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Administrative Politics with Clear Stakes and Venues: Strategic Commenting upon Federal Reserve Debit Card Regulations*

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Because regulation confers benefits and imposes costs, it carries unavoidable redistributive consequences. Many scholars argue that these consequences drive the politics of regulation (Stigler, 1971; Peltzman, 1976). Certainly, the distributive consequences of regulation are a major concern to firms as they engage in legislative lobbying, a well-studied phenomenon. Much less studied has been firms' interventions in regulatory rule-making, particularly through direct lobbying of the regulatory agency as it develops its rules. In this chapter, we provide an in-depth description of the politics of rule-making including direct administrative agency lobbying, in the case of one prominent rule, the so-called Durbin Rule. The Durbin Rule, mandated by the landmark Dodd-Frank banking legislation enacted in the wake of the 2008 financial crisis, required the Federal Reserve Board to regulate fees for debit card transactions. The financial stakes for financial institutions, retailers, and consumers were enormous. The Fed's attempts to write a rule provoked a storm of political activity.

Our theoretical framework highlights two characteristics of potential rules as perceived by firms: the rule's *mechanism clarity* and its *venue clarity*. The former refers to uncertainty about the rule's effects on the firm. The latter refers to uncertainty about who is responsible for the policy and the extent of their discretion. The Durbin Rule was unusual because the consequences

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of any variant were clear to the affected parties. Also clear was the identity of the regulators and their discretion. Under those circumstances, we posit the following:

- Direct lobbying of administrative agencies should be increasing in the discretion those agencies have in choosing policy (venue clarity), while decreasing in the uncertainty with which interests can link the agency's discretionary choice to their expected benefits and costs (mechanism clarity).
- When mechanism clarity and venue clarity are combined with a policy parameter choice that is explicitly zero-sum, we should observe counterlobbying dynamics (one constituency or coalition of constituencies lobbying for an increase in the relevant parameter, and a counter-coalition arguing for a decrease in the parameter.
- If direct administrative lobbying is effective, then observable policy benefits should appear for those who lobbied, as opposed to those who did not.[1]

A single case cannot truly assess these predictions, but it can illustrate them. We study the entire rule-making process, using a wealth of qualitative data. In addition, by analyzing the impact of proposed rules on firms' stock prices, we can gauge quantitatively who won (or stood to win) during the process. The result is a vivid portrait of the politics of rule-making by administrative agencies.

MECHANISM CLARITY, VENUE CLARITY, AND THE DURBIN RULE

Economic Problem and Legislative Action

Debit cards emerged in the 1970s as a way of solving a transaction problem. Retailers who accept payment in check or credit worry that the purchaser will not ultimately pay. Consumers with bad credit face high costs in using such cards. Others believe credit undermines financial self-discipline. Prior to debit, payment alternatives had major drawbacks. Cash transactions introduce physical transportation costs and theft risks. Wire-transfers traditionally require substantial effort to arrange. Debit cards, however, allow retailer and consumer to arrange a bank transfer with a simple swipe. In 2009, there were 37.9 billion debit card transactions in the United States worth 1.4 trillion dollars (Federal Reserve System, 2010).

During a card transaction, most of the action occurs off-stage. First, a card reader contacts the merchant's bank, which will attempt to acquire the necessary funds. This "acquiring" bank contacts the "issuing" bank that gave the consumer the debit card. If the issuer approves, the acquirer signals the retailer,

[1] We forgo a causal analysis in this paper, though see (Libgober, 2020a) for a detailed and exhaustive examination that rules out a range of competing explanations for differential changes in firm valuation.

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who delivers possession of the good. Issuer and acquirer will not, however, directly exchange funds. Rather, they will each have "settlement accounts" with another intermediary, a "network provider" such as Visa or Mastercard. The network provider combines all incoming and outgoing transactions for each account and makes necessary adjustments. "Interchange" fees are what the issuer earns for its service, "network" fees are what the network earns, "discount" fees are what the acquirer earns, and the merchant "pays" all these fees by receiving less than the consumer was charged. A merchant who anticipates these costs may raise prices for consumers. Importantly, the issuing bank does not set its own fee. Rather, the networks compete for the business of the issuing banks, who could choose to give their clients Mastercards, Visas, or other network cards, depending on which interchange fee was higher.[2]

The debit card system had less to do with the financial crisis than the agenda of Assistant Senate Majority Leader Dick Durbin (D-IL). Durbin portrayed himself as a consumer-advocate, tirelessly opposing big finance. Critics have noted Durbin's "knack for delivering on the retail industry's top priorities" (French and Sloan, 2013). At a Judiciary Committee hearing on July 19, 2006, Durbin learned troubling facts. The average American family paid $231 in interchange fees annually, three times the rates in Australia or Canada. Visa's rules governing fees were 1,300 pages long, not available publicly, and allegedly forbade issuers from contracting with American Express or Discover for network services. Following this hearing, Durbin repeatedly offered legislation addressing these market imperfections, without success.

In July of 2009, the Retail Industry Leaders Association invited twenty large retailers to a conference in Washington, DC. Their goal was deciding how to make the most of Dodd-Frank (Mattingly and Schmidt, 2011). The retailers decided to mobilize small-business owners against swipe fees, eventually assembling an email list with more than 20 million contacts. In some cases, they were even more direct, flying small business owners into DC to meet individually with twenty-one Senators. In the midst of the floor debate regarding the Dodd-Frank Act, Durbin offered an amendment that would have the Federal Reserve set debit card fees in such a way that they be "reasonable and proportional." The financial service industry later claimed that this legislative move had taken them by surprise. Indeed, the amendment was carried 64-33 without any Senator taking the opportunity to debate Senator Durbin on the merits.

Administrative Policy: Proposals, Delays, and Revisions

As enacted, Section 1075 of Dodd-Frank was ambiguous. Informed observers argued the Board's implementation could ban interchange fees entirely or issue unenforceable "guidance" for Visa and Mastercard describing what they should

[2] Evans and Schmalensee (2005) offer a nice history of this market.

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charge.[3] Ultimately, the Federal Reserve would take a middle-path, setting a price cap on interchange fees. Importantly, Section 1075 exempted "small" issuers with fewer than 10 billion in total assets. Only the top 1% of issuers were directly subject of regulation. Nevertheless, estimates suggest big issuers represented over 70% of the market (Evans, Chang, and Joyce, 2015, 62). Given the strong possibility that top-tier norms might spread, the more than 12,000 second-tier issuers had substantial stake as well. Section 1075 also included provisions aimed at promoting increased competition by prohibiting "network exclusivity" arrangements and incentivizing fraud-prevention. Final regulations were due no later than nine months after enactment on July 21, 2010, a tight time-line. As a kicker, some provisions became effective on July 21, 2011. Failure to issue rules would allow stakeholders to enforce the law in court, potentially leading to judicial intervention on agency turf.

On December 16, 2010, the Board proposed a rule implementing the Durbin amendment. They suggested two possible formulas for defining a reasonable interchange fee, and asked for comment on which to enact. Under the first, up to seven cents per transaction was permissible. If the issuer wanted more, it would need to establish its average variable costs per transaction were higher than seven cents. Nevertheless, this increase could not exceed \$0.12. Mathematically,

$$\text{Per Transaction Interchange Fee} \leq \max\{\min\{\text{Average Variable Costs}, \$0.12\}, \$0.07\} \quad \text{(A)}$$

The second alternative was a simple price cap at \$0.12 per transaction:

$$\text{Per Transaction Interchange Fee} \leq \$0.12. \quad \text{(B)}$$

The proposal also suggested two approaches to incentivizing fraud-prevention. Under the first, card issuers could charge more to offset the costs of using specific technologies known to prevent fraud. Under the second, an issuer could charge more to offset the costs of running a fraud-prevention program that satisfied Board-specified standards. It also described two approaches to network competition. One would require a card issuer to accept transactions over at least two non-affiliated networks, regardless of whether the network relied on PINs or signatures for authorization. Since most merchants cannot accept PIN transactions, this alternative would not greatly induce network competition. The other alternative would require issuers to carry at least two networks for both PIN *and* signature transactions, a much tougher requirement.

Despite its plans, the Board would find itself receiving comments for longer than the usual sixty days from publication in the Federal Register. Over 11,000 letters were sent to the Board about the rule. Most were form responses that contributed minimally to debate (Mendelson, 2012). Nevertheless over 1,500 comments were unique, and hundreds were submitted by associations,

[3] In order to simplify presentation, links to primary source material referenced without citation are reserved for the Appendix.

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organizations, or firms. On March 29, 2011, Chairman Bernanke informed oversight committees in Congress that the Fed would miss its legal implementation deadline of April 21st, but was committed to completing rulemaking before the July 21st legal effective date.

On June 29, 2011 the Federal Reserve approved a final rule implementing the network competition and interchange fee portions of the Durbin Amendment. Interchange fees would follow this formula:

$$\text{Per Transaction Fee} \leq \$0.21 + 0.0005 \times \text{Cost of Transaction}.$$

This formula represented a massive reversion to the pre-legislative status quo. According to the proposed rule, the average interchange fee in 2009 was 23 cents for PIN transactions and 56 cents for signature transactions, or 44 cents overall (75 FR 81725). The final rule would entail no reduction in rates for PIN networks relative to 2009. The rule would hit signature debit cards harder, but the bite was a fraction of what the Board had first proposed. As for network competition, the Board implemented the weaker alternative A, which was "universally preferred" by issuers and network providers (Staff Memo, June 29, 2011).

The Board issued a separate interim final rule addressing fraud. Tentatively, they would allow $0.01 in additional fees for those who ran a suitable fraud-prevention program. The Board indicated openness to comments on whether to require specific technologies or adjust the incentive-fee. On July 27, 2012, the Board confirmed its interim approach. Senator Durbin described the Fed's implementation of fraud-prevention as "incompatible with both the plain text and intent of Section 1075" (Durbin Letter, September 30, 2011).

Proposal Development

Table 14.1 outlines the stages of an archetypal proposal-development process according to the published procedures of the Board (Federal Reserve Board, 1979), which are similar to the procedures of other agencies. The process begins by forming a team to work on writing the regulation. Next, the agency begins the task of formulating the regulatory problem, in particular developing an account of the primary and secondary goals of regulation, identifying important stakeholders, and developing a blueprint of what data collection and analysis steps they will need to complete before publishing a proposal. The agency will then acquire necessary data, analyze it, and in the final phase formulate policies based on this data and analysis. One should not assume rule development

TABLE 14.1 *Stages of rule development*

Phase I	Phase II	Phase III	Phase IV	Phase V
Team Formation	Problem Definition	Data Collection	Analysis	Policy Selection

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processes always conform neatly to this archetype. Indeed, insider accounts suggest that hardly anyone pays attention to these internal guidance documents (West, 2009). For presentational purposes, however, the development of the Durbin Rule appears to have fit the archetype relatively well.

As others have noted, the debit card rule involved a fundamentally "new set of responsibilities for the Federal Reserve" (Open Board Meeting, December 16, 2010), more akin to utilities regulation than bank supervision. Although the Board's staff are experts on payment systems, most of their prior work concerned institutional banking and not retail. To understand retail systems, the staff would depend on outside interests such as card issuers, network providers, merchants, and consumer groups. Without it, they would not know how to begin formulating their regulatory task, let alone solving it. Two days after Dodd-Frank was enacted, staff from the Division of Reserve Bank Operations and Payment Systems (DRBOPS) met with Visa to discuss implementation of the Durbin amendment. Visa's presentation emphasized three key themes: the large number of stakeholders that depended on debit, the usefulness of these services, and the complexity of the field at play. For example, Visa noted that interchange policies are calibrated biannually and discriminate between features such as whether the transaction is face-to-face, online, or a recurring payment, for example because the risk profiles of each transaction necessitate different authorization procedures. Their powerpoint did not explicitly mention the Durbin Amendment or its interpretation at any point. Thematically and informationally similar presentations were given by Mastercard, Bank of America, JP Morgan, and others. No presentation by a major issuer or network explicitly addressed policy selection issues before October 4th, precisely when the agency was shifting from data acquisition to data analysis. The lobbying of these largest regulated players demonstrated sophisticated situational awareness about where the staff were in the rule development process and what information the agency was most likely to actually use.

On August 5th, DRBOPS staff met with Visa to discuss a potential survey of issuers to identify costs, an indication that staff were moving from problem formulation to data acquisition. Visa's presentation focused on the methodology behind the issuer benchmark studies that Visa "has been evolving … for more than three decades." Although the staff may have wanted to benefit from Visa's prior experience, the design of the survey instrument had significant distributive implications. For example, it is notable that the sample population focused on the 131 institutions with 10B+ in assets. While these institutions were the only ones subject to the cap, representatives of the 12,000 smaller issuers believed their fates were linked to the bigger issuers. As Mary Dunn, deputy counsel at the Credit Union National Association, emphasized to DRBOPS Chief Louise Roseman during an August 6 phone call, "higher interchange fees to small issuer … may not be accommodated in the marketplace if interchange fees to large issuers are much lower." The decision not to collect data about the, likely higher, costs of the smaller banks represented a significant bet by the

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Federal Reserve that either (a) a two-tiered market would form or (b) if a single-tiered market were maintained, then the effect on smaller entities was not a significant component of the Board's regulatory problem. The failure to address the impact of regulation on smaller banks would later produce significant political blow-back, illustrating the pivotal importance of even subtle issues in rule development. Also noteworthy is that the small issuers advocacy at the earliest stage was focused on policy selection, at a time when the majority of the staff's meetings suggest they were focused on how to collect data. The small issuers lobbying did not demonstrate the same situation sense as the biggest financial institutions.

The survey was fielded between September 13 and October 12. After September 13, the Board changed gears in two ways. High-level officials were deployed to sell the agency's process to the regulated industry. In the last half of September, Director Roseman, Governor Tarullo, and two other associate directors gave presentations about the Board's process to the American, Maryland, and Indiana Bankers Associations, respectively, apparently answering questions but not actively soliciting information. Additionally, the board began to receive presentations from retail interests for the first time. On September 15, the Board met with Craig Wildfang, lead counsel in a 7.5 billion dollar class-action anti-trust suit against major issuers and network providers. Wildfang presented himself as an available resource, offering to share 60 million pages of materials uncovered via litigation or connect the Board with other lawyers representing retail interests. On October 13, the staff had its first significant meeting with consumer groups, almost three months after its first meeting with Visa. These groups argued that Durbin should require "par clearance," or de minimis exchange fees, the same as checks. There is no evidence in the logs that anyone had previously advocated this viewpoint, *after* the survey was fielded. If consumers had persuaded staff that zero was the reference point, not the cost of providing the service, it is likely that a different and harsher proposed rule would have emerged. Nevertheless, since the agency had already invested a great deal in estimating service provision costs, it is unlikely that the no fee position was seriously considered.

As October turned to November, the Board began receiving communications targeting the specifics of interpretation and rate setting. A key point to understand about the arguments that were made is that the more capacious the definition of cost, the larger the potential revenue for financial institutions. Commerce Bank, for example, gave presentations describing hundreds of distinct marginal costs in providing debit cards. The Clearinghouse, a bank trade association, sent a letter on November 1 arguing fees should include "all costs incurred … plus a return on capital," and that anything less was a violation of the Constitution's takings clause. Oliver Ireland, Visa's attorney and senior partner at Morrison and Forrester, argued that the Board should allow "non-variable" costs related to the provision of debit cards, and also raised the takings issue. Celebrated University of Chicago economist Kevin

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Murphy submitted his own views, at the behest of Bank of America, on what "incremental costs" should mean: any costs that vary with the number of debit transactions, and also floated the notion that the amendment might only require guidance. Georgetown Law School's Steven Salop, at the behest of a retail coalition, submitted a white paper describing how the Board could issue a rule saying debit cards should clear at par, unless the issuer could establish to the regulator that the fee would "clearly lead to likely consumer benefits" (Merchants Payment Coalition Letter, November 2, 2010). Since he believed this standard was unmeetable by most issuers, fees would as a practical matter equal 0.

Although it is impossible to conclusively determine what influence these meetings had on the Board purely from the logs, taken together they suggest a multiplicity of reasons for efficacy. The firms that participated earliest had significant opportunities to shape the staff's formulation of its regulatory problem and data collection strategy (Naughton et al., 2009). The largest financial institutions like Visa were given many opportunities to contribute in this fashion, in part because they possessed information that was helpful for formulating a plan for issuing a reasonable regulation (McCarty, 2017), in this case experience with running similar surveys. At the same time, these interests may have succeeded to some degree in influencing the staff's values and perspective on the subject matter being regulated. Many interest groups that participated later in the process subsidized the production of policy more favorable to their interests by describing specific language to include in the regulation and providing economic, legal, or policy rationales for their preferred approach (Hall and Deardorff, 2006). Meetings also allow for saber-rattling about legal claims that stakeholders might make post-finalization (Yackee, 2006). Meetings at all stages plausibly allowed regulator to gauge the intensity and range of preferences among stakeholders. Conversely, early meetings allowed interests the opportunity to experiment with different kinds of arguments, perhaps learning through these encounters where the regulatory might budge. More speculatively, outside advocacy may have also contributed to the decision to give further study to the fraud-prevention issue, an exercise of agenda control (Yackee, 2012). Although these reasons for influence are likely to reveal themselves in proposed rules, many might prove durable across the months and years that rulemaking requires.

Zero-Sum Politics, Commenting, and Free Riding

The debate visible from post-notice meetings and written comments was similar to what occurred earlier. Yet the conflict was louder and broader. Over 11,000 comments were submitted to the regulatory docket, the vast majority from community banks, credit unions, and small business owners. Most of these letters engaged sincerely, but not very substantively, with the proposed rule. The CFO of North Georgia Bank wrote that his bank "projects that the proposed

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changes will reduce non-interest income by over 10%." The owner of a Mister Bagel franchise wrote that "Credit card companies are getting richer and richer on the backs of small business owners … Support small business owners by supporting the cap on debit fees."

The more substantively meaningful engagement involved a smaller set of core market participants, advocacy organization, and policy experts. Many, but not all, of these actors had been involved in rule development. Georgetown's Steve Salop had a meeting with Janet Yellen to explain the no-fee position, which Craig Wildfang also wrote a long letter to support. Visa, Mastercard, JP Morgan, and other regulated firms recapitulated their position. Yet their advocacy had a different tone. They did not emphasize complexity and value, but rather distortions and and perverse consequences for underrepresented interests. For example, the first fault Mastercard found with the proposal was the "fail[ure] to consider the consequences the Proposal would have on key payment system constituencies, including consumers, community banks and credit unions." Consumer advocates' role in the rulemaking, to this point lackluster, now became ambiguous. On January 7, 2011, general interest organizations such as AARP met with Governor Tarullo to explain why they had taken no formal position on the rule. The Consumer Federation of America wrote to explain their concerns about the effects on retail consumers and debit card users. They also noted that based on data from their member credit unions, the costs of providing debit cards was above the cap the Federal Reserve had set based on data from larger institutions. It is notable that this interest group held itself out as having comparable expertise in designing cost surveys as Visa, but was not active in rule development.

Many substantive comments emerged from interest groups that had not previously participated. Associations of Lumber Dealers, Air Carriers, Grocery Store Owners, and others wrote to ask the Board to tighten the fee. Numerous members of Congress, as well as a State Banking Commission, wrote to defend the interests of local banks. A smattering of big firms in retail and banking who had not yet participated, such as PNC Bank to McDonalds, now sent letters. These comments often reiterated previously identified concerns. However, some noted important issues that had not received enough attention. For example, a number of firms claimed that complying with the network exclusivity requirements would prove difficult to impossible on the Board's proposed timetable (HSBC Letter). A number of companies also wrote to note that they were outside the regulatory perimeter of the proposed rule, and insisted that the Board keep it that way (American Express Letter, ISIS Letter). Both requests were granted in the final rule.

To show that the zero-sum nature of the fee constraint and the high traceability of interests' welfare to the parameter choice induced a qualitatively and quantitatively different kind of lobbying, we examine commenting on the Durbin Amendment in context of other Dodd-Frank rules. Figure 14.1 shows the total number of comments received by the two rules on debit card regulation

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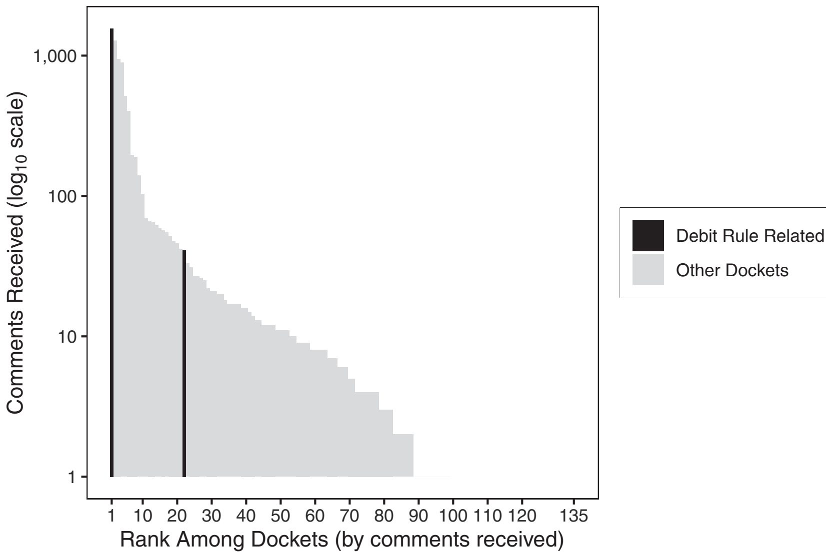

FIGURE 14.1 Distribution of Dodd-Frank rulemaking dockets ranked by number of comments received

Bars indicate the dockets for the first NPRM (left) and for the interim rule (right).

as part of the overall (ranked) distribution of the number of commenters for all rules issued under Dodd-Frank. The debit card fee constraint rule was the single most commented-upon rule in all of Dodd-Frank, and the fraud prevention and fee adjustment rule was also in the top third of rules. This is so in spite of the fact that by any plausible reckoning, the Volcker Rule and other capital standards regulations clearly carried greater aggregate economic impact than did the debit card rules. Because a general measure of "traceability" across rules is elusive, we use this case-centered approach for demonstrative purposes.[4]

Beyond the sheer number of commenters, our theoretical perspective also suggests that the distribution of commenters should look different for the debit card rules. Given the staggering qualitative heterogeneity of rules, this is a complicated undertaking, so we focus our analysis on those aspects of the commenters that involve non-financial and non-bank organizations. To measure the concentration of comments within industrial categories, we compute a Herfindahl index of the concentration of commenting activity in one industrial category; lower values of the index imply a lower level of concentration and, in turn, a greater diversity of commenters based on breadth of economic interest. We find that the Herfindahl index of commenters across

[4] We do not attempt any statistical analysis of this distribution, as the point seems demonstrated sufficiently by the primary rank of the debit card fee rule.

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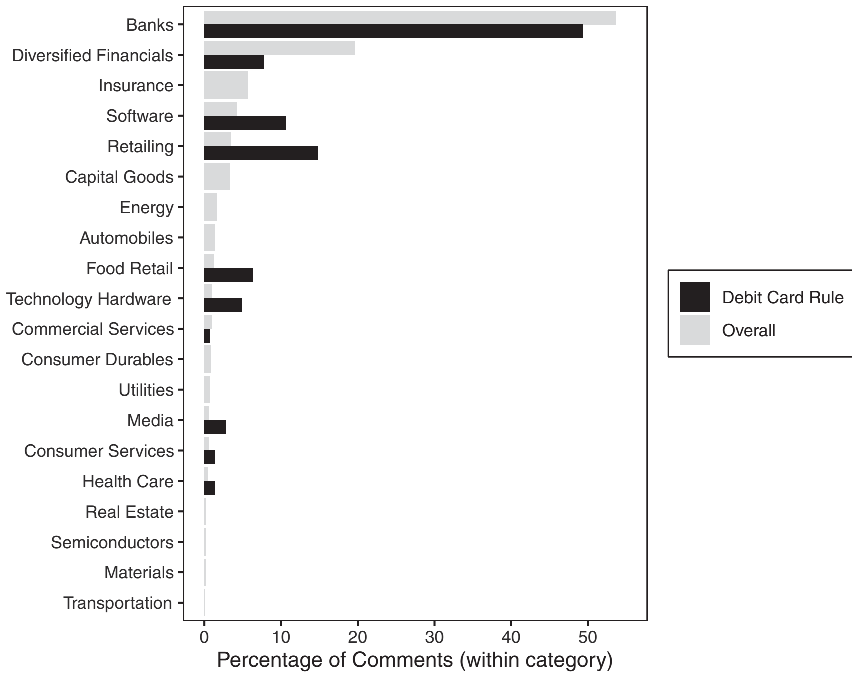

FIGURE 14.2 Proportion of comments from publicly traded companies according to global industrial classification system industry group

all Dodd-Frank rules is 0.303, but for the Durbin Amendment rules it is 0.255. A skeptical reading might simply claim that this is because the debit card rule brought non-bank (or non-financial-services firms) into play, but if we restrict the sample of commenters to non-bank firms, we observe an all-Dodd-Frank HHI of 0.185, while we observe a Durbin-related HHI of 0.154. Here too, our evidence is suggestive rather than statistical, again because of the difficulty of producing a cross-rule measure of mechanisms and venue clarity. Yet among the population of Dodd-Frank commenters that includes banks, as well as among that population that excludes them, the Durbin-related rules attracted a greater diversity of commenters than did other rules (consult Figure 14.2).[5]

[5] We think, however, that this measurement exercise would form an excellent research agenda for the next generation of Arnold-inspired regulatory politics scholars. We would start with the cautionary note that just examining the degree of quantification involved in a rule would be an insufficient place to start, as quantification might raise the degree of traceability if in fact several organizations collaborate to the parameter choice, and or if the parameter-choice problem involves beforehand the determination of a number of other parameters and functionals that feed in to the final choice (as, say, the calculation of costs and benefits for a particular rule might depend heavily upon separable decisions about discount rates, or estimates of the cost of a statistical life).

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Although the breadth and depth of engagement by retail and banking interests was profound, what is arguably more remarkable is the extensive free-riding. The vast majority of small issuers, who were presumably in positions similar to North Georgia Bank, did not submit comments. Most of the largest banks *also* did not submit comments. If one were to speculate why, one would have to assume it had to do with their belief that the trade association would lobby on their behalf, and so too would other organizations that were similarly affected. Yet this argument could easily prove too much. Why did *any* firms participate in rulemaking, besides oligopolists such as Visa or Mastercard? The self-selection mechanisms at play here remain perplexing. The extent of free-riding raises the serious possibility that both our aggregate commenting measures and our commenter concentration measure *understate significantly* the degree of diverse and high-intensity commenting and influence activity on the debit card rules.

Off-Stage Action and Aftermath

While some financial institutions and retailers were engaging the Board, others were advancing their interests elsewhere. Shortly after the rule proposal, a banking consortium gave the Electronics Payment Coalition (EPC) a starting budget of 11 million dollars to build grass-roots support for repealing the Durbin amendment (Mattingly and Schmidt, 2011). One use of these funds was to run ads in the DC Metro. They also hired high-power congressional lobbyists. To Republicans , lobbyists described typical big government interference in well-functioning markets. To Democrats, they talked about access to banking services. Besides more conventional lobbying and media engagement, some banks also sought to mobilize their clientele. JP Morgan notified Disney Rewards customers that they were discontinuing the program, citing a "new law known as the Durbin Amendment (emphasis in original) (Mattingly and Schmidt, 2011).

On February 17, 2011, Chairman Bernanke and Governor Raskin appeared before Senate and House oversight committees, respectively. While the questioning was polite, doubts about the amendment were palpable. "[A] move from 45 cents down to 12 cents, that is a glaring 73 percent reduction. Is that fair?" asked Representative Scott (D-GA). Representative Hensarling (R-TX) was more blunt: "I just wonder how 7-Eleven would feel if the Federal Reserve came with a rule that said you can only recover incremental cost of selling a Slurpee." A repeated theme in bipartisan questioning was the effect of regulation on community banks. "Is there any way to actually ensure that community banks and credit unions are exempted in practice from this provision?" asked Senator Tester (D-MT). Bernanke did not defend the rule vigorously, saying that there were no guarantees and giving two reasons why the small-issuer exemption might not work. Tester turned to Bernanke's co-witness, FDIC Chairwoman Bair, to ask if delaying the Federal Reserve's implementation

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would make sense. "Yes," she replied, "Look, there are legitimate policy arguments on both sides of this, but it was done very quickly."

Tester would join Senator Corker (R-TN) in offering a bill to delay the implementation of the debit card interchange regulation, in order to allow further study. The retail coalition reacted with alarm, once again footing the bill for local retailers to meet with their representatives in Washington. Tester-Corker would eventually get fifty-four votes, which was insufficient to overcome a filibuster.

While some representatives from finance went to Congress, others went to court. TCF Bank filed suit on October 12, 2010 in the District of South Dakota, seeking a declaration that the Durbin Amendment was unconstitutional even before the rule was proposed (McGarity, 2012). Although the case was described by observers as a "Hail Mary," it attracted many amicus briefs from interested parties on both sides (Serres, 2011). The court refused to enjoin the rule because it did not believe TCF would win on the merits, a position that was affirmed on appeal.

Interestingly, following the issuance of the final rule, the *retailers* felt themselves sufficiently aggrieved that they sought judicial review. They wanted to correct the doubling of the fees and the weak competition requirement (NACS v. Board, DC Cir., 2014). The retailers' case was stronger. Indeed, the district court in DC would give them summary judgment, finding the Board's interpretation of the statute "utterly indefensible." The Board was ordered to correct its mistakes by not allowing compensation for costs that were not truly incremental, and also imposing a strong network competition requirement (NACS v. Board, D.D.C, 2013). Nevertheless, on appeal, a unanimous circuit court held that the Durbin Amendment was drafted ambiguously and the agency was entitled to make the rule it wanted. The merchants appealed the reversal to the Supreme Court, but certiorari was denied.

ASSET PRICE ANALYSIS OF THE DEBIT CARD RULE

The Market Anticipates and Responds to the Proposed Rule

Although the details of policy implementation were varied and technical, they represented big money for market participants, who were well-incentivized to pay attention. Contemporaneous accounts of business journalists and equity analysts attest that the market reacted strongly to these regulations. Dozens of examples are cataloged in Evans, Chang, and Joyce (2015), an inter-day event study analysis of debit regulations that also found significant market impacts. The direction of these effects were as expected: the proposal hurt debit providers and the final rule helped. Nevertheless, it is worth clarifying how and why markets were able to register these facts within hours *if not minutes* of regulatory announcement.

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Over the summer of 2010, debit providers convinced markets that the Durbin amendment was not so ominous as it initially seemed. In a teleconference with analysts, Visa's CEO said the regulatory risk was "minimal," since only interchange fees would be capped, not network fees. Analysts agreed. "What is at stake [for Visa] is the 6.7 basis points of volume fees," wrote one, so as long as cuts are not "draconian" enough to cause an exodus from debit cards, the fundamental business model of Visa would remain strong (Janney Capital markets, May 19, 2010). A Morgan Stanley note from September 20 also read the tea-leaves on the Board's extensive engagement with industry during the rule-development phase: "[The Board seemed] very intent on learning more about the industry and avoiding unintended consequences." Analysts who covered card issuers instead of networks agreed that regulated entities would adjust, for example by cutting costs or imposing minimum balance requirements.

On December 9th, the Board notified the public that the debit card proposal would receive a vote at the next Open Meeting, scheduled for 2:30pm on the 16th. The meeting would have a live-stream and staff summary and rule text disseminated shortly before. Analysts sent last minute advice to their clients. A December 15th report from JP Morgan Equity Research was typical:

> Our sense is that the market is pricing in (1) … that regulators will not require multiple signature networks on debit cards … and (2) a 50% reduction in debit interchange rates. If consensus is right, a modest relief rally is likely … The bad case is if signature debt can no longer be exclusive. **We would be incrementally more negative on both stocks if signature debit cards can no longer be exclusive to one network** … This is a low probability (< 20%) risk, but it can't be ignored. (Huang and Smith, 2010)

Notably, these analysts, who covered Visa and Mastercard, were more concerned about the complex network competition provisions than the easier to parse rate formula. Around or shortly after the start of the meeting, the same analysts at JP Morgan sent their clients a single-page alert, entitled "More Negatives than Expected." The first bullet-point emphasized that both hard and soft exclusivity requirements were still under consideration, while the second emphasized an 80–90% cut to interchange fees, much worse than prior consensus. Figure 14.3 shows the price of key stocks on the afternoon of December 16. Visa, the leading network-provider, lost 10% of its market valuation in less than an hour. JP Morgan, a prominent issuer, bore a less severe, but still significant 1.5% loss over the same time domain. Walmart, a retailer, found its stocks climbing significantly. The reaction for Discover, an alternative network to Visa, was more mixed. For Discover, more competition and lower fees meant a bigger proportion of a shrinking pie.

Market analysts continued to watch the rule development process and form their expectations accordingly. On June 22nd, the Board notified the public that they would meet at 3:30pm on the 29th, with materials posted online shortly before. Equity analysts again simplified the task of interpreting the

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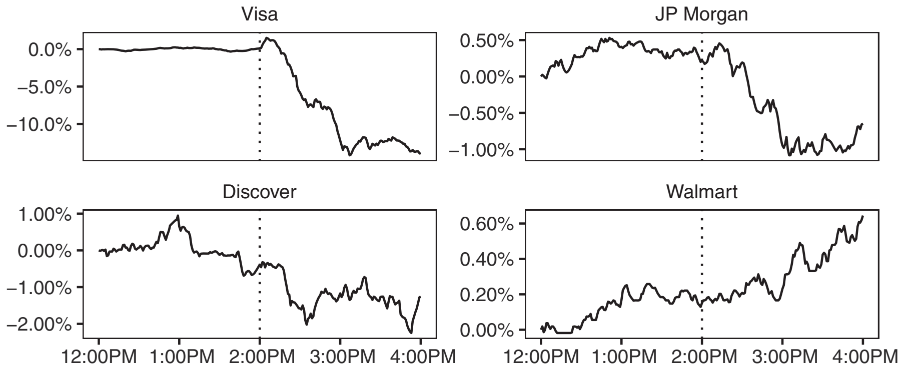

FIGURE 14.3 Percentage returns for key stocks on afternoon of NPRM, December 16, 2010
Webcast of Open Board meeting was scheduled at 2:30pm, with staff memo and rule released shortly before. Vertical dots indicate 2:00pm.

announcement by providing valuation models under a variety of regulatory scenarios. Analysts at Jeffries described market expectations.

> The consensus expectation is for the interchange fee to be increased to the $0.15–$0.20 range in the final rules, from $0.12 in the proposed rules ... [While we believe] multiple signature/multiple PIN would prove very cumbersome for the industry to implement, and further . . . our checks have indicated that there is a greater chance that the Fed will go with the much simpler single signature/unaffiliated PIN scenario, the final outcome of the Fed's rulemaking process remains unclear. (Kupferberg and El-Assal, 2011)

The final rule was better for debit providers on both counts. Figure 14.4 shows how the price of Visa, JP Morgan, Discover, and Walmart responded on the afternoon of June 29. Shortly after 3:00pm, Visa's share price increased almost 10%, leveling off around 15% higher before market close. The +1% and +2% reactions for JP Morgan and Discover were also symmetric reversals of what happened at proposal. Walmart's reaction was negative, as expected.

The Market Reacts to Finalization

The policy issues raised by the Durbin rule were sufficiently complex that the Federal Reserve would ultimately finalize two separate rules in response to its initial proposal of December 12, 2010. The first one addressed the reasonableness of fees (76 *FR* 139) and the other addressed fraud-prevention standards (77 *FR* 46258). Because we require intra-day trading data, we can only examine the second of these rules for firm-specific differences in returns, as the final rule for the first regulation was not announced during trading hours. However, we describe the aggregate, inter-day change in issuers' stock prices below as illustrative of the stakes involved.

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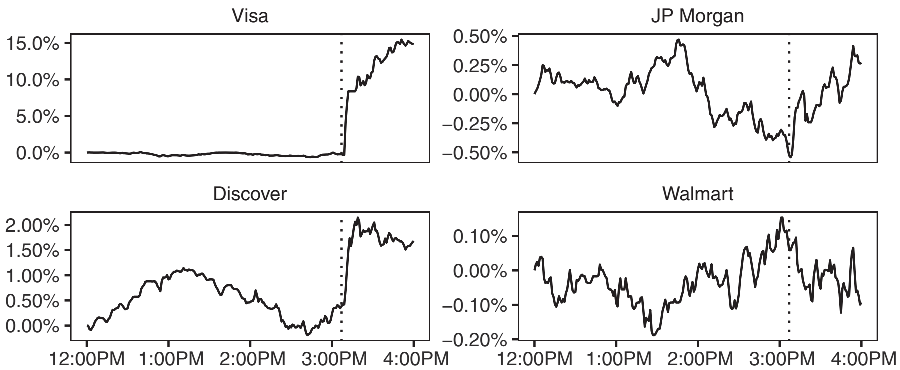

FIGURE 14.4 Percentage returns on afternoon of finalization, June 29, 2011
Webcast of Open Board meeting was scheduled at 3:30pm, with staff memo and rule released shortly before. Vertical dots indicate 3:07pm.

We focus on the fraud-prevention standards component of the rule, which was announced at noon on July 27, 2012. First, we analyze the market performance of four publicly traded companies between 11:00am and 1:00pm that day: Apple, BlackRock Financial, American Express, and Capital One Financial. Apple and BlackRock serve as our placebos, since the future profitability of neither electronics manufacturers nor investment managers seems obviously connected to debit card fees.[6] Indeed, neither firm commented. By contrast, payment processors like American Express and Capital One were directly concerned and both submitted comments that discussed the issue of fraud-prevention standards. We briefly summarize the issues at stake in rulemaking in order to identify how we should expect the market to react for those two firms.

The Durbin Amendment allows issuers to charge additional transaction fees reimbursing the issuers for fraud-prevention costs. The two key issues at stake in rulemaking were the size of the fees and what kinds of fraud prevention measures would qualify. The proposed rule did not set a maximum fee and outlined two possible approaches to qualification: (1) a rules-based approach that would require the adoption of certain technologies and (2) a more flexible approach based on standards. American Express, Capital One, and many other issuers submitted letters requesting high-fees and flexible qualification standards. Merchants wanted lower fees and less flexible qualification standards. The interim final rule of June 29, 2011 adopted a 1% fee and provisionally established a standards-based approach. The outcome was a clear victory for the issuers. As the National Association of Convenience Stores lamented,

[6] Apple certainly does have *some* exposure through its chain of retail stores. However, its 2011 10-K makes clear that the Apple Store is a relatively small component of its business, with 88% of sales deriving from other sources.

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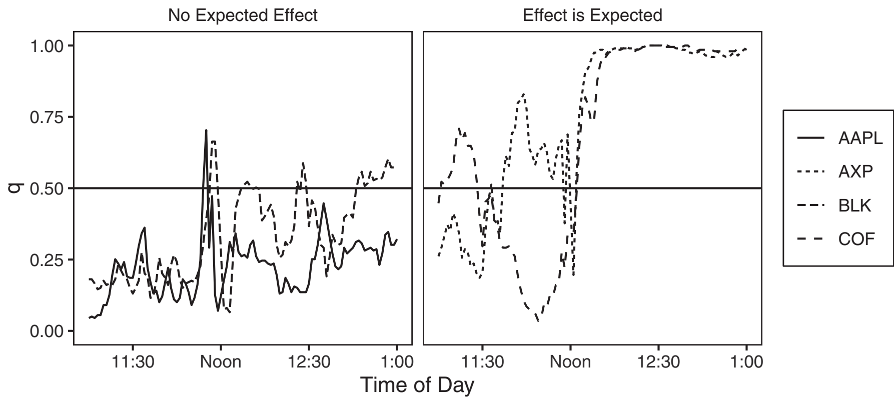

FIGURE 14.5 $\hat{Q}^k_{i\omega(j)}$ for two firms benefitting in expectation and two firms in expectation not affected.

"the Rule lacks any mechanism to ensure that issuers receiving the fraud prevention adjustment are actually preventing fraud." Senator Durbin himself sent a letter to the Federal Reserve insisting that the Board "must address the shortcomings of the interim final rule by implementing a final rule that requires actual compliance with effective fraud prevention steps in order for a fee adjustment to be allowed." For their part, Capital One and other issuers sent comments supporting the interim rule. The final rule largely confirmed the approach of the interim rule, including the 1% fee and non-prescriptive qualification standards. As proof-positive of their displeasure, retailers sued the Board over the rule. For our purposes, the important point is that we should expect a favorable market reaction for representative issuers Capital One and American Express.[7]

Figure 14.5 shows the change in price for each stock relative to its price at noon on July 27, 2012. The price path for Capital One and American Express both indicate notable upward jumps shortly after noon, while Apple and BlackRock do not. In order to emphasize the magnitude of these jumps, the illustration also shows what would have been observed at noon on each of the previous 100 days. Against this 100 day benchmark, the price paths of Apple and BlackRock are unremarkable before and after noon. While American Express and Capital One are also quite typical between 11:00am and noon,

[7] The interim final rule was released too late in the day to permit for the intra-day measures we use. Yet payment processor stocks rose strongly in the following trading day. See Glenn Schorr, "Volcker Rule Due Out Soon: Hopefully More Bark Than Bite," October 6, 2011; `http://xa.yimg.com/kq/groups/17389986/555239495/name/NOmura+US+Bank+%26+Brokers.pdf`. We examine only the July 2012 rule here, which suggests that our estimates of commenter benefits are, if anything, underestimated, as some of the market reaction favorable to payment processors took place over a year beforehand.

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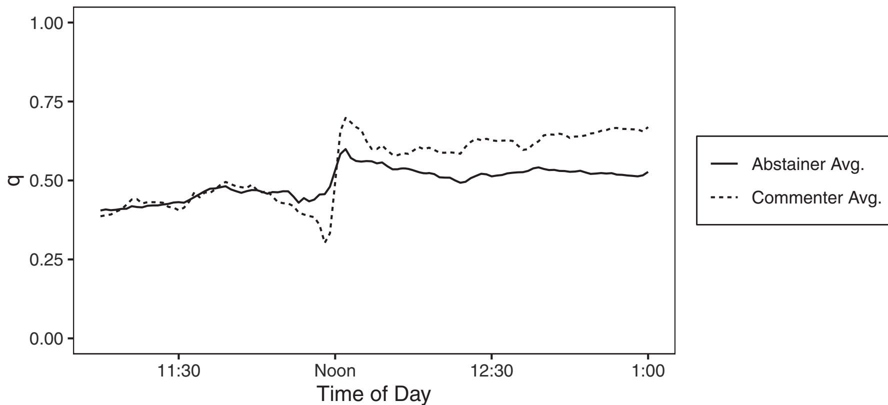

FIGURE 14.6 Illustration of common trends among commenters and abstainers prior to rule announcement: Debit card final rule announcement, July 2012

after the first few minutes the returns are higher than would have been observed on previous days, and stay that way throughout the hour.

Figure 14.6 shows what happens when we separately average the reactions of US financial firms that commented on the Durbin rule and those that abstained. We focus on using quantile returns, the construction of which is described in more detail in the appendix of (Libgober, 2020a). In contrast with the variability of firm-level returns (see Figure 14.5), returns that are averaged across several firms are quite stable. Indeed, for abstainers, these returns are essentially flat around 0.5.[8] Second, note that before noon the two paths are similar. Around the announcement time the returns of the commenters become more volatile. By 12:15pm the difference between the curves is apparent and remains stable over the hour.

While we have thus far used the Debit Card rule to emphasize the logic of our empirical method, the case also fills out the larger story that emerges from looking across the entire set of rules. The retention of the interim rule's outcomes represented a preservation of policy wins for card-issuing banks. In particular, it allowed issuers the right to "tax" retail transactions for costs that were largely illusory, at least according to the merchants and Senator Durbin. For producers, preserving these wins were crucial. The burden of these fees for most merchants was small. For some large retailers, like Amazon or Best Buy, the little burdens may have been enough to justify commenting, but even for them the 1% fee hardly represents an existential threat to their business. Indeed, bank letters were notably more numerous and more detailed than

[8] Note that there is some evidence that *abstainers* stock experienced a positive response as well at noon, consistent with the notion that some banks materially gained by "free-riding" on others' commenting activity.

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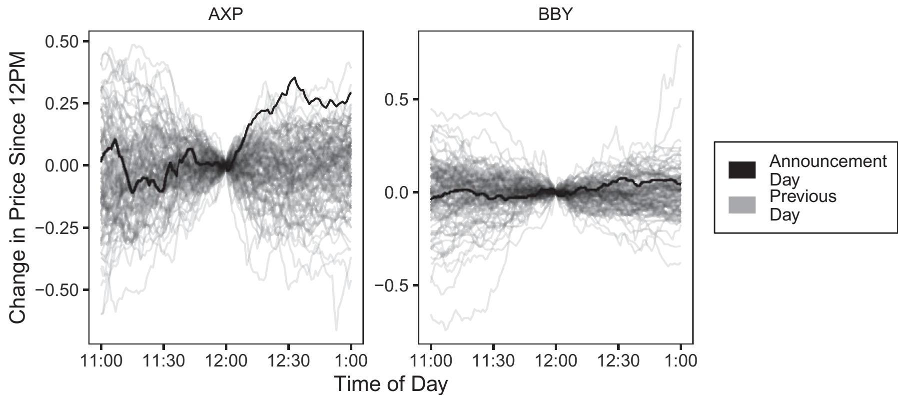

FIGURE 14.7 Returns to final rule for American Express and Best Buy 2012

the merchants at both the proposal and interim final rule stage. Consumer advocates were hardly represented at all. As an illustration of how well commenting financial firms did relative to commenting non-financial firms, American Express experienced returns near the top of its quantile returns distribution while a representative merchant (Best Buy) saw flat stock returns (see Figure 14.7).[9]

This case study demonstrates that increased mechanism clarity can be observed in the rapidity of market responses to the event of rule issuance. Public deliberation allows interested observers to identify a finite set of possible alternatives and their consequences. One of the two major outcomes was partially capturable in a number – the retention of the one cent adjustment. The other major issue was only slightly harder to understand, standards versus specific technologies. The Fed's press release makes clear which way the rule went on both issues, and so does the rule's preamble. Unsurprisingly, the market reaction to the debit card rule was immediate and sustained. Indeed, the differential returns experienced by commenting firms are observable very quickly after final rule announcement, as commenters saw returns at the 60th percentile of ranked returns after just five minutes ($\hat{\beta} = 0.1000$ (0.0374), $p = 0.008$). Average returns after the first hour were highly correlated at $\rho = 0.55$ ($p < 0.001$) with the returns in the first five minutes.

Lessons from the Final Rule on Maximum Interchange Fees

The final rule on maximum interchange fees was issued on June 29, 2011. The rule was highly anticipated and, from all accounts, anxiety-provoking.

[9] Amazon's stock rose in the aftermath but that rise had started fifteen minutes before the final rule for reasons unrelated to the rule.

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In the proposed rule, issued December 16, 2010, the FRB suggested a maximum interchange fee of 12 cents per debit card transaction. Payment processor firm stocks fell by 7% immediately after the announcement. Comments soon flooded the FRB from payment processors. The letter of American Express (sent February 22, 2011) was indicative of financial institution comments. It combined a dual legal argument (that the EFTA did not give the Fed authority to impose a price cap upon debit card transactions, along with the argument that no cost-benefit analysis or economic impact analysis had been done) with an economic argument that the price caps would be inefficient, damaging both to consumer welfare as well as producer welfare. Here firms mobilized not only legal expertise but also industrial organization expertise. American Express contracted with Princeton economist Robert D. Willig, who wrote a memorandum arguing that "if the price-setting or price-capping mechanism described in the NPRM were applied to American Express, the result would be seriously damaging to the Company's prepaid business and … ultimately to merchants and consumers."[10]

The final rule represented a medium among the competing demands. A price cap upon interchange fees was kept, but was raised from 12 cents to 21 cents, as well as five basis points of the transaction amount. Payment processor firms immediately saw a 5% increase in stock price. [11]

The trajectory of debit-card rulemaking was closely watched by equity traders (as evidenced from the intra-day movements) and, what is even clearer, by equity market analysts. This not only because of the stakes involved and the zero-sum nature of the policy choice, but also because the debit card rules were some of the first rules that went through the notice-and-comment process under Dodd-Frank rulemaking (this is especially so for highly significant, economically influential rules). In an important and influential memo written in October 2011, as traders eagerly anticipated the proposed rule for the Volcker Rule that would prohibit proprietary trading by bank holding companies subject to limited (but highly significant) exceptions, Nomura Securities analyst Glenn Schorr drew directly upon the evolution of the Durban amendment rules to make forecasts on the shaping of the Volcker Rule. If the Fed's recent behavior was any guide, Schorr suggested, the proposed rule would seem strict and burdensome, but that in the longer run, the rule would be weakened during the Fed's response to the notice-and-comment process. His evidence came directly from the stock prices of payment processor firms.

[10] Willig, "Avoiding Misapplication to American Express of the Proposed Debit Card Interchange Fee Rules: An Economic Assessment," February 22, 2011, p. 3; www.federalreserve.gov/SECRS/2011/March/20110303/R-1404/R-1404_022211_67230_584162046602_1.pdf.

[11] A "first" Final Rule was announced over a year earlier, then subsequently revised; Board of Governors of the Federal Reserve System, "Federal Reserve issues a final rule establishing standards for debit card interchange fees and prohibiting network exclusivity arrangements and routing restrictions," June 29, 2011; www.federalreserve.gov/newsevents/pressreleases/bcreg20110629a.htm.

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What Schorr's analysis of the payment processors' stock prices shows is that rulemaking, more than any other factor, induced the greatest one-day ("discontinuous") swings in payment processors' firm values over a nearly one-year period. While the proposed rule triggered losses in firm value in December 2010, these were regained by the time of the final rule announcement, and the one-day rise after the final rule announcement (or 5%) gained back over 70% of the losses incurred by the proposed rule. Although we lack intraday evidence on this final rule (having been revealed after trading hours), it is clear that the rule moved in the direction desired by the commenting payment processors, and that the *inter-day* stock price movements reflect this return to commenting.

Yet the context of the Schorr memo tells us something else. First, private equity traders and the analysts who inform them see these intra-day stock price movements as informative of the benefits and costs to firms from regulatory rules. Second, Schorr *explicitly used the trajectory of asset prices in response to the Durbin Rule as a lesson for traders wishing to follow the Volcker Rule*. This suggests, first, that equity markets were not as well accustomed to the process of rulemaking under Dodd-Frank as they would be later on (which fact supports our assumption as to the non-anticipability of the rules and events assumed in our analysis) and, second, that the pattern of costly proposed rule, followed by comments, followed by conditional amelioration of the costs of the rule, is a more general pattern that equity analysts see at work in much rulemaking in the financial sphere (see Libgober, 2020b for a general model that endogenizes the costliness of the initial proposed rule).

INFLUENCE OR LEARNING OR BOTH? ALTERNATIVE EXPLANATIONS

One challenge in interpreting these results concerns how to understand the mechanism by which the notice-and-comment process shaped changes in policy. Different political and industrial observers likely learned that the political coalition supporting the draft rule had weakened during the notice-and-comment process, and observers may also have detected a greater role for economists vis-à-vis lawyers (Katzmann, 1980) as the debate unfolded. Whether our statistical results reflect agency learning about the rule, as opposed to a story about political influence, is not entirely clear, and the evidence retains some ambiguity on this point.

While some degree of learning often occurs during the notice-and-comment process, the contours of this process in particular suggest that learning alone provides a poor explanation for the totality of the results we observe. The first reason is that there was considerable opportunity for learning at the legislative stage. The Durbin rule was a surprise to no one – it was authorized as a plank with the statue itself – and it occasioned considerable lobbying of members of Congress. Once the statute had passed and the administrative stage was reached, moreover, the strength of the political coalition mattered

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far less to the final outcome. The second is that there was also interaction between affected parties and the Federal Reserve directly well before the publication of the proposed rule.[12] The existence of the Durbin Amendment in statute and the pre-notice-and-comment meetings cast doubt on the existence of significant policy uncertainty remaining at the notice-and-comment stage, which is when we observe significant firm-specific asset price changes. Those changes, finally, correspond directly to those who commented, which is a more direct and simpler explanation than changes in policy uncertainty (which would require much greater theorization), and which would likely have led to more generalized influence activities. While firm-specific influence may have carried policy information, the timing of asset price changes suggests that the particular effect was realized during the notice-and-comment process, as firm asset prices would already have captured previous policy changes and reductions in uncertainty.

CONCLUSION: WHAT DEBIT CARD RULEMAKING TELLS US ABOUT REGULATORY POLITICS

The idea of *explicitly redistributive* political influence over bureaucracy – theoretically pioneered in (Arnold, 1979) – usefully steps apart from the all-too stale debates over principal-agent and bureaucratic control problems and points instead to a world that has received little study in the social sciences: the abundant, little measured and highly significant attempts to influence administrative policy by targeting administrative actors themselves. The notice-and-comment provisions of the Administrative Procedures Act (APA) provide merely the best-observed features of this process. Important studies have demonstrated that direct meetings with rulemakers are also plausibly influential in moving policy, perhaps more than in the notice-and-comment process itself (Krawiec, 2013; Libgober, 2020a). Important qualitative accounts also point to meetings with policymakers (the "13 bankers" case being just one example) where the issue at hand concerns not rulemaking but enforcement (Johnson and Kwak, 2010).

The battle over debit cards comprises, to be sure, only one case. Chapter 12 by Powell et al. in this volume, for example, highlights regulatory policy making with direct and extensive lobbying of the agency by members of Congress,

[12] These include FRB staff meetings meetings during the pre-notice-and-comment period with American Express in August 2010 (www.federalreserve.gov/newsevents/rr-commpublic/amex_20100803.pdf and www.federalreserve.gov/newsevents/rr-commpublic/amex_20100816.pdf), with the ABA's Card Policy Council in September 2010 (www.federalreserve.gov/newsevents/rr-commpublic/ABA_council_meeting_20100922.pdf), and with Mastercard in October 2010 (www.federalreserve.gov/newsevents/rr-commpublic/mastercard_meeting_20101004.pdf) and November 2010 (www.federalreserve.gov/newsevents/rr-commpublic/mastercard_meeting_11162010.pdf).

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rather than primarily by organized interest groups.[13] That said, no other Dodd-Frank rule attracted as much attention in the notice-and-comment process, and the various interests in play also marshaled a diverse range of academic and legal analyses. Whenever administrative rulemakers engage in the direct choice of explicit policy parameters, and perhaps when the costs are implicit but more easily estimable and traceable, direct lobbying of administrative actors should follow.

A truly general account of high-clarity regulatory politics should comprise an important agenda for the next generation of political scientists. The case study here can be extended to other cases, as well as to cross-policy studies where the variable of traceability is more systematically measured, and where influence activities are structured both formally and informally. Finally, theories that endogenize mechanism clarity and venue clarity in the administrative realm – when clearer decisions are left to agencies and when they are retained by Congress itself – should provide a fruitful research agenda for theorists and empiricists alike.

[13] Chapter 13 by Drutman in this volume helps put the tactics of the Electronic Payment Coalition in context.

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