

April 21, 2011

The Honorable Richard J. Durbin
United States Senate
309 Hart Senate Office Building
Washington, DC 20510-1304

Dear Senator Durbin:

You will recall that I wrote to you in February to express the banking industry's concerns regarding your debit interchange amendment. Since that time, the industry has worked diligently to make policymakers aware of these concerns and impress upon them the need to take a step back and consider the negative effects that the Federal Reserve's proposal to implement your amendment will have on banks of all sizes, on consumers and on the broader economy.

Confusion about this issue remains, and I feel compelled to reach out to you once more, on behalf of all our members, to again express our concerns and add some clarification.

Fact 1 – The Federal Reserve's rule will affect banks of all sizes

Language in your amendment purporting to exempt banks with fewer than \$10 billion in assets will not work and cannot be made to work. Having two different prices for the exact same product is not sustainable in a free market economy. Business will always flow to the lowest priced product, even if the lower price is the result of government price controls. The Federal Reserve's proposal imposes a price cap that is so low it creates enormous economic incentives for retailers – especially big box stores – to adopt strategies to favor debit cards with lower interchange rates. Smaller banks will either lose customer accounts to larger banks or lose revenue that is used to support free checking and other valuable services. Community banks will struggle to survive in an environment where they are the highest priced providers in town.

Fact 2 – Congress has not fully explored the potential impact of the Durbin amendment

Though Congress has held a few hearings on *credit card* interchange fees, your amendment placing restrictions on *debit card* interchange fees was never the subject of any Congressional hearings. Furthermore, there have been no studies on debit interchange. Debit cards are very different from credit cards and, unlike credit cards, they are issued by nearly every bank in the country. Debit interchange supports free and low-cost checking accounts and Congress has never fully considered the impact that debit interchange regulation will have on the cost of basic banking services for everyday Americans.

Fact 3 – Debit cards provide enormous value to consumers and retailers alike

Consumers like the safety and convenience of debit cards and are choosing to use them more frequently. In a recent letter to Congress, Federal Reserve Chairman Ben Bernanke said that the number of debit card transactions has grown from about 8 billion in 2000 to 38 billion in 2009. Debit cards now make up more than 27 percent of all transactions, up from just 10 percent in 2001.

The benefits of debit cards for retailers are enormous. They get guaranteed payment for in-person transactions, increased sales volume, faster check-out, and reduced losses from bad checks or stolen cash. They also get higher sales volume, which ultimately increases retailer revenue and profits. Paying a little over a penny for every dollar spent to get these benefits is a small price to pay for the fraud protection, system maintenance and other benefits that retailers receive.

Fact 4 – Retailers do not have to accept debit cards

Retailers are not forced to accept debit cards and can always choose to accept only cash or checks. Many retailers operate on a cash-only basis, but those that choose to accept debit cards do so because of the value they bring. Retailers can offer discounts to customers who pay with cash or check. This gives them the ability to let their customers decide if they want to pay a little more for the convenience of using their debit card and makes it possible for retailers to avoid paying interchange fees.

More importantly, this option serves as a tempering force in the marketplace. It gives card-issuing banks and the networks an incentive to ensure that interchange fees remain at a level that encourages transactions. After all, networks and card-issuing banks have a financial interest at stake. If customers choose not to use their debit cards, revenue does not flow to the bank that issued the card.

Fact 5 – Accepting cash or checks is not free for retailers

All forms of payment involve risks and costs, and cash and checks are no different. Cash can be lost or stolen and retailers must pay to bundle it, store it, transport it to the bank, and pay for someone to count it (and recount it) and make sure the cash in the register matches up with sales. Checks have to be bundled and deposited at the bank and can be returned because they are fraudulent, counterfeit, or drawn on accounts with insufficient funds, leaving retailers to suffer the loss. With debit cards, banks take all the risk once the card is correctly run at the register. Debit cards are the most efficient form of payment for retailers, saving as much as \$1.65 over checks and \$.39 over cash, as a recent study by AEI Brookings bears out. Debit cards simply offer more and cost less.

Fact 6 – Mandating prices below cost is a recipe for serious problems

It costs a typical bank between \$250 and \$300 a year to make a basic checking account with debit card access available to customers. Interchange revenue helps offset some of this cost and enables debit card services to be offered at very low or no cost to consumers, including low-income consumers. However, under the Federal Reserve’s proposed rule, debit card issuers would suffer a 70 percent to 85 percent reduction in debit interchange revenue. The rule does not allow banks to recover fraud losses suffered by the bank or fraud prevention costs. It also does not allow banks to recover the cost of maintaining a card payment system that ensures 24/7, 365 days-per-year access for consumers, nor does it cover expenses for further enhancements or upgrades to the system. It doesn’t even cover the cost of responding to customer inquiries regarding specific debit transactions, or the cost of providing or replacing debit cards.

In the end, this means that the income earned from debit cards will be less than the cost of providing them, and banks will lose money on every debit card transaction. Thus, the only options left will be to shift these costs to consumers or cease providing debit cards. Basic economics dictates that revenue must exceed expenses in order for a business to remain viable.

Fact 7 – Consumers will not benefit from the Federal Reserve’s rule

Despite claims by retailers that the Federal Reserve’s rule will allow them to reduce prices for consumers, nothing in your amendment or the rule compels them to do so. It is far from certain that they will. Home Depot’s CFO recently said she expects the price caps to benefit Home Depot to the tune of \$35 million per year. She said nothing about passing that benefit on to customers.

Conclusion

The harm to consumers, banks and the communities they serve that will result from the Federal Reserve’s rule is real. This is evidenced by the fact that roughly 86 percent of the comment letters received by the Federal Reserve express opposition to the proposal. Congress has the power to step in and stop and study this rule before it goes forward.

Sincerely,

Frank Keating