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March 22, 2016

SUBMITTED VIA E-MAIL AND ONLINE

Janet Yellen, Chair
Board of Governors, Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Comments, Regulatory Publication and Review under the Economic Growth and Regulatory Paperwork Reduction Act of 1996, Docket No. R–1510

Dear Chairwoman Yellen:

On behalf of the National Association of Convenience Stores ("NACS") and the Society of Independent Gasoline Marketers of America ("SIGMA"), I respectfully submit this letter in response to your request for comments published on December 23, 2015, regarding the Board of Governors of the Federal Reserve System's (''Board'' or the "Fed") review of regulatory requirements imposed on insured depository institutions, as required by the Economic Growth and Regulatory Paperwork Reduction Act of 1996 ("EGRPRA").

NACS is an international trade association representing the convenience store industry with more than 2,200 retail and 1,600 supplier companies as members. NACS member companies do business in nearly 50 countries worldwide, with the majority based in the United States. The convenience store industry as a whole operates approximately 153,000 stores across the United States.

SIGMA represents a diverse membership of approximately 260 independent chain retailers and marketers of motor fuel that sell more than 50 percent of motor fuel sold in the United States. Most SIGMA members are involved in gasoline retailing, approximately two-thirds are involved in wholesaling, 36 percent transport product, 25 percent have bulk plant operations, and 15 percent operate terminals.

In 2014, the convenience store and fuel retail industry posted almost $700 billion in total sales, representing approximately 4% of United States GDP. In light of the number of fuel and other transactions that our industry engages in, we handle approximately one of every 25 dollars spent in the United States. In fact, our retailers serve about 160 million people per day – around half of the U.S. population – and our industry processes over 73 billion payment transactions per year.

Specifically, this letter provides comments on 12 C.F.R. Part 235, the Debit Card Interchange Fees and Routing regulations, also known as "Regulation II".[1] Regulation II sets standards for assessing whether debit card interchange fees are reasonable and proportional to the costs incurred by the debit card issuer with respect to the transaction. It is arguably the single most important federal regulation affecting our industry. Above all, Regulation II provides a method of addressing the market failure which exists with respect to debit card interchange fees.

While debit fees should have been reduced even further than they have been to date under Regulation II, overall, the impact of Regulation II on the payment system, retailers, consumers, and the vast majority of financial institutions has been a net positive. By lowering retailers' costs of accepting debit transactions, small businesses have been able to pass on savings to consumers in the form of lower prices. By making debit interchange resemble something slightly closer to a competitive market, small banks have flourished. Regulation II is not unduly burdensome on financial institutions and, in fact, is a benefit to them.

I. BACKGROUND

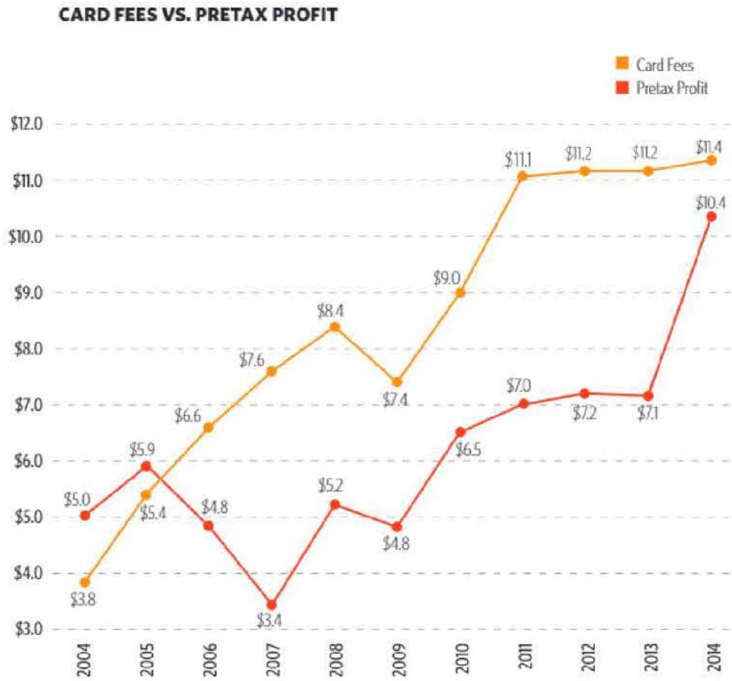
A. Small Businesses Predominate in the Convenience Store and Fuel Retail Industry and Operate on Thin Margins.

The convenience store and fuel retail industry is truly an industry of small businesses. NACS' and SIGMA's members employ over 2.47 million people and represent 80 percent of the country's retail fuel sales. Approximately 98 percent of all retail gasoline stations nationwide are owned and operated by small business gasoline and petroleum marketers. Major branded refiners own the other two percent. Furthermore, approximately 63 percent of convenience store owners operate a single store, and approximately 75 percent of the NACS' total membership is composed of companies that operate ten stores or less.

The convenience store and retail fuel market is one of the most competitive in the United States. NACS' and SIGMA's members operate on tiny margins (around 2% or less) and are unable to absorb incremental cost increases without passing them on to consumers. In 2014, for example, the industry paid $11.4 billion in card fees compared to $10.4 billion in pre-tax profits.[2] As the table below shows, there is very little space for our retailers to maneuver and cut costs given the exorbitant expenses associated with payment cards.

[1] *See* 12 C.F.R. Part 235 [Reg. II].

[2] NACS, State of the Industry, Annual Report 2013.



In fact, swipe fees associated with payment card transactions are the second highest operating expense for convenience stores – second only to labor.

II. COMMENTS ON REGULATION II

Payment card costs, which include interchange as the largest component, represent the single largest operating expense in our industry behind payroll expenses. By regulating debit card interchange fees, which represent only one part of the $11.4 billion in card fees that our industry paid in 2014, Regulation II is widely regarded by retailers as one of the most important regulations implemented by the Fed. Regulation II has not only benefited our industry, it benefits consumers. This is because the cost of debit and the escalating cost of credit card transactions, which are borne directly by retailers, are paid by consumers through higher prices.[3] The debit card market is characterized by centralized price-fixing among competing banks. Basically, the card networks and the major banks centrally set prices—and the banks, which should be competing against one another, agree to charge the same fees. This results in dramatically inflated fee levels. Because of these fees, American consumers pay inflated prices for virtually everything they buy. Interchange is effectively a regressive national sales "tax" levied on all consumers through price fixing. Regulation II continues to play an important role in capping the costs of debit interchange and has not negatively impacted financial institutions.

[3] A report by the Hispanic Institute found that over 97% of the cost of payment cards is passed on to consumers – whether they pay with cards or cash - translating into over 3 cents per every gallon of fuel sold in the United States as of 2009. *See* Effraim Berkovich, PhD, "Cross-subsidization of Consumers in the Payment Card Market," Hispanic Institute, November 2009. This number may have increased over time as consumers use payment cards on increasing percentages of their transactions.

A. Regulation II remains a much-needed regulation that continues to protect small businesses and consumers from the anti-competitive debit card market.

Prior to Federal Reserve regulations, debit card swipe fees increased rapidly – and costs increased along with them because they were not disciplined by competitive market forces. After regulation, however, a study by the Merchant Advisory Group found that between 2009 and 2013, issuers' self-reported average cost of handling debit transactions had decreased by 42%, from 7.6 cents to 4.4 cents.[4] While NACS and SIGMA have maintained that debit fees should have been reduced even further, the impact of banks reducing costs when faced with a somewhat more competitive fee structure is striking and demonstrates the benefits of Regulation II. Financial institutions, like other businesses, need pricing pressures to create incentives to discipline their costs.

Since the publication of Regulation II in July 2011,[5] there have not been significant changes in the financial services industry or in consumer behavior that render these regulations outdated. Today's payments ecosystem remains dominated by Visa and MasterCard and is inefficient, opaque, and excessively costly. The Visa-MasterCard duopoly continues to stifle competition in the payment card space and with the continued growth of high-rewards payment cards; consumers continue to use payment cards as their primary method of payment.

The response to Regulation II demonstrates the need for it. When the Regulation II was first being considered, some falsely assumed that payment card issuers would compete down the price of interchange fees below any standard amount set by the Fed and that market pressures would force issuers who were exempt from the regulation to reduce their prices to compete with regulated institutions. Neither of those things has happened. Interchange fees have been raised across the board to the limits set by the Fed and exempt institutions have continued to charge the same rates they did before Regulation II – even though those rates are, on the whole, higher than regulated rates. These responses show that interchange is not a competitive market but is a clear area of market failure that requires regulation.

Since Regulation II took effect, there have been two shifts within the traditional payments sphere – a shift to mobile platforms and a switch to EMV chip cards – yet neither of these developments have made Regulation II any less necessary. Despite offering a unique opportunity to disrupt inefficiencies in the current payments marketplace, mobile payments innovation has not yet impacted the market failure in the debit interchange market.

Similarly, the United States has only recently begun to transition away from fraud-prone magnetic stripe cards. Twenty years after Europe began this transition, much of the U.S. market formally shifted to EMV this past October. To upgrade the approximately 153,000 convenience stores to render them EMV capable will cost $3.9 billion (around $26,000/store). Average profits for a convenience store per year are about $47,000; thus, just the costs of the initial installation of EMV technology will amount to more than half of the average store's profits.

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[4] Merchant Advisory Group, Volume and Cost Trends in the Debit Card Industry (2015), *available at* https://files.ctctcdn.com/26db5c23201/8b43b2a5-993d-4c1a-ac9b-07c8acc488ea.pdf.

[5] https://www.gpo.gov/fdsys/pkg/FR-2011-07-20/pdf/2011-16861.pdf

The problems that existed in the payment card space pre-mobile and pre-EMV, namely a lack of competition and transparency, still exist today. Therefore, Regulation II continues to serve an important purpose.

B. Regulation II has benefitted American consumers.

According to noted economist Robert Shapiro,[6] in the first year of implementation (2012), the reduction in debit swipe fees under the Federal Reserve's regulation generated almost $6 billion in lower prices for consumers and $2.6 billion in merchant savings, which supported 37,501 new jobs. Those numbers were just the initial net benefits of Regulation II in its first year of implementation. Given that nothing in the foundational characteristics of the payments space has truly changed since the implementation of Regulation II, these regulations are still needed to ensure that there are similar savings and jobs created in the future. Regulation II ensures that Visa, MasterCard, and the large banks cannot raise debit interchange fees to purportedly pay for the costs of the EMV transition, which have fallen predominately on the retail industry.[7] Ensuring a cap on fees will also, as mentioned above, force banks to find ways to make debit transactions more cost-efficient.

C. Contrary to statements from small banks, Regulation II does not pose a burden on regional banks and other smaller, insured depository institutions.

Over the past few years, many large, medium-size, and small banks that have assets below $10 billion and are exempt from Regulation II have complained that Regulation II will be harmful to their industry. According to those banks, the competition between large and small banks would result in reduced debit interchange at all banks even though most are exempt. This simply has not happened. In fact, the Economic Research Department at the Philadelphia Federal Reserve Bank has recently published an article disproving these claims.[8] Specifically, the authors found that "evidence does not support the claim that competitive forces have effectively imposed the interchange fee ceiling on small banks."[9] Rather,

> There is substantial evidence that the ceiling did lower interchange fees collected by banks with assets above $10 billion, from around 44 cents to about 22 cents per transaction. But there was no such decline for small banks. Furthermore, after

[6] Robert J. Shapiro, Chairman, Sonecon, LLC, *The Costs and Benefits of Half a Loaf: The Economic Effects of Recent Regulation of Debit Card Interchange Fees* (Oct.1, 2013).

[7] For decades, retailers have been told that swipe fees were (and are) needed to pay for investments in electronic payments technology. Notwithstanding the age of this near-obsolete technology, which has been paid for many times over and now requires minimal amounts to maintain, fees continue to increase. During the past decade alone, swipe fees on credit cards have increased rapidly to an average of 2 to 3 percent of the purchase price.

[8] James DiSalvo and Ryan Johnston, Federal Reserve Bank of Philadelphia, Research Department, *Banking Trends: How Dodd-Frank Affects Small Bank Costs. Do Stricter Regulations Imposed After the Financial Crisis Pose a Significant Burden?* (First Quarter 2016).

[9] *Id.* at 17.

> the ceiling was imposed, the volume of transactions conducted with cards issued by exempt banks grew faster than it did for large banks… interchange revenue fell substantially at large banks after the fee ceiling was imposed but continued rising for small banks.[10]

The bottom line is that Regulation II has benefitted banks with less than $10 billion in assets and helped them increase their debit interchange revenues. Only the largest 100-plus institutions have seen a reduction in interchange revenue.

It is clear that the guaranteed anti-competitive revenue stream from debit interchange incentivizes spending that is generally not economically efficient. By limiting debit interchange prices for the largest banks, Regulation II has reduced incentives to bloat prices.

There is no reason, therefore, why the Fed should consider Regulation II to impose unnecessary requirements on smaller financial institutions or to harm those institutions in any way. On the contrary, Regulation II has provided small banks with benefits so that they can better compete for market share and grow their profits.

III. Conclusion

Regulation II is a clear example of a regulation that has had a positive effect on competition, creating opportunities for small banks to compete more effectively against larger companies. In fact, Regulation II has reduced the costs of covered institutions by incentivizing enhanced efficiency. Regulation II has also protected small businesses, including convenience stores, and created savings for consumers. These should all be reasons enough for the Fed to reduce the debit interchange fee standard in order to further extend the beneficial impact of the regulation.

NACS and SIGMA appreciates the opportunity to comment on Regulation II as required by EGRPRA. Please do not hesitate to contact me if NACS or SIGMA can be of assistance as the Fed continues its review of Regulation II.

Sincerely,

R. Timothy Columbus
Counsel to NACS and SIGMA

[10] *Id.*