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May 13, 2011

VIA E-MAIL

The Honorable Sarah Bloom Raskin
Federal Reserve Board of Governors
20th & Constitution Ave NW
Washington, D.C. 20551

Re: Small Bank Exemption under the Durbin Amendment

Dear Governor Raskin,

This letter explains why the small bank exemption under the Durbin Amendment will work. The Durbin Amendment exempts banks with under \$10 billion in assets from the regulations of lower interchange fees that will be implemented by the Federal Reserve Board of Governors.

First, the major debit card networks processing over 80% of PIN debit-card transactions have committed to a two-tier interchange system. A two-tier interchange system will provide significantly higher interchange for card issuing banks exempt under the Durbin Amendment. A two-tiered system will work for a number of reasons:

- **PIN debit networks are loyal to the small banks.**
- **Each bank will choose which networks to place on its debit cards.**
- **The networks have multi-tiered rates on the merchant side, and have successfully implemented them for years.**

Second, merchants cannot discriminate based on card-issuers. Therefore the argument that small banks will be harmed because merchants will refuse small bank-issued debit cards is misplaced for several reasons:

- **Retailers are in a customer service business. Therefore, any rejection of a card will lead to a loss of customers.**
- **Contractual restraints by the networks, including stiff fines and penalties, prevent merchants from discriminating among card issuers.**
- **Merchants cannot practically distinguish among card issuers at the point of sale.**

A Two-Tiered Interchange System Allows Exempt Banks to Maintain Higher Interchange

In response to the Durbin Amendment, Visa announced that it will implement a two-tier interchange system that will give financial institutions with less than \$10 billion in assets higher debit interchange fees than the country's biggest banks. As of March 2011, six major debit card networks -- Visa, Star, Pulse, Shazam, Accel-Exchange and CU-24, which process an estimated 80% of PIN debit-card transactions -- have all committed to a two-tier system. In order to remain competitive among their bank customers, it is very likely that other networks are sure to follow their lead. The two-tiered system will protect exempt banks' interchange revenue for three reasons.

First, small issuers are the primary customers of the PIN debit networks, such as Star, Pulse, Shazam, Accel-Exchange. Small banks account for a large percentage of the leadership in some of the networks.¹ These networks are therefore very loyal to the small banks, which will have the ability to select their networks for debit card transactions. These networks will also be eager to sign up the smaller banks to maximize the number of cards they will process. Accordingly, they will not only have to offer two interchange tiers, like the large networks, they will also have to offer high rates to the smaller banks to retain their loyalty. Finally, smaller networks rely on membership fees from their small bank customers; therefore it is very important for them to protect their membership.

Second, the banks will choose the networks that can process their debit card transactions. Networks must win over the banks before they even have a shot at retailer routing. Exempt banks, acting individually and through their associations, will protect themselves by choosing networks that are willing to contractually commit to multiple years of favorable smaller bank interchange fees.

Third, it is not a problem for networks to manage multi-tiered interchange rate systems. For many years networks have charged merchants hundreds of different rates depending on the type of merchant, type of transaction and many other factors. The networks have the experience and the ability to maintain and enforce multi-tiered rates. If the networks have been successfully able to maintain multiple rate tiers on the merchant side of their business, they will be able to do so on the issuer side.

Merchant Discrimination against Small Bank Cards is Inconsistent with Economic Reality

Some large banks have suggested that a two-tiered system will not work because merchants will discriminate against small bank-issued cards, rendering the two-tiered rate system meaningless. This simply is not consistent with economic reality. Merchants have never discriminated by type of issuer. In a recent letter sent to Congress by 20 merchant trade associations and the Merchants Payments Coalition, whose collective member associations represent 2.7 million stores and 50 million employees, the retail groups explained why they will continue to accept all debit cards, regardless of issuer. The letter states that they "are committed

¹ For example, 4 of the 5 Directors of Shazam are executives at small banks. See www.public.shazam.net.

to customer service and it is not in their interest [or ability] to discriminate against debit cards that so many customers carry.”²

First, merchants are in a customer-service oriented business. If they rejected a card they would likely lose a customer forever. Most of a merchant’s debit card customers have only one debit card. And if they switched to a credit card, the interchange rate would be even higher. Merchants have no incentive to differentiate among cards that come anywhere close to balancing the substantial risks of turning customers away.

Second, all merchants that accept Visa and MasterCard are subject to the network rules imposed by the companies. The networks’ rules require merchants to accept all Visa and/or MasterCard debit cards, regardless of who issues the card. This is known as the Honor-All-Cards rule, which imposes the threat of a \$5,000 per day penalty for refusing to accept any Visa and/or MasterCard card presented for payment.³ Additionally, the rules also prevent merchants from pricing goods differently based upon the financial institution that issued the card. Visa and MasterCard would have every incentive to aggressively enforce these rules.

Finally, merchants do not have the practical ability to distinguish between cards issued by big banks and small banks at the point of sale. Merchants do not know the interchange fee rates associated with different cards, until they receive their monthly statement. Moreover, training employees to recognize and distinguish among debit cards from thousands of banks would be expensive, time-consuming and not practical -- most employees never get to examine the cards customers are using because in most retail environments today the customers swipe their cards themselves.

I am happy to provide additional information or address any questions you may have.

Sincerely,



David Balto

² See the attached letter from the Merchants Payments Coalition to members of Congress dated May 2, 2011.

³ See Visa General Fines Schedule – U.S. Region at pg. 65. <http://usa.visa.com/download/merchants/visa-international-operating-regulations-main.pdf>.

UNFAIR CREDIT CARD FEES.COM

May 2, 2011

The Honorable Shelley Moore Capito
U.S. House of Representatives
2443 Rayburn House Office Building
Washington, DC 20515

Dear Representative Capito:

We understand that some in the financial services industry are claiming that the Durbin Amendment exemption from interchange “swipe fee” regulation for financial institutions with assets under \$10 billion will not be effective in practice because merchants will discriminate against debit cards with higher swipe fees. On behalf of the undersigned trade associations, and the tens of thousands of merchants and retail locations we represent, we are writing to make clear that we have no contractual or practical ability to treat debit cards issued by small financial institutions or credit unions differently than those issued by large institutions. Furthermore, our member companies are committed to customer service and it is not in their interest to discriminate against debit cards that so many customers carry.

Currently, merchants are subject to Visa and MasterCard network rules that require us to accept all Visa and/or MasterCard debit, regardless of which bank or credit union issues the card. This is called the Honor All Cards rule and we risk the threat of \$5,000 per day fines -- or higher -- if we break this rule, so we assure you that merchants have no intention of violating this term of brand acceptance. These rules also prevent merchants from pricing goods differently based upon the financial institution that issued the card.

Additionally, even if these rules were not in place, merchants have no practical ability at the point-of-sale to distinguish between big bank and small bank cards, nor the swipe fee rates associated with those cards. Indeed, in many if not most retail environments, employees never see the face of the card the customer is using: the customers swipe their cards themselves.

Lastly, even if merchants could differentiate between card issuers, there are no market or economic incentives to discriminate against mid-sized and smaller financial institutions' cards. If a customer wants to pay with a card, merchants will let them use



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that card because the retail industry is fundamentally all about competing to deliver value and customer service. If merchants didn't accept the card, they would risk losing the sale and losing the customer; a risk very few in the competitive retail industry are willing to take. Additionally, most consumers only have one debit card in their wallet. We would absolutely prefer they pay with that debit card, rather than with a credit card, because while debit card per transaction rates have grown exponentially over the past several years, *credit card* swipe fees are far higher and continue to be a significantly more costly burden on businesses of all sizes.

We appreciate the opportunity to set the record straight regarding the many misrepresentations being made about the Durbin Amendment, and you have our commitment that the retail community across the nation will do its part to help ensure that the exemption of financial institutions with less than \$10 billion in assets from the swipe fee reforms on debit cards will work in the marketplace.

Sincerely,

American Beverage Licensees
Coalition of Franchisee Associations
Food Marketing Institute
Interactive Travel Services Association
International Franchise Association
National Association of College Stores
National Association of Community Pharmacists
National Association of Convenience Stores
National Association of Shell Marketers
National Association of Theatre Owners
National Association of Truck Stop Operators
National Council of Chain Restaurants
National Franchisee Association
National Grocers Association
National Restaurant Association
National Retail Federation
National Small Business Association
Petroleum Marketers Association of America
Retail Industry Leaders Association
Society of Independent Gasoline Marketers of America

CC: Members of the United States Senate

Members of the United States House of Representatives

Hon. Ben Bernanke
Chairman
Board of Governors of the Federal Reserve System

Hon. Janet Yellen
Vice Chair
Board of Governors of the Federal Reserve System

Hon. Elizabeth Duke
Member
Board of Governors of the Federal Reserve System

Hon. Daniel Tarullo
Member
Board of Governors of the Federal Reserve System

Hon. Sarah Bloom Raskin
Member
Board of Governors of the Federal Reserve System

Hon. Timothy F. Geithner
Secretary
Department of the Treasury

Hon. Sheila Bair
Chairperson
Federal Deposit Insurance Corporation

Mr. John Walsh
Acting Comptroller
Office of the Comptroller of the Currency

Hon. Debbie Matz
Chairman
National Credit Union Administration

Hon. Karen G. Mills
Administrator
Small Business Administration