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What Has Durbin Done?

By controlling debit interchange and supercharging the administrative state, the Durbin Amendment has inflicted immense harm, says Eric Grover.

With virtually no debate, the Durbin Amendment was sold as pro-consumer, pro-small bank, and pro-merchant—a political trifecta. Widely understood to be bad for politically unsympathetic large banks, U.S. Sen. Richard Durbin, D-Ill., attached an amendment to the Dodd-Frank Act, which President Barack Obama signed into law on July 21, 2010.

Roughly five years later, what has it delivered?

The Durbin Amendment mandated price controls for debit interchange, banned issuers aligning debit cards with a single network, politicized retail payments, and, as ratified by the U.S. Circuit Court of Appeals for Washington, D.C., ceded enormous power to the administrative state. In short, it has caused immense harm.

Price Controls

Price controls create shortages in two-sided markets, like payment networks, that employ asymmetric pricing, just as they do with apartments and gasoline. Interchange fees are debit cards' principal revenue source. Cutting them by more than 50% for two-thirds of the market, as the Durbin Amendment did, created a shortage of consumer value and issuer innovation.

Bankrate.com's 2009 survey reported 76% of banks offered free checking. Anticipating losing billions of dollars of interchange, banks slashed free checking. The percent of banks offering it fell to 65% in 2010, and by 2015 only

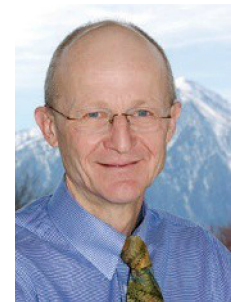
37% of banks surveyed offered free checking with no conditions. Increased fees and niggardly benefits hurt debit card holders and pushed less affluent consumers out of the banking system.

Even more worrying, Durbin's throttling of interchange suppressed issuer-side payments innovation, which is largely funded by interchange income. Interchange helped launch general-purpose prepaid payment cards, for example. Slashing interchange reduced the attractiveness of decoupled debit, which had the potential of increasing debit competition and cardholder value.

Partisans of interchange controls argue consumers benefit because merchants pass acceptance-cost savings on by lowering prices. But last year, a Federal Reserve Board of Richmond study suggested most merchants whose debit-acceptance costs decreased did not consequently lower prices or reduce debit-use restrictions. It estimated 77.2% of merchants didn't change prices, 1.2% reduced prices, and 21.6% increased prices.

Value and costs must be considered holistically. On the other side of the network, banks raised fees and reduced benefits for retail-bank customers to offset lost interchange revenue. Durbin and the merchant lobby claimed they were acting on consumers' behalf. How many cardholders would choose to pay higher fees and lose rewards in return for the promise of merchants lowering prices because of reduced acceptance fees?

The paramount question isn't: What are the right prices for debit interchange? Rather, it is:



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Should they be determined in the market or by the state?

Prices dynamically set in competitive, free markets is the most effective system of allocating resources to where they deliver the greatest value. Washington mandarins can't match the dynamic intelligence of tens of billions of payment decisions by consumers, merchants, banks, networks, and processors.

Politicization

The merchant lobby sought and won pricing concessions in Washington it couldn't win in the market. Washington's increasing role in payments isn't a good harbinger.

One set of rules for competitors is the *sine qua non* of fair play. Under Durbin's amendment, small banks enjoy a huge debit-interchange advantage over large banks. That edge however, was overwhelmed by Dodd-Frank's suffocating tsunami of regulation.

Dodd-Frank put the administrative state on steroids. On the law's fifth anniversary, the law firm Davis Polk & Wardwell reported 22,296 pages of Dodd-Frank-related rules had been published, 13,115 of which are final.

George Mason University's Mercatus Center put a spotlight on Dodd-Frank's bank straitjacket, reporting that, as of December, 2014, Dodd-

Frank imposed five times as many regulatory restrictions as any law and more than all laws passed under the Obama administration combined.

The Administrative State

Dodd-Frank conferred enormous new power on the Fed, including the power to implement the Durbin Amendment. The Fed understood that strictly implementing Durbin's punitive price caps would harm banks, many of which were reeling from the financial crisis. So it took liberties tantamount to law-making, permitting banks to recoup costs in addition to incremental issuer-processing and fraud-prevention costs that the legislation's text proscribed. No matter how bad the law, the Fed's role is to implement, not make, policy.

Retailers filed a suit contending the Fed didn't faithfully implement the law. On July 31, 2013, federal judge Richard Leon granted summary judgment, ruling the Fed's implementation was "non-compliant with Congress's clear mandate," ran "afoul of the text, design, and purpose of the Durbin Amendment," "ignored critical statutory terms," and was "utterly indefensible." On appeal however, the D.C. Circuit Court of Appeals, on March 21, 2014, overturned Leon's decision, bending over backwards to give deference to the administrative state.

In March, the Electronic Payments Coalition's executive director, Molly Wilkinson, wrote a letter to Fed chair Janet Yellen contending retailers held back \$8 billion annually in debit-interchange savings, or \$36 billion since the price controls took effect in October 2011. Whether merchants retained interchange savings or passed every cent on to consumers, however, is irrelevant to the Fed's task. I hope Wilkinson's real target was Congress, where she may score political points and make the Durbin Amendment's repeal more likely.

Ultimately, Congress is to blame for the harm the Durbin law has wrought. It is Congress's, not the Fed's, place to rectify it. While there are probably enough votes to repeal the Durbin Amendment—albeit not enough to overcome a veto—most Congressmen would prefer to avoid a vote where they have to take sides between banks and merchants. If, however, the issue were framed as a vote between consumers and Walmart, congressmen on both sides of the aisle would take a different view.

The U.S. retail-payments market is the most competitive and innovative in the world. Other than tweaking laws to enhance competition, Washington should let the market determine winners and losers. **DT**

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