Debit cards are one of the most ubiquitous, convenient and safe means of electronic payment available to consumers today. In the first decade of this century, debit card usage grew at an average annual rate of 18 percent and became the most commonly used non-cash form of payment in the United States, with payment volume for debit cards surpassing credit card volume for the first time in 2009.¹ In the U.S. alone, 37.9 billion debit card transactions occurred in 2009, representing 35 percent of all non-cash retail payments.

Regulating Interchange
In 2010, the “Durbin Amendment,” a provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act, tasked the Federal Reserve with establishing interchange fees at a level “reasonable and proportional to the cost incurred by the issuer with respect to the transaction.” The amendment was passed by the U.S. Senate at the last minute without debate, and was never brought for a vote before the House of Representatives. In June 2011, a Senate bill aimed at delaying the implementation of the Durbin Amendment to allow adequate time to study its consequences received significant bipartisan support—a majority of Senators (54) supported the delay and study measure, but the vote fell short of the threshold necessary for passage under the Senate rules governing that debate.

Not only was there significant bipartisan, bicameral concern about the Durbin Amendment, but credit unions and community banks also publicly voiced their concern that “market forces in an industry dominated by big banks subject to new price controls will drive their debit revenues down.”² While small banks and credit unions with fewer than $10 billion in assets are technically exempt from the Fed’s rules, many industry observers and policymakers, including Federal Reserve Chairman Ben Bernanke, have speculated that the exemption will not work in practice.

Operating at a Loss
In implementing the Durbin Amendment, the Fed took a narrow approach in its consideration of the costs incurred by payment card issuers. Their determination ignored the many benefits of interchange to consumers, merchants, and society— including faster transactions, increased security, payment system efficiency, and increased financial inclusion.

The Fed’s ultimate decision to limit interchange to 21 cents per transaction plus an 0.05 percent ad valorem charge for fraud losses and 1 cent for anti-fraud measures sets interchange fees at levels that will, under the Fed’s own analysis, prevent issuers from recovering the vast majority of the costs associated with offering debit card products and services. The rule, as implemented, represents a 45 percent decrease in interchange fees from pre-regulation market rates.

Unintended Consequences
Interchange facilitates the global electronic payments system and serves as a critical tool to ensure that each participant in the system pays its fair share of the costs associated with electronic payments transactions. When regulators cap prices in a free market, we have seen that the consequences are very different from the intention.

² http://www.digitaltransactions.net/news/story/3106
The Australian Interchange Case Study

In October 2003, the Reserve Bank of Australia (RBA) capped credit interchange fees on purchases made with MasterCard, Visa and Bankcard cards, believing this action would benefit consumers because merchants would reduce their prices in response to lower costs of accepting credit cards. The RBA mandate decreased interchange fees from 0.95 percent to 0.55 percent, and fees were later decreased to 0.5 percent – nearly halving the fees card issuers could collect. Unfortunately, the real-world effects of these changes are quite different from regulators’ intentions; data shows that merchants have benefited enormously while consumers have paid the price.

According to reports by both the U.S. GAO and CRA International, Australian cardholders now face fewer benefits and higher costs. CRA International estimates that Australian consumers now pay more than AU$480 million in additional fees while rewards have decreased by 23 percent. There is also no evidence that merchants passed their cost savings onto consumers in the form of lower prices.

Industry-wide, the Australian regulation served as a disincentive to firms considering market entry. There have been no new entrants of significant size to the Australian payments market and, in fact, the entire credit union industry exited credit card issuing and the Bankcard brand has been discontinued. Adoption of new technology in the Australian market has slowed and innovation has been stifled as the RBA’s fragmented approach eliminated processors’ ability to plan for adequate market demand and the return on investment in innovation.

The Impact of the Durbin Amendment

The lessons from Australia are already being felt in the United States as a result of the Durbin Amendment. Prior to the Amendment’s implementation, banks such as JPMorgan Chase, PNC Bank and Regions Bank, among others, anticipated the effects of the Fed rule by announcing significant reductions in cardholder benefits. Since the Amendment’s implementation on October 1, 2011, the ill effects of this price control regulation are affecting consumers, financial institutions, merchants and their employees.

Consumers are feeling adverse impacts in the form of reduced cardholder benefits and rising fees – average checking account fees have risen 75 percent in the last year alone. Not only are consumers paying more to own and use their debit cards, but data also suggests they will not see any corresponding savings at the point of sale. A recent survey\(^3\) revealed that only 3 percent of retailers intend to pass any newfound savings to consumers, while 41 percent of retailers said they have no plans to pass on lower prices to consumers at all, and the other 56 percent are unsure.

The consumers most adversely affected by this provision will be the country’s “underbanked” population – the low-income customers already on the cusp of being pushed completely out of the financial system. Industry estimates expect that up to 5 percent of bank consumers could be forced out of the banking system as financial institutions alter their pricing structures to close the gap created by the drastic reduction in debit interchange. Further industry estimates cautioned that cutting interchange revenue in half (the approximate magnitude of the Fed’s final rule) could result in lending reductions of up to $74 billion.\(^3\)

As the global economy struggles to right itself, policymakers continue to search for ways to improve employment opportunities. The Durbin Amendment, however, is forcing banks to

\(^3\) [http://www.digitaltransactions.net/news/story/3188](http://www.digitaltransactions.net/news/story/3188)
choose between harming their consumers and harming their employees. In late September, 2011, International Bancshares Corp. of Laredo, Texas, announced the bank would close 50 branches and lay off 500 people instead of charging consumers higher fees for their checking accounts – a result attributed by the company to the Durbin Amendment’s price controls.

Evidence from other countries – and early signs in the United States – strongly suggests that imposing price controls in a free marketplace imposes negative consequences on the very groups the regulations sought to help. In the United States, Representatives Jason Chaffetz (R-Utah) and Bill Owens (D-New York) introduced a bill to the U.S. Congress to repeal the Durbin Amendment, calling it “an affront to consumers and the banking industry” and “legislatively enacted price controls” that hurt consumers and their communities.

Interchange is a crucial tool to ensure the global electronic payments industry continues to provide new and innovative benefits to consumers, merchants, and society. To learn more about how interchange promotes a strong, competitive and efficient global electronic payments industry, please visit http://www.mastercard.com/us/company/en/whatwedo/interchange.html.