# Capital One’s Bid for Discover Will Lift Many Boats

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Capital One’s proposed $35.3-billion acquisition of Discover will be a thunderclap for the debit-card, retail-banking, and payment-network markets. The Discover network has long been the number-five U.S. retail-payment network, after Visa, Mastercard, American Express, and PayPal. Since its acquisition of Diners Club from Citi in 2008, Discover has struggled as a weak, aspiring global payment network. Capital One’s acquisition of Discover will improve its prospects.

Economic activity and innovation move away from price controls and prescriptive regulation toward freer domains. With Discover, Capital One has a signal opportunity to disrupt Senator Durbin’s shackled U.S. debit market

In 2011, Durbin’s price controls were imposed on the debit-interchange fees that politically unsympathetic large banks earn. Price controls reduced fee-free banking, debit rewards, and innovation. Politically sympathetic but resource-and-reach-constrained community banks enjoy market interchange but have had difficulty capitalizing on their advantage. *Grover: Consumers, Capital One, and*

However, collaborating with players with greater resources and reach—such as PayPal, Block, and the neobank Chime—they've enjoyed some success taking debit-payment share. Threatened, large banks have lobbied the Fed to extend debit-interchange price caps to these programs, thus far unsuccessfully. They should instead put their shoulders four-square behind repealing Durbin's price controls.

When Capital One's debit-card portfolio is converted from Mastercard to the Discover network, it will benefit from higher market interchange and will not have to offer merchants one of its network competitors. Operating as a three-party debit network routing transactions to itself as an issuer, Capital One will be exempt from the Durbin Amendment. Assuming all its debit transactions are Discover (some will be Pulse), its debit-interchange revenue will increase roughly 300% for a $50 payment.

Capital One Mastercard-branded debit cards would earn 17.7 cents per payment under the Fed's **proposed** debit cap of 14.4 cents per transaction, 4 basis points, and 1.3 cents for fraud-prevention recovery. Capital One Discover debit cards will earn 71 cents per transaction, reaping interchange of 110 basis points and 16 cents per transaction.

Fueled by higher interchange, Capital One will offer consumers richer value propositions than behemoths like BofA, Chase, and Wells Fargo—fettered by the Illinois senior senator's handiwork—can.

Capital One has an online and brick-and-mortar retail bank, which will be bulked up by Discover’s digital bank. With its prowess crafting and executing strategies to originate cardholders and incent use, honed since its days as an aggressive monoline credit-card issuer, Capital One will win share from banks straightjacketed by Durbin’s price controls.

America already has the world’s most competitive debit-network market. Competition will only intensify. Bolstered by Capital One, Discover will become a more formidable competitor against Visa, Mastercard, Fiserv’s Star, and FIS’s NYCE.

Progressive heartthrob and financial-services-industry nemesis Sen. Elizabeth Warren hyperbolically warns the merger “threatens our financial stability, reduces competition, and would increase fees and credit costs for American families,” is “dangerous” and “will harm working people.” Average Americans, however, might not view fee-free banking and richer debit rewards—say, 1% cashback—as harmful.

In 2021, 56.2% of U.S. debit transactions were subject to interchange price controls. With the merger, the percentage of debit transactions subject to price caps will fall precipitously, which will be good for consumers. Also, debit-network and deposit-account competition and value for consumers will increase.

Strengthening Discover’s credit-card network will be more challenging.

Notwithstanding a patchwork of reciprocal-acceptance relationships with foreign payment networks, Discover has much weaker acceptance than Mastercard and Visa, and paltry issuance, abroad. Its reciprocal-acceptance network is handicapped by a lack of cobranding and co-signage at the point of sale. While Capital One will keep a huge portfolio of Mastercard and Visa credit cards, tens of millions of credit cards it migrates will add heft to the Discover network.

Capital One will earn network-acceptance licensing and processing fees, instead of paying them to Mastercard and Visa. And, it will no longer pay issuer- licensing and processing fees on cards converted to Discover.

In many countries, issuers enable a national network for domestic payments and Mastercard or Visa for payments abroad. Chinese banks often co-brand CUP cards with Mastercard or Visa. French issuers co-brand all Cartes Bancaires cards with Mastercard or Visa. Capital One might seek a similar arrangement to provide acceptance worldwide. However, Capital One, Mastercard, and Visa would all have reservations. For Capital One a hybrid card might hamper enhancing Discover’s brand. And for the global networks, while they’ve done it with CUP, they’d have reservations about strengthening a competitor.

To boost its value, the Discover credit-card network most needs third-party issuance and greater acceptance abroad. If Capital One’s converted portfolio prospers, banking giants issuing Mastercard, Visa, and American

Express cards will be easier, albeit still difficult, to persuade to offer Discover as well.

Community banks currently issuing Pulse and retailers with co-branded credit cards may be easier prospects for Discover than a U.S. Bank or Citi.

In sum, Capital One’s acquisition of Discover could only increase competition. Consumers, Capital One, and Discover shareholders, along with policymakers, should applaud the deal.

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