ICLE tl;dr

Credit Card Competition Act

October 2022

tl;dr

Background: Sen. Richard Durbin's (D-Ill.) amendment to 2010's Dodd-Frank Act capped interchange fees on debit cards issued by large banks and required all debit-card issuers to permit routing of payments over multiple networks. Now, he and co-sponsor Roger Marshall (R-Kan.) have introduced the Credit Card Competition Act, which would impose similar routing requirements on credit cards. With the bill having few prospects to move forward on its own, Durbin and Marshall hope to attach it as an amendment to the National Defense Authorization Act.

But: As with the original Durbin Amendment, the mandate would benefit some competitors but won't increase competition. Instead, by rigging markets, it will lead to higher costs, less security, and less innovation. Ultimately, consumers will be the losers.

KEY TAKEAWAYS

INTERCHANGE FEES ARE ESSENTIAL TO THE FUNCTIONING OF PAYMENT NETWORKS

Payment-card networks balance "two-sided" markets, with consumers on one side and merchants on the other. In many two-sided markets—such as newspapers and search engines—it is optimal for one side to "subsidize" the other. In the case of payment cards, merchants (who are less price sensitive) subsidize consumers. The mechanism through which this subsidy takes place is the interchange fee, which is paid by merchants' (acquiring) banks to consumers' (issuing) banks.

Interchange fees are set by payment networks, who have incentives to balance the two sides of the market. Their interest is to maximize some combination of the amount and value of transactions.

Large merchants have long complained about interchange fees and have negotiated, sued, and lobbied to reduce them. While negotiated reductions only affect transactions with the individual merchants, mandatory reductions apply much more broadly and are thus more likely to distort the system.

ROUTING MANDATES CUT INTERCHANGE FEES

Although smaller banks and credit unions were not directly subject to the Durbin Amendment's fee cap, the routing mandate reduced fees for all lenders because it enabled merchants to route payments over smaller networks that charged lower interchange fees.

Durbin and Marshall's routing mandate for credit cards would have similar effects. Issuers would be forced to enable routing of payments over smaller networks. Those smaller networks would charge lower fees in order to attract merchants to use them, effectively forcing the larger networks to lower their fees, as well. Interchange fees would therefore fall across the board.

BANKS COMPENSATE BY RAISING OTHER FEES

It is important to remember that interchange fees don't simply represent the cost to operate the network. They are instead primarily a way to balance the two sides of the market.

Experience suggests that mandating lower fees does more harm than good. Mandatory fee caps and routing mandates reduce income to issuing banks, who have responded by increasing other charges, thereby harming consumers.

The original Durbin amendment reduced interchange-fee revenue by billions of dollars, while banks responded by increasing monthly fees for checking accounts and raising the minimum balance required to qualify for "free" checking. These changes hurt the poorest consumers the most and likely led to hundreds of thousands of consumers exiting the banking system altogether.

HIGHER FEES, LOWER REWARDS

In other countries where mandates have reduced interchange fees from credit cards, issuers have responded by introducing or increasing annual card fees and by reducing the availability of rewards. This seems an almost certain consequence if the proposal is adopted in the United States.

Likewise, cards co-branded by airlines, hotels, retailers, and other merchants, could be effectively eliminated. These cards rely on interchange fees to cover the costs of the rewards they offer. If fees are reduced dramatically, the revenue won't be sufficient to cover the rewards, which will become a liability for the brands.

FRAUD COSTS WILL RISE

The major card networks have developed several systems designed to reduce fraud. First and foremost, they have deployed highly sophisticated machine-learning algorithms to detect suspicious transactions by comparing all transactions with a card owner's purchasing history. By diverting traffic away from the major cards' networks, the routing mandate would reduce the effectiveness of these systems, resulting in an increase in preventable fraudulent transactions.

Additionally, some anti-fraud measures—such as granting cardholders the ability to disable their cards temporarily (e.g., when a card might have been stolen)—are facilitated by the payment networks themselves. In such cases, if the card is used on a different network, it will not be disabled, leading to preventable fraud.

SMALLER MERCHANTS WOULD BE HARMED

Before the Durbin amendment, card networks set lower interchange fees on small-ticket debit charges.

In the wake of its implementation, such fees generally were set at the highest allowable rate. For many small-ticket charges, this meant higher interchange fees. It appears likely that the Durbin-Marshall proposal would have a similar effect if implemented.

For more on the effects of routing requirements, see the ICLE white paper *Regulating Routing in Payment Networks* by Julian Morris and Todd J. Zywicki. For more on card rewards, see the ICLE issue brief *Credit Cards and the Reverse Robin Hood Fallacy* by Todd Zywicki, Ben Sperry, and Julian Morris.

CONTACT US

Julian Morris
Senior Scholar
jmorris@laweconcenter.org

ICLE International Center for Law & Economics

The International Center for Law & Economics (ICLE) is a nonprofit, nonpartisan policy research center. We develop and disseminate academic output to build the intellectual foundation for economically-grounded policy.