NACS®

February 6, 2015

**<u>SUBMITTED VIA E-MAIL AND ONLINE</u>**

NACHA,
The Electronic Payments Association
Ms. Jan Estep, Chief Executive Officer
2550 Wasser Terrace, Suite 400
Herndon, Virginia 20171

**Re: Request for Comment on Same-Day ACH Proposal**

Dear Ms. Estep:

The National Association of Convenience Stores ("NACS") respectfully submits this letter in response to your request for comment on NACHA's proposal ("Proposal") to amend its Operating Rules to enable the same-day processing of Automated Clearing House ("ACH") payments that was published on December 4, 2014.

Currently, NACS members use next-day ACH transactions to process payments. The ability to use same-day ACH transactions would benefit our members and NACHA's Proposal to implement faster clearing of ACH transactions is laudable. Nevertheless, the Proposal raises serious concerns for our members. Specifically, the Proposal appears to undermine the potential for ACH transactions to remain a valuable low-cost alternative to payment card transactions. By setting prices for an entire industry, this Proposal will harm competition in the ACH marketplace and thus raises antitrust concerns. Furthermore, although the Proposal sets forth a ceiling for the interbank fee, NACS remains concerned that this fee will increase over time, in part because the structure of the fee-setting creates economic inefficiencies that will be free from market forces. Lastly, this Proposal does not go far enough. Same-day processing will not even be fully implemented when real-time processing should be taking place. Given the amount of investment needed to upgrade the existing system, NACS questions why NACHA is not proposing a processing system that would transition quickly to real-time clearing.

## I. Background

### A. <u>NACS Members process over 5.2 billion payment transactions per year</u>.

NACS is an international trade association representing the convenience store industry with more than 2,200 retail and 1,800 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 150,000 stores across the United States.

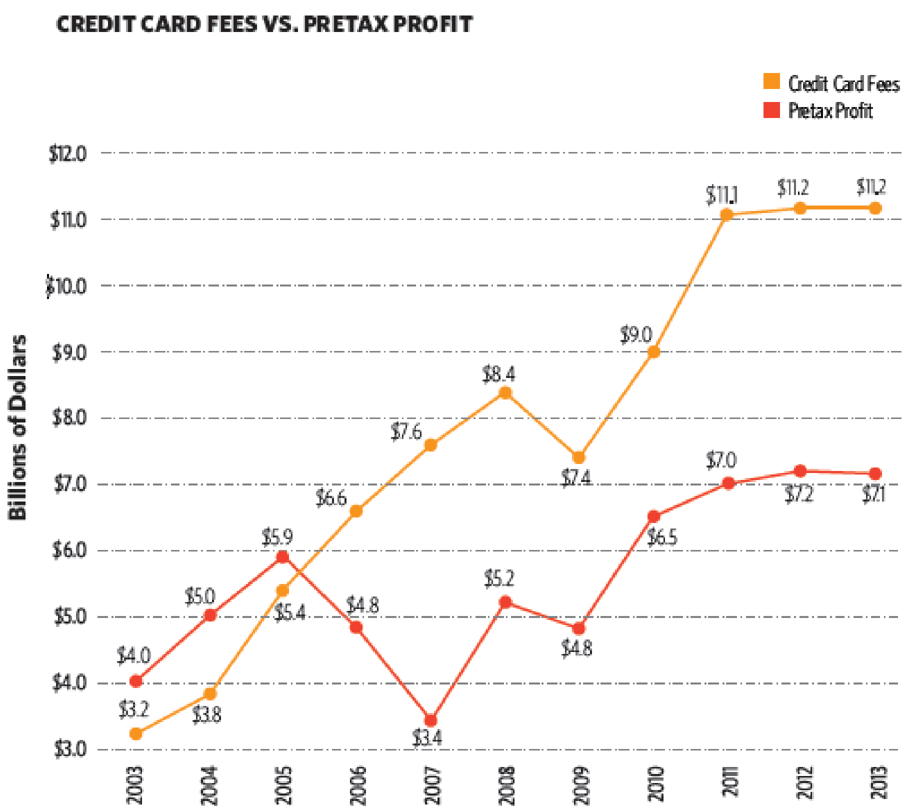
In 2013, the convenience store industry posted almost $700 billion in total sales, representing approximately 2.5% of United States GDP. In light of the number of fuel and other transactions that our industry engages in, we handle approximately one of every 22 dollars spent in the

United States. In fact, our retailers serve about 160 million people per day – around half of the U.S. population.

**B. <u>Small Businesses Predominate in the Convenience Store Industry and Operate on Thin Margins</u>.**

The convenience store industry is truly an industry of small businesses. Not only are the vast majority of branded outlets locally owned, more than 70 percent of the NACS' total membership is composed of companies that operate ten stores or less, and more than 60 percent of the membership operates a single store.

The retail convenience store and fuel market is one of the most competitive in the United States. NACS members operate on tiny margins (around 2% or less) and are unable to absorb incremental cost increases without passing them on to consumers. In 2013, for example, the industry paid $11.2 billion in card fees compared to $7.1 billion in pre-tax profits.[1] As the table below shows, there is very little space for our retailers to maneuver and cut costs given the exorbitant expenses associated with credit cards.




NACS members process at least 68 million transactions per year using the ACH system. ACH transactions serve as an important alternative to credit card transactions, which have

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

exorbitant swipe fees attached to processing and are thus extremely costly for our members. 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 THE PROPOSAL

Updating the ACH system so that it can process same-day transactions would improve ACH and benefit the market. The ACH system is a valuable payment transaction pathway that needs to be updated to remain relevant in today's economy. As such, NACS supports the Proposal's goals to update the ACH system to allow for faster processing. Nevertheless, NACS has concerns with this proposal which are outlined below.

### A. Short Response to Specific Proposal Questions.

NACHA requested comments on the following specific questions:

1. *What does your organization think of the new ACH Network functionality?*

NACS applauds NACHA's goal of promoting faster ACH processing. The ability to process same-day ACH transactions is long overdue. Nevertheless, given the costs of investing in new technology, NACHA should be promoting a shift to the most advanced processing solution available or as the Federal Reserve describes in its recently released report on strategies to improve the payment system, "ubiquitous, safe, faster electronic solutions."[2] In this instance, that means NACHA should be promoting real-time ACH processing. Real-time clearing is already available for PIN debit transactions, which are even priced at par with signature debit. We question why NACHA would not be trying to upgrade its system so that it would at least be comparable in speed to PIN debit transactions.

2. *Whether your organization thinks that as an alternative to this Same-Day ACH proposal, the industry should adopt same-day ACH without an interbank fee for other, strategic reasons?*

The interbank fee in the Proposal presents antitrust concerns and would create inefficiencies in the ACH market. Prices should be set by individual competitors rather than a central body. NACHA setting the prices that all banks will charge for ACH amounts to price-fixing with NACHA as the hub in a classic hub-and-spoke conspiracy. This type of arrangement cannot survive scrutiny under U.S. antitrust laws because it destroys the ability of banks to compete on price.

In addition, the placement of the fee between the transacting banks extracts funds where a typical fee arrangement does not exist. There is no contractual relationship between the bank receiving the payment and the account-holder's bank. By setting the fee centrally, in between two banking entities, NACHA would essentially be permitting and encouraging a fee extraction

[2] *See, generally* Federal Reserve System, Strategies for Improving the U.S. Payment System (Jan. 2015), *available at* https://fedpaymentsimprovement.org/wp-content/uploads/strategies-improving-us-payment-system.pdf.

that would not have to respond to market pressures and would develop deep procedural inefficiencies over the long-term because there would be no ability for the payor of the fee to shop for a cheaper service.

As an alternative, therefore, NACHA should upgrade the ACH system so that it becomes a true competitor in the payments market—offering real-time processing and allowing for price competition, thus upgrading the U.S. payments system so it does not fall further behind the systems already in place around the world.[3]

3. *Whether your organization thinks that a Receiving Depository Financial Institution's* ("RDFIs") *costs of mandatory same-day ACH implementation could or should be addressed in other ways that could achieve a same-day ACH capability reaching all financial institutions?*

RDFIs need to charge businesses with which they transact prices the market will bear. While NACHA should push to update the ACH system, it should not set fees centrally and distort the market. Centrally set fees will reduce the incentive for RDFIs to manage their costs efficiently and will load additional costs onto merchants and consumers. That will stunt the innovations that can come from competition and thereby result in poorer but more expensive service than would otherwise occur.

Looking at parallel situations may be instructive. When states mandated healthcare providers to begin using electronic medical records, they did not centrally set a fee that one provider would have to pay another for accessing e-records. Rather, states set the final goal – system-wide electronic records usage – and individual providers had to incorporate the costs of that service into their business model. Because providers had to compete on price, those providers had an incentive to push costs down and change over to electronic records in the most efficient way possible.

Similarly, when automakers were required to make cars more fuel efficient, they were not told how much to charge to cover the expense of the necessary technology upgrades. Instead, each auto manufacturer had to improve their technology and control their costs while competing for business. That gave auto-makers incentives to adopt fuel efficient technology in the most economically efficient way possible.

The auto and health industries are not alone in having to upgrade technologies and services without a centrally fixed (and automatic) cost-recovery mechanism. State and federal governments frequently mandate requirements for businesses, which then have to adapt and compete or perish. The same principles should apply to financial institutions. Certainly, the ACH system must evolve technologically to meet the needs of the 21st Century marketplace—and NACHA should promote technological and process innovation such as same-day (or better yet,

[3] For example, the Faster Payments System ("FPS") in the United Kingdom, which uses near real-time processing available 365 days per year, does not set a fixed fee for banks to charge to process payments. Instead, each bank must compete on costs and set their own fee according to the costs involved in participation. We also note that the FPS also permits transactions of up to £100,000 while NACHA's proposal would limit each transaction to $25,000. *See generally* http://www.fasterpayments.org.uk/.

real-time) ACH processing. However, there is no need for NACHA to set prices for financial institutions. Those financial institutions (and their customers) will be more efficient and, in the long run, better off if they have to compete on their own pricing in order to get revenue. It will keep prices down and incentivize them to find ways to deliver services while keeping costs down as well.

### B. <u>This Proposal May Undermine a Low-Cost Alternative to Payment Card Transactions</u>.

As described above, the ACH system is currently a critical low-cost alternative payment method for retailers. Currently, processing a check via the ACH system costs some NACS members less than half the cost of debit transactions that are limited according to Federal Reserve rules and less than one quarter of the cost of debit transactions that are not subject to Federal Reserve rules.[4] And, credit card transactions are even more expensive for NACS members than debit card transactions. Under the Proposal, however, NACHA has proposed an "interbank fee" ("IF") of 8.2 cents per same-day ACH transaction. The imposition of the IF would double the costs of an ACH transaction for some of our members. Doubling the cost may make some of our members question the value of accepting ACH transactions.

More specifically, Originating Depository Financial Institutions ("ODFIs") would pay the IF to RDFIs, thus providing RDFIs with guaranteed revenue. That revenue is calculated by NACHA to cover up-front investment costs, operating costs, and opportunity costs associated with setting up same-day ACH processing. While this fee would technically be levied onto the ODFI, the experience of the payments system shows that the ODFI will charge this fee to the merchant that accepts the ACH transaction.

The inclusion of "opportunity costs" in NACHA's calculation is particularly troubling. That concept appears to contemplate that RDFIs may lose interchange fee revenue as some transactions that would have taken place on payment cards instead take place through ACH. That type of market reaction would make sense and be beneficial for everyone involved in the payments system – lower costs and greater efficiencies benefit consumers and businesses. Rather than allowing and celebrating this potential market efficiency, however, NACHA appears to be proposing to stunt the positive impacts of same-day processing by handing the savings to RDFIs without justification. Doing that removes the potential efficiencies that could result from shifting transactions to ACH. And, of course, there are antitrust concerns with the interchange fees that issuing institutions receive today. Moving some of those fees into the ACH system compounds the antitrust problem that already exists by both adding a legally problematic centralized fee and hiding interchange fees within it.

---

[4] *See* Understanding the Federal Reserve's Proposed Rule on Interchange Fees: Implications and Consequences of the Durbin Amendment: Hearing Before the Subcomm. on Financial Institutions and Consumer Credit of the H. Comm. on Financial Services, 112th Cong. at 54 (Feb. 17, 2011) (Response to Rep. David Scott (D-GA) by Mr. Brian Seltzer, 7-Eleven), *available at* http://financialservices.house.gov/uploadedfiles/112-8.pdf. In addition, ZipLine, a guaranteed ACH service, charges 13 cents for a fully guaranteed ACH transaction, settled on next-day basis, with the base ACH cost being .2 cents. Should a merchant wish to use same-day processing as proposed by NACHA, the price would rise to at least 21.2 cents, which is almost identical to the cost of regulated debit transactions under the Federal Reserve.

According to the Proposal, the IF would serve as a cost recovery mechanism and be calculated over the lifetime of the investment (11.5 years). Moreover, the Proposal notes that the fee would be assessed at defined intervals and while the IF could be reduced at such times to account for inaccuracies in projected transaction volume – thus preventing excessive cost recovery – it "could not be increased." Although NACS is pleased that NACHA views its Proposal as a permanent ceiling for the IF, we remain concerned that any fee structured as NACHA proposes is unjustified and illegal and, ultimately, that the IF will continue to increase beyond NACHA's proposed cap.

Given the history retailers have had with the card networks and card issuers in the payment card arena, this Proposal with its supposed IF cap is very disturbing. In the payment card space, retailers were told that swipe fees were needed to pay for the investments in electronic card payments technology decades ago. Despite the fact that the technology was built long ago, has been paid for, and now costs a relatively small amount to maintain, fees have continued to grow. Over the last ten years alone, swipe fees on credit cards have increased exponentially to an average of 2 to 3 percent of the purchase price. According to the card networks setting these fees, swipe fees are supposedly still needed to cover investment costs for infrastructure that was paid for many years ago.

We know from experience that guaranteeing an anti-competitive revenue stream incentivizes spending that may not be economically efficient. NACHA is incentivizing that bloat by setting prices, which will result in financial institutions building-in additional costs so that they can justify NACHA continuing to set higher fees.

While NACHA's Proposal does not project an IF increase, NACS remains concerned that the IF cap may fall to the wayside over time as banks become accustomed to their fixed IF revenue. And, regardless of whether or not the IF will increase over time beyond what NACHA has proposed, the imposition of the IF would dramatically raise the cost of ACH transactions. This cost will be passed along to retailers and, ultimately, consumers. And it will undermine the availability of a low-cost alternative to payment cards.

### C. <u>This Proposal raises antitrust concerns and will create economic inefficiencies that will perpetuate a high IF</u>.

Under this Proposal, NACHA, a private actor, would be setting a price for a bank-provided service. Although the Federal Reserve permits and defers to NACHA in the ACH rule-setting space,[5] NACHA has no authority to set prices.[6] Currently, the Federal Reserve and Electronic Payments Network ("EPN") are the two national ACH operators who compete on their own prices. Those are prices which both the ODFI and the RDFI pay for processing ACH

[5] Federal Government participation in the Automated Clearing House is regulated under 31 C.F.R. §§210.2 (a), (d); *see also* 12 C.F.R. § 229.2 (b).

[6] The Federal Reserve has no such power either but even if it did, it would be considered an illegal delegation of the Fed to give up that power.

transactions. Fees do not currently flow between the ODFI and the RDFI. That makes sense – they are not dealing directly with one another.

This Proposal, in contrast, would set a standard price across the entire system. NACHA would be mandating a fee between institutions that do not currently have a fee relationship and it would be instructing and preventing banks from competing on price, thus restraining trade and competition, a violation of Section 1 of the Sherman Antitrust Act.[7] NACHA should not be striving to replicate the years of litigation and controversy that have surrounded payment card swipe fees.

In addition to the antitrust problem, this Proposal also creates serious economic policy concerns. Above all, by setting a central fee that is not subject to market pressure, this Proposal will generate economic inefficiency. As history has shown in other markets, such as the payment card market discussed above, this inefficiency will start small but will soon grow.[8] An inefficiently set fee will result in inefficiencies in other parts of this market – labor costs and other administrative costs will increase – and that will not work to push the fee down, instead, it will push the fee up. Specifically, a fee not set by the market will incentivize spending on services and banks will not be pressured to monitor and compete on costs. Over time, it will become more expensive – not less – for banks to provide this service, and the costs will fall onto retailers and thus consumers.

### D. <u>This Proposal Would Not Update ACH in the Most Technologically Advanced Way.</u>

NACS is concerned that this Proposal would require substantial investment for technology that has already been surpassed in the marketplace. NACS does not dispute that faster ACH processing is needed and valuable, however, NACHA should be pushing investment in real-time processing. Given the speed of technological advancement and the availability of real-time processing – that is already being used outside of the U.S. – and is currently being used in the U.S. for PIN debit, same-day ACH will clearly be obsolete by the time the up-front investments in same-day ACH are paid for (i.e. in 11.5 years). Moreover, financial institutions are not footing this investment cost alone. To be able to utilize same-day processing, merchants will also have to invest heavily to update their file transferring and accounting systems so that they are compatible with same-day processing. No merchant wants to invest in a system that will be considered obsolete when he finishes paying for it – particularly when that merchant is paying not only for its own upgrade costs but those of the financial institutions as well.

In addition, under NACHA's proposal, same-day processing may only benefit merchants operating in the East Coast and Central time zones of the United States. According to the Proposal, any activity occurring after the 3pm EST settlement window – i.e. any time between 3pm EST and 2am EST – will be processed with next-day processing, not same-day. Thus, West

---

[7] 15 U.S.C. § 1.

[8] *See* Economides, Nicholas, "Competition Policy Issues in the Consumer Payments Industry," NYU Center for Law, Economics and Organization. Working Paper 08-56 (2008)(describing how the lack of competition and free market pressures in the payment cards market has led to price distortions).

Coast merchants will not have the opportunity to use same-day processing during some of their busiest hours, 12pm PST to 11pm PST, which fall after NACHA's proposed same-day settlement clearing windows close.

## III. Conclusion

NACS appreciates the opportunity to comment on NACHA's Same-Day ACH proposal. Please do not hesitate to contact me if NACS may provide any assistance to NACHA during its proposal process.

Sincerely,

Lyle Beckwith

Lyle Beckwith
Senior Vice President, Government Relations
National Association of Convenience Stores