforms have benefitted the nation's economy – and therefore has kept them in place. In one of its most thorough reviews of credit and debit card reforms, the Reserve Bank of Australia concluded:

> "The Board's overall assessment is that the welfare gains from the reforms are likely to have been substantial. Not only has the change in payment patterns relative to what would have occurred in the absence of the reforms resulted in lower costs, but there has also likely been an increase in welfare from consumers using a payment instrument from which they derive higher benefits. An estimate of the welfare gain of some hundreds of millions of dollars per annum would not be inconsistent with the available data."[4]

Given that the U.S. economy is ten times larger than Australia's (based on gross domestic product) the benefits to the U.S. economy of reforming credit cards to make their fees more competitive clearly would be substantial.

Impact on Ability to Participate in the Economy

Bringing competition to credit card swipe fees would also improve the ability of a number of players to participate in the economy. Swipe fees are most harmful to low income Americans and create a regressive welfare shift from low income to high income people. The Hispanic Institute had an economist study credit and debit card swipe fees in 2009 and concluded, according to the author Dr. Efraim Berkovich, "This study found that there is a massive wealth transfer caused by credit and debit card industry pricing policies in which the poor pay higher prices to subsidize the most affluent Americans."[5] By making credit card pricing more competitive, lower income consumer will have an improved ability to participate in the economy and will not be burdened by transferring wealth to higher income Americans through the higher prices caused by price-fixed swipe fees.

Competition in credit swipe fee pricing would also improve merchants' ability to participate in the economy by reducing their second-highest and fastest-growing operating expense. This would be a welcome change in light of the fact that retailers are closing stores at a faster rate than during the height of the financial crisis.[6]

Proposal: Improve Credit and Debit Card Security

Another area in dire need of reform is credit and debit card security. Fraud costs are rising in the United States, particularly for online payment card transactions.[7] The mistakes of the credit card industry are a large contributing factor to this negative trend. While the industry introduced cards with both computer chips and personal identification numbers (PINs) around the world to fight fraud, it did

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[4] "Preliminary Conclusions of the 2007/08 Review," Reserve Bank of Australia, April 2008, at 5.2.2.
[5] See "Trickle-Up Wealth Transfer:Cross-subsidization in the payment card market," The Hispanic Institute, November 2009.
[6] "America's Retailers Are Closing Stores Faster Than Ever," by Lindsey Rupp, Lauren Coleman-Lochner & Nick Turner, *Bloomberg*, April 7, 2017.
[7] "Experian: EMV Tied to a New Wave of Ecommerce Fraud," Steven Anderson, www.paymentweek.com, April 3, 2017.

not do that in the United States. Instead, the industry only pushed computer chips and ignored the PINs – which do far more to protect against fraud. This is true even though U.S. financial institutions use PINs to ensure security anytime someone uses a debit card at one of their automated teller machines (ATMs). And, the federal government took steps in 2014 to ensure that its payment cards were protected by PINs.

The failure of the dominant payment card networks to take this basic security measure here means that sellers of goods and services cannot protect themselves in the same way that every financial institution does. In fact, Visa is litigating against multiple merchants to try to stop them from being allowed to require their customers to enter a PIN on debit transactions – even though those cards have PINs. Of course, these actions by the credit card industry make all of us pay more for the fraud that results.

The fact that PINs can now be used to protect against online fraud makes this oversight even more egregious.[8] Chip cards do not protect against online fraud. PINs do. But, U.S. credit cards are not protected with PINs for transactions (even though most have PINs for use at ATMs). The credit card industry could protect its cards with PINs that work to protect transactions, but it has not done so. That should be changed in a way that allows the industry to move to more effective fraud prevention measures when those become available. Legislation to that effect would reduce the billions of dollars in credit card fraud that Americans suffer every year.

* * *

Legislative language to effectuate these proposals that would ensure competitive pricing on credit cards and allow merchants and consumers to use PINs to protect against fraud are attached to this letter. Thank you for your consideration.

Sincerely,

Lyle Beckwith
Senior Vice President, Government Relations

Attachments

[8] See "Acculynk Enters Acquiring Market, Gains Small-Merchant Footprint with PayLeap Deal," www.digitaltransactions.net, Sept. 5, 2012.

Prohibition on Card Network Price-Fixing

Section __. Prohibitions.—One year after the date of the enactment of this Act, no payment card network may set required, suggested, or default rates for the fees to be charged by any issuer of the payment card network's credit cards, or for the fees to be charged by any agent, processor or member of the network unless such issuer, agent, processor or member is the payment card network itself and not a separate legal entity.

Section __. Enforcement.—A violation of subsection (a) shall be treated as a an unfair or deceptive act or practice prescribed under section 18(a)(1)(B) of the Federal Trade Commission Act (15 U.S.C. 57a(a)(1)(B)). The Federal Trade Commission shall enforce this section in the same manner, by the same means, and with the same jurisdiction, powers, and duties as though all applicable terms and provisions of the Federal Trade Commission Act (15 U.S.C. 41 et seq.) were incorporated into and made a part of this Act.

Prohibition on Blocking Anti-Fraud Policies

Section __. Prohibitions.—Not later than 1 year after the date of the enactment of this Act, the Federal Trade Commission shall prescribe rules, in accordance with section 553 of title 5, United States Code, prohibiting a payment card network from, directly or through any agent, processor, or licensed member of the network, by contract, requirement, condition, penalty, or otherwise, inhibiting a person who accepts a debit card or credit card as a form of payment from seeking to reduce the occurrence of fraud by requiring that the debit card or credit card be authenticated by the card holder with—

(a) a personal identification number; or

(b) some other unique identifier that is at least as effective as a personal identification number in reducing fraud, as determined by the Federal Trade Commission.

Section __. Enforcement.—A violation of a rule prescribed under subsection (a) shall be treated as a violation of a rule defining an unfair or deceptive act or practice prescribed under section 18(a)(1)(B) of the Federal Trade Commission Act (15 U.S.C. 57a(a)(1)(B)). The Federal Trade Commission shall enforce this section in the same manner, by the same means, and with the same jurisdiction, powers, and duties as though all applicable terms and provisions of the Federal Trade Commission Act (15 U.S.C. 41 et seq.) were incorporated into and made a part of this Act.

<u>Prohibition on Consumer Fees for Requesting or Using Fraud Protection</u>

12 U.S.C. § 5536 is amended to add the following subsections –

(c) **No Fees for Issuance or Delivery of Secure Payment Cards**. It shall be unlawful for an issuer to charge a consumer any fee for requesting or receiving a debit card or credit card that is enabled with personal identification number (PIN) technology. For purposes of this subsection, prohibited fees include – any convenience fees, customer service fees, reissuance fees, shipping fees, or any other fees associated with or related to a consumer request for, or receipt of, a PIN-enabled debit card or credit card.

(d) **No Fees for Use of PIN.** It shall be unlawful for an issuer or payment card network to charge a consumer any fee for using a PIN to authenticate an electronic debit transaction or electronic credit transaction. For purposes of this subsection, prohibited fees include – any transaction fee charged to the consumer, convenience fees, customer service fees, or any other fees associated with or related to the consumer's use of PIN to authenticate a transaction.