

The Durbin Interchange Price Control Amendment Benefits Retailers' Bottom Line – At the Expense of Consumers.

During debate on the regulatory restructuring bill, the U.S. Senate approved an amendment by Senator Richard Durbin that directs the Federal Reserve to set price controls on debit card interchange transactions. The amendment inevitably will shift costs away from merchants to card customers. When merchants choose to accept payment cards, they pay a fee for the many benefits that come with accepting electronic payments. These interchange fees are an essential but modest cost to pay to support a system that works 24 hours a day, 365 days a year almost anywhere in the world.

The Durbin amendment directs the Federal Reserve to set rates considering only the incremental costs of clearing a specific transaction. It specifically excludes from consideration the costs related to building, maintaining, and improving the network systems, fraud losses and prevention, privacy protection, and security, among other costs. There is no allowance for a return on investment.

Intended to lower costs to merchants, the amendment will shift these debit card costs in significant degree from the retail merchants that benefit from this secure and efficient payments system to the customers who use the cards. The price controls also will chill innovation and discourage payment system improvements. Consumers will be footing the bill without seeing any benefit, with merchants merely lining their pockets with additional profits and no reduction in the cost of their products.

The government-set fee will not contribute to paying for system costs. Eliminating interchange revenue as a source to cover basic system costs will mean both a reduction in the quality of the service and an increase in fees consumers pay. It may mean, for example, fees for checking accounts, or for payroll, government assistance, and prepaid cards that today are supported by interchange.

The government-controlled fee will not contribute to covering fraud and fraud prevention costs.¹ The concept of interchange resulted from merchants being frustrated with the losses they suffered when customers' checks were returned unpaid. In exchange for shifting these costs from the merchant to the bank, merchants agreed to pay a percentage of the transaction to the banks to create and maintain a better payment system. The Durbin amendment means businesses will not compensate banks for the cost of maintaining the system and the risk of losses.

Moreover, the interchange fee is used to provide a variety of benefits to merchants and customers, including improved fraud controls and the adoption of new fraud *prevention* measures. Under the amendment, merchants would pay nothing for these benefits and have less financial incentive to improve their anti-fraud efforts.

Price controls will mean fewer innovations and improvements that benefit consumers. Interchange pays for new or improved products that benefit businesses and consumers. Interchange has led to the improvement of the basic plastic card product (both credit and debit), as well as new products such as prepaid, payroll, government assistance, and gift cards. Processing times are now faster and more reliable, and cards are available to more people and are usable in more places. Discounts for interchange also help improve the system by encouraging merchants to upgrade their card readers so consumers are less likely to see a hold on their debit card authorizations.² Eliminating this source of income will mean existing products will not improve and new ones will not emerge due to lack of funding and lack of reward.

¹ In 2008, banks lost \$788 million to debit card fraud, with 92 percent of community and mid-sized banks and all of large institutions reporting losses.

² Because the fee will be so low under the bill, a discount will be insufficient to encourage beneficial practices or changes.

Banks, like any business in a free market, should be permitted to make a return on their investment. As with any business, for a bank to be successful in the long term, revenue has to exceed expenses, and the opportunity of reward for improvements needs to be available. Indeed, in a free market, the bank and the merchant are expected to make a return on investment to encourage imagination, innovation, and investment. Under the bill, banks are not permitted to make a return on their investment. They are not even permitted to cover their costs. Banks, like any business or merchant, should be permitted to make a profit on a valuable product and be rewarded for valuable improvements. Otherwise, the service will stagnate and overtime become degraded.

The Durbin amendment will raise the cost of state government assistance payments. State government officials have written in opposition to the amendment, explaining how it will undermine the low-cost distribution of government benefits, such as unemployment benefits and Temporary Assistance to Needy Families. Forty-seven state governments provide benefits to recipients through prepaid debit card programs at little or no transaction cost to the states, supported in large part by interchange fees. Limitation of these fees will shift the costs of these programs to the recipients or to the government agencies.

Merchants can use the anti-trust laws to challenge perceived uncompetitive practices. The Justice Department and the Federal Trade Commission are well aware of the issues involved in interchange and review them on a regular basis. In fact, these government anti-trust bodies have criticized the *merchants'* legislative efforts as being anti-competitive.

Merchants benefit from the debit card product and should pay for a valuable service.

- **Debit cards are safer than cash.** Cash in the till can be lost or stolen (by outsiders as well as by employees), so merchants have to pay for the security costs to protect cash from loss or theft. Card safety features also limit theft or other customer losses.
- **Merchants are virtually guaranteed payment for debit card transactions.** Unlike checks, which may be returned at merchants' expense, merchants are almost always guaranteed that they will be paid for debit card transactions.
- **Debit cards increase business.** Debit (and credit) cards have increased the number of possible shopping venues, allowed businesses to stay open later without an increased risk of theft, and allows consumers to spend more than just the cash in their wallets.
- **Check-out is faster for debit cards, increasing merchant efficiency and customer satisfaction.**
- **Debit cards provide merchants immediate credit for their transactions and more convenient processing.** Unlike cash and checks, which must be bundled, delivered, and processed before the merchant gets credit, merchants get immediate credit for their debit card transactions. This means that they have their money sooner to invest, earn interest, and pay bills.

Since merchants receive considerable benefits from debit cards, they should be willing to pay for the service, as is the case with all their other services. Instead, they have asked Congress to give them a free lunch through a government-mandated price cap that will not even come close to covering the cost of the service. The result will be higher costs for consumers and government programs, and the degrading of popular and safe consumer products.

Strike the Durbin Interchange Amendment