STATEMENT

OF

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ON BEHALF OF

VISA INC.

BEFORE THE

SUBCOMMITTEE ON

FINANCIAL INSTITUTIONS

AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

Understanding the Federal Reserve's Proposed Rule on Interchange Fees: Implications and Consequences of the Durbin Amendment

February 17, 2011

Chairman Capito, Ranking Member Maloney and Members of the Subcommittee, my name is Joshua R. Floum. I am the General Counsel of Visa Inc. ("Visa"). Visa appreciates the opportunity to address the important issues raised by today's hearing on the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") provisions related to debit interchange and the exclusivity and routing of debit transactions, as well as the corresponding regulatory proposal issued by the Federal Reserve Board ("Board") to implement these provisions.

Visa is a leading consumer payments system, and plays a pivotal role in advancing new payment products and technologies worldwide to benefit its more than 15,000 participating financial institutions, tens of millions of merchant outlets that accept Visa-branded cards, and the tens of millions of consumers who use over 1.8 billion Visa-branded cards.

Visa commends the Subcommittee for focusing on the potential negative impact of this debit regulation affecting all U.S. debit transactions. The Dodd-Frank Act amendments to the Electronic Fund Transfer Act (the so-called "Durbin Amendment") to implement government-mandated price controls, as well as changes to the structure of the payment industry, were enacted in haste and with little or no open discussion and debate in Congress. The Durbin Amendment was enacted through an extraordinary process in which there was no consideration in any Congressional committee, no vote on the Durbin Amendment in the House of Representatives, and only scant discussion of select provisions in the Senate. We believe that changes of this magnitude should not be imposed without serious and careful consideration, analysis and study. The Amendment could have significant, long-term consequences for American consumers, our financial and payment systems, and the U.S. economy as a whole. These changes are so fundamental and far-reaching that the extent of the consequences cannot be fully determined today. As a result, we believe it is critical for Congress to suspend implementation of the Durbin Amendment and the Board's related regulatory proposal and request an impact study of the unintended consequences on participants in debit transactions, particularly consumers, small businesses, community banks, credit unions and other financial institutions. Although the GAO has completed studies that address certain topics dealing with interchange fees, those studies were conducted prior to the Board's interchange proposal and do not focus on the fundamental issues raised by the Durbin Amendment and in my testimony. In fact, only one of the studies addressed debit cards at all, and it narrowly focused on interchange for federal government entities.

President Obama recently challenged this country in his State of the Union Address to "out-innovate, out-educate, and out-build the rest of the world" in order to secure America's future.[1] As the President succinctly noted, "[t]he first step in winning the future is encouraging American innovation," and it is "[o]ur free enterprise system [that] drives [this] innovation." American ingenuity created electronic benefits, which have been enthusiastically adopted globally. And we continue to be a leader in developing digital currency and the great benefits that accrue to all as a result. The Durbin Amendment, and the Board's related regulatory proposal to implement the Amendment, however, stands in stark contrast to the President's call for innovation and his recognition of the importance of America's free enterprise system. The Durbin Amendment and the Board's proposal would supplant free market pricing in favor of government price controls, and could single-handedly remove all incentives for debit card issuers and payment card networks to innovate in debit card payments. Similarly, the Durbin Amendment and Board proposal send a clear signal to financial institutions that innovation and development of new services will not be encouraged. The very purpose of the Dodd-Frank Act

[1] *Available at* http://www.npr.org/2011/01/26/133224933/transcript-obamas-state-of-union-address.

as a whole was to bolster and strengthen this country's financial system and to protect American consumers. Yet, the Durbin Amendment and the Board's proposal represent a direct attack on American consumers and this nation's financial institutions, and their combined efforts to recover from the worst economic conditions this country has faced since the Great Depression.

In fact, debit cards themselves represent the very type of innovation called for by President Obama. Designed to replace single-purpose ATM cards and give consumers a non-credit point-of-sale payment option, debit cards are valued and used extensively by consumers as a replacement for cash and checks. Retailer acceptance of debit cards also has increased substantially as retailers recognize the efficiencies and savings of debit cards over cash and checks and the value of guaranteed payments. But instead of acknowledging the risks and investments that led to this innovation, now that this innovative product has taken root, the retailers are asking issuers through government-mandated price controls to give them access to the debit payment system for next to nothing in return. Retailers would have us believe that debit transactions are nothing more than "electronic checks" and should be priced like paper checks that clear at par. To the contrary, debit cards are not "electronic checks;" they are a form of payment that delivers significantly more value to all parties than paper checks do. Debit cards provide consumers and retailers with the ability to make and receive instantaneous payments. Unlike checks, Visa's debit card payments are generally accompanied by a guarantee to retailers. According to the 2010 Federal Reserve Payments Study, in 2009 there were $103 billion worth of checks returned unpaid, a decrease from 2006 when $182.5 billion worth of checks were returned unpaid. This reduction corresponds to an increase in debit card use over that same period and the guaranteed payment feature of debit cards.

Unlike checks, debit card payments are processed over state-of-the-art networks that provide consumers and retailers with robust security for transactions and secure access to funds anytime and anywhere these debit cards are accepted. Although consumers and retailers are not required to use or accept debit cards, their choice to do so is a clear recognition that debit cards provide both consumers and retailers with substantial value. Today's consumer has many payment options at her disposal. She frequently carries cash, checks, a debit card and one or more credit cards, as well as stored value or prepaid cards—all within one purse or wallet. Nonetheless, she continues to reach for her debit card on a more frequent basis for an increasingly broad selection of transactions. Each time she selects her debit card, that card serves as an engine for growth in this country's consumer-driven economy.

The Debit Interchange Price Controls

The debit interchange fee is commonly misunderstood and misinterpreted. The debit interchange fee represents a payment or value transfer made by a retailer's acquiring bank to the bank that issued the debit card, often based on the type of card used and the type of transaction or merchant category involved. This transfer of value between banks is necessary because the debit card cannot be used without participation of the consumer using the card from her issuing bank, and the retailer accepting the card with its acquiring bank.

For debit transactions, Visa has undertaken to provide extremely low rates, as well as certainty, in many merchant segments -- interchange rates on supermarket transactions are capped at only 35 cents, regardless of whether the purchase is for $50, $200 or any other amount. Similarly, interchange for utilities payment transactions is capped at 75 cents, and in the fuel segment, interchange is capped at 95 cents. On smaller ticket transactions, retailers may see interchange as low as five or six cents for small dollar purchases. And, the diversity of rates in the Visa system reflects the wide range of retailers and merchant segments, sales channels and ticket sizes that Visa seeks to serve and make available to the consumer. The Board itself reports that average debit interchange across the industry is 44 cents per transaction—or 1.14% of the average transaction amount. Overall, Visa's effective debit interchange rate has remained flat, with only a minimal rate of change in interchange rates over the past ten years. In fact, retailer claims of "cost increases" overwhelmingly are driven by increased acceptance and usage of debit cards, rather than increases in the interchange rates themselves. But earning more revenue by offering more efficient and innovative products, at pricing that leads to more and more use by both consumers and retailers, is not unlawful or the exercise of "market power" as the retailers claim: it is the essence of market based competition.

Products and services in this economy should be fairly priced based on the value provided, not some limited concept of cost, and certainly not on some artificially selected portion of those costs. Instead, however, the Durbin Amendment would place an arbitrary, government-mandated price cap on the amount of debit interchange fees. This price cap would be dramatically below a debit card issuer's variable costs for those transactions and far more restrictive than the limitations placed on public utilities, since utilities are uniformly permitted to recover all costs of providing their services, plus a reasonable rate of return on their investments. In fact, the Board's debit interchange proposal not only takes an extraordinarily narrow reading of an already narrow statute, but also arbitrarily reduces the level of debit interchange fees by excluding costs that are clearly provided for under the statute. For example, the Board's proposal would not permit issuers to recover either the processing fees they pay to networks or fraud management expenses that are clearly related to the authorization, clearance and settlement of debit card transactions.

Essentially, the Durbin Amendment, together with the Board's related regulatory proposal, would force a transfer of approximately $12 billion per year from debit card issuers to retailers, with the largest retail chains being the primary beneficiaries of this government-mandated transfer. In fact, the very largest merchants would capture the vast majority of the interchange reductions, despite the extraordinary value that these merchants receive from the acceptance of debit cards, including driving increased, faster, and more efficient incremental merchant sales and profits.

Ironically, it's these same big box retailers who claim that Visa and MasterCard are "cartels" engaged in unlawful price fixing, and that this somehow justifies Congressional intervention. In fact, the claim that setting interchange equates to price fixing has been litigated—and lost—by the retailers on numerous occasions, and instead interchange has been found to be necessary, lawful and pro consumer. *See Nat'l Bancard Corp. v. Visa U.S.A., Inc.*, 596 F. Supp. 1231 (S.D. Fla. 1984), *aff'd*, 779 F.2d 592, 605 (11th Cir. 1986) (affirming the trial court's findings that interchange is pro-competitive "because it was necessary to achieve stability and thus ensure the one element vital to the survival of the V[isa] system—universality of acceptance"); *Kendall v. Visa U.S.A., Inc.*, No. C 04-04276 JSW, 2005 U.S. Dist. LEXIS 21449 (N.D. Cal. July 25, 2005), *aff'd*, 518 F.3d 1042, 1049 (9th Cir. 2008) (concluding that it was not unlawful for the networks to set interchange fees and that the acquiring banks' conduct was suggestive of "a rational business decision, not a conspiracy"); *Reyn's Pasta Bella, LLC v. Visa U.S.A., Inc.*, 259 F. Supp. 2d 992, 1000 (N.D. Cal. 2003) (quoting *State Oil Co. v. Kahn*, 522 U.S. 3, 10 (1997)) (holding that the rule of reason should apply because "the uniform interchange fee does *not* appear to be one of the few types of restraints exhibiting a 'predictable and pernicious anticompetitive effect' without potential for pro-competitive benefit") (emphasis added), *aff'd on other grounds*, 442 F.3d 741 (9th Cir. 2006). And, these Court decisions were delivered when Visa and MasterCard were bank associations owned and governed by the banks. Now, of course, both are independent public companies, and the big box retailers' claims ring even more hollow. Nonetheless, the big box retailers continue to litigate the same claim in private class actions lawsuits. Of course, any remedy for so-called price fixing lies in the Courts, not in rushed legislation.

Before the Durbin Amendment, price control legislation understandably had not been enacted in this country for decades. Not only is the Durbin Amendment inconsistent with basic American free enterprise principles, but price controls in general have proven to be a failure, producing unintended consequences, stifling innovation and competition, and harming the very consumers the legislation was designed to protect. But here, the Durbin Amendment makes not even the slightest pretense about protecting or helping consumers. In fact, the Durbin Amendment has nothing to do with helping consumers. Its only focus is rewarding the big box retailers that successfully lobbied for this legislation. Ultimately, it is the consumer who will suffer.

1. *Consumers will pay more*. Already many banks have announced new programs to restructure pricing for checking and debit programs because the Durbin Amendment and the Board's related regulatory proposal would permit debit card issuers to recover only a small fraction of their debit card costs. The Board itself, in discussing its interchange proposal, acknowledges that issuers would not be permitted to recover their costs, but explains that "issuers have sources of revenue in addition to interchange fees, such as cardholder fees, to help cover their costs."[2] So, the Board itself recognizes that as a result of its proposal, consumers ultimately will pay for this

[2] 75 Fed. Reg. 81,722, 81,737 (Dec. 28, 2010).

value transfer to retailers, by paying for many services that today they get for free, including free debit cards, free online banking and free bill payment. In fact, a recent Independent Community Bankers of America survey found that 93 percent of its members will be required to charge their customers for services that are currently offered for free and 72 percent of its members will no longer offer free checking because of the new law and Federal Reserve rule. The decline or end of "free checking" will disproportionately hurt people at lower income levels, potentially moving them outside the banking system completely and back to corner "check cashers," and making it far harder for the unbanked or under banked to open or maintain debit accounts, and enjoy the mainstream benefits of electronic payments.

2. *Consumers will get less*. Because issuers will only be permitted to recover a small fraction of their debit card costs through interchange fees, many issuers will be forced to cut the costs associated with their debit card programs. As a result, it is likely that many issuers will limit, or eliminate altogether, a number of important consumer benefits, including transaction alerts, innovative loyalty programs and potentially, fraud protections that exceed what is legally required. Similarly, many issuers will be forced to limit investments in their debit card programs, including investments in technology that could lead to new ways of conducting even faster, more secure and reliable transactions for consumers.

3. *Retailers won't pass savings on to consumers*. There is no requirement in the Durbin Amendment (or even the faintest expectation) that retailers will pass along to consumers even a portion of the annual $12 billion windfall they will receive by reducing the prices that they charge for their goods and services. This was the case in

> Australia after that government imposed price controls on interchange fees; consumers in that country saw no meaningful reduction in the cost of goods and services. The reality that consumers will not share in this government-mandated transfer of value is clear from statements by retail representatives themselves. Mallory Duncan, the National Retail Federation's general counsel said, that retailers "might offer free shipping or free gift-wrapping."[3] And when asked whether a reduction in interchange fees would lead to a reduction in consumer prices, Tom Robinson, the owner of "Rotten Robbie's" fuel stations and food stores, testified before the House Judiciary Committee that "there is not a businessman that doesn't attempt to keep the margin."[4]

It is important to keep in mind that the "primary objective" of the Electronic Fund Transfer Act, which regulates consumer electronic fund transfers and of which the Durbin Amendment is now a part, is "the provision of individual consumer rights."[5] The Durbin Amendment, however, is anti-consumer, representing instead only a dramatic windfall to the largest retailers in this country. Because of the manner in which the Amendment was inserted—at the last minute without notice or debate—into the broader Dodd-Frank Act, Members of Congress who voted for the Act overall were not given an accurate or complete picture of the full scope and impact of this legislation, nor the appropriate time to consider these complex issues. As a result, ordinary consumers will be harmed by this law and the primary beneficiaries will be a small number of powerful big box retailers.

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[3] Changes in Bank, Debit Card Fees May Have Limited Impact, *USA Today*, May 25, 2010. (attached)
[4] Credit Card Fair Fee Act of 2008: Hearing on H.R. 5546 Before the H. Comm. On the Judiciary, 110th Cong., Serial No. 110-179, at 161-162, May 15, 2008. (attached)
[5] 15 U.S.C. § 1693(b).

The Exclusivity and Routing Provisions

After the initial Senate vote on the Durbin Amendment, two more harmful provisions were added during the conference committee process, again with no meaningful discussion or debate. The first is an "exclusivity" provision requiring that issuers must do business with two unaffiliated debit networks, essentially compelling issuers to contract with networks that are unnecessary, and completely redundant to services they already contract for—and probably more costly to work with or less secure—than the networks they already chose to do business with. One egregious option under the Board's proposal would go even further and require two unaffiliated networks per authentication method for use of the debit card – meaning an issuer might be forced to pay the extra costs of putting four redundant networks on every card.

The second is a "routing" provision under which retailers, not cardholders, get to direct how transactions are routed at the point of sale. Similar to the government-mandated price controls on interchange fees, the network exclusivity and routing provisions will essentially mandate how debit card transactions are handled in this country. The network exclusivity and routing provisions, like their interchange counterpart, will have harmful intended and unintended consequences, many of which cannot be fully known at this time. And unlike the debit interchange provisions, no banks, financial institutions, or government programs are "carved out" or exempted from the network exclusivity and routing provisions.

The Exclusivity and Routing Controls Eliminate Consumer Choice

The Durbin Amendment and the Board's related regulatory proposal eliminate the consumer's choice in how her debit transaction is handled. If the transaction initiated by the consumer is changed, at the sole direction of the retailer to route through a different payment network, then a completely different set of rules applies to the transaction to which the consumer would now be bound without her knowledge or consent. When dealing with a subject as sensitive as how people want their own money stored and accessed, consumers have a number of reasons for having a preference for how their transactions are processed (*e.g.*, speed, reliability and security) and the rules and protections that apply to those transactions. In many circumstances, a consumer will only receive certain benefits or protections associated with her card when a transaction is routed through a specific network. As a result, if a retailer steers the consumer's transaction to a different network, the consumer will lose access to certain features and protections associated with her account. For example, Visa's Zero Liability policy does not apply if transactions are processed on non-Visa networks; so, a retailer's choice to route a transaction through any network on the card can expose the consumer to fraud losses from which she otherwise would be protected. In addition, some consumers absolutely refuse to enter a PIN at a retail location because of understandable concerns about the security of that sensitive information being used "in public." Although other consumers may be comfortable entering PINs, the government should not be in the business of taking away the consumer's choice of how she will complete a debit transaction.

Ultimately, the routing provision gives retailers, rather than consumers or issuers, control over the debit payment system. It will now be the retailers—not consumers, not issuers, not networks—who make decisions for how the system operates, even though it is the consumer's money and checking account being accessed and used. These retailers are, for the most part, unregulated by financial regulators and lack financial prudence requirements. It would be unprecedented to leave the welfare of America's payment systems in the hands of unregulated entities. In fact, it is this very issue of control over those affecting our financial system that drove a number of the Dodd-Frank Act provisions designed to increase financial stability within this country. As retailers make the routing decisions, not only are they depriving consumers of choices today, they are also depriving consumers of future choices. Networks and issuers, deprived of their ability to "win" the consumers, have less incentive to innovate and offer new products and services. Consumers will lose their option to use a mobile phone or newly designed technology to make their payments, and if new technology becomes available, retailers will control if and when it gets used, not consumers.

Retailers are also paving the way to drive transactions to networks, even retailer-owned or affiliated networks, that may offer a cheaper option but only because they have not made the necessary investments in security, error-free processing, or consumer protections. If the network used by the retailer is less secure, the consumer's financial information could be more exposed to theft or compromise—and the cardholder would have been given no say. In fact, consumers may ultimately feel misled because they will have expected their transactions to be handled by a safe and trusted network like Visa (or MasterCard) and the retailer will send it through some other, less reliable network. Moreover, one of the most serious consequences of both the routing and exclusivity provisions is that they deprive issuers of the ability to tailor unique products and fraud protection measures most suitable to their business goals and the needs of consumers. Instead, the Durbin Amendment, and the Board's related regulatory proposal, would commoditize debit payments for the sole purpose of driving down retailer costs and issuer revenue.

The Exclusivity and Routing Controls Will Compromise Security and Fraud Prevention

The exclusivity and routing controls also will compromise the security of debit transactions and compromise fraud prevention—not only because retailers will choose the cheapest (and likely least protected) network, but also because each issuer will need to interface with additional payment network fraud detection services, thereby degrading the value of each fraud detection service. As issuers are required to spread their volume over multiple networks, issuers will not be able to tailor programs that identify fraud and other risk patterns. Many consumers, for example, have received calls from issuers asking them to confirm that they actually engaged in a particular transaction, rather than a fraudster. This antifraud service is made possible because the issuer and the network can see many of the consumer's transactions. If the retailer has the sole discretion to determine how the transaction will be processed, this antifraud tool may no longer be available or will be much less effective. Some special innovative services, like immediate "alerts" on transactions sent to the consumer's cell phone or email, simply will not be available unless the transaction is handled by the network offering that service. As a result, the ability of an issuer or a network to protect their customers and themselves will be materially reduced. Such a result is especially troubling given the recent instances of identity theft and cyber attacks, which demonstrate the critical need for robust systems and data security, and the related need for ongoing vigilance and continued investment in this area. Investments in new types of data security and fraud prevention can only be made, however, if there are sufficient economic incentives to do so, and there are opportunities to recover the costs of these investments. The combination of the interchange limitations and the exclusivity and routing requirements drastically limit these incentives and, therefore, materially compromise both security and fraud prevention.

The Exclusivity and Routing Controls Will Limit Interchange Rates

The debit interchange limitations and the exclusivity and routing requirements are inextricably linked. Retailers support the exclusivity and routing provisions because these provisions would further limit interchange fees. By requiring that issuers include multiple networks on debit cards and by giving the retailer the routing choice over which network to process transactions, retailers will force a “race to the bottom” on the features and protections offered with debit cards. When a consumer pays by debit card, a retailer can aggressively route the transaction toward the network with the lowest interchange fee regardless of whether that network is the most secure, or provides unique benefits that the cardholder may value. As a result, in order to compete for the retailer’s routing decision, some networks would be incentivized to provide fewer protections or fewer features for the transaction in order to win the retailer’s routing choice. Ultimately, this will allow retailers to put pressure on issuer revenue by ensuring that all rates fall to the lowest possible government-mandated price controls, if not further, and potentially degrade consumer protections on transactions, since any network that invests in consumer protections may cost more and, therefore, not be selected by the retailer for routing. The incentive for issuers or networks to invest in new innovations or consumer features will be undermined.

This routing race to the bottom will have a particularly significant impact on community banks and credit unions, and on the government and prepaid programs that rely in part on debit interchange to fund their operations. Although Congress purposely exempted smaller community banks and credit unions and government-sponsored and prepaid debit programs from direct interchange price regulation, these small financial institutions and government and prepaid programs are nonetheless subject to the same exclusivity and routing provisions. This may have the effect of undoing the statute’s small financial institution, government and prepaid exemptions by indirectly leading to the very interchange limitations that they were to be exempted from. Economic pressures could drive interchange on “exempt” volume toward the level established by the price controls, thereby degrading the operating revenue of all financial institutions, including community banks and credit unions. This was precisely the intent of the big box retailers who surreptitiously put the provision in the bill during the conference committee process.

The Non-Exclusivity and Routing Controls Add Additional Complexity and Cost

As discussed above, the Durbin interchange limitations would permit an issuer to recover only a small fraction of its incremental costs. In addition, the exclusivity and routing provisions represent government-mandated increases in issuer costs coupled with an already drastic reduction in revenue. The non-exclusivity requirement for multiple networks introduces unnecessary complexity and cost to payment networks, issuers and acquirers. Issuers will be forced to enter into additional contracts, build new system connections and maintain network relationships they may not want and that may not be profitable for them. In fact, given current industry-wide processing systems and requirements, a number of specialized prepaid products such as healthcare reimbursement-type cards may not work if they have to comply with the exclusivity and routing controls. This will result despite statements on both the House and Senate floors that members of Congress thought healthcare related cards were excluded since they are valued by consumers and drive widely recognized efficiencies in health care management.

All of the contracts, systems and relationships required to meet the exclusivity and routing controls will be duplicative of the same services they already pay for, simply adding government-mandated cost and inefficiency, all against the backdrop of a price control regime that does not even permit the recovery of all such costs of providing valuable debit card services to retailers. This problem would be exponentially magnified by the untenable alternative in the Board's proposal that multiple networks should be provided for each authentication method established for a debit card. As complexity and costs increase, consumers face the real possibility of reduced access to their funds, higher fees and fewer benefits from their debit products, and likely degraded consumer protections.

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We urge Congress to extend the effective date of the Board's interchange rule and request an impact study conducted by appropriate federal agencies of the unintended consequences of the Durbin Amendment and recommendations on the legislative or regulatory steps that might be taken to address the unintended consequences, particularly those affecting consumers and small financial institutions.

Thank you, again, for the opportunity to present this testimony today. I would be happy to answer any questions.

United States House of Representatives
Committee on Financial Services

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Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	2. [illegible]
JOSHUA R. FLOUM	VISA, INC.

3. [illegible]

[redacted]

4. [illegible]	5. [illegible]
☐ Yes ☑ No	☐ Yes ☑ No

6. [illegible]

7. Signature:

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