The war over interchange will continue. Washington should stay out of it, playing the role of night watchman in payments, not central planner.

Interchange Armistice? Not a Chance

The long war over interchange isn't likely to end any time soon, which means its harmful effects will go on as well, says Eric Grover.

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With major merchants and retail interest groups objecting right and left to the July settlement their own attorneys made in a massive credit card antitrust case, the decades-long war on card interchange appears set to go on years longer.

To be sure, it is a war being waged on multiple fronts. A determined coalition spearheaded by the merchant lobby has sought to curb interchange via litigation, regulation, and legislation. Goliath merchants in particular want cards to be free and for cardholders to bear the costs.

But this battle has real costs for the U.S. economy. Let's review how we got here.

The first major battle was Nabanco's antitrust suit against Visa. Nabanco lost, with federal judge William Hoeveler deciding in 1984 interchange fees were not illegal price fixing.

Then came the 2003 Wal-Mart suit settlement, which was retailers' first U.S. victory. MasterCard and Visa unbundled debit and credit acceptance, coughed up $3 billion for merchants and their attorneys, and lowered signature-debit interchange by a third for five months.

Durbin's Pivot

In 2006 and 2007, a House Energy subcommittee, in a bit of political theater, suggested interchange was causing higher gas prices, and the House and Senate Judiciary committees used a parade of small merchants as props to suggest an antitrust problem.

In 2008 and 2009, Sen. Richard Durbin's and Rep. John Conyers's Credit Card Fair Fee Acts and Congressman Peter Welch's Credit Card Interchange Fees Act threatened card-acceptance price controls.

The payments industry argued issuer costs—in particular credit losses per dollar spent—were greater than interchange, so merchants had a great deal. In the Great Recession, with credit-card losses cresting at 11% of receivables, that argument resonated politically. The bills stalled.

So Durbin pivoted, turning his sights on debit card interchange, which is indefensible based on an issuer-cost-recovery model. In 2010, he motored around a complacent payments industry's Maginot Line, winning 64 votes for an amendment to the Dodd-Frank Act that capped debit interchange and gave merchants routing choice.

The amendment as interpreted by the Federal Reserve had a huge impact. Large banks lost $6.5 billion in debit interchange and network competition was upended.

Debit gorilla Visa acted decisively to defend its economics and market share. It implemented "fixed" monthly acceptance fees on top of traditional variable licensing and processing fees, provided funds to incent issuers to align with and merchants to route over its Interlink debit network, and cut variable debit transaction fees to merchants. Visa also committed to using its signature-debit platform to compete for PIN-debit routing.

Then, in March, all these changes at Visa sparked an investigation at the U.S. Department of Justice.

Pre-Durbin, Visa had 75% of the signature-debit market and over 50% of PIN debit. After Durbin, its PIN-debit franchise was at risk of being destroyed. At one national merchant processor, Visa's PIN-debit transaction share fell more than 40% from September 2011 through May 2012. MasterCard was the big winner, gaining 343% and vaulting from nowhere to fleeting market leadership ("The Great Debit Network Reshuffle, page 34).

In June and July, Visa clawed its way back to the top PIN-debit perch, increasing the chances the DoJ will pull the trigger on an antitrust suit.

And in July, MasterCard, Visa, and credit card issuers tentatively agreed to settle the aforementioned credit card interchange antitrust suit, whose roots go back seven years.

Shifting to Washington

The nature of settlements is that neither party gets everything it wants. Some high-profile merchants and retailer associations, however, want a better deal and are trying to scuttle the proposed settlement.

Implacable payment-industry foe Durbin also weighed in, thundering that merchants weren't getting enough and that it would make legislation reducing credit-card interchange more difficult. His senior judiciary counsel Dan Swanson warned, "This is going to foreclose the prospect of good legislation for the foreseeable future. It will essentially be game over."

That's unlikely, though Durbin will have a higher burden of proof on the Hill when he next sallies forth to gore the payments industry.

If the settlement is approved, the war will shift to Washington and state capitals. Ten states including California, Florida, New York, and Texas ban credit card surcharging. For instance, California's Song-Beverly Credit Card Act's intent is "to protect consumers from deceptive price increases for goods and services by prohibiting credit card surcharges..."

Congressmen Jason Chaffetz and Bill Owens have a bill to repeal the Durbin Amendment. In the 112th Congress, its prospects are greater than those for Durbin's capping credit card interchange.

Most government interventions in payment-network markets have reduced competition, innovation, and network value. The DoJ's antitrust suit ending MasterCard's and Visa's bans on member banks licensing Discover and American Express products stands out as an exception.

Retail payment networks have never been more competitive, innovative, or delivered greater value. With PayPal going to the physical point of sale, the U.S. will soon have five full-spectrum, branded retail-payment networks competing vigorously, plus half a dozen national PIN-debit networks, all of which are bank-independent commercial enterprises. Additionally, notwithstanding challenges, capital continues to be deployed to build new payment systems.

Barring legislation or an improbable court decision rendering it illegal, the war over interchange will continue. Washington should stay out of it, playing the role of night watchman in payments, not central planner. DT