PAYMENTS PROS: THE PAYMENTS LAW PODCAST – ANALYZING THE CREDIT CARD COMPETITION ACT OF 2023

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Josh McBeain:

Welcome to another episode of *Payments Pros*, a Troutman Pepper podcast focusing on the highly regulated and ever evolving payment industry. This podcast features insights from members of our FinTech and payments practice, as well as guest commentary from business leaders and regulatory experts in the payments industry. I'm Josh McBeain, one of the hosts of the podcast. Before we jump into today's episode, let me remind you to visit and subscribe to our blog, consumerfinancialserviceslawmonitor.com. Don't forget to check out our other podcasts on troutmanpepper.com/podcast. We have episodes that focus on trends that drive enforcement activity, digital assets, consumer financial services and more. Make sure to subscribe to hear the latest episodes.

Today I'm joined by Isaac Boltansky, managing director and director of policy research at BTIG, to discuss the Credit Card Competition Act. Isaac is responsible for coordinating BTIG's Washington policy analysis and forecasting how potential policy shifts could impact investors, corporations, and other market participants. He focuses particularly on financial services, housing policy, digital assets, cannabis policy, tax legislation, and Congress. Isaac, thank you for joining me today, and I look forward to our discussion.

Isaac Boltansky:

Thanks for the invite, Josh.

Josh McBeain:

Well, the Credit Card Competition Act at a high level what is it?

Isaac Boltansky:

Well, I think anyone in and around the payment space is aware of its lead sponsor, and that's Senator Durbin from Illinois and we know his name well from the Durbin Amendment, which passed in the cover of night as part of the Dodd-Frank Act and impacted debit cards. Senator Durbin is back at it again with a new bill, the Credit Card Competition Act, which you mentioned. Really the bill is aimed at the credit card side of the equation here. At the highest level, this bill would focus on issuers with over a hundred billion in assets. They are the covered issuers and networks. What it says here is that those issuers and networks will not be permitted to restrict a credit card transaction to a single network, two or more affiliated networks or two networks owned by the two largest networks in the US, which are currently defined as Visa and MasterCard.

Josh McBeain:

Okay.

Isaac Boltansky:

All of that put together means that they are trying to require cards to have two networks.

Josh McBeain:

Interesting, because just as a comparison today if I go to use a credit card to purchase something, that purchase is going to run over one network. This would require, not in all instances, because you said it would be only for issuers with over a hundred billion in assets, it would require those issuers to allow my purchase that previously ran over one card network, it would require that to run over two card networks.

Isaac Boltansky:

That's exactly right. Instead of your card, if you're one of those banks just running over let's say Visa's network, well now you have to have a second network on there. Importantly, this bill makes it so that that second network can't be MasterCard. It has to be another network. That's the important key here. It's requiring two networks on the card, but it's also mandating that only one of those networks can be either Visa or MasterCard.

Josh McBeain:

Okay. We should say as it's drafted it would do this by amending the Electronic Fund Transfers Act, and it would require the Federal Reserve to issue regulations within a year of this passed to provide additional guidance on how this would function. For what we know now, when I make a purchase, it runs over one network, this is going to require it to run over potentially two or at least the card that I would use to pay that transaction would be able to run over two different networks. Who gets to choose which network if this were to pass and if my card could function on two networks, who chooses which network that purchase transaction's going to run over?

Isaac Boltansky:

Josh, our understanding right now is at the basis level, the merchant gets to choose, although there are some questions about how that'll work in practice, and of course if this were to pass, we would look to the regulations to understand some of the peripheral issues there, routing restrictions and how those things would work. I think the point I've tried to make to my clients here is the one choice that has been made in the bill in terms of structure is that they want competition to be defined as one of the networks being either MasterCard and Visa and the other network being anyone else in the ecosystem.

The one decision that's been made by the structure of the Bill is a look at market share by number of cards. The one decision that's getting made for you as the consumer here is the Bill measures market share by the number of cards in circulation. If you do that, Josh, Visa is number one as of 2021 data, MasterCard's number two, Discover is number three, and American Express is number four. Visa and MasterCard are far and away, number one and number two. This bill would require two networks on every card that's covered and for only one of those to be either Visa or MasterCard. That's the choice that I think is most noteworthy.

Josh McBeain:

Okay. We should say, I think the proposed Bill doesn't actually list these networks, but the way it's drafted, it's such that the second network cannot be owned or controlled by affiliated versions of the card issuer. The two networks cannot hold the two largest market shares, as you said, which basically means today Visa and MasterCard. What's interesting is it does include a provision that the Federal Reserve would review the card networks at least once every three years to determine if the two biggest card networks have changed, which is interesting. This may change the two largest if it were to pass.

Isaac Boltansky:

I think that's fair. Let me tell you, of course, I mean the Fed isn't busy doing anything else, so why not add more to their plate? I think the decision that was made here is truly intriguing and something that I hear a number of lobbyists around this issue highlighting. In at least the financial services world I think generally we look at payment volume. If you look at payment volume, Visa and MasterCard are still number one, number two. American Express is pretty close with 19% compared to MasterCard in the second spot at 24%. I think the drafters of this Bill looked at market share by cards because Visa and MasterCard are so far and away, number one and number two, it doesn't seem like there's going to be any shift in that ranking anytime soon. The decision was made here to focus on Visa and MasterCard, even though they're not named explicitly in the Bill.

Josh McBeain:

The other thing, and we mentioned this, but it's worth focusing on, this would apply to credit card issuing financial institutions with assets over a hundred billion. This wouldn't apply to all issuers, so it applies to credit card issuing financial institutions with assets over a hundred billion. Smaller financial institutions issuing cards wouldn't be required to have this two-network requirement.

Also, there's an applicability exclusion for credit cards issued in a third-party payment system model, meaning a credit card is issued by a card issuer that is also the payment card network with respect to the card under common ownership. What this is doing is drawing a distinction for applicability between open loop and closed loop card models. Isaac, do you have any thoughts on that?

Isaac Boltansky:

Once again, the point of this bill is to go after what Senator Durbin has repeatedly said is the Visa and MasterCard duopoly in his view. This is something that isn't my opinion, he has held hearings on this. He has released statements on this. This has been something that he's been working on since well before even the Durbin debit amendment back in 2010. When you think about the policy decisions that are in this bill, including the decision to focus on market share by number of cards versus payment volume, and what you just mentioned which is focusing the requirements in this Bill on the open networks or the four party construct as the bill mentions; I think that that tells you once again that Senator Durbin's focus remains narrowly on Visa and MasterCard.

Josh McBeain:

The other two major networks, Amex and Discover would be excluded, wouldn't they?

Isaac Boltansky:

Yeah. This is a way to think about impact, and I know we're going to get into this, but the Bill's clear impact is negative for Visa and MasterCard. I have argued to my clients that it's neutral to even slightly positive for American Express and Discover as they would not have to comply with the vast majority of the provisions in this bill. They could continue to issue their own cards that work on their network and would not have to add a second network, would not have to comply with the routing restrictions. It would clearly benefit them from a competitive perspective and from a regulatory cost perspective.

Josh McBeain:

Okay. You mentioned this earlier too, large issuers using an impacted network, you have to have two options. The Bill has routing restriction limitations that are intended to prevent firms from maintaining exclusive network by alternative means. An issuer couldn't prohibit a merchant from routing transactions over the other network. You couldn't say there's two networks now on this card, but you can't use the other network. They've specifically addressed that, but they've gone a step further and said that card issuers, they can't impose a penalty for failing to route transactions over a particular network or can't impose a penalty for failing to route a certain number of transactions, or an aggregate dollar amount of transactions over a particular card network.

You couldn't contract with a merchant to route a certain number of transactions over one network. Basically, they've thought about people trying to do an end run around this merchant choice of having an option to run transactions and included that in the Bill. There's been a lot of opinions on all of this and some of those specific points, particularly the first of mind is concerns about fraud and infosecurity and how the routing may or may not impact that. Isaac, do you have any thoughts on that?

Isaac Boltansky:

I just want to make a point clear here. I think it's fair to disagree with the purpose of this Bill. I think it's fair to disagree with the framing politically of some of these issues. I think it's important to note that the staffers working on these issues are steeped in them. They have worked on them for years. They understand these issues backwards and forwards. When you get to that routing restriction language, Josh, it's really clear that they played this forward and they made sure that we wouldn't see any type of end runs. For example, issuers and networks are not allowed to penalize a merchant for failing to hit a volume floor. That limits Visa and MasterCard's capacity to creatively price around volume thresholds. It also makes volume discounts more difficult. It's pretty explicit that those things are prohibited here. I understand that. You don't want an end run around the spirit of the bill.

What scares me a bit is some of the requirements on routing as it relates to fraud. I do believe that the industry is making a good argument here stating that when you have requirements effectively establishing a lowest common denominator for fraud prevention, it is going to lead to less innovation in that space. It's going to lead to more fraud, and I think it's ultimately going to hurt all the folks you wanted to help, which are the consumers and the merchants. When I think about the lobbying around this, and I know we'll talk about this in a bit, I do believe that the routing restrictions and their limitations as they relate to fraud prevention, I think that concerns around that are the strongest argument against this Bill on Capitol Hill.

Josh McBeain:

That's really interesting and explicitly what the Act says is in the no routing restrictions section, it prohibits any person who accepts credit cards for payments to exclusively use a specific authentication, tokenization or other security technology that cannot be used by all the payment card networks that may process electronic card transactions. I think this goes directly to your point about potentially driving to the lowest common denominator whereby if there was an advancement in technology that bolstered security for processing transactions, this would prohibit requiring that if another network couldn't use that. It would effectively say, "Well, you can't use this great new technology that would make transactions more secure and maybe reduce fraud because it's not available to this other network." What's the incentive of investing in that technology?

Isaac Boltansky:

Yeah. Josh, this is one of the numerous ways why the Bill's name is inherently ironic. It's called the Credit Card Competition Act. But by making it so that the Fed will have to issue regulations making it so that we have to have effectively standardization around fraud as it relates to authentication, tokenization, and whatever other security technologies may be, that means that we're not going to have the same level and fervor of competition around establishing the safest process around the safest transaction framework. We have to then move towards a lowest common denominator that can be used to process by both networks in this example on the card. You are removing some of the competition from the ecosystem.

Josh McBeain:

What I'm hearing you say is competition drives innovation and the proposed Bill as it's currently drafted might deprive us or the industry of that innovation.

Isaac Boltansky:

I think that's absolutely right, and again, it's tough to sometimes know how these things will play in the real world of course.

Josh McBeain:

Right.

Isaac Boltansky:

I think security is always going to be important for these companies. They're always going to invest, they're always going to spend, it's always be top of mind for consumers and merchants. Again, I do think that that is an open question, a concerning question, and one that I think is really gaining mind share when you talk to lawmakers and staffers who are ultimately the ones who have to vote yes on something like this.

Josh McBeain:

One other thing I want to talk about, for those of us that are interested in this, there's been a lot of opinions shared, and we've echoed some of those here as we discussed the nuts and bolts of the Act, but there's been some opinions shared that the practical impact of this, including for example, this would end credit card rewards, would increase fees or loss of services as issuers try to recoup the potential loss of the interchange fee or favors large issuers. What's your sense in Washington around those conversations and are they impacting its likelihood to pass this year?

Isaac Boltansky:

My job at BTIG is to analyze how policy will impact markets and also to forecast how those policies will play out either on Capitol Hill or through the rulemaking process. Part of that is assessing whether a Bill will become law. Another part of that is then trying to figure out how regulations will go from a proposed phase to a final phase. We are bearish on this bill becoming law for three reasons, and I think we should go through all of them, but I can tell you that the credit card reward issue is one that continues to animate everyone around this. Josh, I think your listeners would agree. Credit card rewards are great, whether they're points or miles or cash back, there's something that's become part of the consumer conversation and part of how we decision our credit usage in this department. I think that that's something that continues to animate my clients when they ask about it.

Josh McBeain:

Hold on, on that note specifically thankfully it was short and I didn't see credit card rewards mentioned. It's interesting to hear that there's a lot of fervor about rewards. What is that stemming from?

Isaac Boltansky:

Well, two points on this. Number one, let's look back at history. The Durbin debit interchange cap studies have shown led to a reduction in free checking accounts. Now we can point to other regulations impacting that calculus as well, but that argument is being made on the Hill right now, and I think that's one that again, has some traction that we capped the interchange on debit cards and look just a few years later, we had fewer free checking accounts. Again, obviously, we can't look at any of these issues in a vacuum, but that is one of the key bullet points of this argument.

Furthermore, and then I'll shut up after this, I promise, Josh, we just got to think if you are reducing the overall fee here, there will be naturally attempts to make up for that fee elsewhere. The industry is arguing. We'll see if it becomes law, but the industry's arguing one of the places where they will cut back is their beneficence when it comes to credit card rewards.

Josh McBeain:

Okay, how you are saying this would play out is card networks now they charge an interchange, card networks set the interchange cost, which is a reimbursement between the merchant and the card issuer. The card issuer receives the majority of that. That's revenue to the card issuer. One of the benefits provided by a lot of cards is rewards. If you're reducing some of the revenue by a lower interchange, maybe some of the benefits would have to go away, i.e., credit card rewards, that's how it would practically play out. Am I describing it correctly?

Isaac Boltansky:

Correct. Josh it is, again, I think important to note that it's incredibly difficult to gauge how any of this will play in the real world, but lawmakers and staffers do listen to historical framing, and a recent report by Cornerstone Advisors noted a steep reduction in free checking accounts following the introduction of the Durbin debit interchange requirements following Dodd-Frank. They also have some statistics around this. Average checking fees increased from $4.34 to $7.44, monthly minimums increased by 25%, monthly maintenance fees increased by 13%.

I think we can cut all this data numerous different ways, but when we're talking about the impact of the interchange cap on debit cards, of course there is going to be a lateral made to say that we will see similar pullbacks on credit cards. One of the areas where we will see that pullback is likely to be on credit card rewards, which again, is something that animates staffers and lawmakers and voters. Lawmakers aren't in the business of taking things away.

Josh McBeain:

Interesting. You said there's three points total, so I'm interested to hear what the two other ones are that are impacting the decision in Washington.

Isaac Boltansky:

Sure. The second point, and this is the one that again, I think is continuing to gain mind share as the industry pushes back on the Bill, is concerns around fraud and security investment. When we think about setting a lowest common denominator for the fraud side, there is real fear. That's something that I think when I have to categorize the industry's strongest argument against the Bill, it's that, it's the fraud side of things. The third, and this one I think is more general, but Josh most lawmakers absolutely loathe this issue because it forces them to choose sides in this unholy war between banks and retailers. When we do the history of how Senator Durbin got the debit interchange provision through before it was at like 1:30 in the morning while they were working on the floor for the Dodd-Frank Act. That was a totally different world. You didn't have nearly as much coverage of financial services issues. You didn't have nearly as much understanding and just look at what you and I are doing. I can tell you there wasn't a podcast dissecting the potential implications of it. There weren't even podcasts.

I think you put all that together and realize that this Congress is not going to do much more than it absolutely needs to do to get us from here to the 2024 election, and it makes it very difficult to believe that this Bill's going to become law. I do tell my clients that we've got to be cognizant of must pass legislative vehicles. For example, I'm watching the annual defense Bill, the NDAA. That's something that Senator Durbin has tried to use before. I'm also going to watch whatever spending Bill comes together in the fourth quarter to see if there's an attempt to attach this to those Bills. With only two Republican co-sponsors in the Senate and a whole lot of questions over how it would work in the real world, right now I think that this Bill should be viewed more in terms of rhetoric than reality.

Josh McBeain:

Thank you very much, Isaac, for joining me today, and thank you to our audience for listening today's episode. Don't forget to visit our blog, consumerfinancialserviceslawmonitor.com and subscribe so you can get the latest updates. Please make sure to also subscribe to this podcast on whatever platform you use. We look forward to next time.

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