Congress, not the Fed, is at fault for slashing interchange fees

By Eric Grover

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In a recent BankThink article, "The Fed's manipulation of debit card interchange fees must stop" Americans for Tax Reform's Director of Financial Policy Bryan Bashur excoriates the Federal Reserve for proposing to lower the debit-interchange price cap. He's right that the debit-interchange price controls cause enormous harm, and that a lower cap will cause greater harm, but Bashur has the villain wrong. Congress, not the Fed, is the policymaker and culprit. The Fed is Congress' instrument, charged with implementing debit-interchange price controls mandated by Congress in the Dodd-Frank Act's Durbin Amendment.

He complains that the Fed "arbitrarily and impractically excludes consideration of costs such as rewards, card production and delivery costs, marketing and research and development costs." While it's bad policy, it's not impractical. And, while the Fed has taken an extraordinarily broad and charitable — arguably unlawful — view of what costs covered debit issuers can recover via interchange, it's not the Fed's prerogative to permit recovery of reward programs and other issuer costs not permitted by the statute.

Moreover, arguing that the Fed should permit a broader range of issuer costs to be recouped via interchange is doubly flawed. It assumes that it is a beneficent Fed's prerogative to determine what types of costs debit issuers can recover via regulated interchange. And, it accepts the public utility framework. Fed discretion tantamount to lawmaking would be dangerous and is contrary to our tripartite constitutional system in which the legislature is the lawmaker. And competitive markets are more innovative, self-correcting and deliver superior value to regulated public utilities.

Debit interchange fees fund issuer innovation, fee-free demand deposit accounts and debit cards and rewards. They're the principal source of revenue for most neobanks.

Banks and credit unions with less than $10 billion in assets aren't "ostensibly exempt from the debit interchange fee cap." They are exempt. That means they enjoy market interchange which gives them an enormous economic advantage over covered larger issuers, which must subsist on stingy regulated interchange.

Durbin-exempt community banks should be able to offer consumers fee-free accounts and meaningful rewards. That's pro-consumer. However, because of community banks' lack of reach and resources they've had difficulty capitalizing on interchange-revenue advantage over retail-banking Goliaths like Bank of America, Chase and Wells Fargo. But, when community banks issue debit cards with partners with powerful brands, reach and resources, like PayPal, Block and Chime, they have taken debit share.

A campaign to end destructive debit-interchange price controls is eminently worth waging. It should be vigorously prosecuted in the public and political arena. It should spell out the enormous harm interchange price controls cause and make an affirmative case for payment networks to freely compete and set prices in the market. Joe and Sally Sixpack need to be incensed over payment-industry price controls and to share their anger with their congressmen. To effect genuine reform, to repeal Senator Durbin's interchange price controls, Congress, not the Fed, needs to feel political heat.

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