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Fee Debate Shifts with Political Winds

By Eric Grover

The controversy over fees of retail-card-payment networks, how they're determined and whether consumers or merchants bear them is coming to a head.

The merchant lobby argues for focusing narrowly on card-acceptance fees, utility-like cost recovery rather than value-based pricing, and government intervention. Thus far it has been more effective than the payments industry in setting the terms of the debate. In response to a concerted assault on their business models, commercial payment networks and their licensees' have behaved like a boxer on the ropes. While consumers have much at stake, they are not engaged.

Consumers and merchants jointly consume credit and debit cards and take their enormous global utility for granted. Payment networks are two-sided markets. Fees are set at different levels on the spend and acceptance sides of the network to maximize total value. Higher merchant fees fund card-issuer innovation and consumer benefits, spurring greater use. More spend brings greater value to merchants and wider acceptance more value to cardholders.

Because fierce competition delivers compellingly differentiated card products, consumers have payment preferences, and in the free market they trump merchants' preferences. In its report "Interchange Fees and Payment Card Economics, Industry Developments and Policy Issuers" the Fed rightly notes if consumers all had half a dozen payment products toward which they were indifferent, merchant payment desires would rule instead, driving down interchange. It is consumer choices that frustrate merchants and limit their ability to reduce card-acceptance costs.

However, merchants believe they can win pricing concessions in Washington that they can't in the market. They may be right.

While Washington has long interested itself in revolving credit, it has not worried about the networks. Its only serious intervention was the DOJ suit ending MasterCard's and Visa's prohibitions of member banks participating in American Express and Discover. Competition was enhanced. There was no attempt to regulate network fees or products.

The political climate, however, has shifted. Government is now attempting to extend suzerainty over card payment systems. And while U.S. regulators have been restrained compared with their peers abroad, that too may change.

The recently enacted Credit Card Accountability, Responsibility and Disclosure Act calls for the GAO to study interchange and in November recommend regulation if "appropriate." The review will provide ammunition to regulation advocates.

Notwithstanding their support of the study, congressional partisans of card-acceptance-fee regulation are plowing ahead.

Rep. Peter Welch's Credit Card Interchange Fees Act would prohibit different interchange for payment cards under one brand and reduce networks' ability to define and guarantee the customer experience at the point of service.

House Judiciary Committee Chairman John Conyers and Senate Majority Whip Dick Durbin envision a world in which a single government-chaperoned negotiation between the payments industry and those accepting cards, rather than the market, determines fees.

Conyers' Credit Card Fair Fees Act would grant merchants a limited antitrust exemption to bargain collectively with the MasterCard and Visa payments industry and require disclosure of card-payment economics including merchant acquirer contracts. The DOJ would monitor negotiations and report back to Congress after seven months. Any agreement would be the same for all merchants regardless of size or category. While nobody would be compelled to agree to anything, the bill would set the stage for a renewed call for card-acceptance price controls in early 2010.

Durbin's Senate version of the bill is more severe. It would cover MasterCard, Visa and Amex and establish a regulatory tribunal of electronic payment system judges to oversee negotiations and impose card-acceptance price caps.

The merchant lobby is waging an aggressive, inflammatory and effective campaign for government intervention. The payments industry makes a monumental mistake not systematically engaging consumers. If one polled a hundred voters on whether they would like to pay higher card fees and lose rewards so merchants could pay lower "fair" fees, is there any doubt how Joe and Sally Sixpack would define their interests?

In markets with bank-controlled monopoly networks such as China and France an antitrust issue exists. However, in the U.S. the electronic-payment-network market is independent and fiercely competitive. Amex, Discover, MasterCard, Visa, Star, NYCE and PayPal compete. Despite consolidation, issuing and acquiring remain ferociously competitive. And capital continues to be deployed, funding challengers.

If, however, Washington treats the networks as public utilities payments, innovation and value delivered to consumers would be suppressed, acceptance reduced, prepaid cards for the unbanked and underbanked less available and debit cards more expensive.

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