Government Usurping Market Role on Interchange

American Banker | Friday, August 27, 2010

"$2 Billion Revenue Loss for Debit Issuers?" [Aug. 17] suggested large issuers could lose $2 billion due to new rules governing interchange and over-limit fees. That's low.

The interchange reduction alone will be greater, probably five- or sixfold bigger.

Industry analysts comfort themselves that the Fed is a reasonable regulator and wouldn't — in contrast with others in Washington — seek to harm the card payments industry.

The Fed doesn't exist in a political vacuum. In the current climate financial regulators are vying to see who can be the toughest on banks. But the Fed's job is to implement, not make, policy.

The best way to get a sense of how much the central bank will cut interchange is to read the Dodd-Frank Wall Street Reform and Consumer Protection Act, not to consider what may be fair or what regulators have done abroad. While it doesn't specify rates, the legislation provides the Fed with parameters to cap interchange.

Annual U.S. debit interchange revenue is roughly $15 billion, most of which is earned by the big issuers. Of the top 30 debit and prepay issuers only Metapay and Bancorp have less than $10 billion of assets and are therefore exempt from interchange price controls.

The Fed is likely to slash debit interchange on the order of 90% from current levels, of which Visa's 95 basis points and 20 cents per transaction are representative.

And Visa has the largest network.

Why so harsh? The legislation has the answer.

Regulated interchange must be reasonable and proportional to incremental issuer authorization and to clearing and settlement processing costs, which are *de minimis*, perhaps a few cents per transaction. Fraud prevention costs — roughly 7 to 8 basis points, also can be recovered.

The Dodd-Frank Act prohibits consideration of costs not particular to the specific debit transaction, which may leave the door open a crack to consider other costs.

While not in the spirit of the law, one could, for example, argue that a 5-cent reward for every purchase is a cost particular to the debit transaction.

The merchant lobby wants card acceptance to be free. Why not? It's human nature to want someone else to pick up the tab. Better yet, they would like to be paid to accept cards. If merchant rather than consumer payment choice reigned at the point of service, they would be.

The merchant lobby and Sen. Durbin believe retail card payment networks are a public utility and consumers rather than merchants should bear the bulk of acceptance costs. In 2011 they will attempt to extend the Fed's authority to set debit interchange rates and regulate network fees to credit.

The critical public policy question is not what should interchange prices be but rather how they should be set.

America is sliding into a realm where lobbying and government, not markets, set them.

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