

INTERCHANGE & RELATED ISSUES

Interchange is the mechanism by which the card networks balance the costs of the “four-party” electronic payments system between themselves, the merchants who accept such payments, the banks that sign-up merchants and issue cards, and the consumers that use them. So-called “interchange fees,” characterized by the merchants as “swipe-fees,” are a single element of the Merchant Discount Rate that a merchant’s bank pays to the bank of a consumer as compensation for guaranteeing the payment and assuming the risk of fraud or default where merchants control the point of sale interaction. The networks themselves (Visa, MasterCard, Discover, etc.) set interchange in ways that balance the costs of supporting the system and encourage expansion of the system (acting as an incentive for banks to innovate new electronic payments, sign-up more merchants and issue more cards; encourage merchants to accept electronic payments; and promote consumer usage of electronic payments). The networks do not receive fees from interchange.

The Durbin debit card amendment to the Dodd Frank Wall Street Reform Act of 2010 is the latest and most significant development in an ongoing campaign by merchants to convince government to impose price controls on interchange – that is, to limit the amount of interchange that can be levied per transaction. Rules promulgated by the Federal Reserve Board currently set base price controls at roughly 21 cents per debit transaction, less than half the previously prevailing rate, which translates to the loss of billions of dollars in income for financial institutions and a windfall for the merchants, who do not adjust prices downward. Many states have experimented with laws that have similar effects, with a significant new law being passed in Vermont in 2010 (see below), which is likely to spawn copycat laws across the country in 2012.

Associated legislative issues include attempts to remove the so-called Honor-all-Cards/Issuers rule, in which legislators try to allow merchants the right to reject, say, debit versions of Visa, MasterCard, etc. and only accept credit or prepaid versions, or reject a certain issuing bank’s version of a card (thus upsetting the power and convenience of merchants’ claims to “accept Visa/MC etc.”), and surcharge, in which legislators try to allow merchants to impose a fee for accepting cards. Merchants are legally allowed under federal law to offer discounts for cash, but not impose surcharges for the use of certain means of payment.

AFSA’S POSITION

The American Financial Services Association (AFSA) opposes legislative efforts to impose price-controls on interchange at federal and state levels, believing that banks will be forced to limit the electronic payments options for consumers and raise fees on other services (e.g.

checking accounts) as the markets demand they compensate for lost income. The benefits to the merchants, therefore, come at a high-price for consumers.

AFSA believes that interchange is an element of the cost of doing business and merchants benefit immensely from the use of cards. The growing usage of cards instead of cash or checks is directly attributable to ongoing payment card industry advancements to increase convenience, fraud protection and personal security for consumers. For merchants the benefits are enormous. Card acceptance brings increased revenues through guaranteed payment and more sales. Card acceptance increases the likelihood that cardholders will spend more (“ticket lift”), and enables rapid, unplanned purchases in emergencies or in response to store sales or other incentives. Electronic payments are also faster at checkout, allowing retailers to increase sales volume and enhancing the customer experience. Merchants could offer discounts for cash, but they don’t typically do so, presumably because of the risk of theft associated with holding large amounts of cash.

AFSA’s position is that free market pricing of interchange fees leads to the most efficient allocation of resources and the greatest benefits for consumers. The payment card market is highly competitive and payment card issuers compete fiercely for new customers and consistently lower their fees and devise new rewards programs to entice consumers to use their products. These low costs and valuable rewards, which are largely the result of interchange income, are a benefit to every participant in the electronic payments system including cardholders, merchants and financial institutions.

THE VERMONT LAW

AFSA believes that Vermont SB 138 as enacted is bad public policy and had asked the Governor of Vermont to veto it. AFSA believes the bill will increase compliance costs significantly for Vermont creditors – costs that will ultimately be passed on to consumers. In addition, the new law violates Congress’ sole authority to pass laws on interstate commerce, with its definition of “merchant” that applies to Vermont companies doing business in other states. The United States Constitution grants Congress the sole authority to pass laws on interstate commerce.