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No Change Needed:

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INTRODUCTION

One of the greatest challenges for policymakers is the "unexpected negative consequence" of a change in law or regulation. There is a well-documented history of proposed policies that have achieved successes, but not without negative externalities. Prohibition in the 1920s United States, originally enacted to suppress the alcohol trade, drove many small-time alcohol suppliers out of business and consolidated the hold of large-scale organized crime over the illegal alcohol industry.

Tradeoffs in pursuit of greater benefits to society are worth the cost if the positives are greater than the negatives. But if the negative consequences of a policy change outweigh the benefits — or actually make the problem worse — then that policy can only be described as problematic and worth reconsidering. The "Durbin Amendment," enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, has been cited by some as an example of a policy that did not achieve the goals of the authors of the policy while imposing new costs on the financial and debit exchange sectors. Yet despite its mixed record, some in Congress want to extend the Durbin Amendment to interchange fees for credit cards.

BACKGROUND ON THE 2010 DURBIN AMENDMENT

In 2010, the Durbin Amendment was enacted as part of the historic Dodd-Frank Act. Named after its primary sponsor Senator Richard Durbin of Illinois, the Durbin Amendment established a ceiling on debit card interchange fees issued by banks holding more than $10 billion in assets. Interchange fees are part of the cost that merchants pay each time a customer makes a purchase using a credit or debit card.[1]

The Federal Reserve was charged by Congress with regulating and enforcing the law, and did so when it issued a rule in 2011 that restricted debit card interchange fees to a base of $0.21 cents plus .05% of the transaction value.[2] This cap represented a more than 50% decline in interchange fees: prior to the Durbin Amendment, debit interchange averaged $0.48 per transaction.[3] It should be noted that neither the fee nor the threshold on bank asset size were subject to inflation adjustment, so the cap is now more than 25% lower in real terms than what it was a decade ago.[4]

Since its implementation, a number of studies have been conducted to review the effectiveness of the Durbin Amendment. At the time, one key goal for the law was to reduce the cost of interchange fees, providing savings to merchants who would, in theory, pass on those benefits to consumers. Yet several studies have found that the expected price reductions never came to pass, and in some cases, prices increased. For example:

- A 2014 study by the **Federal Reserve Bank of Richmond** noted that three-fourths of merchants did not change their prices after the interchange fee caps were introduced, and another 22% raised prices.[5]

- A paper from 2019 issued by researchers at the **University of Pennsylvania and Georgetown University** furthered the conclusions of the paper by the Federal Reserve Bank of Richmond. The authors noted that the Durbin Amendment of 2010 “led to higher checking account fees paid by consumers, the previously subsidized side of the market.” The paper produced data that the Durbin Amendment likely increased the use of credit cards with higher interchange fees than debit cards, “thus diminishing — if not offsetting entirely — merchants' savings.”[6]

- In a study by several faculty at the **University of Chicago**, the authors estimated the discounted value of the losses for consumers as a result of the implementation of the Durbin Amendment to be $22 to $25 billion.[7]

- A report by the **General Accounting Office** also noted that some banks indicated that the Durbin Amendment interchange fee cap “limited banks” ability to offer free checking accounts, as some banks noted, banks used revenue generated from interchange fees to help cover the cost of accounts.[8]

While some other studies, notably one by respected economist Robert Shapiro, have come to a different conclusion,[9] the majority have found that the Durbin Amendment did not benefit consumers as promised.

WHY DID CONSUMERS NOT BENEFIT AS EXPECTED?

What are the reasons consumers have not realized the type of savings proponents the Durbin Amendment had envisioned? One possibility is "price stickiness" — the resistance of market prices to quick shifts, despite movements in the economy, suggesting a different price is optimal. In the case of debit cards and the cap on debit fees, merchants may have been quicker to raise prices before the cap and were much less likely or took longer to lower them, in part because they enjoyed the excess profits.

Another hypothesis put forward is that prior to the enactment of the Durbin Amendment, merchants had not raised prices to help cover the costs of interchange. Why? Because the value of accepting payment cards outweighed the costs, therefore, they did not choose to cut prices once the caps took effect.

Some of those benefits included faster transaction times, new retail channels online, increased spending by customers, and reduced costs of cash, i.e., risk of theft, time spent counting cash and bank trips, etc. One study by a retail consulting firm found that the costs of cash are as high as 9% of the purchase value, compared to a merchant discount fee of 2%.[10]

Other evidence also points to the revenue-boosting and cost-saving features of credit and debit card acceptance. For example, restauranteurs often receive advice to accept payment cards to boost their bottom lines.[11]

SHOULD THE DURBIN AMENDMENT BE EXTENDED TO CREDIT CARD INTERCHANGE FEES?

Now, lawmakers are considering the implementation of a similar model to cap interchange fees for credit card transactions. Though the drawbacks of the proposal mirror those raised with the implementation of the Durbin Amendment, this effort poses additional concerns when considering the benefits that credit card rewards programs currently offer cardholders.

Analogous to their role in debit transactions, interchange fees are paid as a percentage of a transaction from merchants to card issuers to contribute to costs associated with accepting, processing, and authorizing card transactions. These costs include fraud protection and maintenance of safe, secure systems. The merchants, in return, are able to accept electronic payments, which widen customers' ability to spend and reduce their cost of holding cash. This fee, which is set by card issuers, has remained stable over time. The average interchange fee for credit transactions has hovered around 1.6% to 1.7% between 2012 and 2020. For comparison, the average interchange fee for debit transactions has been stable at between 0.78% and 0.80% over the same period — kept artificially low by the Durbin Amendment.[12]

Proponents of a cap on interchange fees may argue that merchants pass the cost onto consumers — disproportionately impacting lower income groups while subsidizing rewards benefits for higher income individuals. This is a misconception which ignores three crucial points. First, as highlighted in the prior section, the aftermath of the Durbin Amendment showed no evidence that a cap on interchange fees encourages merchants to pass savings off to consumers. Second, low-income individuals use rewards credit cards at a rate similar to high-income individuals. And third, there is substantial evidence that caps placed on credit card transactions reduces rewards offered to consumers while increasing the cost of holding a card, ensuring consumers across income levels are left worse off.

82% of Americans had a credit card in 2022,[13] with high levels of usage of credit cards distributed across income levels and geographic regions.[14] Among credit cardholders, 86% have an active rewards card, including more than three-quarters of balance-active cardholders with a household income of less than $50,000.[15] This is of note because following the implementation of the Durbin Amendment, offerings for debit rewards programs faded rapidly. Within one year of its enactment, 30% of debit card issuers covered by the law eliminated or downsized their debit card rewards programs, and 81% state that they did not plan to offer a rewards program in the future.[16] Now that caps on debit interchange fees are in place, cardholders who benefit from debit rewards programs are disproportionately high-income individuals.[17] If a similar policy were applied to credit transactions, we risk similarly disenfranchising lower income groups from accessing the credit rewards programs which have become standard for U.S. consumers.

This is consistent with outcomes observed in international jurisdictions which have attempted comparable policy. In Spain, for example, a government-enforced agreement to reduce interchange levels was implemented over a five-year period from 2006-2010. The result was found to be an increase in cost to consumers, primarily in the form of annual card fees, by 50%. This is in addition to subsequent increases in overdraft fees, as well as the devaluation of rewards benefits.[18] Efforts by the Reserve Bank of Australia to limit interchange fees in the early 2000s resulted in similar consequences for consumers. Prior to the implementation of the policy in 2003, the cost of a standard rewards card was A$61. By 2004, the cost had risen roughly 40% to A$85.[19] The value of rewards benefits also declined, with the average amount of spending required to earn A$100 in rewards through rewards cards issued by the four largest banks in Australia went from A$12,400 to A$18,400.59 between 2003 and 2011.[20]

Safety of Consumer Data

Another concern of extending the Durbin Amendment to credit card interchange fees is the possible impact on network security. Attacks on networks and data breaches have increased rapidly over the last several decades. This increase is particularly prevalent in the case of financial services businesses, which experience up to 300 times more cyber-attacks per year than other firms.[21] Due to the heightened risk, banks and financial firms have invested considerable sums in data security.[22] However, under the Durbin Amendment, routing decisions are shifted from banks and consumers to merchants, leaving the level of network security variable among any number of merchants.

Unfortunately, many merchants have not adequately invested in data security resulting a number of serious data breaches, including:

- **Target**. Hackers stole the data of up to 40 million credit and debit cards by accessing Target's gateway server through a third party vendor. Forty-seven state attorneys generals plus the District of Columbia sued Target on behalf of consumers, and the corporation was required to pay a settlement and adopt more advanced measures to secure customer data.[23]

- **Home Depot**. Hackers used a vendor's username and password to infiltrate Home Depot's network and access payment card information and email addresses. While Home Depot did not admit liability, they settled for $17.5 million and agreed to hire a chief information security officer and upgrade security procedures. "Companies that collect sensitive personal information from customers have an obligation to protect that information from unlawful use or disclosure," Connecticut Attorney General William Tong said in a statement. "Home Depot failed to take those precautions."[24]

- **Wawa**. Hackers accessed payment card data by deploying malware on Wawa's point-of-sale payment systems. Wawa was sued by and settled with the attorneys general of NJ, PA, DE, FL, MD, VA, and DC. The AGs alleged that Wawa did not have reasonable security measures in place to protect consumer data. While Wawa did not admit wrongdoing in the settlement, the fact that state AGs brought this suit on behalf of consumers demonstrates the seriousness of the charge and Wawa's level of responsibility.[25]

Many analysts believe this shift in onus onto the merchants will weaken the security of customer data because banks will have little or no control over the routing systems used for credit card transactions. Merchants have the incentive to minimize the cost of accepting transactions, thus allowing them to retain a larger share of transaction revenue. This becomes an issue when considering that the cheapest networks are likely to be those that are the least secure.

This is particularly relevant to credit cards as they are an unsecured loan from a financial institution while debit cards are directly linked to a customer's bank account. Because credit cards represent a higher level of liability for banks, smaller ones who are less equipped to take on higher risk prefer to use networks that have made higher investments in security measures. The higher level of liability, in contrast to the incentive to the merchants, pushes banks to choose networks where customer data is highly secure. Of course, the Durbin Amendment, by shifting the responsibility of network choice, strips the bank from being able to select the most secure network while retaining most of the liability.

CONCLUSION

The record of the Durbin Amendment for debit interchange fees is mixed at best. In fact, much of the evidence collected in recent years is that the amendment had little or no impact on prices, and in some cases may have led to higher costs for customers as well as for the banking sector. Good policymaking practices would suggest extending the Durbin Amendment to credit card interchange fees should be a nonstarter, certainly until it is conclusively proven that the law had some positive impact on consumers. Most evidence suggests that the Durbin Amendment likely had a net negative effect on consumers.

The Durbin Amendment was originally intended to help U.S. consumers. But sometimes, well-intentioned laws lead to unintended consequences. Policymakers corrected the mistake of Prohibition by repealing the policy after just 14 years, and today's Congress should consider taking a similar approach — or, at a minimum, tabling any effort to expand the Durbin Amendment to credit cards given the substantial body of evidence that doing so would ultimately harm U.S. consumers.

ABOUT THE AUTHORS

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Notes and References

[1] Interchange fees are the largest component of the "merchant discount fee," also sometimes referred to as a "swipe fee." The merchant discount fee is comprised of three separate fees: the interchange fee, the acquirer fee (paid to the merchant's bank), and the network fee (paid to the payment network). Interchange fees, which are the largest component of the merchant discount fee, are set by payment networks such as Visa or Mastercard but are ultimately paid to the bank that issued the card.

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[11] See the advice and explanation given in this video from CNBC's The Profit: https://app.frame.io/reviews/f97598d6-d2e4-4c5c-a173-d1acbcbc527e/0379eab2-ca82-4144-aea2-dc16c87ac315.

[12] EPC Interchange data from 2023.

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