ICLE tl;dr

Impact of the Durbin Amendment's Cap on Interchange Fees

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tl;dr

Background... The Dodd-Frank Act of 2010 set price controls for debit-card interchange fees charged by banks with more than $10 billion in assets. Known colloquially as the "Durbin Amendment" after Sen. Dick Durbin, who sponsored the original proposal, the provision was supposed to cut costs for customers and merchants by cutting the interchange fees charged by large banks roughly in half.

But... Covered banks and credit unions have recouped these losses by eliminating free checking accounts, raising minimum balance requirements, and charging higher maintenance fees. While retailers have seen cost reductions as a result of the Durbin Amendment, there is little evidence those savings have been passed on to consumers.

However... In recent years, some lawmakers have signaled interest in limiting interchange fees on credit-card transactions, as well. Some elements of the retail sector likewise sought a cap on credit card interchange fees as part of COVID-19 relief legislation in 2020. Sen. Durbin himself also recently suggested the Durbin Amendment's cap on interchange fees should be extended to credit cards. The predictable result would be a reduction in credit and rewards programs made available to consumers.

KEY TAKEAWAYS

FROM A PROFIT CENTER TO A LOSS CENTER

The Durbin Amendment cut the interchange fee on a debit transaction to a base of 0.05% of the transaction value plus $0.21 and, in some cases, an additional $0.01 for fraud protection. This resulted in a 52% decline in the average per-transaction interchange fee, from $0.50 to $0.24. By defining allowable costs to exclude many of the necessary costs of operating a debit-card program, the Durbin Amendment effectively transformed debit card operations from a profit center to a loss center for covered depositories.

BANKS RECOUPED LOSSES BY RAISING FEES AND CUTTING REWARDS

The interchange fee cap reduced large banks' annual revenues by between $6.6 billion and $8 billion. To make up for the lost revenue, many lenders reduced access to free checking accounts and rewards programs.

One study found that the share of covered lenders offering free basic checking accounts fell from 60% to 20%. The study also found that average monthly checking account fees increased from $4.34 to $7.44, while the minimum account balances required to avoid these fees increased by roughly 25%.

Another study found that fees charged by covered depositories were 15% higher than they would have been without the Durbin Amendment. The increases were found to offset 90% of the banks' lost revenue.

EFFECTS ON LOW-INCOME CUSTOMERS

The reduced availability of free checking and imposition of new fees has been felt most acutely by lower-income consumers, with one study finding that roughly 1 million consumers lost access to the banking system as a result. The effect of fewer lower-income consumers using debit cards and checking accounts has been increased use of credit cards, which accrue interest charges for cardholders who carry a balance.

MERCHANTS HAVE NOT PASSED ON SAVINGS

Since banks almost completely offset lost interchange fee revenue, there would be no impact on consumer welfare if merchants passed all of their interchange fee savings on to consumers. There would still be negative distributional effects, as lower-income consumers are disproportionately affected by higher bank fees. But research has found little evidence that merchants have passed on savings.

APPLYING THE DURBIN AMENDMENT TO CREDIT CARDS

Extending the cap on interchange fees to credit card transactions would curtail the consumer credit market that has served as a lender of last resort. As of 2017, about 64% of U.S. adults and 79% of consumers with a credit record had at least one credit card. The average cardholder has between two and five accounts.

Cardholders today easily switch among offerings to take advantage of such innovations as rewards programs, digital account servicing tools, enhanced account security, and special time-limited offers. One recent study found 74% of cardholders hold a rewards account.

As with debit cards, capping interchange fees on credit cards would lead to constriction of benefits that would lead to an overall reduction in consumer welfare unless merchants passed on 100% of savings. It also could have a significant impact on the availability of revolving consumer credit.

For more on this topic, see Zywicki, Manne & Morris, *Unreasonable and Disproportionate: How the Durbin Amendment Harms Poorer Americans and Small Businesses*; Mukharlyamov & Sarin, *The Impact of the Durbin Amendment on Banks, Merchants, and Consumers*; and Kay, Manuszak, & Vojtech, *Competition and complementarities in retail banking: Evidence form debit card interchange regulation*.

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