Testimony of

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Good morning, Chairman Durbin, Ranking Member Grassley, my home state senator Mr. Hawley, and members of the committee. My name is Chuck Kim, and I am the Chief Financial Officer of Commerce Bancshares. I am pleased to testify before you today on behalf of Commerce Bank team members who serve communities up and down America's heartland.

Commerce is a mid-sized Main Street bank founded in Kansas City in 1865. We are honored to employ talented people in Missouri, Tennessee, Texas, Kansas, Illinois, Iowa, Oklahoma, Colorado, Ohio, Indiana, and Michigan. We have grown over the years but have done so responsibly. During the financial crisis, we were proud when former House Financial Services Committee chairman Barney Frank and our hometown Congressman Emanuel Cleaver recognized our business and financial strength. We offer a full suite of payments services, including debit and credit cards and merchant card acceptance services that keep money moving in the communities we are privileged to serve, as well as all over the world, 7x24 wherever our customers are traveling or shopping.

I intend to share perspectives which are broadly held among my colleagues at the thousands of mid-size and community card issuers across this country. Just this week, letters have come to this committee signed by every single state bankers association, community bankers association, credit union league and minority-owned banks. From small to large, from public banks to non-profit mutual banks and cooperative credit unions owned by their depositors, urban, rural, and suburban, we are united in our view: price controls in the form of interchange regulation like the Durbin Amendment harms consumers, harm small merchants, harms competition, and harms communities.

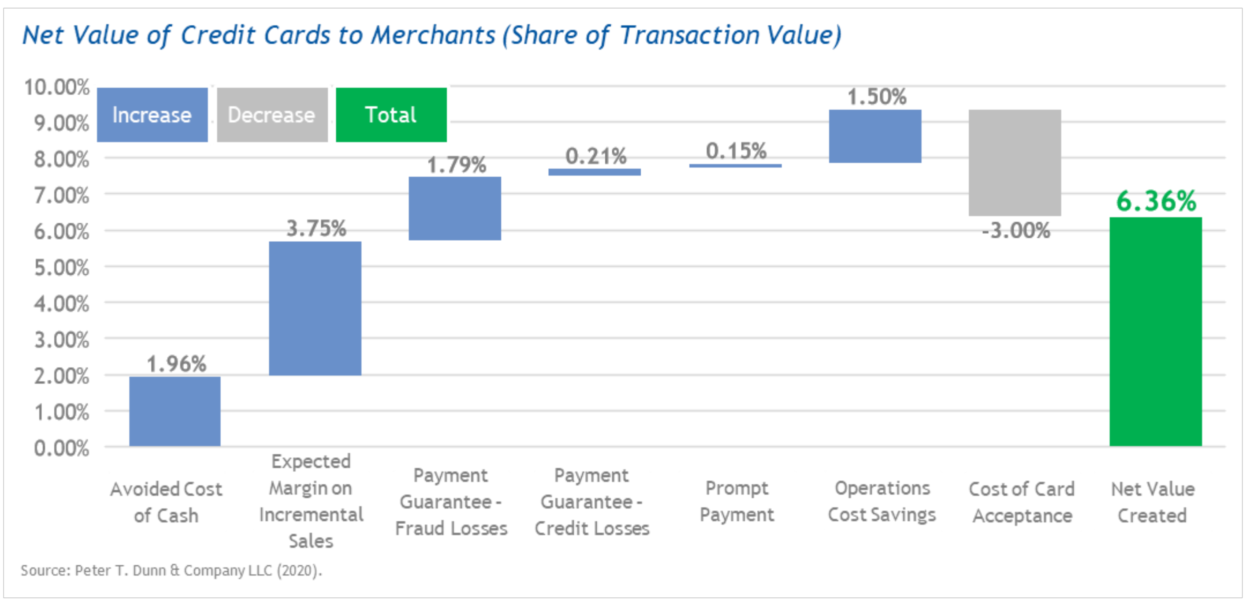
What is interchange and is there a competition problem around it? Simply put, our payment system requires constant investment and protection and we need a fair way to pay for it. I believe that banks and merchants should pay in first and the consumers should pay last, and hopefully not at all. Banks and credit unions invest billions into building and securing the payment system before, during, and after the sale. Merchants contribute to these costs by paying a small fee when they use the system to make a sale. That's interchange and as a fee, it's just a convenient and proportional way to pay their share. Accepting cards cost less than any other form of payment, including cash. In fact, U.S. and Canadian retailers spent more than $96 billion on cash-handling activities in 2017.[1]

[1] *Cash Multipliers: How Reducing the Costs of Cash Handling Can Enable Retail Sales and Profit Growth.* IHL Group. 2018

So paying interchange actually saves merchants money. How many things get you more value than they cost? I can also say that when we compete for merchants' card business, it's a very competitive situation – we are up against many players trying to give the merchant a slightly better deal. That used to just mean other banks selling a card terminal, but today there are so many independent providers competing, I think the average merchant probably gets tired of the sales calls. But cards aren't the only choices today. There's Venmo, PayPal, Square, Cash App, Clover, Toast, RTP, FedNow, same-day-ACH, BNPL: new payment rails and merchant payment solutions at all price points, including *free*. If this is a noncompetitive market, how are hundreds of new payments companies thriving? Merchants have far more choices to "plug in" than I do as a bank on the other side of the transaction.

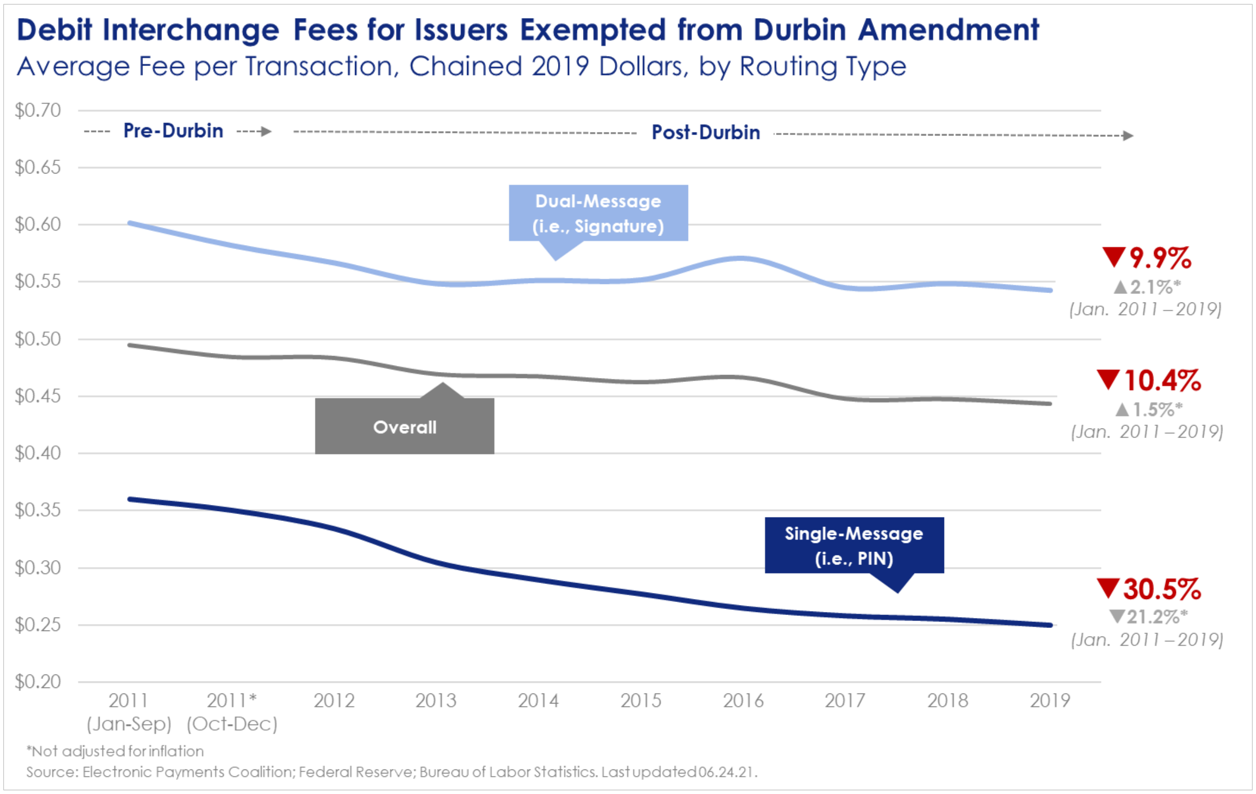
A decade ago, my bank's Executive Chairman testified in the House and predicted that the Durbin Amendment would cause "great harm to consumers… and will affect banks of all sizes." Now the data is in and we can quantify the size of the harm and how the promises made about protecting community banks and lowering prices turned out to be empty. Interchange regulation was a mistake a decade ago, and it remains a mistake today.

Many consumers have lost access to free checking, minimum balance and monthly fees are up, debit card rewards are scarcer, and small merchants have seen their cost of accepting cards rise. These are the findings of federal banking regulators and respected academics. Per research from the Federal Reserve Board and Dr. Natasha Sarin a University of Pennsylvania law professor who is now a senior economic policymaker in the Biden Treasury Department, banks were 35 to 40 percent less likely to offer free checking accounts following the passage of the Durbin Amendment.[2]



[2] Manuszak, M. and Wozniak, K. (2017). *The Impact of Price Controls in Two-sided Markets: Evidence from US Debit Card Interchange Fee Regulation*. Federal Reserve Board, Washington, D.C., and Sarin, N. and Mukharlyamov, V. (2019). *The Impact of the Durbin Amendment on Banks, Merchants, and Consumers*. Faculty Scholarship at Penn Law. 2046.

For the largest merchants, this law has been a windfall and it's helped some get more market share, but for smaller businesses and financial institutions that can't tap into a law that encourages consolidation and scale, the costs have been steep. Small banks and credit unions, which were prominently proclaimed as "exempt" from the price caps in the Durbin Amendment,



have seen their interchange revenue drop 30% per swipe on PIN debit transactions. It's awfully hard to offer a free checking account with that kind of reduction. This is a direct result of small issuers being covered by the law's backdoor price controls, known as "routing mandates". I am concerned that the Fed is now proposing to expand these rules to mandate that financial institutions take new kinds of transactions which carry higher fraud costs. Banks should make risk decisions themselves.

Merchants also promised Congress that they would reduce retail prices after the law passed. But the Fed found that nearly 99% of merchants did not pass on any savings they received to their customers. At the very least, this should make us skeptical about their current demands that the debit routing rules be expanded and the law even be extended to credit cards.

But those new demands now come without any predictions of consumer benefit, perhaps an admission that this is about one industry using government policy to elevate their own economic interests in what should be a normal commercial negotiation. Left unsaid is that regulating credit interchange would spell the end of card rewards, which would harm consumers who love them[3] and American companies that depend on them, like our travel and tourism sectors.

Some say that rewards are a wealth transfer from the poor to the wealthy and that interchange is part of the problem. The reality is that while there is a Reverse Robin Hood effect in the rewards payments marketplace, it is one created by regulation and not banks: the loss of rewards on debit cards due to the Durbin Amendment has allowed some large merchants to increase profits. For checking accounts covered by Durbin, the minimum balance required to avoid fees increased 50% after the law came into effect. During the same time period, large merchants received over $50 billion in benefits from the law. Many bank customers can now only access rewards programs if they can qualify for a credit card. This is the definition of Reverse Robin Hood – using the force of law to remove benefits from basic financial products such as debit cards in order to increase profits at large global retailers. Many of the current discussions about the "real value" of rewards are really arguments about the costs to merchants of payment acceptance.

Members of the Committee, take it from a bank that called it correctly a decade ago: please save our miles and points and reject expansion of this failed law. Instead, I respectfully urge you to give serious consideration to repealing the Durbin amendment and undoing the harm it has caused.

But there are also regulatory threats to the integrity and sustainability of our payments system. The Federal Reserve Board should withdraw its 2021 Proposed Rule to expand the Durbin Amendment to cover virtually any kind of debit card transaction, a standard which is so vague and confusing that it threatens to undermine key parts of the mobile wallet ecosystem. Its implicit endorsement of a mandate that community financial institutions accept so-called "PINless" transaction types would fundamentally transform the payments system in a manner not required by Congress, while removing card issuer discretion in preventing fraud – a harsh blow to small banks and credit unions operating payment systems on tight margins. The Proposed Rule was issued without the analyses required by law, including regarding the impacts on small entities. Once withdrawn, it should only be reproposed after all procedural requirements are satisfied and its substantive flaws remedied, and if the Federal Reserve can articulate a compelling justification for continuing to pursue this discretionary rulemaking at the expense of small financial institutions and their customers.

The reality is that card acceptance is a two-sided market, which the Supreme Court affirmed just a few years ago. Some commentators on interchange ignore that there are separate but intersecting markets for card issuance and card acceptance. Policies which focus exclusively on the merchant side of the story ignore the other side of the market: card-issuing financial institutions and their customers. This is an intentionally narrow analysis, akin to examining the sustainability of newspapers but only looking at *either* their advertising sales or their subscriber sales. Cards are much the same: merchants must be attracted by a platform that provides value

[3] *The Value of Rewards*. Electronic Payments Coalition, 2019. http://www.electronicpaymentscoalition.org/wp-content/uploads/2019/03/EPC-Value-Of-Rewards.pdf

and customers at a fair price and banks must see a sustainable way to engage with that platform and bring their customers to the market.

Our nation needs to keep up when it comes to payments technology and security, and that won't happen if we cost cut the investment out of our own infrastructure. Countries like China and Russia are investing heavily in innovating their payments systems and challenging America's leadership in this key area of national and economic security. Yet policies like the Durbin Amendment create rigid rules and investment caps that limit our potential to do the same. The payments world is changing fast and smaller financial institutions are facing enormous costs to upgrade, offer new products, and stay in the game. Interchange is an investment in American commerce, not a junk fee.

The question before us is whether we want to maintain a leadership posture with our payments system or invest the same or less than our global competitors, creating an artificial austerity that undercuts innovation and security. I urge the Committee to look at both sides of this story and put the consumer and sound economics first. Thank you again for having me.