

There's a Global, National and State Assault on Payments

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There's a legal, regulatory and political assault on the payments industry and its freedom to set prices in the market, at the global level, at the national level, and as Illinois's [Interchange Fee Prohibition Act](#) (IFPA) signed into law June 7, 2024 highlights, at the state level.

The U.S. payment system works extraordinarily well for consumers, businesses, and banks. Consumers take it for granted. The Illinois legislature's ill-considered IFPA throws a monkey wrench in the works. It imposes price controls on payment networks' interchange fees, substituting politicians' judgement of the best price, for the market's. Effective July 1, 2025, it bans interchange fees on sales tax and gratuities and prohibits the use of "associated data" for purposes other than processing payment transactions.

Two factors impelled Springfield's price controls.

First, merchant lobbyists have been clamoring for price controls to force down payment acceptance costs, for government to give them prices that they can't get in the

market. Springfield set the interchange price on sales tax and tips to zero.

Second, the Prairie State's insatiable appetite for ever more tax revenue played a role. At 8.87% Illinois' [average sales tax is the seventh highest in the US](#) and the highest of the large states. In Cook County the [sales tax is a whopping 10.25%](#).

Illinois gives merchants a 1.75% credit on sales tax for collecting it. Springfield capped the credit at \$1000, which will cost merchants and generate for the state roughly [\\$186 million](#) annually. To offset the financial pain they inflicted, Illini legislators and Governor Pritzker are trying to give merchants a gift at the expense of cardholders, banks, and the payments industry.

The IFPA will cause enormous harm.

Nobel-Prize-winning economist Friedrich Hayek observed prices convey information and coordinate economic activities by incorporating the dispersed intelligence of individuals across the economy. Price controls disrupt information flow causing inefficiencies, shortages, and resource misallocation. Politicians no matter how smart and well-intentioned can't match the market's vast, dynamic, distributed intelligence.

Asymmetric interchange prices are used by two-sided payment networks like Mastercard and Visa to balance participation on both sides of the market to maximize total value for consumers and merchants. Many two-sided

markets employ asymmetric pricing to maximize value. Internet search is free for consumers. Advertisers pay. Bars sometimes give women but not men free drinks.

Interchange fees fund issuer innovation, fee-free bank accounts and payment cards, fraud prevention, grace periods, and a trove of rewards and benefits. They're the principal source of revenue for many neobanks and fintechs. They promote financial inclusion, enabling more affordable payment products and bank accounts for underbanked and unbanked households.

The IFPA's price controls will cause resource misallocation in the payments industry and shortages of fee-free accounts and payment products, and rewards consumers love. They will put a damper on payments innovation.

Policymakers' question shouldn't be what's the optimal interchange price. The question should be how it's set. Should interchange prices be determined by politicians, regulatory diktat, the settlement of law suits, or the interplay and enormous distributed intelligence of billions of decisions by consumers, merchants, payment networks, banks, and merchant processors.

On top of destructive price controls, the IFPA's data-use restriction kneecaps the payment industry's ability to fight fraud.

Complying with the IFPA will roil the interconnected global payment system.

Every bank and nonbank merchant acquirer providing payment acceptance, payment facilitator, and software provider with embedded payments serving Illini merchants will be affected.

Traditional and alternative U.S.-domiciled payment networks including Visa, Interlink, Mastercard, Maestro, Discover, Pulse, Diners Club, Star, Accel, NYCE, Jeanie, Coop, Shazam, AFFN, ATH, Culiance, Alaska Option, PayPal, Venmo and Cash App Pay will have to make significant changes their systems.

While regulators are sometimes reluctant to regulate transactions with one leg offshore, the IFPA doesn't exempt interchange fees paid by Illinois merchants to foreign issuers. Foreign payment networks like China UnionPay, JCB, Alipay and WeChat Pay used to make payments in the Prairie State will also be forced to comply.

As of May 16, 2024, the Fed reported there were [9,572 banks and credit unions issuing in the U.S. issuing debit cards](#). Many of them also issue credit cards. All are subject to the IFPA.

Over five thousand foreign issuers whose payment cards can be used in Illinois will be impacted.

Changes to separately capture sales tax and gratuities and to treat them differently, must be made across the entire payments ecosystem, from merchant to acquirer to payment network to bank issuer.

It will cost the payments industry and merchants billions of dollars and take a minimum of 3 to 5 years to effect necessary changes. Massive effort will be expended planning, coordinating, testing, and implementing changes to payment systems to transfer money from cardholders and bank issuers to merchants, instead of on enhancing them.

The law requires that manual refunds of interchange fees assessed on sales tax and gratuities be supported. Automated IFPA compliance by 2025 is impossible. Merchant acquirers, consequently, will be deluged with snail mail, faxes, and email requesting refunds from hundreds of thousands of Illinois merchants. The new manual operations will be expensive, fraught with errors, and an invitation for fraud. It's a step back to the nineteen seventies before electronic payment processing.

Springfield appears not to have considered the mammoth costs of complying with its price controls. The merchant lobby wasn't concerned with the burden for the payments industry. But, the IFPA's putative beneficiaries - Prairie State merchants, will also pay dearly, upgrading their systems to separately capture sales tax and gratuities and pass them to their acquirers, and submitting manual refund requests.

Banks and the payments industry are alarmed.

The American Bankers Association, Illinois Bankers association, America's Credit Unions and Illinois Credit Union League [filed a suit challenging the IFPA](#) contending

it's unconstitutional and preempted by the National Banking Act, the Home Owners' Loan Act, and the Federal Credit Union Act, and conflicts with powers granted to the Federal Reserve under the Durbin Amendment to the Electronic Fund Transfer Act. It's a righteous suit.

Interested parties have weighed in, in support and opposition.

The OCC filed [an amicus brief](#) contending that the IFPA is at odds with national banking laws giving financial institutions the right to charge fees for credit and debit card transactions. The OCC warns that the IFPA's banning the use of data for anything other than processing payment transactions will impair financial institutions' ability to prevent fraud and manage risk.

The Electronic Transactions Association filed [an amicus brief](#) supporting an injunction to stay the IFPA taking effect until the case challenging its legality is decided. It observes "payment processing is an interconnected system involving many parties, each of which will be required to overhaul its payment systems and introduce new manual transaction operations..." The ETA warns "if the IFPA is permitted to take effect while this litigation is pending, merchants and institutions operating around the world will need to overhaul their payment systems to comply with the laws of a single state. The enormous costs, delays, and uncertainties that would inevitably follow will fundamentally alter and disrupt the global payment system, harming banks, payment networks and processors, merchants, and consumers."

The Bank Policy Institute, the Clearing House Association, and the Consumer Bankers Association filed [an amicus brief](#) supporting an injunction to stay the IFPA taking effect while litigation challenging it is pending. They argue that the National Banking Act preempts the IFPA's restrictions on interchange fees and data use and that the Durbin Amendment preempts it with respect to debit-interchange fees.

For price controls, the scourge of the payments industry Senator Dick Durbin filed an [amicus brief supporting Illinois](#) declaring "the IFPA is both consistent with the Durbin Amendment and consistent with sound policy that will help to protect merchants and consumers from excessive and anti-competitive fees." Illinois's senior senator contends the Durbin Amendment created a ceiling for debit-interchange fees, which states are free to reduce.

The Restaurant Law Association, Illinois Restaurant Association, and Retail Litigation Center Inc. filed an [amicus brief opposing an injunction](#) to stay the IFPA taking effect. They argue that "the payment ecosystem is broken and badly in need of reform." That the payment system is "broken," however, would be news to hundreds of millions of consumers using it. Rather, it's price controls and prescriptive regulation that threaten to break or at least to hobble the payment system.

The Restaurant Law Association et al complain "there are currently no federal laws or regulations that govern the cost of credit card transactions within the U.S. payments ecosystem." Alert. America, for the most part, remains a

free-market economy. The credit card market at every stage is fiercely competitive. No federal price controls on credit-card transactions enable market dynamism and are good for consumers and merchants. Restaurants would howl in outrage if Washington imposed price controls on them to fight inflation.

Earlier this year Florida [Governor Ron DeSantis vetoed a bill](#) banning interchange fees on sales tax, [Pennsylvania's legislature failed to move one](#), and [Georgia](#) and [Tennessee](#) authorized studies of prohibiting interchange fees on sales tax. If the IFPA isn't ruled illegal or repealed by Illinois's legislature, merchant lobbyists in state capitals from sea to shining sea will demand onerous interchange price controls.

The payments industry can't bank on the court overturning Illinois's interchange price controls. It should pull out the stops making the case to Illini voters for repealing the pernicious IFPA. Ideally Springfield politicians will do the right thing because they understand it's the right thing. It's helpful, however, to bring political heat to persuade politicians otherwise inclined, to do the right thing.

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