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MISGUIDED REGULATION OF INTERCHANGE FEES: THE CONSUMER IMPACT OF THE DURBIN AMENDMENT

Patrick C. McGinnis

I. INTRODUCTION

During a famous episode of *Seinfeld*, Jerry performs a stand-up routine about how women prefer to make purchases with checks.¹ In contrast, men seem to find checks unmanly, as they are like, “A note from your mother that says, ‘I don’t have any money, but if you contact these people, I’m sure they’ll stick up for me.’”² This episode aired in 1990 and while this is simply a humorous interpretation of an everyday event, it highlights a period of transition from predominantly using checks for purchases to debit cards. For consumers, debit cards limit liability when a card is stolen, offer easy access to Automated Teller Machines (“ATMs”) and points of sale, allow for more efficient record keeping of transactions, and provide a safe alternative to carrying large sums of cash.³ In 2009, consumers made almost thirty-eight billion debit card transactions in the United States, accounting for 35% of all non-cash payments.⁴ Debit cards have now surpassed checks as the most frequently used method of payment.⁵

However, unlike checks, debit card transactions generate an interchange fee, which is paid by the merchant to the

¹ *Seinfeld: The Stake Out* (NBC television broadcast May 31, 1990).

² *Id.*

³ Mercator Advisory Group, *The Durbin Amendment: Impact Analysis* 5 (June 7, 2010), available at http://www.mercatoradvisorygroup.com/images/durbin_analysis.pdf.

⁴ *TCF Nat’l Bank v. Bernanke*, No. CIV 10-4149, 2011 WL 1578535, at *2 (S.D. Apr. 25, 2011)(affirmed by *TCF Nat’l Bank v. Bernanke*, 643 F.3d 1148 (8th Cir. 2011)).

⁵ *Id.*

cardholder's issuing bank.⁶ In response to the soaring cost of interchange fees, United States Senator Dick Durbin negotiated the inclusion of an amendment in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.⁷ Known as the "Durbin Amendment," this provision sought to ensure that "[t]he amount of any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction shall be reasonable and proportional to the cost incurred by the issuer with respect to the transaction."⁸ Senator Durbin contends that this amendment will help regulate interchange fees, resulting in lower prices for both consumers and merchants.⁹

This Note examines the impact the implementation of the Durbin Amendment has had on consumers thus far. It demonstrates how reduced interchange fees have not led to reduced prices for consumers and how the reduced revenues collected by banks on debit card transactions have led to the elimination of other consumer benefits. Part II provides background on the development of debit cards and the use of interchange fees.¹⁰ Part III explains the evolution of the Dodd-Frank Wall Street Reform and Consumer Protection Act and the inclusion of the Durbin Amendment.¹¹ Part IV analyzes the impact of the Durbin Amendment and the effect it has had on consumers.¹² Finally, Part V examines the outlook for the Durbin Amendment and its impact on consumers and the banking industry going forward.¹³

⁶ *Id.* at 3.

⁷ Press Release, U.S. Senator Dick Durbin, Durbin, Local Business Owners Call for Prompt Federal Reserve Action on Swipe Fee Regulations (June 10, 2011), *available at* <http://durbin.senate.gov/public/index.cfm/pressreleases?ID=31031ccd-2dc6-4045-886f-b7b5b02c1e26>.

⁸ Electronic Fund Transfer Act, 15 U.S.C. § 1693o-2(a)(2) (2010) (Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act amends the Electronic Fund Transfer Act to add a new Section 920).

⁹ Press Release, U.S. Senator Dick Durbin, Durbin: Lower Debit Card Swipe Fees Good For Consumers (Sep. 30, 2011), *available at* <http://durbin.senate.gov/public/index.cfm/localnews?ID=717a4e2b-2958-460a-9929-c30e7995c6fd>.

¹⁰ *See infra* Part II.

¹¹ *See infra* Part III.

¹² *See infra* Part IV.

¹³ *See infra* Part V.

II. RISE OF DEBIT CARDS AND INTERCHANGE FEES

This Note will first examine the fundamental aspects of how debit cards work and how they have become the prominent non-cash payment method within the United States. This section first examines the creation of ATM cards and explains how debit cards evolved from the development of ATM cards. Next, the increased use of debit cards during the 1990s is chronicled to highlight how debit cards have become so popular today. Finally, this section analyzes interchange fees and their vital role within debit card transactions.

A. *General Descriptions of ATM Cards and Debit Cards*

What unites ATM and debit card transactions is that both deduct funds directly against the consumer's bank account.¹⁴ ATM and debit card transactions permit any bank to link its customers with the customers of another bank worldwide to transact business almost immediately.¹⁵ While ATM and debit cards may appear to serve the same function, there are distinctions that make each of them unique.

An ATM card is used to withdraw cash from an automated teller machine.¹⁶ Consumers may use ATMs affiliated with their bank to perform regular banking transactions or any other ATM to withdraw money.¹⁷ The consumer enters a personal identification number ("PIN") and the checking account is accessed to determine if adequate funds are available.¹⁸ If adequate funds are found, the cash is dispensed to the consumer.¹⁹ Today, ATM cards generally serve the dual purpose of both an ATM and debit card and can be used for either type of

¹⁴ Fumiko Hayashi et al., *A Guide to the ATM and Debit Card Industry* 5 (Federal Reserve Bank of Kansas City 2003), available at <http://www.kansascityfed.org/publicat/psr/BksJournArticles/ATMpaper.pdf>.

¹⁵ *Understanding Interchange*, MASTERCARD WORLDWIDE, <http://www.mastercard.com/us/company/en/whatwedo/interchange.html> (last visited Sep. 30, 2012).

¹⁶ Hayashi et al., *supra* note 14, at 5.

¹⁷ DAVID EVANS & RICHARD SCHMALENSSEE, *PAYING WITH PLASTIC: THE DIGITAL REVOLUTION IN BUYING AND BORROWING* 298 (1st ed. MIT Press 1999).

¹⁸ Hayashi et al., *supra* note 14, at 5.

¹⁹ *Id.*

transaction.²⁰

Debit cards are used in transactions for the purchase of goods or services.²¹ When consumers use their debit cards to make a purchase, they are required to either enter their PIN or sign a receipt to verify their identity.²² Next, an electronic-authorization request is sent from the merchant to the merchant's bank, which then forwards this request to the issuing bank.²³ The issuing bank checks the corresponding account for adequate funds and sends a message authorizing or declining the transaction.²⁴ The merchant is then reimbursed by the issuing bank for the price of the transaction.²⁵

B. ATM Cards and the Development of Debit Cards

The first ATM in the United States was developed in 1969.²⁶ By the early 1970s, ATMs were capable of taking deposits, transferring money between checking and savings accounts, dispensing cash from a credit card, and accepting bill payments.²⁷ Banks soon began establishing shared ATM networks, and by 1977 the networks had online access to account information.²⁸

Regional ATM networks then began recognizing that ATM cards could provide a convenient payment method at stores.²⁹ By the 1980s, supermarkets and other retailers began testing point-of-sale ("POS") debit systems.³⁰ Shortly thereafter, merchants began installing PIN pad devices to process the POS debit transactions.³¹ However, during the 1980s the number of POS debit transactions remained relatively modest.³²

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ TCF Nat'l Bank v. Bernanke, No. CIV 10-4149, 2011 WL 1578535, at *2 (S.D. Apr. 25, 2011)(affirmed by TCF Nat'l Bank v. Bernanke, 643 F.3d 1148 (8th Cir. 2011).

²⁴ *Id.*

²⁵ Hayashi et al., *supra* note 14, at 5.

²⁶ EVANS & SCHMALENSSEE, *supra* note 17, at 298.

²⁷ Hayashi et al., *supra* note 14, at 12.

²⁸ *Id.* at 14.

²⁹ EVANS & SCHMALENSSEE, *supra* note 17, at 298.

³⁰ Hayashi et al., *supra* note 14, at 14.

³¹ EVANS & SCHMALENSSEE, *supra* note 17, at 298.

³² Hayashi et al., *supra* note 14, at 14.

C. Growth of the Debit Card in the 1990's and Beyond

Several factors led to the growth of debit card transactions during the 1990s. First, ATM cards had become extremely common. In 1990, over 200 million consumers had ATM cards providing access to about 80,000 ATMs.³³ The ATM cards that consumers already possessed provided a simple transition for ATM networks seeking to expand to debit transactions.³⁴ Another reason for the growth of debit card transactions was the installation of PIN pads in retail stores across the country. Merchants realized the advantage of installing PIN pads because debit transactions offered a guaranteed payment, a proven increase in sales, lower labor cost through reduced transaction times, and the elimination of the risk of bad checks.³⁵ The number of PIN pads in retail stores throughout the United States increased almost tenfold from 53,000 in 1990 to 529,000 in 1995.³⁶ This number tripled to 1.7 million PIN pads by 1998 and increased to over 6.6 million in 2009.³⁷

A third reason for this growth was that ATM networks became increasingly interconnected. While only 14% of ATM networks were shared networks in 1980, by 1990 nearly 94% of networks were shared.³⁸ With 100% of networks being shared by 1996, POS debit transactions became much easier to implement.³⁹ Additionally, in 1990 an agreement was reached between Cirrus and Plus, the two major ATM networks, which permitted ATM owners to service customers from the other network without incurring additional membership fees.⁴⁰ These developments established a national network and assured universal access to ATM services.⁴¹ Aggressive marketing by banks to encourage the use of debit cards and the emergence of Visa and MasterCard's off-line debit products, which do not require the use of a PIN, further stimulated the environment for the growth of debit cards

³³ EVANS & SCHMALENSSEE, *supra* note 17, at 303.

³⁴ *Id.* at 301.

³⁵ Mercator Advisory Group, *supra* note 3.

³⁶ EVANS & SCHMALENSSEE, *supra* note 17, at 308-09.

³⁷ *Id.* at 309.

³⁸ Hayashi et al., *supra* note 14.

³⁹ EVANS & SCHMALENSSEE, *supra* note 17, at 306.

⁴⁰ Hayashi et al., *supra* note 14.

⁴¹ *Id.*

and debit card transactions.⁴²

Although debit card transactions were negligible in relation to all non-cash payment methods at the start of the 1990s, by 2000 over 11.6% of non-cash payments were made with debit cards.⁴³ By the end of the 1990s, over 235 million debit cards were in circulation in the United States.⁴⁴ Debit cards totaled over 509 million in 2009 with a purchase volume of over \$1.4 trillion in throughout the United States.⁴⁵ According to the 2009 Survey of Consumer Payment Choice, debit cards are used for 29.3% of all transactions and have become the most frequently used method of payment, eclipsing cash, credit cards, and checks individually.⁴⁶

D. Understanding Interchange Fees

The increased use of debit cards has led to an explosion in revenue collected by banks for what are known as interchange fees. Interchange fees are small fees paid by the merchant's acquiring bank to the cardholder's issuing bank for debit card transactions.⁴⁷ After debit card transactions are authorized, the issuing bank posts a charge for the transaction on the consumer's bank account and transfers the funds minus the interchange rate to the acquiring bank.⁴⁸ The acquiring bank then posts the funds minus the interchange rate to the merchant's bank account.⁴⁹ The revenue from interchange fees is divided amongst the issuing

⁴² *Id.*

⁴³ *Id.*

⁴⁴ U.S. Census Bureau, Statistical Abstract of the United States, Table 1188 (2012), *available at* <http://www.census.gov/compendia/statab/2012/tables/12s1187.pdf>.

⁴⁵ U.S. Census Bureau, Statistical Abstract of the United States, Table 1187 (2012), *available at* <http://www.census.gov/compendia/statab/2012/tables/12s1187.pdf>.

⁴⁶ Kevin Foster et al., *The 2009 Survey of Consumer Payment Choice*, Federal Reserve Bank of Boston, Public Policy Discussion Paper No. 11-1 (April 2011).

⁴⁷ *Interchange: Facilitating Benefits to Cardholders, Merchants, and Society*, MASTERCARD WORLDWIDE, http://www.mastercard.com/us/company/en/docs/Interchange_Benefits.pdf (last visited Sep. 30, 2012).

⁴⁸ TCF Nat'l Bank v. Bernanke, No. CIV 10-4149, 2011 WL 1578535, at *2 (S.D. Apr. 25, 2011)(affirmed by TCF Nat'l Bank v. Bernanke, 643 F.3d 1148 (8th Cir. 2011).

⁴⁹ *Id.*

bank, the acquiring bank, and the network that supplies the card swipe machine, while the merchants generally bear the cost.⁵⁰

Financial institutions contend that interchange fees serve as “a critical tool to balance the benefits and costs of electronic payments, and ensure that each participant pays their fair share associated with processing and protecting payment card transactions.”⁵¹ Consumers also benefit from the resources created by interchange fees through benefits such as the ability to make secure worldwide payments in a fraction of a second.⁵² These fees totaled over \$16.2 billion in 2009 with the average fee of \$0.44 per transaction.⁵³

The assignment of interchange fees for debit card transactions has changed over time as banks debate which party benefits most from the transaction.⁵⁴ The interchange fee initially went from the issuing bank to the acquiring bank, but this is now reversed.⁵⁵ Merchants have long argued that issuing banks should simply pay acquiring banks because the issuing banks save money on the transaction through reduced paper check processing costs.⁵⁶ While merchants have largely been unsuccessful at deferring the costs of these transactions to the banks, the dynamics of the interchange arrangements changed with the implementation of the Durbin Amendment. Now, banks are no longer able to recoup the cost of debit card transactions from merchants, so the cost is now being passed along to consumers.

III. THE WALL STREET REFORM AND CONSUMER PROTECTION ACT AND THE OPPORTUNITY TO REGULATE INTERCHANGE FEES

In order to fully understand the Durbin Amendment, it is essential to understand the environment in which it was

⁵⁰ Christopher Maag, *Interchange Fees: The Billion Dollar Fight for Control of Your Wallet*, BUSINESS INSIDER (Mar. 18, 2011), <http://www.businessinsider.com/interchange-fees-the-billion-dollar-fight-for-control-of-your-wallet-2011-3>.

⁵¹ MASTERCARD WORLDWIDE, *supra* note 47.

⁵² *Id.*

⁵³ *TCF National Bank*, 2011 WL 1578535, at *3.

⁵⁴ EVANS & SCHMALENSEE, *supra* note 17, at 307.

⁵⁵ *Id.* at 306.

⁵⁶ *Id.*

developed and implemented. This section provides the historical foundation of the financial crisis in the United States and the creation of a climate ripe for new banking regulations. Next, the Dodd-Frank Act will be explained to convey the framework within which the Durbin Amendment was created. Finally, this section will review the Durbin Amendment and its general implications for debit card transactions.

A. Banking Regulation and the U.S. Financial Crisis

After the stock market crash of 1929 and the failure of thousands of banks the United States government passed the Banking Act of 1933.⁵⁷ Known as the Glass-Steagall Act, this New Deal legislation sought to regulate banks by: 1) separating commercial banks from investment banks in order to shield bank account funds from risky investments and 2) creating the Federal Depository Insurance Corporation (FDIC) to insure bank deposits.⁵⁸ After a period of increasing financial industry deregulation President Bill Clinton signed into law the Financial Services Modernization Act in 1999.⁵⁹ This legislation repealed many of the banking regulations of the Glass-Steagall Act, including the separation of commercial banks from investment banks.⁶⁰

Beginning in 2008, the United States underwent the worst financial crisis since the Great Depression.⁶¹ Many believed that a major cause of this financial crisis had been the repeal of Glass-Steagall and the deregulation of the banking industry.⁶² At the very least, financial instruments and new forms of financing within the banking industry exacerbated the American financial situation.⁶³ In response, many Americans called for a new

⁵⁷ *Glass-Steagall, Dodd-Frank and the Volker Rule: A Primer and Resources*, BILLMOYERS.COM (Mar. 16, 2012), <http://billmoyers.com/content/glass-steagall-dodd-frank-and-the-volcker-rule-a-primer-and-resources> [hereinafter *Glass-Steagall*].

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ David A. Skeel Jr., *The New Financial Deal: Understanding the Dodd-Frank Act And its (Unintended) Consequences*, U. of Penn., Inst. for Law & Econ. Research Paper No. 10-21 (October 2010).

⁶² *Glass-Steagall*, *supra* note 57.

⁶³ Skeel, *supra* note 61.

regulation system that could deal with the intricacies of the twenty-first century financial system.⁶⁴

B. Dodd-Frank Wall Street Reform and Consumer Protection Act

In March 2009, the Department of the Treasury released its framework for regulating the banking industry in its “Rules for the Regulatory Road.”⁶⁵ The Treasury later released a more detailed white paper that served as a template for the congressional legislation that would later pass.⁶⁶ The House of Representatives passed legislation proposed by Congressman Barney Frank, Chairman of the Committee on Financial Services, on December 11, 2009.⁶⁷ The Senate passed its own version of this bill, proposed by Senator Christopher Dodd and known as the Restoring American Financial Stability Act, on May 20, 2010.⁶⁸ A congressional committee was then appointed to work out the differences between the two bills.⁶⁹

On July 21, 2010, Congress passed and President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).⁷⁰ According to the Act’s subtitle, the legislation intended to, “Promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ‘too big to fail,’ to protect the American taxpayer by ending bailouts, to protect the consumers from abusive financial practices, and for other purposes.”⁷¹ The act provides for the creation of up to 400 new regulations and various new regulatory and watchdog agencies, including the Financial Stability Oversight Council, the Office of Financial Research, and the Bureau of Consumer Financial Protection.⁷²

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ David H. Carpenter, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Title X, The Consumer Financial Protection Bureau*, Congressional Research Service, 1 (July 21, 2010), available at <http://www.llsdc.org/attachments/files/313/CRS-R41338.pdf>.

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ Skeel, *supra* note 61.

⁷⁰ TCF Nat’l Bank v. Bernanke, 643 F.3d 1158, 1161 (8th Cir. 2011).

⁷¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

⁷² *Glass-Steagall*, *supra* note 57.

C. The Durbin Amendment

During the negotiations of the Dodd-Frank Act, Senator Dick Durbin saw an opportunity to implement regulations regarding bank fees on debit card transactions. According to Senator Durbin, the current system provided for “virtually no competition and no recourse for merchants exploited by the rate structures and fees” from the payment card networks.⁷³ Senator Durbin argued, “[m]ost retailers have no bargaining power when it comes to how much they’re charged for the use of debit cards. . . [which] leads to higher prices for consumers.”⁷⁴

Consequently, the Dodd-Frank Act included what is commonly called the “Durbin Amendment.” Title X of the Dodd-Frank Act, also known as the Consumer Financial Protection Act, specifically required the Federal Reserve Board to prescribe rules on debit card interchange fees that ensure they are “reasonable and proportional.”⁷⁵ As a result, the Federal Reserve Board passed a rule on December 16, 2010 approving the implementation of the Durbin Amendment in the Dodd-Frank Act.⁷⁶ The Rule initially established a cap on interchange fees at \$0.12 per transaction for issuing banks that, together with their affiliates, have assets of \$10 billion or more.⁷⁷ Financial institutions responded by strongly opposing and lobbying against processing debit card payments at such a low rate.⁷⁸ TCF

⁷³ Letter from Senator Richard J. Durbin, U.S. Senate, to Camden Fine, President and CEO, Indep. Cmty. Bankers of Am., and Dan Mica, President and CEO, Credit Union Nat’l Ass’n. (June 11, 2010), *available at* <http://durbin.senate.gov/public/index.cfm/pressreleases?ID=d9c42bd5-b945-4bee-b025-55aab2fd586a>.

⁷⁴ Brandy Donaldson, *Durbin: Lower Debit Card Swipe Fees Good for Consumers*, Moline Dispatch & Rock Island Argus (Sep. 30 2011), *available at* <http://durbin.senate.gov/public/index.cfm/localnews?ID=717a4e2b-2958-460a-9929-c30e7995c6fd>.

⁷⁵ Carpenter, *supra* note 66.

⁷⁶ Winston & Strawn LLP, *Implementing the Durbin Amendment: What Was the Fed Thinking?*, 1 (April 2011), *available at* http://www.winston.com/siteFiles/Publications/FRB_04_04_11_Briefing.pdf.

⁷⁷ Press Release, Board of Governors of the Federal Reserve System (Dec. 16, 2010), *available at* <http://www.federalreserve.gov/newsevents/press/bcreg/20101216a.htm>.

⁷⁸ Herb Weisbaum, *Farewell Debit Reward Cards: Banks, Credit Unions Ax Programs In Anticipation of New “Swipe-fee” Rules*, NBCNEWS.COM, http://www.msnbc.msn.com/id/42459217/ns/business-consumer_news/t/farewell-debit-reward-cards/#.UGxxFFHDu8A (last visited

National Bank even filed a federal lawsuit against the Board of Governors of the Federal Reserve System claiming that the proposed interchange rate was below their cost to provide debit card services.⁷⁹ The Federal Reserve Board ultimately issued a final ruling on June 29, 2011, capping debit interchange fees at \$0.21 plus 0.05% of the transaction, and an additional cent for fraud prevention costs and eliminating the requirement that debit cards be processed on only one network.⁸⁰

Less controversial provisions of the Durbin Amendment include a provision that allows merchants to set a \$10 minimum on credit card transactions and another provision that permits merchants to provide discounts to consumers who use a specific method of payment.⁸¹ These regulations are expected to save merchants an estimated \$14-19 billion dollars a year in revenue issuing banks normally collect on debit card transactions.⁸² The interchange fee regulations stemming from the Durbin Amendment became effective October 1, 2011.⁸³

IV. CONSUMER IMPACT OF THE DURBIN AMENDMENT

Senator Durbin explained that the purpose of the Durbin Amendment was to “help small businesses, merchants, and consumers by providing relief from high interchange fees for debit card transactions.”⁸⁴ Proponents of the amendment base the benefit to consumers on the assumption that card issues will bear the cost of the lost revenue from reduced fees and that merchants will pass these savings onto consumers through lower prices.⁸⁵

Sep. 27, 2012).

⁷⁹ TCF Nat'l Bank v. Bernanke, 643 F.3d 1158, 1162 (8th Cir. 2011).

⁸⁰ Press Release, Board of Governors of the Federal Reserve System (May 1, 2012), *available at* <http://www.federalreserve.gov/newsevents/press/bcreg/20120501a.htm>.

⁸¹ 15 U.S.C. § 1693o-2(b)(2-3) (2010).

⁸² Gerri Detweiler, *What the Debit Card Interchange Rules Mean For Consumers*, ABC NEWS (June 30, 2011), <http://abcnews.go.com/Business/debit-card-interchange-rules-consumers/story?id=13967755#.UGx2YFHDu8A>.

⁸³ Press Release, Board of Governors of the Federal Reserve System (May 1, 2012), *available at* <http://www.federalreserve.gov/newsevents/press/bcreg/20120501a.htm>.

⁸⁴ 156 Cong. Rec. S3695 (daily ed. May 13, 2010) (statement of Sen. Richard Durbin).

⁸⁵ David C. John, *The Durbin Debit Card Interchange Fee Cap Hurts Consumers*, THE HERITAGE FOUNDATION (March 17, 2011), *available at*

Highlighting its purpose to help consumers, the Durbin Amendment was even included in the section of the Dodd-Frank Act entitled the Consumer Financial Protection Act.⁸⁶ Despite its apparent intentions, the Durbin Amendment has not necessarily benefited consumers. This section will show that the Amendment's implementation unintentionally eliminated certain benefits consumer's received from using debit cards.

A. Merchant Savings Have Not Reduced Consumer Prices

There has been significant debate about whether merchants will pass along the savings from reduced interchange fees to consumers in the form of reduced prices or if they will simply retain the savings as profit.⁸⁷ Advocates such as Travis Plunkett with the Consumer Federation of America argue that these excessive fees paid by merchants are eventually passed on to consumers in the form of lower prices.⁸⁸ It logically follows that a reduction in interchange fees paid by merchants should also reduce prices on consumer goods.

In reality, a Federal Reserve Board study examining countries implementing interchange fee regulations shows that prices on consumer goods do not necessarily experience a corresponding reduction as a result of increased fee regulation.⁸⁹ Moreover, reports discussing Australia's reduction of interchange fees in 2003 published by both the United States Government Accountability Office and Charles River Associates International, a business consulting firm, found no evidence that merchants' savings were being passed along to the Australian consumers.⁹⁰

Data on consumer prices in the United States show that the Durbin Amendment has caused similar effects. An examination of the automobile gas industry provides further proof of an interchange fee reduction failing to reduce consumer prices. Gas retailers received over \$1 billion in annual savings due to reduced interchange fees.⁹¹ While this should mean savings

<http://report.heritage.org/wm3194>.

⁸⁶ Carpenter, *supra* note 66.

⁸⁷ Winston & Strawn LLP, *supra* note 76.

⁸⁸ Weisbaum, *supra* note 78.

⁸⁹ Detweiler, *supra* note 82.

⁹⁰ *Id.*

⁹¹ *Gas Retailers Gained a \$1 Billion Subsidy from Durbin Amendment, With No Evidence of Lowering Gas Prices*, BUSINESS WIRE (Apr. 16, 2012)

of roughly \$0.03 per gallon, no savings have been passed on to consumers.⁹² This is especially disconcerting as debit cards account for one third of all transactions and over half of non-cash payments for gas retailers.⁹³ If retailers that receive such a significant portion of their payments from debit cards are not passing along the saving to consumers, it is likely most retailers would refrain from doing so as well.

Retail marketing consultant Kevin Coupe indicated that the Durbin Amendment would at least allow retailers to “hold the line” against price increases.⁹⁴ However, a study performed by the Electronic Payment Coalition found that consumer prices one year after the implementation of the Durbin Amendment actually rose 1.5%.⁹⁵ The study examined prices at four major retailers and found the prices on most products increased from September 2011 to September 2012.⁹⁶ However, as the study failed to hold certain factors such as inflation constant, it is unclear the actual effect the Durbin Amendment had on consumer prices. According to the Consumer Price Index, from September 2011 to September 2012 there was an inflation rate of just under 2%.⁹⁷ Consequently, it appears that retailers were unable to “hold the line” on consumer prices and at most were able to stave off an additional 0.5% in price increases.

In addition to these major retailers, small business owners were also forced to raise prices for consumers because of the interchange regulations. Prior to the Durbin Amendment, small business owners who sold low priced goods received a discount

12:00 PM), <http://www.businesswire.com/news/home/20120416006410/en/Gas-Retailers-Gained-1-Billion-Subsidy-Durbin>.

⁹² Victor Nava & Anthony Randazzo, *Durbin Swipe Fee Watch V: Gas Retailers*, REASON FOUNDATION BLOG (Apr. 23, 2012, 12:20 PM), <http://reason.org/blog/show/durbin-swipe-fee-watch-v-gas-retail>.

⁹³ BUSINESS WIRE, *supra* note 91.

⁹⁴ Tim Parry, *Merchants Prevail in Swipe Fee Reform Vote*, MULTICHANNEL MERCHANT (Jun. 9, 2011, 11:27 AM), <http://multichannelmerchant.com/crosschannel/news/swipe-fee-reform-0609tpp1/>.

⁹⁵ Electronic Payment Coalition, *Where's the Debit Discount? The Durbin Effect: Retailers Gain without Consumer Benefit*, 9 (Sep. 28, 2012), available at http://wheresmydebitdiscount.com/wpcontent/themes/epc/media/Durbin%20White%20Paper_092812_small.pdf.

⁹⁶ *Id.*

⁹⁷ CPI Detailed Report - September 2012 70 (Malik Crawford et al. eds., 2012).

from financial institutions on interchange fees for goods under \$10.⁹⁸ However, the banking industry has largely eliminated these discounts in order to make up some of the lost revenue from the overall caps on fees.⁹⁹ As a result, many businesses are raising their prices on low-priced goods in order to cover these increased interchange costs.

For example, Redbox, a company that operates movie rental vending machines, raised their prices from \$1 per movie per day to \$1.20 on October 31, 2011.¹⁰⁰ Redbox admits on their company website that the increased cost is due to “rising operational costs, including increased debit card fees.”¹⁰¹ Beginning in January 2012, many vending machine operators that accept credit and debit cards either raised prices or began offering a \$0.25 discount for customers who paid in cash.¹⁰² Consequently, instead of consumers benefiting from lower prices, the cap on interchange fees led to little difference with large merchants and actually resulted in slight price increases from small retailers.

B. Elimination of Debit Card Rewards Programs

Debit card rewards programs allow customers to earn points for actions like spending, carrying high balances, and making minimum deposits.¹⁰³ These points are then used by

⁹⁸ Robin Sidel, *Debit-Fee Cap Has Nasty Side Effect*, WALL ST. J. (Dec. 8, 2011), http://online.wsj.com/article/SB10001424052970204319004577084613307585768.html?mod=WSJ_article_comments#articleTabs%3Darticle.

⁹⁹ Robin Sidel, ‘Free’ Checking Costs More, WALL ST. J. (Sep. 24, 2012), <http://online.wsj.com/article/SB1000872396390444032404578010631476813890.html>.

¹⁰⁰ Anthony Randazzo, *Durbin Swipe Fee Watch IV: Redbox Edition*, REASON FOUNDATION BLOG (Dec. 4, 2011, 4:29 PM), <http://reason.org/blog/show/durbin-watch-iv-redbox-edition>; see also Donna Freedman, *Redbox Price Hike Angers Customers*, MSN MONEY (Oct. 28, 2011, 8:29 AM), <http://money.msn.com/saving-money-tips/post.aspx?post=8000d0de-d0e4-4ed8-955f-d16f7464c448>.

¹⁰¹ *General Questions: Price Change*, REDBOX, <http://www.redbox.com/pricechange> (last visited October 3, 2012).

¹⁰² Sidel, *supra* note 98.

¹⁰³ Blake Ellis, *Wells Fargo, Chase, SunTrust Cancel Debit Rewards Program*, CNN MONEY (Mar. 28, 2011, 10:08 AM), http://money.cnn.com/2011/03/25/pf/debit_rewards/index.htm.

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consumers to redeem merchandise, gift cards, or even cash.¹⁰⁴ Rewards programs are used by banks to encourage consumers to use debit cards because these transactions are profitable for the financial institutions.¹⁰⁵

Before the Durbin Amendment took effect on October 1, 2011, banks had already eliminated most rewards programs on debit cards.¹⁰⁶ As early as March 2011, Wells Fargo, Sun Trust, and JPMorgan Chase had announced that they would no longer offer debit card rewards programs.¹⁰⁷ PNC Bank quickly followed in September of 2011, announcing that they would no longer be offering customers free checking or debit rewards.¹⁰⁸ Even USAA, a part co-operative serving primarily U.S. military personnel, veterans, and their families, was forced to shut down their rewards program.¹⁰⁹ USAA account holders consequently lost an average of \$84 per year due to the elimination of these programs.¹¹⁰ In this instance, the Durbin Amendment is taking money directly out of consumers' pockets.

C. New Fees on Consumer Bank Accounts

Jamie Dimon, the president and CEO of JPMorgan Chase, compared how banks will respond to the Durbin Amendment to how a restaurant would deal with a similar situation. He explained that, "if you're a restaurant and you cannot charge for the soda, you're going to charge [more] for the burger. Over time, it will all be repriced into the business."¹¹¹ This highlights how increased costs on debit services and other banking transactions

¹⁰⁴ *Id.*

¹⁰⁵ Detweiler, *supra* note 82.

¹⁰⁶ Todd Zywicki, *The Dick Durbin Bank Fees: Bank Branches Close While Banking Becomes More Expensive and Less Consumer Friendly*, WALL ST. J. (Sep. 29, 2011), available at <http://online.wsj.com/article/SB10001424052970204831304576597173130633798.html>.

¹⁰⁷ Ellis, *supra* note 103.

¹⁰⁸ Weisbaum, *supra* note 78.

¹⁰⁹ Anthony Randazzo, *Durbin and Wal-Mart vs. Consumers*, REASON FOUNDATION BLOG (Nov. 10, 2011, 5:21 AM), available at <http://reason.org/blog/show/durbin-and-wal-mart-vs-consumers>.

¹¹⁰ *Id.*

¹¹¹ Anthony Randazzo, *Durbin Swipe Fee Watch III: Banks of America Debit Card Fees*, REASON FOUNDATION BLOG (Oct. 23, 2011, 8:52 AM), available at <http://reason.org/news/show/durbin-swipe-fee-watch-iii-bofa>.

is a foreseeable consequence of the Durbin Amendment. In other countries that regulate interchange fees, consumers now pay periodic account fees, checking account fees, and transactions fees.¹¹² In response to the lost revenue, banks are often required to alter their business model in order to keep up their profits.¹¹³ The Eighth Circuit even argued in *TCF National Bank v. Bernanke* that the likelihood of increased debit card service fees is what makes the Durbin Amendment legal and prevents it from serving as a price control.¹¹⁴ It is clear that increased fees on consumers are not only likely, but they also appear to be necessary to ensure the amendment's legality.

According to a survey conducted by Bankrate.com, in 2012 only 39% of banks offered free checking, defined as accounts with no minimum balance requirements and no monthly fee.¹¹⁵ This decreased from 45% in 2011, the year in which the Durbin Amendment was implemented, and 76% at its peak in 2009.¹¹⁶ Rather, in 2012, the average monthly maintenance fee for noninterest-bearing checking accounts rose 25% to a record high of \$5.48.¹¹⁷ However, some large banks, such as Bank of America, originally announced plans to charge a \$5 monthly fee for debit card services which were previously free.¹¹⁸ Due to customer outcries, many banks abandoned these plans.¹¹⁹ Banks instead have raised amounts on existing fees, such as on ATM machines, overdrafts, and checking accounts.¹²⁰

Examples of banks increasing fees include Sun Trust, the 11th largest bank in the United States, who raised charges on overdrafts from \$25 to \$36 on August 24, 2012.¹²¹ Sun Trust also increased its minimum balance requirement to avoid a \$7 monthly fee on checking accounts from \$500 to \$1,500.¹²²

¹¹² Mercator Advisory Group, *supra* note 3.

¹¹³ Randazzo, *supra* note 111.

¹¹⁴ *TCF Nat'l Bank v. Bernanke*, 643 F.3d 1158, 1161 (8th Cir. 2011).

¹¹⁵ Claes Bell, *Checking Fees Rise to Record Highs in 2012*, BANKRATE.COM (Sept. 24, 2012), available at <http://www.bankrate.com/system/util/print.aspx?p=/finance/checking/checking-fees-record-highs-in-2012.aspx&s=br3&c=checking&t=story&e=1&v=1>.

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ Zywicki, *supra* note 106.

¹¹⁹ Sidel, *supra* note 98.

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² Catherine New, *SunTrust to Raise Minimum Balance, Overdraft Fees*

Similarly, Wells Fargo stopped offering free checking accounts and now requires account balances to exceed \$1500 each month to avoid a \$7 monthly fee and in December 2011 TD Bank increased their fees on services like wire transfers and money orders and instituted a \$9 fee for consumers making more than six withdrawals during a billing cycle.¹²³

Banks have also begun charging higher fees to use ATMs. ATM fees charged by the institution that owns the ATM increased 4% in 2012, along with an 11% increase in fees charged by banks for out-of-network ATM withdrawals.¹²⁴ Overall, this means an average fee of over \$4 for out-of-network ATM withdrawals for consumers.¹²⁵

In addition to the fees instituted by large banks, small financial institutions have also been forced to increase banking fees. As the Durbin Amendment causes a decline in the number of debit card transactions, operating costs for small banks increase per account and per transaction.¹²⁶ Thus, small banks will also be forced to issue fees on consumers in order to support these operations.¹²⁷

These checking fees predominantly affect consumers from lower and moderate income levels, as wealthy consumers have avoided the fees by easily maintaining minimum account balances.¹²⁸ Industry experts estimate that up to 5% of consumers will be forced out of the banking system as the costs of maintaining a bank account increase to cover the reduction in debit interchange.¹²⁹

on Everyday Checking Accounts, HUFFINGTON POST (June 6, 2012, 12:55 PM), available at http://www.huffingtonpost.com/2012/06/06/suntrust-minimum-balance-overdraft-fees_n_1574152.html.

¹²³ Blake Ellis, *TD Bank Adds \$9 Savings Account Fee, Adds Others*, CNN MONEY (Nov. 3, 2011, 1:39 PM), available at http://money.cnn.com/2011/11/02/pf/td_bank_fee/index.htm.

¹²⁴ Bell, *supra* note 115.

¹²⁵ *Id.*

¹²⁶ Mercator Advisory Group, *supra* note 3.

¹²⁷ *Id.*

¹²⁸ Zywicki, *supra* note 106.

¹²⁹ *Interchange and the Durbin Amendment*, MASTERCARD WORLDWIDE, http://www.mastercard.com/us/company/en/docs/Interchange_and_Durbin.pdf (last visited Sep. 30, 2012).

D. Reduced Access to Banking Services

One of the benefits of the growth of debit cards and the banking industry has been increased bank branches, longer branch hours, and more days of service.¹³⁰ Since the Durbin Amendment, financial institutions have begun to cut back on these banking services due to their decreased revenue.¹³¹ In order to cut costs, Bank of America eliminated 17,800 jobs through September 30, 2012.¹³² In September of 2011, the Texas-based IBC Bank also closed fifty-five supermarket-based locations and eliminated 500 jobs.¹³³ The loss of the bank branches and banking employees means fewer banking services are being offered. Overall, these lost banking services impair the quality of banking provided to consumers.

V. OUTLOOK UNDER THE DURBIN AMENDMENT

Despite attempts by financial institutions and consumer advocate groups to inform regulators of the detrimental effects of the Durbin Amendment, the amendment was passed, implemented, and upheld after being challenged in federal court.¹³⁴ In light of the amendment's staying power, this section evaluates the effect that regulations on interchange fees will have moving forward. First, the innovations consumers have experienced within the banking industry will become less profound. Furthermore, now that merchants have succeeded in

¹³⁰ Zywicki, *supra* note 106.

¹³¹ James Groth & Anthony Randazzo, *Consumers to Dick Durbin, Walmart: Thanks for the New Banking Fees*, REASON FOUNDATION BLOG (Nov. 10, 2011), available at <http://reason.org/news/show/consumers-to-dick-durbin-walmart-th>.

¹³² Maureen Farrell, *Hey Wallstreet, Get Ready For More Layoffs*, CNN MONEY (Jan. 15, 2013, 5:08 AM), <http://money.cnn.com/2013/01/15/investing/wall-street-banks-layoffs/index.html>.

¹³³ Zywicki, *supra* note 106.

¹³⁴ The Amendment's "staying power" was solidified in TCF Bank's failed challenge of the legality and constitutionality of the Durbin Amendment in a federal lawsuit against the Board of Governors of the Federal Reserve. See *TCF National Bank v. Bernanke*, 643 F.3d. 1158, 1161 (8th Cir. 2011). The Court denied TCF's preliminary injunction to enjoin the implementation of the Durbin Amendment as there was insufficient legal grounds to strike down the provision. *Id.*

regulating fees on debit cards, they will likely turn their attention to interchange fees for credit cards. However, one benefit for consumers may be an additional payment option on bills for consumers. This section highlights these likely outcomes and how they will affect consumers.

A. Limited Innovation in Banking Services

The U.S. financial services market has developed an industry that provides proven benefits to consumers. Some of these benefits include mobile banking, internet based services, identity verification services, risk management, and consumer education programs.¹³⁵ The revenues collected from interchange fees are not merely profits for banks, but rather they fund many of the programs and benefits consumers receive from banks.¹³⁶ The Durbin Amendment's limitation on the revenue financial institutions can collect on debit card transactions limits the funding necessary to support innovation and investment in network operations.¹³⁷ As a result, consumers will see less innovation in areas such as risk management, security, loyalty programs, product development, and user education due to the limited capital available for investment.¹³⁸

For instance, funding by financial institutions for fraud prevention and customer authentication is largely funded by revenue from interchange fees.¹³⁹ Banks will be forced to either pass the cost of forgery or fraud protection to the consumers or to cut investment in developing technology in these areas.¹⁴⁰ A sign of this stress was revealed in the 2012 Faces of Fraud Survey, which found that only 11% of financial institutions indicated being in compliance with federal regulations for security controls in conformance with the Federal Financial Institutions Examination Council Guidelines.¹⁴¹ Whether banks pass the cost

¹³⁵ Mercator Advisory Group, *supra* note 3, at 9.

¹³⁶ Randazzo, *supra* note 111.

¹³⁷ Mercator Advisory Group, *supra* note 3.

¹³⁸ *Id.*

¹³⁹ Groth & Randazzo, *supra* note 131.

¹⁴⁰ Richard A. Epstein, *The Dangerous Experiment of the Durbin Amendment*, REGULATION MAGAZINE, Spring 2011, at 27.

¹⁴¹ Tracy Kitten, Fraud Survey: Banks Get Bigger Budgets, BANK INFO SECURITY (Apr. 12, 2012), <http://www.bankinfosecurity.com/fraud-survey-banks-get-bigger-budgets-a-4673/op-1>.

of these programs along to consumers or simply decrease funding for security and innovation, consumers are likely to feel the effects.

B. Interchange Fees on Credit Cards

Like debit cards, credit card transactions require an interchange fee to be paid by merchants. Two factors make it likely that credit card interchange fees will be the next fees to be regulated. First, interchange fees on credit cards, especially rewards cards, are significantly higher than debit card fees.¹⁴² Now that merchants have succeeded in lowering the costs of debit card transactions, they are beginning to turn their resources towards regulating credit card transaction fees.¹⁴³ In July of 2012, a settlement was reached between retailers and Visa, MasterCard, and a number of major banks over price-fixing claims on credit card interchange fees.¹⁴⁴ Large merchant groups, however, have begun to disavow the settlement as it limits legal challenges that could be brought in the future.¹⁴⁵ As this perspective accounts for the likelihood of future challenges to transaction fees by merchants, it appears these groups also believe that credit card regulations are the next challenge facing the banking industry.

The second factor is that merchants are unable to differentiate between payment methods when setting their prices, which causes merchants to have to account for significant interchange fees that come with credit card transactions when setting their prices.¹⁴⁶ This may be a significant reason why regulations on interchange fees for debit cards alone has not reduced prices for consumers. Therefore, in order to succeed at lowering prices for consumers, credit card interchange fees will

¹⁴² See Anisha Sekar, *The Durbin Amendment Explained*, NERD WALLET BLOG, <http://www.nerdwallet.com/blog/banking/durbin-amendment-explained/>.

¹⁴³ Karen Weise, *A Year After Durbin, Wipe Fee Battles Still Rage*, BUSINESS WEEK (Sep. 25, 2012), available at <http://www.businessweek.com/articles/2012-09-25/a-year-after-durbin-swipe-fee-battles-still-rage>.

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

¹⁴⁶ Anisha Sekar, *The Durbin Amendment Explained*, Nerd Wallet Blog, <http://www.nerdwallet.com/blog/banking/durbin-amendment-explained/>.

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also have to be regulated. Both of these factors highlight how the Durbin Amendment has set the stage for future caps on credit card transactions in addition to debit card caps.

C. Increased Options for Bill Payment Methods

While card payments account for over 72% of payments in retail stores, only a small fraction of loan and bill payments are made this way.¹⁴⁷ One possible benefit from the Durbin Amendment may be that more companies will offer debit cards as a payment method for loans and bills.¹⁴⁸ With lower interchange fees being charged to these companies and institutions, there is more incentive to offer an additional payment option for the convenience of consumers. While this small benefit does not outweigh many of the negative effects of the Durbin Amendment, it is important to realize that benefits will be realized.

VI. CONCLUSION

Senator Dick Durbin may have had the best intentions in placing a cap on interchange fees charged in debit card transactions, but the real life consequences turned out to be largely negative. Consumers have been adversely affected, having begun to lose many of their previous banking benefits. Financial institutions have consistently argued that such regulations would harm consumers, but regulators paid little attention, possibly assuming their intentions were purely selfish. In reality, consumer interests in relation to the banking industry and debit card programs are largely in line with those of the banks.

After a year of life under the Durbin Amendment, it has become obvious that consumers are not benefiting from the amendment's regulation and are in fact paying for or losing their banking services. Studies examining prices within the gas and retail industries and small businesses show that savings are not being passed onto consumers and that prices are even increasing. Meaning, the revenue merchants are saving on reduced interchange fees are being retained rather than passed on to

¹⁴⁷ Bill Kinnelly, Durbin and the Future of Payments, ONLINE RESOURCES CORPORATION (Sep. 30, 2012), *available at* <http://www.banktech.com/durbin-and-the-future-of-payments/240007700>.

¹⁴⁸ *Id.*

consumers.

Furthermore, due to reduced revenue from interchange fees banks are eliminating some banking service or increasing prices to retain them. For example, debit card rewards programs and free checking accounts have been eliminated by many banks. Other banks have kept these services, but introduced annual fees on debit cards and monthly fees on checking accounts. Banks have also been forced to lay off employees and close some branch locations as a result of the reduced revenue.

Some of the benefits of interchange fee regulation, however, may not be realized because higher interchange fees are still permitted on credit cards. Therefore, the regulation of credit card interchange fees may be where the Durbin Amendment is taking the banking industry. Moreover, with reduced revenue the banking industry may produce less innovation in products and services in the foreseeable future.

The only way to correct the negative impact of capped interchange fees on consumers is to repeal the Durbin Amendment. While the implementation of interchange fee regulation on credit cards may help to actually reduce consumer prices, the elimination of credit card rewards and additional banking services would counteract this benefit. Only the repeal of the Durbin Amendment will return the quality of banking services, rewards programs, and lower retail prices to consumers.