

Illinois' interchange fee law sets a dangerous precedent

By Eric Grover

The American Banker

October 2, 2024

At the national level, the payment industry is subject to debit-interchange price controls. It's at risk from Senator Durbin's Credit Card Competition Act, which aims to commoditize credit network routing. Finally, it's threatened by an outstanding antitrust suit against Mastercard and Visa over interchange fees and acceptance rules.

[There's menace](#) at the state level as well.

[Illinois' Interchange Fee Prohibition Act](#), signed into law by Governor Pritzker in June, mandates [destructive price controls](#) that ban interchange fees on sales tax and gratuities, and restricts transaction data use. While many states have proposed laws curbing interchange fees, Illinois is the first to pass one. The law takes effect July 7, 2025. It was passed in haste at the behest of the merchant lobby and to offset Illinois' reduction of credits merchants receive for collecting sales tax.

The law will have horrific unintended and unanticipated consequences. Price controls cause shortages and resource misallocation. Implementing these price controls will be enormously costly. And, the bill's data-use

restrictions will hamper the payment industry's management of fraud.

Illinois is a difficult state for consumers and businesses. The Cato Institute ranks it 39th in its [rating of economic freedom](#) in the 50 states. The Prairie State has [the highest sales tax rates in the Midwest and eighth highest in the U.S.](#) In some cities in Cook County, consumers pay a whopping 11.5% in sales tax.

Springfield is capping the 1.75% credit it gives retailers for collecting sales tax. That will cost [merchants \\$186 million](#). Illinois' legislature and Gov. Pritzker think banning interchange fees on sales tax and tips will make their reduction of credits retailers receive for collecting sales tax less objectionable.

But the Interchange Fee Prohibition Act, or IFPA, is a poisoned chalice for merchants. It will be costly for them to implement. It will also harm consumers, banks, and payment networks and processors, which ultimately isn't good for merchants.

Interchange fees play a critical role in payments. They're used by two-sided payment platforms to dynamically balance participation on both sides of the network, and, thereby, maximize total value for consumers and merchants. Interchange fees fund fee-free bank accounts and payment cards, rewards and benefits, grace periods, risk management, and issuer innovation. Forced interchange reductions will reduce the supply of many

things consumers love, and which Illinois' politicians should value.

Complying with the IFPA will be enormously expensive.

The payments industry and most merchants don't separately capture gratuities. Except for business-to-business transactions, the payments industry rarely separately captures sales tax. Critical systems at each stage in the payment value chain must be changed to break out and capture tips and sales tax and treat them differently. Planning, making and rolling out these changes will cost the payments industry and Illinois merchants billions of dollars and take a minimum of three to five years.

Electronic payments are made possible by a complex interconnected system. Consumers and merchants take its convenience, reliability, security, access and ever-improving value, and the ability to pay anywhere, anytime, for granted.

The IFPA requires massive changes to these systems and introduces manual operations to heretofore highly efficient electronic processes. The entire payments industry is impacted, including at least several dozen traditional and alternative U.S. and foreign payment networks accepted in-person and online in Illinois, hundreds of merchant acquirers and processors, payment gateways, payment facilitators, software providers with integrated payments, thousands of U.S. and foreign issuers of credit and debit cards, and hundreds of thousands of Illinois merchants.

When the law takes effect in 2025, the only way for the global payments industry and merchants to try to comply will be with a huge, labor-intensive effort, reminiscent of the early 1970s when card payments were largely manual. It will be an additional expense for merchants and payment processors, fraught with mistakes and ripe for fraud. Moreover, even if the payment industry makes the changes to support electronic compliance, many small merchants won't spend to upgrade their systems. They'll submit paper documentation to request interchange refunds.

Changes to the payment system must be meticulously planned, coordinated, tested and effected across the entire value chain. Each payment network's electronic integration with each processor and each issuer must be carefully tested. The colossal industrywide change entails risk.

Moreover, it's likely some foreign payment networks and small merchant acquirers will decide it's not worth their while to continue serving Illinois merchants.

There will be a huge opportunity cost. The payments industry continually invests in expanding access for consumers and merchants, reducing friction and adding features, and improving security. Scarce resources will instead be employed transferring money from one set of pockets (cardholders and banks) to another (merchants)

rather than in improving the payment system for the benefit of consumers, merchants and banks.

There's a danger other states will follow suit, resulting in a ghastly patchwork of state-specific payment-network price controls.

For the sake of everybody who uses electronic retail payment systems, Illinois should take stock and repeal the IFPA.

Eric Grover

Principal, Intrepid Ventures