# The Fed Can't Ignore the Durbin Amendment

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By Eric Grover

The Division of Reserve Bank Operations and Payments Systems on Thursday will present its thoughts on implementing Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (aka the Durbin interchange amendment) to the Federal Reserve board.

Lo at the 11th hour on Dec. 9 Sen. Tom Carper and 12 fellow senators sent a letter to Fed Chairman Ben Bernanke urging him to ignore key elements of the legislation.

Two of the senators, Mike Crapo and David Vitter, voted for the Durbin interchange amendment, which they are now pleading with the Fed to disregard. The time for the world's "most deliberative body" to weigh its implications was before voting on it.

The 13 senators rightly decry the government fixing prices: the core of the Durbin interchange amendment.

In setting interchange rates they ask that all debit issuer costs and economic benefits to merchants be considered, yet the legislation instructs the Fed to consider only two pools of costs: incremental debit issuer processing costs and fraud-prevention costs. It was intended and written to be a punitive public utility model not a full-cost-plus-reasonable-return public utility model. It expressly prohibits the Fed from considering all debit issuer costs.

The senators worry that small banks will be disadvantaged because their debit cards will be more expensive for merchants (and therefore cheaper for consumers). To the contrary, the more severe the Fed's interchange caps — the closer to Sen. Durbin's and the merchant lobby's intent, the more small issuers exempt from the price controls will be advantaged. The legislation prohibits merchants from discriminating on price based on issuer or network. If a retailer offered a 1% debit discount, it would have to offer it to a regulated major bank debit transaction with perhaps 10 basis points of interchange and for a community bank debit transaction with 125 basis points of interchange. To offset lost interchange, large issuers will introduce a battery of new debit and demand deposit account fees, and cut rewards, while small issuers with richer unregulated interchange will be able to entice consumers with free checking, debit and rewards.

Most networks will maintain a two-tier interchange system because it is in their interest. Unregulated transactions for the three largest debit networks, Visa, Star and MasterCard, will be sheltered in the slipstream of their cheaper, regulated transactions. However, with virtually all their small issuers exempt from interchange caps, networks such as CO-OP and Discover's Pulse face a problem. Retailers could stop accepting them if they maintained rich interchange.

Political pressure should not trump legislative text. The rule of law is more important to the well being of consumers, merchants and banks than the consequences of bad legislation. The Fed disregarding a harmful law is a greater danger than implementing it.

That said, nine of the senators petitioning Bernanke will be in the 112th Congress. They comprehend the Durbin interchange amendment was falsely sold as pro-consumer. In 2011 they should move to repeal it.

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