



GEORGETOWN UNIVERSITY LAW CENTER

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Ms. Jennifer J. Johnson
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington DC 20551
regs.comments@federalreserve.gov

Re: Docket No. R-1404
Regulation II: Debit Card Interchange Fees and Routing

Dear Ms. Johnson:

I am an Associate Professor of Law at Georgetown University Law Center, where I teach courses in payment systems, consumer finance, and commercial law. I have written extensively on payment card interchange issues,¹ testified on interchange fees before Congress at hearings on legislation that became the Credit C.A.R.D. Act of 2009, and presented on interchange fee regulation at conferences sponsored by the Federal Reserve Banks of Chicago and Kansas City.

I am writing in support of the Board's rule-making on debit card interchange fees under section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Durbin Interchange Amendment"). I believe that Congress has given the Board sufficient guidance and time to execute the rulemaking, and should proceed with the rulemaking. I would, however, urge the Board to add clarity to the rulemakings provisions on network fees and the small issuer exemption, as well as to reconsider the level of its debit card interchange fee safe harbor (which should be set at zero) and to adopt Alternative B under the network exclusivity provision.

In the interest of full disclosure, I have been retained by the Credit Union National Association (CUNA) to advise them on the Board's rulemaking on debit card interchange. In this letter, however, I write solely on my own behalf; indeed, some of the opinions I am espousing are not supported by

¹ Adam J. Levitin, *Cross-Routing: PIN and Signature Debit Interchangeability Under the Durbin Amendment*, 2 LYDIAN J.16 (Dec. 2010); Adam J. Levitin, *Interchange Regulation : Implications for Credit Unions* (Filene Research Institute research brief,# 224, Nov. 2010); Adam J. Levitin, *Priceless? The Competitive Costs of Credit Card Merchant Restraints*, 55 UCLA L. REV. 1321 (2008); Adam J. Levitin, *Priceless? The Social Costs of Credit Card Merchant Restraints*, 45 HARV. J. ON LEGIS. 1 (2008); Adam J. Levitin, *Payment Wars: The Merchant-Bank Struggle for Control of Consumer Payment Systems*, 12 STAN. J. L., BUS. & FIN. 425 (2007); Adam J. Levitin, *The Antitrust Super Bowl: America's Payment Systems, No-Surcharge Rules, and the Hidden Costs of Credit*, 3 BERKELEY BUS. L.J. 265 (2005).

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CUNA. I have no financial interest in the outcome of the Board's rule-making other than as a consumer and debit cardholder.

1. The Board Should Proceed with Its Rule-Making Under the Durbin Interchange Amendment

At recent Congressional hearings, concerns were expressed that Congress had given the Board insufficient guidance as to its Durbin Interchange Amendment rulemaking and that there was insufficient time for such a rule-making. I do not believe that these arguments have purchase. Congress gave the Board sufficient guidance on debit card interchange fee rulemaking. The Board has successfully engaged in rulemaking with even less specific guidance, such as under the penalty fee provision of the Credit C.A.R.D. Act of 2009, which also mandated "reasonable and proportional" fees. In comparison with the Credit C.A.R.D. Act, the Durbin Interchange Amendment is remarkably specific as to what costs the Board may and may not consider in determining what fees are "reasonable and proportional." While the rule-making timetable mandated by the Durbin Interchange Amendment is tight, but it is no tighter than many other rule-makings, and interchange fees are an issue that has been studied by the Federal Reserve system for several years now and been the topic of several conferences hosted by the Federal Reserve system. Accordingly, the learning curve for interchange fee regulation is well within the ken of the Board.

2. Interchange Fee Level

The Board has proposed a safeharbor for I would urge the Board to instead adopt an at-par (zero interchange fee) standard for the reasonableness of debit card interchange fees. The actual incremental cost of a debit card transaction is negligible, and a par clearing system would create the fairest allocation of costs within the debit card space, just as it does for checks and cash.

3. Network Non-Exclusivity Provision

I urge the Board to adopt proposed Alternative B under the network non-exclusivity provision in the Durbin Interchange Amendment rulemaking. I have written about the proper interpretation of the network non-exclusivity provision of the Durbin Interchange Amendment at length in an article in the *Lydian Journal*, a payments-focused publication.² I refer the Board to this publication for the full textual argument as to why Alternative B is the proper reading of the network non-exclusivity provision, but would note that the clear intent of the Durbin Interchange Amendment is to create competition for the processing of every electronic debit transaction, not just electronic debit transactions when the merchant happens to have a PIN-pad.

As Senator Durbin noted in his floor statement about the Amendment, the non-exclusivity provision "is intended to enable each and every electronic debit transaction—no matter whether that transaction is authorized by a signature, PIN or otherwise—to be run over at least two unaffiliated networks, and the Board's regulations should ensure that networks and issuers do not try to evade the intent of this amendment by having cards that may run over only two unaffiliated networks where one of those networks is limited and cannot be used for many types of transactions."³ The only type of network that is "limited and cannot be used for many types of transactions" is a PIN debit network because there are many types of merchants that do not have PIN pads—e.g., many restaurants, utilities, landlords, mass transit and Internet merchants. Thus, cards that can be routed over only a single signature and single PIN debit network (or even a single signature and multiple PIN debit networks) would frustrate the intent of the Durbin Amendment's multi-homing provision.

I would suggest that the Board also be explicit in permitting PIN debit networks to process signature-debit transactions as long as the merchant and/or network is willing to assume the chargeback risk. Signature is not an authorization device, but an ex-post loss allocation device in the event a transaction is challenged by the cardholder. Restricting limitations on cross-routing on debit cards

² Adam J. Levitin, *Cross-Routing: PIN and Signature Debit Interchangeability Under the Durbin Amendment*, 2 LYDIAN J.16 (Dec. 2010).

³ 156 CONG. REC. S5926 (daily ed., July 15, 2010) (statement of Sen. Durbin).

between PIN and signature debit networks would enhance the competition among networks for processing transactions, which is precisely the goal of the Durbin Interchange Amendment.⁴

4. Small Issuer Exemption

I strongly urge the Board to ensure that the small issuer exemption from the “reasonable and proportional” fee requirement of the Durbin Amendment be meaningful and effective. I believe that the anti-evasion authority granted to the Board under the Durbin Amendment gives the Board broad ability to ensure that the networks offer two-tiered interchange schedules and that these schedules reflect competitive fees for small issuers.

If a small issuer exemption is not effective, the result will be greater consolidation in the financial services industry. Some small issuers will not be able to offer debit card services with interchange fees within the safe harbor proposed by the Board. The result will be that these issuers will either cease to offer debit card services or will have to charge fees on other services. In either case, these small issuers will become less competitive overall. The inevitable result will be further consolidation of financial institutions. This is deeply troubling because the United States’ largest financial institutions, which have already shown themselves to be endemic centers of systemic risk, will only become larger, thereby aggravating the existing “too-big-to-fail” problem.

A meaningful small issuer exemption would also have major consumer protection benefits. If small issuers are able to retain close to current levels of interchange income, they will be able to continue to offer other retail banking products, such as checking accounts, at low cost or for free. As long as small issuers are able to do so, it will limit large issuers’ ability to increase costs on retail banking products. In other words, if small issuers are meaningfully exempt from interchange regulation, it will check any attempt by large issuers to shift the costs of debit card payments from merchant to consumers, and will instead force large issuers to simply accept reduced levels of profitability from the surrender of uncompetitive rents.

5. Network Fees Should be Set at Net Zero on an Issuer-by-Issuer Basis

I urge the Board to clarify that its proposed requirement that debit-related non-interchange payments between the networks and issuers be set at net zero *on an issuer-by-issuer basis*. The current proposed network fee regulation proposal is unclear as to whether debit-related, non-interchange payments between networks to issuers must be net zero on a network-by-network basis or on an issuer-by-issuer basis. It is important that the Board clarify that the network fee regulation is on an issuer-by-issuer basis because absent such a requirement, debit-related, non-interchange payments would be set at net zero on a network basis, but the networks would use network fees and rebates to provide extra compensation to large issuers at the expense of small issuers. Such a situation would have the effect of undercutting the Durbin Interchange Amendment’s exemption for small issuers from interchange fee regulation; it would effectively create a two-tiered interchange structure that would compensate small issuers *less* rather than *more* as envisioned by the Durbin Interchange Amendment.

6. Ensuring Consumer Benefits

Some of the payment card networks have argued for a very narrow reading of the network exclusivity provision of the Durbin Amendment on the basis that consumers care about what payment card network processes their debit card transactions. This assertion is, to my knowledge, without any evidentiary basis, and it contrary to common sense.

First, consumers lack contractual privity with debit card networks. Consumers only have contractual privity with their financial institutions, and cannot rely on a debit card transaction being processed in any particular manner or on any particular network. Thus, payment card network policies, like Visa’s “Zero Liability Policy” is unenforceable by consumers. In legal terms, it is not a contractual right, but “mere puff.” Similarly, the benefits of network rewards programs, such as Visa’s Superbowl for

⁴ For a more detailed explanation of this proposal, see Adam J. Levitin, *Cross-Routing: PIN and Signature Debit Interchangeability Under the Durbin Amendment*, 2 LYDIAN J.16 (Dec. 2010).

Life promotion can be obtained without using the payment card network's products. Visa's Superbowl for Life promotion is a sweepstakes that can be entered by mailing in an entry and without use of a Visa product.

Second, the benefits of network programs are themselves quite dubious. Visa's Superbowl for Life promotion is of less value to consumers than even a ticket in the California Lottery,⁵ and the benefits of zero liability policies are also dubious in light of the federal limitations on consumer liability for unauthorized transactions (\$50 in most cases) and the discretionary nature of the networks' zero liability policies.⁶

Third, very few consumers are aware of how debit card routing works or even the difference between a payment card network and a payment card issuer. Consumers are not aware of the security features or clearance time for any particular network beyond whether it is a PIN or signature transaction. In such circumstances, it is hard to believe that consumers would place any meaningful value on their debit card transactions being cleared by a particular network.

There are real consumer protection concerns regarding regulation of debit card interchange fees, but there is simply not a cognizable consumer interest in having debit card transactions routed over one network or another. Instead, the real consumer protection concerns in debit card regulation are ensuring that there is not regressive cross-subsidization of high interchange fee debit card users by cash or EBT payment users and in ensuring the lowest possible interchange fees so that consumers will benefit from the stronger price competition that exists in retail markets than in the financial service provision markets.

Some consumers have expressed a concern that merchants will not pass on the reduction in interchange revenue to consumers. There is no way to guarantee such a pass-thru other than through perfect competition. The level of competition in retail markets varies significantly, but it is not the Board's responsibility to ensure perfect retail competition. That authority is given to the FTC and to consumers under the antitrust laws. Instead, the Board is justified in relying upon competitive pressures on merchants generally resulting in a reduction in interchange fees benefitting consumers in the form of lower prices or better service. There is unlikely to be 100% merchant pass-thru of savings to consumers, but the lack of complete savings pass-thru is not a valid reason for limiting the reduction in interchange fees or postponing the rulemaking. Instead, the Board's mandate under the Durbin Interchange Amendment is to proceed with the rule-making in accordance with Congress's clear instructions, irrespective of disagreements over the policy imbedded in the legislation.

Conclusion

I strongly urge the Board to consider adopting an at-par interchange fee interpretation of the Durbin Interchange Amendment's "reasonable and proportional" requirement. I also urge the Board to adopt proposed Alternative B for network exclusivity, and to clarify its small issuer exemption and network fee regulation.

Yours,

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⁵ See Adam J. Levitin, *Visa's Identity Theft (I Mean Superbowl) for Life Promotion*, blog post on Credit Slips, Jan. 23, 2011, at <http://www.creditslips.org/creditslips/2011/01/visas-identity-theft-i-mean-superbowl-for-life-promotion.html> (calculating that an entry in Visa's Superbowl for Life sweepstakes is worth 1/72 of an entry in the California MegaMillions lottery, not counting the costs of identity theft).

⁶ See Adam J. Levitin, *Private Disordering: Payment Card Network Liability Rules*, 5 BROOKLYN JOURNAL OF COMMERCIAL, FINANCIAL, AND CORPORATE LAW 1 (2011) (discussing policy justifications for consumer liability limitations for unauthorized payment card usage).