Statement of the

National Retail Federation

and

National Council of Chain Restaurants

submitted to the

U.S. House of Representatives
Financial Services Committee

for its hearing

"A Legislative Proposal to Create Hope and Opportunity for Investors, Consumers, and Entrepreneurs"

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Debit card reform has been a remarkable success. It has saved retailers and their customers billions of dollars and it has brought the beginnings of transparency and competition to a market where swipe fees were price-fixed and all banks linked arms to charge the same high fees. If reform is repealed, the big banks and card companies will go back to those practices. Nothing will stop them from returning to monopoly-high fees – driving up costs for Main Street merchants and the prices paid by their customers in the process. Moreover, reform reopened competitive markets for routing transactions, providing better prices and better security in the process. If reform is repealed, nothing will prevent them from again strangling innovative regional networks, further driving costs back up and hammering competition back down. This has been settled law for the better part of a decade. We should be looking at the future of payments rather than trying to re-legislate these important protections for transparency and incentives toward fair market competition.

Prior to the passage of Dodd-Frank, the costs associated with networked debit card transactions were not subject to true market competition. The problem was made worse by a lack of transparency.

Debit interchange fees were centrally fixed. As a consequence, every one of the more than 100 largest banks ultimately charged merchants exactly the same high rates for interchange fees. Year in, year out, all those banks consistently raised their identical fees by the same amount at the same time.

In addition, in the years immediately preceding the passage of Dodd Frank, the capacity for competitive routing of those transactions over more than a dozen robust networks was systematically being removed from the market by the actions of the dominant debit card players.

Market failures also were occurring in the credit card market. As a result, consumer prices were being forced up by the escalating fees. Main Street merchants in particular were being harmed, and card company rules effectively prohibited merchants from showing their customers the escalating costs of cards, which amounts to hundreds of dollars per year for the average household.

Section 1075 of Dodd-Frank enacted provisions designed to partially address these market failures, focusing on debit cards but also providing minor relief for credit cards as well. These are the three primary provisions.

1. For banks that continued to link arms and charge the same centrally fixed debit card interchange fees in lieu of competition, the Federal Reserve was ordered to develop standards that ensured those fees were reasonable and proportional to their actual cost. If a bank chose to unlink arms and compete independently, it would not be governed by the Fed standards and could charge whatever price the open market would accept.
2. To counter the fact that banks were being paid to eliminate the connectivity necessary for regional or smaller innovative networks to compete for the ability to route transactions, the law required that access to at least two unaffiliated networks be available for every debit transaction.

3. The law took a first step toward transparency by allowing merchants to set a minimum purchase amount for credit cards of up to $10. It did so by overturning card company rules that effectively prohibited merchants from doing so. This gave merchants the ability to suggest to consumers the high costs involved in accepting credit cards. And by moving some transactions away from credit cards, it ameliorated some of the credit card costs merchants (and ultimately consumers) bore.

These reforms have significantly improved the market.

As to routing, the competitive networks have increased their market share by offering services the dominant legacy players had not, such as less downtime, encrypted transactions to better protect merchants and their customers from breaches, and lower prices. As to debit interchange, the law has produced lower fees across the board, saving merchants and their customers more than $40 billion even while providing the regulated banks a 500 percent markup above their costs as calculated by the Fed. In addition, the incentives to compete outside the centrally fixed system have already induced one money center bank to offer an array of competitive services outside the Fed requirements that are mutually beneficial to merchants, their customers, and the bank. Finally, the freedom to post minimum credit card purchase signs has particularly helped small merchants. Low-dollar purchases are among the costliest to process, with the card fees often higher than the profit on the products sold.

The law's limited foray into debit reform has largely been a success. It has saved consumers billions of dollars. (For example, studies have shown that widely transparent gasoline prices result in vigorous competition. Gasoline prices at the pump track underlying costs nearly perfectly. The savings to station owners when interchange fees drop have allowed them to lower prices by several cents a gallon. That is one of many genuine consumer benefits.)

The Committee should explore ways to extend the benefits of increased transparency and enhanced incentives for competition to currently price-fixed credit cards. There is no rational reason why entrepreneurial networks should not be allowed to route credit transactions that dominant credit networks would like to preserve just for themselves; than there was a rational reason why entrepreneurial phone networks were for years not allowed to carry long distance calls that Ma Bell wanted for itself. A phone call is a phone call. A credit card transaction message is a credit card transaction message. The biggest players ought not to be allowed to blunt innovation and stymie this market.

Dodd-Frank has already demonstrated that competitive networks can route debit card transaction messages as fast, safer, and more cheaply than can today's Ma Bell equivalents. Competition in credit card routing would be a modest but important step toward a more robust, diverse, and redundancy-protected financial system.

Transparency works. As discussed, the debit reform provisions in Dodd-Frank have provided opportunities for the cost of cards to become more transparent and incentives for banks and card networks to openly compete to better route and service customers' transactions.

Repealing debit reform would block even the limited transparency and competition that exist today. Main Street merchants and their customers would once again be forced to blindly pay for subpar transactions.