Senator Dick Durbin
Chair, Senate Judiciary Committee
Written Questions
Hearing on "Excessive Swipe Fees and Barriers to Competition in the Credit and Debit Card Systems"
May 11, 2022

Questions for Charles Kim, Executive Vice President and Chief Financial Officer, Commerce Bancshares, Inc.

1. You testified during the hearing that "I think roughly 60 percent of interchange revenue goes out in the form of rewards."

   a. **Does this 60 percent figure apply across the banking industry or just to Commerce Bank?**

      My answer was based on Commerce Bank's portfolio and my general knowledge of industry figures I've seen over time, and the figure represents the equivalent value of rewards relative to interchange. There are multiple income streams for credit card products. As a two-sided market, the interchange paid to retailers and the rewards received by consumers are determined through different but related market forces. These competitive forces provide the most value to all participants, merchants and our customers alike, and are not unlike those in other two-sided markets.

   b. **Does this 60 percent figure apply to credit card interchange revenue, debit card interchange revenue, or both?**

      My answer was based on credit card interchange revenue. There are generally no rewards directly associated with debit cards.

   c. **Prior to your testimony, has Commerce Bank informed other card networks or banking trade associations about the percentage of interchange revenue that goes out in the form of rewards? If so, when and to whom?**

      No, not that I am aware of.

   d. **To the best of your understanding, do Visa and Mastercard set default interchange fee rates at a level that enables 60 percent of interchange revenue to go out in the form of rewards?**

      No, to the best of my knowledge, interchange rates are not set based on rewards. In this two-sided market, competitive forces will tend to drive the importance of factors like risk, benefits, features and services associated with the card. Rewards are determined by the individual issuing banks and vary by individual products, customers and terms and conditions that are specific to each bank. There is not one kind of rewards card or card portfolio, which is a good thing.

Questions for Charles Kim

1) I have heard competing views on whether changes to interchange fees are beneficial for the consumer. Some argue that the consumer benefits through lower prices at the store while others say that the consumer benefits through free checking or rewards through their cards. What is your view on how any changes to interchange fees could impact the consumer?

   Interchange is an essential part of the income banks need to provide card-based services. It is therefore essential to consumers too, although they don't know it. If interchange is reduced, whether directly or by stealth, the consumer must necessarily suffer as a result. One can see the true cost of government interference in a functioning market by reviewing the effects of artificially lowered interchange in other countries. The merchant lobby in the US may point to, and cheer, lower European interchange rates imposed by government. They dissemble about the burden paid by the European consumer in the end through higher costs for banking services, and few or no rewards.

   Any reduction in interchange would have a negative impact on consumers because it would have a negative impact on value of payments products, especially those offered by small and medium-sized banks. Banks invest in the card transaction before, during, and after the purchase. They must be rewarded for the ongoing investments that make the payment system possible. A reduction in revenue for those banks would mean a reduction in or exit from card-related businesses. Just as in Europe, Australia, and elsewhere the cost of financial services to the consumer would go up, the rewards for the consumer would go down or disappear altogether and local community banks and credit unions would be forced out of the business. The card business would be left to the Wall Street titans. Compare the thousands of American banks and credit unions serving our communities to the handful of banks in countries like Canada, Australia and elsewhere. We think that concentration of services is to be avoided so that small banks can continue to serve small communities. Interchange is a necessary part of that.

   When the original Durbin amendment was made into law, the merchants cheered. The CFO of Home Depot famously said that company would benefit by taking millions of dollars to the bottom line while on an investor call. Fancy words and clever arguments can't erase that fact.

   According to the Federal Reserve Bank of Richmond, more than three-fourths of merchants surveyed did not change their prices after the Durbin Amendment was implemented, while 22 percent of merchants actually *increased* prices. Only 1 percent of merchants reduced prices after the Durbin Amendment was implemented. As the authors stated, 'a sizable fraction of merchants [raise] prices or debit restrictions as their costs of accepting debit cards increase. However, few merchants [reduce] prices or debit restrictions as debit costs decrease.' Part of the reason for the lack of a savings "pass-through" is that some merchants (particularly smaller merchants) saw interchange rates *rise* after the Durbin amendment was implemented because networks no longer offered discounts for smaller-ticket purchases — in effect, the price ceiling became the floor.

Merchants had the chance to give their Durbin amendment savings to the consumer in the form of lower prices. They just didn't. We have no reason to believe they would do it now.

Last year, an American Bankers Association white paper summarized the benefits to consumers and merchants alike, including lower income consumers, of credit card rewards. Among other findings, the paper concluded that households of all incomes benefit from rewards cards, that most interest is paid by higher-income cardholders, and that credit card rewards are not a wealth transfer. Regarding this last point: merchant groups often argue that credit card rewards are a "reverse Robin Hood" offering whereby lower-income credit cardholders fund rewards for higher-income credit cardholders. Using a comprehensive and representative sample of credit card accounts provided by independent payments data company Verisk Financial, ABA's study found that this view is simply inaccurate. On the contrary, policy proposals based on conjecture and misunderstanding of data about the Reverse Robin Hood theory could lead to serious unintended consequences for the very populations they intend to help

2) Using cards to pay for purchases has been on the rise. Some argue that merchants feel like they have to accept Visa and Mastercard regardless of the fees that are charged, or consumers will go elsewhere. Others believe that these cards allow for convenience and higher buying power benefiting both parties. What is your view on this?

   There can be no doubt that the investments made by U.S. banks and credit unions in the American payment system infrastructure has paid massive dividends for consumers and merchants *all over the world*. As a nation, we should be proud of the fact that we invented and constantly refine the best payment system anywhere. It allows any card user to buy goods and services down the street, on-line, and in millions of merchants around the world, with confidence. We no longer worry about carrying large amounts of cash to buy gas on our road trips. We no longer buy large amounts of foreign currency or traveler's cheques so that we can shop and eat on that once-in-a-lifetime foreign vacation. Instead, we use our rewards to subsidize the vacation and we use our card to rent our car, check into our hotel, and buy our meal in seconds and with ease. Sometimes we use our own money. Sometimes we borrow that money via our credit card. We frequently spend more than we would were we using cash.

No one group has benefitted from the interchange-based US Payments System more than the merchant community. Amazon, Sam's Club, Wal-Mart et al have not suffered under it, they have prospered almost beyond belief. Interchange may be an expense to the merchant community (like the electricity bill), but it is one that has facilitated a *massive* growth in business for them. Merchants don't accept cards because they must, they do so because it helps them grow their business**. A small business can open their doors and be plugged into a worldwide interchange of cardholders and businesses in minutes. That is an astonishing achievement. That system works. It will not benefit from heavy-handed government intervention.

These benefits can be quantified and the costs of accepting cards put in perspective. Per a recent report, the benefits to merchant of accepting cards is 9.36% of transaction value, on average, which far exceeds the 3.0% average cost of credit card acceptance. Interestingly, most major merchants now partner with Buy Now Pay Later firms, paying a fee is generally 2-3x higher than the average credit card fee (and much higher than the average debit card fee).

As for whether merchants *must* accept cards, we feel that they would be foolish not to, but they do have other options. Merchants can and do accept cash, checks, ACH, and various other forms of payment. Those forms of payment are expanding all the time and merchants cheerfully adopt them, even when the cost of doing so is higher than credit cards. Target's own Red Card offers 5% discounts on purchases. There is nothing to prevent merchants from building a better payment system. Failing that, they can pay their fair share for access to the best payment system in the world, the one we have now.

** The following is a partial list of the extra benefits various merchants provide to cardholders for using their credit cards. These generous benefits are in addition to any interchange expense the merchant pays. We suggest this is proof that these merchants value the system more than they let on and can easily afford to pay their share of the system's upkeep. They do not need the Federal Government to favor them with preferred pricing.

- **Walmart Rewards Mastercard:**
    - 5% cash back at Walmart.com.
    - 2% cash back in Walmart stores & fuel stations, at restaurants and on travel
    - 5% cash back in Walmart stores for the first 12 months
- **Sam's Club – Mastercard:**
    - 5% back on gas anywhere
    - 3% back on Sam's Club purchases for *Plus* members

    - 3% back on dining and takeout

- **Walgreen's Mastercard:**

    - $25 Walgreens Cash rewards when you open an account and make your first purchase.
    - 10% Walgreens Cash rewards on Walgreens branded purchases
    - 5% Walgreens Cash rewards on all other brands and pharmacy purchases
    - 3% Walgreens Cash rewards on grocery and health & wellness purchases
    -

- **Southwest - 'Rapid Rewards' Visa:**

    - Earn 40,000 points after you spend $1,000 on purchases in the first 3 months from account opening
    - Refer friends and earn up to 100,000 bonus points per year
    - Earn 5X points on Amazon, grocery and dining
    - Redeem points for flights, gift cards, merchandise, hotel stays, rental cars and exclusive Cardmember experiences

- **Costco – 'Anywhere' Visa:**

    - 4% on eligible gas purchases
    - 3% on restaurants and eligible travel
    - 2% on all other purchases from Costco and Costco.com

In many cases, retailers who partner with banks also get significant interchange reductions, share in card interchange revenue and receive volume discounts all while receiving the benefits of increased spend and customer loyalty. Taken together, these partnerships may make a merchant's branded card the most cost-effective marketing and customer retention strategy.