Bankers Should Call Every New Charge a 'Durbin Fee'

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By Eric Grover

The Fed presented its much anticipated final rule implementing the Durbin Interchange Amendment on Wednesday. The payments industry couldn't have asked for a more accommodating implementation of a nasty piece of legislation. Given the legislation's punitive intent as expressed in the text, the Fed's implementation is about as charitable as it could possibly be toward banks and networks. MasterCard's and Visa Inc.'s stocks surged 11.3% and 15% respectively on the news.

The Fed more than doubled debit interchange price caps from its December 16 proposal to 22 cents plus 5 basis points, adding recovery of issuer network fees, fixed payment hardware and software costs and fraud losses, arguing they are associated with a particular transaction, and fraud prevention costs. Of course so are cardholder rewards which were excluded.

Additionally on its own authority, the Fed deferred the price controls' effective date until October, which saves banks several billion in revenue.

Of greater portent, the Fed could comply with the network exclusivity ban by aligning with at least two unaffiliated networks. This was huge. Combined with the Fed’s implementation of the ban of synthetic interchange it means network pricing power with merchant acquirers will be substantially unimpaired. Issuers by and large will align with a single signature and a single unaffiliated network, meaning while merchants can steer cardholders to use signature or pin, merchants will generally have one network choice whatever cardholders elect to do. Issuers would be foolish to provide more network options because merchants will destroy the economics of whatever they can systematically choose transaction by transaction.

The second network-exclusivity-ban alternative the Fed entertained, would have required banks provide two network options for each debit authorization type. Merchants or merchant processors on their behalf would have been able to pick the least expensive network for each debit transaction, which would have provided a powerful systematic ratchet to force down network fees and interchange.

Curiously, the Fed assumed a bundled view of payment networks, not distinguishing between the routing or processing of a debit transaction and the payment scheme.

Three-party debit systems were excluded from the legislation's expansive definition of payment card network, which may have caused PayPal president Scott Thompson to pop a bottle of champagne.

Fed governor Elizabeth Duke voted against the rule, expressing concern over the effectiveness of small banks' exemption. Governor Daniel Tarullo proposed monitoring its effectiveness, which presumably might inform any future Congressional efforts to amend their destructive handiwork.

The exemption nevertheless ought to provide small banks with ample basis to take share from Golaiths such as BofA, Chase and Wells Fargo who notwithstanding the Fed's more than doubling their expected debit interchange and indirectly reducing knock-on credit interchange reductions, will still be significantly disadvantaged in debit value propositions they can offer consumers.

Consumers don't need U.S. PIRG and the Consumer Federation of America to tend to their interests. Faced with free debit and checking and rewards from community banks or a battery of new fees from interchange-fee capped giants, consumers will vote with their banking relationships.

Nonetheless, while the payments industry breathed a collective sigh of relief Wednesday afternoon, the new regulatory regime is horrific, just not as bad as it could have been, the merchant lobby intended or was expected.

So where does the payments industry go from here? MasterCard 's and Visa Inc.'s CEOs Ajay Banga and Joe Saunders and their bank licensees were forcefully reminded the payments industry may not be interested in politics, but politics is interested in the payments industry.

It shouldn't throw in the towel. The payments industry should take a page from merchants, who, notwithstanding many defeats persisted in their long and relentless quest for government intervention to reduce card-acceptance fees before achieving a big victory last year.

Banks should not simply adapt to the punitive regulation. They should do so in a fashion maximizing chances of repealing it when the political climate is more propitious.

Eighty percent of adult Americans have a debit card. To offset lost interchange, banks will hit many of them with new fees, eliminate rewards, trim features, and try to migrate spend from debit to credit and hybrid credit-debit products. Left to their own devices Jose and Maria Sixpack will blame banks for higher fees. Banks need to connect the dots for them.

Issuers should explicitly brand new fees "Durbin fees." That would help ensure cardholders (voters!) understand and are repeatedly reminded they are paying for Congress's price controls. There is precedent of sorts, albeit positive. Credit-card-term disclosures are called the Schumer box because Congressman (now Senator) Schumer sponsored legislation requiring clear disclosure of terms on credit card promotions.

During Congressional hearings on card acceptance fees advocates of treating payment networks as public utilities employed small merchants as politically sympathetic props and the payments industry countered with community banks. Merchants versus banks was a tough political matchup for banks. Retailers versus consumers however would have been a different story. But consumers had no voice. They were putatively represented by self-anointed consumer activists arguing for price caps and a more stringent regulatory regime   a regime in which they played a role.

The payments industry needs to engage consumers and to frame the debate over total system and consumer value, and choice, rather than permitting the merchant lobby to narrowly define it in terms of POS swipe fees.

Cultivating informed voter fury targeted at politicians supporting government price controls will move more than the 6 votes by which Senator Tester lost his bid to delay the Durbin Interchange Amendment, and the 113th Senate will almost certainly be more receptive than the 112th to gutting it.

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