

ISSUE BRIEF

No. 4644 | JANUARY 4, 2017

Repealing the Durbin Amendment: A Vote for the Rule of Law

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Section 1075 of the Dodd–Frank Wall Street Reform and Consumer Protection Act, known as the Durbin Amendment, requires the Federal Reserve Board of Governors to cap the debit card interchange fees that large banks charge.¹ These fees, charged to merchants every time consumers swipe their debit cards, have long been a source of controversy. Since the 1980s, as the volume of card transactions increased, retailers have complained that the fees are too high because large banks and card network companies collude to fix prices.² Retailers are currently engaged in an antitrust class action lawsuit over *credit* card interchange fees, and it is likely a similar suit would have been filed over *debit* card interchange fees had the Durbin Amendment not been enacted.³

The Durbin Amendment represents a major policy mistake because it forced Congress into a role for which it is ill-suited: adjudicating legal disputes. Of the three branches of the U.S. government, the judicial branch was set up for exactly this purpose. Congress is not set up to be a finder of fact in legal disputes. More than a century ago, with the 1890 Sherman Act, Congress created the basic legal framework for resolving anticompetitive price-fixing disputes, so there is absolutely no reason that the federal courts cannot adjudicate any such dispute over interchange fees.

This *Issue Brief* provides an overview of the debit card interchange fee dispute, and argues that repealing the Durbin Amendment would be a victory for the rule of law that is consistent with the separation of powers created by the Constitution.

Card Interchange Fee Controversy

Retail consumers may not realize it, but they are essentially in the middle of a series of transactions—and a huge controversy—every time they swipe their cards to make a purchase. This series of transactions, for every single purchase, involves the following clients:

- The retail customer (the cardholder);
- The retail store (the merchant);
- The cardholder’s bank (the card-issuing bank);
- The merchant’s bank; and
- The network platform (the card association, often Visa, MasterCard, Discover, or American Express).⁴

When a retail customer swipes his card to make a purchase, he signals the merchant’s bank to estimate whether he (the cardholder) has enough funds to make the purchase. This electronic information is sent, via the network platform, back to the cardholder’s bank, which either authorizes or denies the sale. When the cardholder’s bank approves a purchase, it keeps a percentage of the sale amount and then sends the remainder, via the network platform, to the merchant’s bank. The network platform and

This paper, in its entirety, can be found at <http://report.heritage.org/ib4644>

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the merchant's bank also keep a percentage of the sale amount for their services.

Collectively, these percentages are referred to as *interchange fees*, and they typically sum to approximately 2 percent.⁵ Because it is significant for any low-profit-margin retailer to lose this amount of the sales price, interchange fees are a long running controversy among retailers.⁶ Merchants voluntarily contract to accept cards in their stores, and many choose to contract with Visa and MasterCard networks because doing so provides access to a large customer base. Still, many retailers have long complained that they have little ability to negotiate these fees. Some even argue that card networks and issuing banks represent price-fixing cartels that use "market power to set excessively high interchange fees."⁷

In 2011, Senator Richard Durbin (D-IL) echoed these complaints in a letter to Wells Fargo Chief Executive John Stumpf. According to Durbin, "[I]nterchange fee rates are uniformly and centrally fixed by the card network companies Visa and MasterCard on behalf of Wells Fargo and thousands of

other banks."⁸ More than one century ago, Congress established the legal framework for remedying price fixing and other anticompetitive behaviors such as those charged against card-issuing banks and the network companies: anti-trust law.

Anti-Trust Remedy

The core provisions of federal anti-trust law are found in the 1890 Sherman Act and the 1914 Clayton Act, both of which have been refined over time through amendment.⁹ The Department of Justice and the Federal Trade Commission enforce federal anti-trust law, and price fixing is one of the behaviors traditionally deemed unlawful. However, the U.S. Supreme Court recently ruled that:

The possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The opportunity to charge monopoly prices—at least for a short period—is what attracts "business acumen" in

1. Section 1075 amended The Electronic Fund Transfer Act (15 U.S. Code 1693 et seq.).
2. Brian W. Smith, Abbott B. Lipsky Jr., Andrew J. Robinson, and William J. Rinner, "Why the Market Should Set Credit Card Interchange Fees," Legislative Comment in Bank Accounting and Finance, October–November 2008, pp. 39–44, <https://www.mastercard.com/us/company/en/docs/InterchangeFees.pdf> (accessed December 23, 2016).
3. See *In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*, Case 12-4671, Document 1556-1, June 30, 2016, <https://www.paymentcardsettlement.com/Content/Documents/Second%20Circuit%20Opinion.pdf> (accessed December 29, 2016). Litigation began in 2005, and a federal appeals court recently threw out a \$7.25 billion settlement. See Robin Sidel, "Battle Over Cards Heats Up as Court Rejects Visa, MasterCard Deal With Retailers," *The Wall Street Journal*, June 30, 2016, <http://www.wsj.com/articles/visa-mastercard-class-action-settlement-rejected-by-u-s-court-1467300658> (accessed December 29, 2016).
4. As of 2012, in addition to Visa and MasterCard, there were 13 debit card network operators. See Zhu Wang, "Debit Card Interchange Fee Regulation: Some Assessments and Considerations," Federal Reserve Bank of Richmond *Economic Quarterly*, Vol. 98, No. 3 (3rd Quarter 2012), pp. 159–183, https://www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_quarterly/2012/q3/pdf/wang.pdf (accessed December 23, 2016).
5. In other words, merchants typically keep about 98 percent of the retail price the customer agreed to pay. See Richard Epstein, "Durbin's Folly: The Erratic Course of Debit Card Markets," *Competition Policy International*, Vol. 7, No. 2 (Fall 2011), http://econ.as.nyu.edu/docs/IO/22936/Epstein_02272012.pdf (accessed December 23, 2016).
6. The share of U.S. consumer expenditures paid for with cards increased from approximately 3 percent in 1986 to 25 percent in 2000, and the controversy over debit card interchange fees grew during this period. James Lyon, "The Interchange Fee Debate: Issues and Economics," Federal Reserve Bank of Minneapolis *The Region*, June 1, 2006, <https://www.minneapolisfed.org/publications/the-region/the-interchange-fee-debate-issues-and-economics> (accessed December 23, 2016). Lyon notes that debit and credit cards represented less than 20 percent of noncash payment transactions in 1995, and they exceeded 40 percent of noncash transaction volume by 2003.
7. Wang, "Debit Card Interchange Fee Regulation." See also, Renee Haltom and Zhu Wang, "Did the Durbin Amendment Reduce Merchant Costs? Evidence from Survey Results," Federal Reserve Bank of Richmond *Economic Brief*, December 2015, https://www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_brief/2015/pdf/eb_15-12.pdf (accessed December 23, 2016).
8. Richard J. Durbin, "Letter to Wells Fargo CEO John Stumpf," October 19, 2011, <http://www.durbin.senate.gov/newsroom/press-releases/letter-to-wells-fargo-ceo-john-stumpf> (accessed December 21, 2016).
9. Alden F. Abbott, "A Brief Overview of American Antitrust Law," paper given at The Competition Law & Policy Guest Lecture Programme, The University of Oxford Centre for Competition Law and Policy, January 2005, https://www.law.ox.ac.uk/sites/files/oxlaw/ccplp_1_01-05_1.pdf (accessed December 23, 2016).

the first place; it induces risk taking that produces innovation and economic growth. To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anti-competitive conduct.¹⁰

Retail merchants do not enjoy paying fees, but the question of whether the card networks and card-issuing banks engaged in illegal anticompetitive behavior, such as collusive price fixing, should be settled in federal court. Instead, Senator Durbin's amendment to the Dodd–Frank Act made Congress (and the Federal Reserve) the ultimate judge and jury by implementing a federal price control on interchange fees.¹¹

The Durbin Amendment

Section 1075 of the Dodd–Frank Act amended the Electronic Fund Transfer Act¹² by adding a new section 920 regarding debit card interchange fees.¹³ The statute requires the Fed to set these debit card transaction fees so that they are “reasonable and proportional to the cost incurred by the issuer with respect to the transaction.”¹⁴ The statute also exempts any card-issuer which, “together with its affiliates,” has assets of less than \$10 billion.¹⁵ In other words, small banks that issue debit cards are exempt from the price controls.

The Fed's final rule, issued in July 2011, stipulates that an “issuer may not charge or receive any interchange transaction fee that exceeds the sum of \$0.21 plus 5 basis points (0.05 percent) of the transaction's value.”¹⁶ The \$0.21 represents the base amount, and it corresponds to the per-transaction allowable cost, excluding fraud losses.¹⁷ The 5 basis points are an *ad*

valorem amount that corresponds to the average per-transaction fraud losses of the median card issuer, as estimated by the Federal Reserve.¹⁸ Price caps were not applied to the fees charged by the card networks. The interchange fee on the typical transaction is now approximately half the pre-Dodd–Frank fee, but early evidence suggests that the Durbin Amendment has had “limited and unequal impact” on reducing merchants' overall cost of accepting debit cards.¹⁹

Conclusion

The Durbin Amendment, or Section 1075 of the Dodd–Frank Act, requires the Federal Reserve to cap the debit card interchange fees that large banks charge retail merchants. This outcome has been portrayed as a victory for consumers, but it is doubtful that these reduced fees will ever result in lower consumer prices. More importantly, the Durbin Amendment is a defeat for the rule of law because it forces Congress into adjudicating a legal dispute.

For decades, retailers have accused card-issuing banks and card network companies of colluding to fix prices, and Congress long ago established the legal framework for resolving these types of disputes. The Durbin Amendment, instead of allowing courts to fulfill their well-established role, places federal price controls on banks. Congress should not arbitrarily appoint itself the final judge and jury in discrete antitrust disputes. Repealing the Durbin Amendment would help restore the separation of powers created by the Constitution.

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10. *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko*, 124 S.Ct. 872, 879 (2004).

11. In a 2011 press release, Senator Durbin explains that he learned about the issue years ago from a friend (a “grassroots businessman”) who told him “these credit card companies and their banks are killing us.” Senator Richard Durbin (D-IL), “Response to *The Wall Street Journal's* Editorial on Swipe Fee Reform,” press release, March 17, 2011, <http://www.durbin.senate.gov/newsroom/press-releases/response-to-the-wall-street-journals-editorial-on-swipe-fee-reform> (accessed December 23, 2016).

12. 15 U.S.C. 1693 et seq.

13. *Federal Register*, Vol. 76, No. 139 (July 20, 2011), pp. 43394–43475.

14. Section 1075(a)(2), 15 U.S. Code § 1693o–2.

15. Section 920(a)(6)(A), 15 U.S. Code § 1693o–2(a)(6)(A).

16. *Federal Register*, Vol. 76, No. 139 (July 20, 2011), p. 43420.

17. *Ibid.*, p. 43422.

18. *Ibid.*, p. 43424.

19. Haltom and Wang, “Did the Durbin Amendment Reduce Merchant Costs?”