Out of Balance:

How the Durbin Amendment has Failed to Meet Its Promise

Electronic Payments Coalition

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Executive Summary

Debit cards are one of the most popular forms of payment, allowing consumers to conveniently shop without needing to carry cash or manage a checkbook. Debit cards also provide numerous benefits to the merchants who accept them, including increased sales, faster transactions, reduced costs of cash, and new retail channels. To receive the benefits of accepting debit cards, merchants pay a small fee to their banks and networks known as the “merchant discount fee” for each debit transaction. The merchants’ banks, in turn, pay cardholders’ banks a small fee known as “interchange.”

While merchants typically recognize the benefits they receive from debit cards and other forms of electronic payment, they have historically protested the merchant discount fees used to fund these services.[1] In response to these complaints, Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (frequently referred to as the “Durbin amendment”) instructed the Board of Governors of the Federal Reserve to limit interchange fees for debit cards issued by banks holding more than $10 billion in assets. The resulting regulation, implemented in October 2011, restricted debit interchange fees to a base fee of $0.21 plus 0.05% of the transaction value.[2]

Proponents of the Durbin amendment argued that the interchange fee cap would benefit consumers because merchants would pass through the savings from lower interchange fees via lower prices. Opponents countered that the savings pass-through had not materialized in other countries where interchange fees were restricted, and also argued that the Durbin amendment would harm consumers, small merchants, and community financial institutions in multiple ways.

Seven years later, it is clear that Durbin amendment opponents were ultimately proven correct. As a result of the Durbin amendment, consumers have less access to debit rewards programs and free checking accounts, pay higher banking fees, can no longer choose the network they prefer to route their debit transactions, and have yet to experience the lower prices promised. Low-income families have been particularly impacted by these consequences — especially by the loss of debit rewards, more stringent balance requirements, and higher fees — and some exited the traditional banking system as a result of these effects. At the same time, while large retailers have benefitted from debit interchange caps, many smaller merchants now face higher interchange costs due to the loss of small-ticket discounts, which were rendered economically infeasible when interchange fees were capped. And while lawmakers attempted to exempt community financial institutions and credit unions, in practice these entities have also experienced a decline in per-transaction interchange and must also bear more of the cost to maintain the electronic payments system.

Since the Durbin amendment was implemented, numerous evaluations conducted by respected think tanks, academics, payment industry experts, and state and federal entities have analyzed and documented its unintended consequences. This paper summarizes and provides context for this body of research in one accessible place. Section 1 describes the structure of the electronic payments system and the Durbin amendment. Section 2 assesses the negative impacts of the Durbin amendment on consumers, particularly low-income households. Section 3 evaluates the losses the Durbin amendment has inflicted on small merchants. Section 4 describes the challenges faced by community banks and credit unions following the Durbin amendment’s implementation. A list and brief description of the empirical studies and analyses cited in this paper is included in an Appendix.

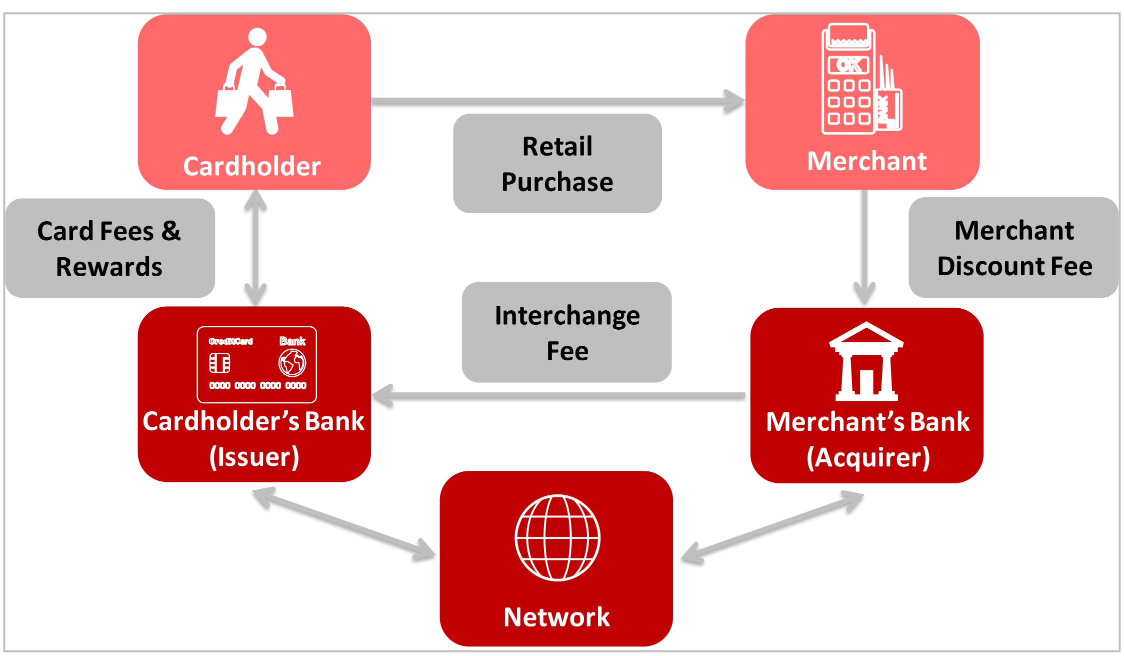
I. BACKGROUND

For decades, the electronic payment system has allowed consumers to conveniently shop using a debit card, decreasing the need to carry cash or manage a checkbook ledger. As a result, debit cards are exceedingly popular; from 2000 to 2012, the number of debit card transactions grew by an average 16% per year, and in 2015, debit cards were used to make 70 billion payments — twice as often as credit cards and four times more frequently than checks.[3] Indeed, nearly 30% of all transactions are conducted via debit cards, second only to cash (36%).[4] As mobile commerce continues to expand its footprint into consumers' shopping behavior, debit card transactions are likely to play an even more prominent role.

A debit card transaction involves five main parties: the cardholder, the cardholder's bank (the issuer), the merchant, the merchant's bank (the acquirer), and the card network. Issuers offer deposit accounts, debit cards, and other account-related services to consumers, while acquirers provide accounts, card-reader technology, and transaction-processing services to merchants. Card networks, such as Visa, Mastercard, STAR, and Shazam, provide the infrastructure and services required to exchange information and funds between issuers and acquirers.

To pay for the valuable services they receive in accepting electronic payments, including debit card payments, merchants pay the small merchant discount fee to their bank or card network. As shown in Figure 1, the merchant bank, in turn, pays interchange fees to the card issuer bank (i.e., the cardholder's bank). The issuer combines these interchange payments with fees paid by cardholders to fund the development and maintenance of a robust, secure electronic payments system, including research and development of new security technologies and fraud prevention techniques. In this way, interchange plays a significant part in enabling the electronic payments system to deliver value to both merchants and consumers.

Figure 1: Overview of an Electronic Payment Transaction



1.1 Two-Sided Markets and the Value of Interchange

Unlike most markets in which a seller provides a product or service to a group of buyers or end-users, the market for electronic payments (including debit) is two-sided. In a two-sided market, a platform or service serves multiple end-users (in this case, cardholders and merchants), and the value that each group derives from using the platform depends on the extent to which the other group participates. In the debit card payments market, cardholders benefit from holding a card only if it is accepted by a wide range of merchants, and merchants benefit from accepting a card only if a sufficient number of consumers use it. This means that for a two-sided market to maximize participation and operate effectively, the two end-user groups may not pay the same price. As a result, the price to participate in the electronic payments system — of which interchange is a key component — has historically been balanced in a manner that allows card issuers to use those funds to increase the number of cardholders and attract merchants, benefiting all market participants.[5] Since flexible interchange rates make it possible for issuers to deliver maximum value for both merchants and consumers, government intervention on behalf of one side of the market (e.g., the Durbin amendment's interchange fee caps that lower costs to merchants) can have adverse consequences on the other side of the market (consumers) and ultimately harm the overall system.

Supreme Court Recognizes Two-Sided Markets: Ohio v. American Express

The two-sided nature of the card payments market recently appeared at the center of the U.S. Supreme Court's July 2018 decision in Ohio v. American Express. In its ruling, the Court held that American Express's anti-steering provisions, which prohibit merchants from discouraging customers' American Express card use at the point of sale to avoid fees, do not violate federal antitrust laws. In delivering its opinion, the Court determined that in a two-sided market, both sides of the platform must be assessed when determining whether a practice is anticompetitive. Since Ohio and other plaintiffs had focused exclusively on the price increase on the merchant side of the market and ignored the impact on cardholders, they failed to show that the anti-steering rules adversely impacted the market as a whole. As stated by the Court:

> *[The] plaintiffs' argument about merchant fees wrongly focuses on only one side of the two-sided credit card market…the credit card market must be defined to include both merchants and cardholders. Focusing on merchant fees alone misses the mark because the product that credit card companies sell is transactions, not services to merchants, and the competitive effects of a restraint on transactions cannot be judged by looking at merchants alone.*

To achieve widespread participation in the debit card payments market, issuers offer incentives to consumers and key services to merchants that are supported by interchange fee revenue. For example, cardholders benefit from incentives like frequent flier miles and cash-back rewards (funded by interchange), while merchants who accept debit cards receive a variety of benefits in return for what they pay. These benefits include:

- **Increased sales.** Since customers are not limited to spending the cash they have on hand, merchants who accept cards typically enjoy higher sales. This phenomenon, known as "ticket lift," is significant: debit and credit card transactions are two to four times larger than cash transactions, and when a merchant first begins accepting card payments, they experience a 10–15% increase in average transaction size.[6]

- **Faster transaction time.** Electronic payments are twice as fast as cash transactions and several times faster than checks, which improves customer throughput and satisfaction. This is a key benefit to many merchants, who prioritize moving customers quickly through the checkout process.[7]

- **Additional retail channels.** Electronic payments allow merchants to access other sales channels through e-commerce and mobile commerce avenues, which are growing rapidly. Nearly three-quarters of small business operators say that accepting credit cards brings in additional business.[8]

- **Reduced cost of cash.** Card acceptance reduces costs associated with counting, storing, safeguarding, and transporting cash, and limits losses from mislaid or stolen cash – all of which are significant expenses that merchants often overlook. A recent study by a retail industry research firm found that the average retailer spends more than 9% of the value of their cash transactions counting, auditing, and depositing cash.[9] In dollar terms, U.S. and Canadian retailers spent more than $96 billion on cash-handling activities in 2017.[10]

- **Prompt, guaranteed payments.** Beyond helping merchants avoid the costs of cash, electronic payments reduce the risks to merchants associated with credit loss. Electronic payments are deposited directly into the merchant's account, and issuers, not merchants, take responsibility for losses if a customer who uses a credit card is ultimately unable to pay.[11]

1.2 The Durbin Amendment

While merchants benefit in myriad ways from the electronic payments system, they have historically protested the interchange fees used to fund these services. In response to these complaints, Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (frequently referred to as the "Durbin amendment" after its primary sponsor, Senator Richard Durbin) instructed the Board of Governors of the Federal Reserve (the Fed) to limit interchange fees for debit cards issued by banks holding more than $10 billion in assets. The Fed subsequently issued Regulation II: Debit Card Interchange Fees and Routing ("Regulation II"), which restricted debit card interchange fees to a base fee of $0.21 plus 0.05% of the transaction value.[12] These restrictions were implemented in October 2011.

Proponents of the Durbin amendment argued that Regulation II would help both merchants and consumers because merchants would pass through the savings accrued from lower interchange fees to consumers via lower prices. However, in failing to recognize the two-sided nature of the debit card payments market, advocates did not consider the losses that would accrue to one market end-user (consumers) given that the other end-user (merchants) would contribute billions less to maintain the electronic payment system. Durbin amendment proponents also failed to consider the ancillary, unintended impact of the regulation on small merchants and community financial institutions. Indeed, following the implementation of the regulation, large financial institutions have seen interchange income decline by around 45% (as intended),[13] but consumers, small merchants, and community banks and credit unions have also born tremendous costs.

II. CONSUMER LOSSES

In lobbying for an interchange fee cap, proponents of the Durbin amendment argued that consumers would benefit from lower interchange fees because merchants would face lower costs and pass these savings to consumers by lowering their prices. In practice, however, the opposite has occurred: more than seven years later, merchants have reaped roughly $50 billion (and counting) in interchange-related savings, while study after study has demonstrated that consumers are left footing the bill. For example, consumers have experienced a sharp decline in the availability of debit card rewards programs — a predictable result given the nature of the two-sided market — decreased availability of free checking accounts, higher minimum balance requirements, and higher fees. These effects have disproportionately affected low-income consumers who struggle to meet the more stringent minimum balance requirements and are less able to afford higher fees. Furthermore, due to the Durbin amendment's routing and anti-exclusivity provisions, consumers are no longer able to choose the network over which their payments are processed, while the lower merchant prices forecast by Durbin amendment proponents have failed to materialize. Collectively, researchers at the University of Chicago estimate that the value of losses to consumers due to the Durbin amendment falls between $22 and $25 billion.[14]

2.1 Lost Rewards

Prior to the enactment of the Durbin amendment, consumers frequently benefitted from reward programs tied to their debit card spending. Offered by about one-third of debit card issuers, such programs allowed customers to earn points redeemable for merchandise, gift cards, and cash that returned up to 20% of a cardholder's spending to his or her account. [15,16] However, following the establishment of Regulation II and the loss of the interchange income used to back rewards, debit card issuers withdrew these programs.[17] For example, in the months leading up to Regulation II's implementation, Wells Fargo, JP Morgan Chase, Sun Trust, and PNC Bank each announced that they would no longer offer debit card rewards.[18] Data from Phoenix Marketing International shows that the percentage of debit cardholders who receive rewards from those cards fell by 30% after the passage of the Durbin amendment.[19] Similarly, a study conducted by consultancy Oliver Wyman found that within one year of the enactment of the Durbin amendment, 30% of covered issuers eliminated or downsized their debit card rewards programs, and a total of 81% did not plan to offer a rewards program in the future.[20]

Given the two-sided nature of the debit card market, it is entirely predictable that a requirement for networks to reduce the price for one end-user (merchants) would lead to an effective price increase on the other end-user (consumers) via the elimination of rewards. Indeed, the same outcome can be observed in other countries that have experimented with interchange fee caps. As researchers at George Mason University noted, "for all countries outside the United States that have imposed price controls on interchange fees, the very point of doing so was to impose higher prices and reduced services for card users."[21] For example, in 2002, the Reserve Bank of Australia sought to curb the generosity of credit card rewards programs and credit card use by issuing a set of regulations that sharply reduced credit card interchange fees.[22] These regulations led issuers to immediately curtail their rewards programs, causing the value of credit card rewards points to decline by 23%.[23]

2.2 Reduction in Free Checking

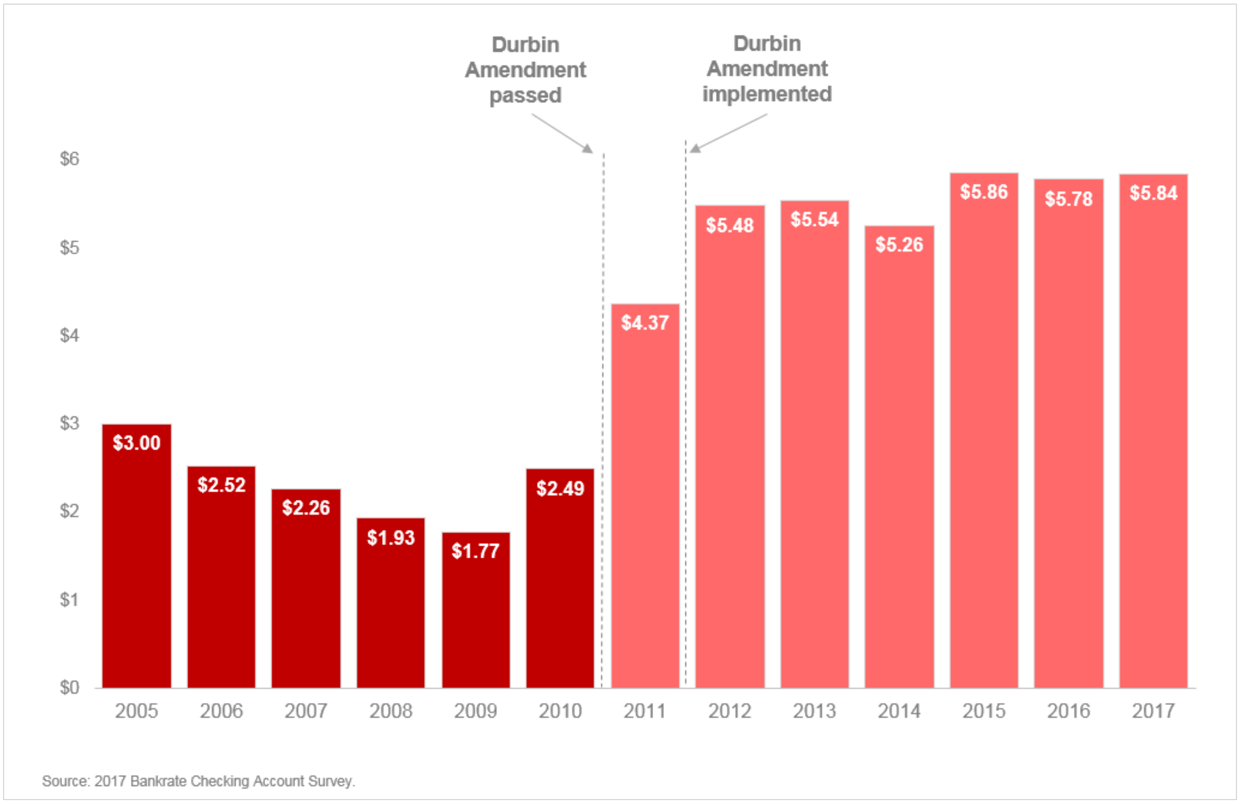
The Durbin amendment has also led to a significant decline in the availability of free checking. A recent Fed study found that as a result of capping debit interchange fees, banks are 35% less likely to offer consumers free checking. Based on this finding, the Fed estimates that if the Durbin amendment had not been passed, twice as many consumers would enjoy free checking as do today — translating to tens of millions of consumers who now face checking account fees as a direct result of the Durbin amendment.[24] A recent study by Harvard researchers arrived at a similar conclusion: after the Durbin amendment was passed, the percentage of banks offering free checking fell by 42%.[25]

As part of this reduction in free checking, consumers now face new, elevated minimum balance requirements that must be met to avoid monthly checking account fees. According to the Federal Reserve Board, banks covered by Regulation II increased the average minimum balance requirement for noninterest checking accounts by $400, or 50%. For interest-bearing checking accounts, minimum balance requirements rose even more, by $1,700, or 55%.[26]

Banks also responded to the Durbin amendment by raising monthly maintenance fees, which consumers incur if they fail to meet the aforementioned minimum balance requirements. According to the Federal Reserve Board, in response to Regulation II, banks raised monthly fees on noninterest checking accounts by 20% and on interest-bearing checking accounts by 17%.[27] These estimates parallel the results of studies by researchers from Harvard and George Mason University, which show that between 2011 and 2012, the average monthly maintenance fee for a noninterest checking account rose 25% to a then-record high of $5.48.[28] As of 2017, those rates had edged up to $5.84 (see Figure 2).[29] In short, consumers now face substantially higher minimum balance requirements and are assessed higher fees if they are unable to meet them, all due to the Durbin amendment.

The American experience with interchange fee caps and rising bank fees mirrors that of other countries following the implementation of similar restrictions. For example, in response to interchange restrictions in Australia, annual fees on standard rewards cards rose 47%, while annual fees on gold rewards cards increased by 77%.[30] Similarly, a study published in the *Review of Network Economics* found that in response to interchange fee regulations, bank service charges to Australian cardholders rose to offset a portion of the AU$490 million (~$350 million) that issuers lost in interchange revenue.[31]

Figure 2: Average Monthly Maintenance Fees on Non-Interest Checking Accounts



2.3 Disproportionate Harm to Low-Income Consumers

The loss of debit rewards and free checking and the implementation of higher minimum balance requirements and account fees have negatively impacted all consumers. However, low-income consumers and households are disproportionately affected because they are more dependent on debit (and hence more exposed to the loss of debit rewards). In addition, research suggests that the combination of higher balance requirements and higher fees levied on consumers who cannot meet the higher balance requirements has driven some consumers out of the banking system and into alternative arrangements that are generally more expensive in the long run.

- **Loss of debit rewards:** The loss of debit rewards has proved particularly acute for low-income households, who have been unable to shift their spending from debit to credit cards (which continue to offer lucrative rewards due to an absence of interchange caps on credit card transactions). Economists at the Federal Reserve Bank of Boston and the Consumer Financial Protection Bureau have shown that in response to the curtailment of rewards programs, low-income consumers are significantly less likely to switch their spending to credit cards than are middle to upper-income consumers.[32] As a 2011 analysis by the Federal Reserve Bank of Boston finds, "low-and-moderate-income consumers tend to use debit cards much more often than they use credit cards, are nearly twice as likely to use one for a given transaction, and in general, tend to rate them as better payment instruments."[33] This is largely due to the fact that lower-income households are less likely to own a credit card: while over 90% of high-income (over $75,000 per year) households have credit cards, only 67% of low-income ($25,000-$50,000 per year) and

38% of very-low-income (under $25,000 per year) households do.[34] Unable to make the switch to credit, lower-income consumers have no way of recouping their lost debit card rewards and consequently face effectively higher prices for their daily purchases.

- **Rise in the unbanked population:** Not surprisingly, low-income Americans are less likely to have access to the traditional banking system than middle- and upper-income households.[35] The Durbin amendment likely exacerbated this problem. According to FDIC data, after the Durbin amendment caused banks to raise minimum balance requirements and checking fees, 38% of previously-banked households cited high or unpredictable account fees as reason for closing their account (up from 12% in 2009). Similarly, 61% reported closing their accounts because they did not have enough money to keep in an account or meet a minimum balance requirement, whereas 34–45% cited these factors in 2009.[36]

  Pushed out of the banking system but still needing access to financial services, many low-income consumers turned to alternative arrangements, such as prepaid cards, money orders, payday lending, and pawnshops.[37] Not only are these services often more expensive than those offered by a traditional bank, they also make it difficult to build a credit history needed to access lower-cost payment methods and loans.[38] As such, the effective cost of the Durbin amendment for low-income consumers may be even greater than the increase in bank fees and loss of rewards programs suggests.[39]

  While a stronger economy has likely helped bring some unbanked and underbanked individuals back into the traditional banking system, the Durbin amendment nevertheless led to higher costs for maintaining a checking account, particularly for consumers who are least able to afford higher and more frequent account maintenance fees.[40]

2.4 Loss of Routing Choice

In addition to establishing an interchange fee cap, the Durbin amendment introduced network anti-exclusivity and routing provisions requiring that all U.S. debit cards issuers have two unaffiliated debit networks to their cards. This lesser-known component of the regulation also mandates that merchants, rather than consumers, select which network is used to process transactions. Routing and anti-exclusivity provisions thus eliminate consumer choice, since cardholders no longer have the option to select the debit network that reflects their preferences on payment speed, reliability, and security. Instead, the Durbin amendment allows merchants to re-route debit transactions from among networks chosen by the issuer, granting merchants both the ability and incentive to select the network with the lowest fees, regardless of its commitment to security.[41] This means consumers may lose access to certain features associated with their accounts, including zero-liability protection or text message alerts. It also means that consumers, who think that their transactions are being routed over long-established, recognizable, and trusted networks, are more exposed to fraud risk while alternative networks have less incentive to invest in their technology platforms or innovative data security measures.[42]

2.5 Promised Price Cuts Fail to Materialize

The losses that consumers suffered in the wake of the Durbin amendment were both severe and predictable, but proponents of the law argued that merchants would pass along the savings they accrued from lower interchange fees to consumers via lower prices. In practice, however, study after study has shown that such price reductions have failed to materialize. The most prominent of these studies is a comprehensive analysis undertaken by the Federal Reserve Bank of Richmond. According to the Richmond Fed, only 1% of merchants reduced prices in the wake of lower debit fee acceptance costs. Most (77%) did not adjust prices at all, and 22% actually *raised* them.[43] As the study states, "few merchants [reduce] prices or debit restrictions as debit costs decrease."

Other independent research corroborates these findings. For example, researchers at the University of Chicago have concluded that merchants did not fully pass through their savings to consumers,[44] and researchers at Harvard University concluded in a recent working paper that the Durbin amendment had no impact on merchant prices.[45] Similarly, a 2013 MasterCard survey found that only 3% of merchants intended to pass on savings.[46]

Consistent with the U.S. experience, savings pass through also failed to materialize following interchange fee regulation in Spain and Australia, where less than 5% of merchants reduced their prices.[47] Further, in 2016 the Reserve Bank of Australia acted to limit merchant surcharging for credit card use since they had begun charging consumers in excess of the cost of accepting cards — hardly the outcome one would expect if merchants were truly passing along interchange savings to their customers.[48]

As summed up by Scott Strockoz, Deputy Regional Director of the FDIC:

> *Consumers were supposed to see lower retail prices due to the implementation of the Durbin amendment, [but] in many cases consumers are seeing higher prices…or no savings at all. Further, banks are increasing or implementing fees on traditional bank products and services, thereby increasing consumer cost. Consumers either have to pay the fees, find a new bank that doesn't charge those fees, or end their banking relationship and use an alternative financial service provider for their banking needs. In certain instances, these providers charge more in fees than a traditional bank, but they do not adequately disclose these fees in advance, so the consumer ends up paying more to a check casher or a payday lender than they would to their bank. It is unlikely consumers will see any tangible benefits from the Durbin amendment.*[49]

III. SMALL MERCHANT LOSSES

Advocates of the Durbin amendment widely held that the new interchange fee cap would provide a boost to merchants by reducing operating expenses and allowing them to hold on to more of their profits. While this may be the case for large merchants, a variety of research indicates that small merchants have, in fact, experienced the opposite. Contrary to enjoying promised cost reductions, many Main Street shops have encountered rising debit card acceptance costs due to issuers withdrawing previously-offered discounts on smaller purchases, which under the Durbin amendment are no longer feasible. Moreover, small merchants also risk losing valuable services received from issuers and card networks as the Durbin amendment reduces their incentive and ability to invest in the electronic payments system.

3.1 Lost Variation in Interchange Fee Rates

While large merchants have benefitted from the Durbin amendment and its restrictions on interchange fees, many small merchants now face higher debit card acceptance costs. This result is due to the loss of interchange discounts for small-ticket purchases. Prior to Regulation II, there was more variability in interchange fees depending on the type of merchant and size of purchases. Networks tailored fees in a manner that optimized income, risk exposure, and adoption rates — as would be expected in a well-functioning two-sided market. As a result, smaller merchants who tended to sell small-ticket items received discounts as a means of encouraging those merchants to accept debit cards. However, after the Durbin amendment was implemented, networks eliminated these discounts and moved to a flatter rate structure which, for some merchants (particularly Main Street stores who specialize in small-ticket items), caused their debit costs to increase rather than decrease.[50]

For example, prior to the Durbin amendment, the interchange fee for signature debit purchases set by Visa and Mastercard on transactions involving small-ticket items of $15.00 or less was 1.55% of the transaction value, plus $0.04. This yielded an interchange fee of $0.11 for a $5.00 purchase. However, after the implementation of the Durbin amendment and ensuing elimination of small-ticket interchange discounts, the fee on that same $5.00 transaction doubled to $0.23.[51] To put the impact of this change into perspective, debit cards were used in 4.9 billion transactions below $5.00 and 10.8 billion transactions between $5.00 and $15.00 in 2009 — collectively comprising more than one-fourth of all payment card transactions. This suggests that small merchants are now paying higher interchange fees on at least 15.7 billion transactions annually. [52] Research published by the Federal Reserve Bank of Richmond supports these conclusions. According to the study, interchange fees increased for 31% of merchants and declined for just 11%.[53] Among merchants with small-ticket transactions, "nine times as many respondents (27% over 3%) reported a cost increase as those who reported a cost decrease."

3.2 Loss of Valued Services

In addition to facing rising fees, small merchants also stand to lose valued services provided by card issuers and payments networks, such as monitoring and preventing fraud, implementing new fraud prevention technologies, and maintaining and improving the U.S. electronic payment system infrastructure. A recent study of small merchants conducted by Javelin Strategy & Research revealed that for most small merchants, the value of services received from electronic payments providers is more important to them than price. Specifically, the study concluded that instead of seeking out payment processing packages that have the lowest possible fees, most small merchants care more about choice and flexibility than price. Further, merchants who demonstrate an understanding of the interchange process are overwhelmingly satisfied with the rates they pay and are more willing to pay a premium for higher-quality payment processing packages.[54]

Furthermore, the Durbin amendment has limited banks' capacity to invest in new technologies to enhance the existing U.S. payments system. As noted by the Mercator Advisory Group, the Durbin amendment's restriction on interchange income has abruptly curtailed the funding issuers use to support innovation and investment in network operations. Unable to recoup their fixed development costs, banks' "willingness to spend money on innovation with regard to payments that fall within the interchange cap rule" has declined. The Mercator Advisory Group warns that this will lead to "less innovation in areas such as risk management, security, loyalty programs, product development, and user capital due to the limited capital available for investment."[55]

Given the high value that small merchants place on high-quality issuer-provided services, the concerning corollary is that as regulators limit interchange prices, issuers may reduce the extent or quality of services offered if they are unable to recover their costs. Since small merchants have indicated that they are most satisfied when receiving more and higher quality services at higher prices, price-control prompted quality reductions are likely to reduce merchant satisfaction.[56] Ultimately, the Durbin amendment has paradoxically put small merchants in the position of paying more for less.

IV. COMMUNITY FINANCIAL INSTITUTION LOSSES

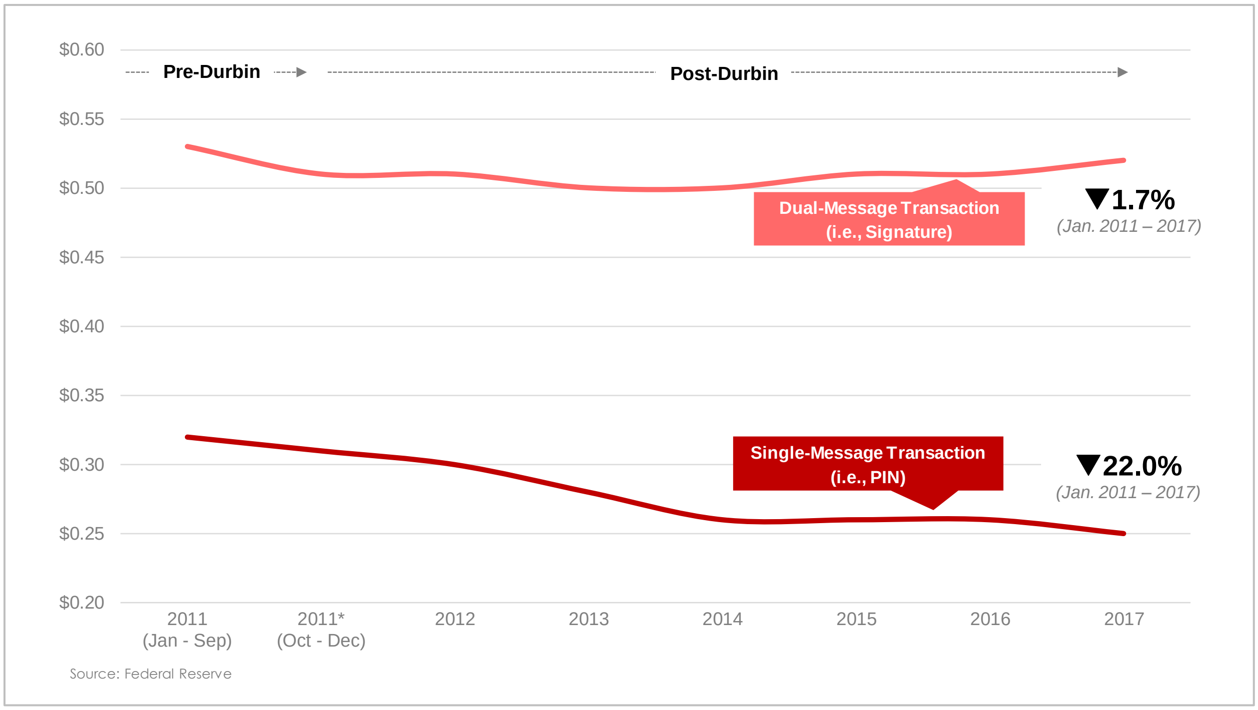
Prior to the passage of the Durbin amendment, proponents posited that community financial institutions would remain unaffected by the regulation because institutions holding less than $10 billion in assets were exempt. However, while smaller banks and most credit unions may be exempt in theory, in practice they have faced significant negative consequences.

Research shows that the repercussions of the Durbin amendment have echoed through the debit card payments market, driving down average interchange income for exempt community banks and credit unions alongside covered institutions. Data from the U.S. Federal Reserve illustrate that the average interchange fee for exempt issuers has fallen 2–22% depending on how the transaction is processed (see Figure 3).[57] As a result, exempt banks will have lost an estimated $4.5 billion in interchange revenue between October 2011 and the end of 2018.[58] This result is consistent with recent surveys of local banks and credit unions. For example, a 2014 study conducted by the Mercatus Center found that the Durbin amendment had reduced earnings at nearly three-fourths of local financial institutions. Of these, roughly one-third reported facing a "significant negative impact," with loss estimates ranging from 7–30%.[59]

Publicly available financial documents corroborate these findings, with many small banks, such as First Citizens Community Bank and Whitney Bank, ascribing millions of dollars in revenue losses to the Durbin amendment.[60] Others, including Banner Corporation and Eastern Bank, have described implementing complex, counterintuitive strategies to keep their assets below the $10 billion threshold when reporting to the Fed to avoid the interchange fee cap and loss of revenue.[61] Many growing community financial institutions, such as Huntington Bank and American Savings Bank, have also reported interchange revenue losses after inevitably crossing the $10 billion threshold, at which point they have suffered tens of millions of dollars in lost revenue.[62]

Community banks are particularly vulnerable to large revenue losses. Local banks and credit unions have few alternative revenue streams to offset losses in interchange income, making it difficult to adapt to changes in their revenue composition.[63] Additionally, reductions in interchange income disproportionately harm smaller financial institutions because their per-transaction debit processing costs are typically higher than those of larger banks due to economies of scale. As of 2015, Federal Reserve data showed the average per-transaction authorization, clearing, and settlement (ACS) costs for low-volume issuers (i.e. local banks and credit unions) were 15 times higher than those of high-volume issuers.[64] Moreover, the Federal Reserve's figures underestimate the true cost to small issuers because they omit several cost components (e.g., transaction monitoring costs, customer inquiry and resolution costs, debit card compliance costs, debit card insufficient funds handling costs, card production and delivery costs, and account relationships costs).

Figure 3: Debit Interchange Fees for Issuers Exempted from the Durbin Amendment



A payments network is, at its core, an interdependent, interconnected cost sharing mechanism. Historically, most of the cost burden associated with running and maintaining the system has been borne by large banks that are covered by the Durbin amendment. These entities play a key role in enabling smaller institutions to participate and compete in the payment card market: there are over 5,000 banks and 6,000 credit unions in the United States, but the roughly 100 institutions covered by the Durbin amendment generate 80% or more of total debit volume, which largely funds the operation of electronic payments networks. The Durbin amendment has consequently shifted more responsibility onto exempt banks with respect to cost-sharing, harming their bottom line and making it more difficult to offer high-quality and affordable banking services to their customers.[65]

CONCLUSION

At the time of its passage, the Durbin amendment was hailed by its proponents as a boon to consumers, merchants, and community financial institutions who were struggling after the recession. However, in the seven years since the regulation's implementation, study after study has demonstrated that each of these anticipated beneficiaries has been harmed by its effects.

Today, consumers have lost access to debit rewards programs and free checking accounts, pay higher banking fees, can no longer choose the network they prefer to route their debit transactions, and have yet to experience the lower prices promised by the retail industry. Low-income families have been particularly impacted by these consequences — especially by the loss of debit rewards, more stringent balance requirements, and higher fees — and some left the traditional banking system in response. At the same time, while big box stores and other large retailers have reaped the benefits of debit interchange caps, many smaller merchants now face higher interchange costs due to the loss of small-ticket discounts. And while lawmakers attempted to exempt community financial institutions and credit unions, in practice these entities have also experienced a decline in per-transaction interchange and must now bear more of the cost to maintain the electronic payments system.

Despite the claims of retail industry lobbyists, the evidence is clear: the Durbin amendment has inflicted unnecessary costs across the retail, banking, and consumer finance markets.

APPENDIX: KEY STUDIES AND ANALYSES EXAMINING THE DURBIN AMENDMENT'S IMPACT

Author	Year	Title	Institution	Summary	Link
Buzek, G.	2018	Cash Multipliers: How Reducing the Costs of Cash Handling Can Enable Retail Sales and Profit Growth	IHL Group	Evaluates the high cost of cash-handling activities to businesses, finding that the cost of handling cash ranges from 4–15% of sales.	https://www.ihlservices.com/product/costofcash/
Chang, H., Evans, D., and Garcia-Swartz, D.	2005	The Effect of Regulatory Intervention in Two-Sided Markets: An Assessment of Interchange-Fee Capping in Australia	Review of Network Economics	Assesses the impact of credit card interchange fee regulation on credit card issuers and merchants in Australia, finding that the regulation has resulted in the transfer of significant profits from bank issuers and cardholders to the merchant sector.	https://papers.ssrn.com/sol3/papers.cfm?abstract_id=820044
Evans, D. and Schmalensee, R.	2018	Accounting for Two-Sided Business Reality Reduces False Negatives as Well as False Positives in Antitrust Decisions Involving Platform Enterprises	CPI Antitrust Chronicle	Describes the dynamics of two-sided markets and argues that both sides of a two-sided market must be evaluated to determine whether fees and pricing are competitive.	https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3131288
Evans, D., Chang, H., and Joyce, S.	2013	The Impact of the U.S. Debit Card Interchange Fee Caps on Consumer Welfare: An Event Study Analysis	University of Chicago Law School, Coase-Sandor Institute for Law and Economics	Estimates the financial impact of the Durbin amendment on consumers, finding that the present discounted value of the losses to consumers as a result of the implementation of the Durbin amendment is between $22-25 billion over the regulation's lifetime.	http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=1651&context=law_and_economics
Hubbard, B.	2013	The Durbin Amendment, Two-Sided Markets, and Wealth Transfers: An Examination of Unintended Consequences Three Years Later	University of Chicago Law School	Assesses the Durbin amendment's adverse consequences for banks, merchants, networks, payment processors, and consumers. The consequences include: reduced consumer access to free checking and rewards programs; lack of savings pass-through from large retailers to consumers; and higher interchange fees for small merchants.	https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2285105
Kay, B., Manuszak, M., and Vojtech, C.	2014	Bank Profitability and Debit Card Interchange Regulation: Bank Responses to the Durbin Amendment	Federal Reserve Board, Washington D.C.	Uses empirical methods to show that as a result of the Durbin amendment, banks subject to the regulation lost nearly $14 billion in annual income, and have only partially offset this loss by raising deposit fees (e.g., maintenance, minimum balance, overdraft, and ATM fees).	https://www.federalreserve.gov/econresdata/feds/2014/files/201477pap.pdf
Lux, M. and Greene, R.	2016	Regressive Trends in Credit Card Access	Harvard Kennedy School, Mossavar-Rahmani Center for Business & Government	Identifies regressive trends driving decreased credit and debit card usage among lower-income Americans, including a rise in financial regulatory restrictions like the Durbin amendment.	https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/files/Out_of_Reach_Lux_Greene_4_7.pdf
Manuszak, M. and Wozniak, K.	2017	The Impact of Price Controls in Two-sided Markets: Evidence from U.S. Debit Card Interchange Fee Regulation	Federal Reserve Board, Washington, D.C.	Uses empirical methods to show that banks subject to the Durbin amendment responded to the regulation by raising checking account prices, reducing the availability of free accounts, raising monthly fees, and increasing minimum balance requirements.	https://www.federalreserve.gov/econres/feds/files/2017074pap.pdf
McGinnis, P.	2013	Misguided Regulation of Interchange Fees: The Consumer Impact of the Durbin Amendment	Loyola University Chicago School of Law, Loyola Consumer Law Review	Examines the impact of the Durbin amendment on consumers, highlighting how reduced interchange fees have led to higher checking account fees without the potentially off-setting benefit of reducing retail prices.	https://lawecommons.luc.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=1914&context=lclr

Author	Year	Title	Institution	Summary	Link
Moeser, M.	2017	Small Merchants on Interchange: Value More Important than Cost	Javelin Strategy & Research	Analyzes a survey of 500 small merchants, finding that the vast majority see interchange fees as a necessary cost of doing business, derive value from the benefits that come with these costs, and are more satisfied with their relationships with issuing banks when they are allowed to choose and pay for additional benefits.	http://www.electronicpaymentscoalition.org/resource/report-small-merchants-on-interchange-value-more-important-than-cost-2/
Pierce, H., Robinson, I., Stratman, T.	2014	How are Small Banks Faring Under Dodd-Frank?	George Mason University, Mercatus Center	Analyzes a survey of 200 small banks to show that Dodd-Frank Wall Street Reform and Consumer Protection Act has adversely affected Durbin-exempt banks and their customers, with almost three-quarters of respondents reporting that the Durbin amendment in particular had a negative impact on their earnings.	https://www.mercatus.org/system/files/Peirce_SmallBankSurvey_v1.pdf
Stillman, R.	2008	Regulatory Intervention in the Payment Card Industry by the Reserve Bank of Australia	CRA International	Examines the adverse effects of the Reserve Bank of Australia's regulation of interchange fees on consumers, including higher cardholder fees and curtailed reward programs.	https://www.rba.gov.au/payments-and-infrastructure/payments-system-regulation/past-regulatory-reviews/review-of-card-payment-systems-reforms/pdf/review-0708-pre-conclusions/cra-28042008-2.pdf
Wang, Z.	2012	Debit Card Interchange Fee Regulation: Some Assessments and Considerations	Federal Reserve Bank of Richmond	Assesses the initial impact of the Durbin amendment on the electronic payments system, finding that the regulation substantially reduced the interchange revenues of large and small issuers, and adversely affected merchants specializing in small-ticket items.	https://www.richmondfed.org/~/media/richmondfedorg/publications/research/economic_quarterly/2012/q3/pdf/wang.pdf
Wang, Z., Schwartz, S., and Mitchell, N.	2014	The Impact of the Durbin Amendment on Merchants: A Survey Study	Federal Reserve Bank of Richmond	Analyzes a survey of 420 merchants across 26 sectors, finding that merchants are not passing on the savings accrued through reduced interchange fees to consumers; more than three-fourths of merchants did not change their prices after the Durbin amendment was implemented, and 22% actually increased prices.	https://www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_quarterly/2014/q3/pdf/wang.pdf
Zywicki, T., Manne, G., and Morris, J.	2014	Price Controls on Payment Card Interchange: The U.S. Experience	George Mason University, International Center for Law & Economics	Finds that the Durbin amendment has resulted in a net transfer of $1-3 billion annually from low-income households to large retailers by inducing banks to reduce the availability of free checking accounts by half and double minimum balance requirements and monthly fees. Notes that merchants have failed to pass on their interchange cost savings to consumers.	https://laweconcenter.org/images/articles/icledurbin2014.pdf
Zywicki, T., Manne, G., and Morris, J.	2017	Unreasonable and Disproportionate: How the Durbin Amendment Harms Poorer Americans and Small Businesses	George Mason University, International Center for Law & Economics	Finds that while the Durbin amendment has benefitted large retailers, it has harmed small businesses by driving up costs for local firms, community banks, and credit unions, and hurt consumers who have not seen any reduction in prices but who now face higher bank fees and minimum balance requirements. These effects are particularly acute among low-income households.	http://laweconcenter.org/images/articles/icle-durbin_update_2017_final.pdf
---	2016	Interchange Fee Revenue, Covered Issuer Cost, and Covered Issuer and Merchant Fraud Loss Related to Debit Card Transactions	Federal Reserve Board, Washington D.C.	Presents annual data collected by the Federal Reserve Board showing that following the implementation of the Durbin Amendment, the average debit card interchange fee for technically exempt issuers has fallen between 2-22% depending on transaction type.	https://www.federalreserve.gov/paymentsystems/files/regiireportsdata.pdf

ENDNOTES

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[1] Most merchants refer to the merchant discount fee as "interchange" even though these are distinct fees paid by distinct market participants.

[2] The regulation also permits an additional $0.01 per transaction to cover banks' costs of fraud prevention.

[3] Federal Reserve (2017). *The Federal Reserve Payments Study: 2017 Annual Supplement*. Federal Reserve System, 1; Federal Reserve (2016). *The Federal Reserve Payments Study 2016*. Federal Reserve System, 1; Federal Reserve (2014). *The 2013 Federal Reserve Payments Study*. Federal Reserve System.

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[8] Turner, M. (2012). *Credit Card Rewards: Context, History, and Value.* Policy & Economic Research Council.

[9] IHL Group (2018). *Cash Multipliers: How Reducing the Costs of Cash Handling Can Enable Retail Sales and Profit Growth*.

[10] *ibid.*

[11] Peter T. Dunn & Company LLC (2018), "Illustrating the Value Provided by Electronic Payments." Peter Dunn is a founder of the management consulting firm Edgar, Dunn & Company and presently provides global advisory services through Peter T. Dunn & Company. He has over 40 years of experience in strategic consulting in payments.

[12] The regulation also permits an additional $0.01 per transaction to cover banks' costs of fraud prevention.

[13] Kay, B., Manuszak, M., and Vojtech, C. (2014). *Bank Profitability and Debit Card Interchange Regulation: Bank Responses to the Durbin Amendment*. Federal Reserve Board, Washington, D.C., 2-10.

[14] Evans, D., Chang, H., and Joyce, S. (2013). *The Impact of the U.S. Debit Card Interchange Fee Caps on Consumer Welfare: An Event Study Analysis*. University of Chicago Law School, Coase-Sandor Institute for Law and Economics, 49.

[15] Hayashi, F., Sullivan, R., and Weiner, S. (2006). *A Guide to the ATM and Debit Card Industry*. Federal Reserve Bank of Kansas City, 14.

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[17] Due to the Durbin Amendment, card issuers have lost substantial interchange revenue. A comparison of annual interchange revenue at covered banks one year before and one year after Regulation II's implementation shows that interchange revenue declined by 21% in the immediate aftermath enactment, and the Federal Reserve Bank of Richmond estimates that the Amendment cost banks $10.4 billion within the first year of its implementation. According to the Federal Reserve Board's 2014 assessment of the Durbin Amendment, Regulation II likely reduced income at covered banks by almost $14 billion annually. See Wang, Z. (2012). *Debit Card Interchange Fee Regulation: Some Assessments and Considerations*. Federal Reserve Bank of Richmond, 166-167; Kay, B., Manuszak, M., and Vojtech, C. (2014), 33; Hubbard, B. (2013). *The Durbin Amendment, Two-Sided Markets, and Wealth Transfers: An Examination of Unintended Consequences Three Years Later.* University of Chicago Law School, 29.

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[27] *ibid*.

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[36] FDIC (2014). *2013 FDIC National Survey of Unbanked and Underbanked Households*, FDIC, 6; FDIC (2009). *National Survey of Unbanked and Underbanked Households*, FDIC, 27. Note that both the FDIC's 2009 and 2013 National Survey of Unbanked and Underbanked Households instructed previously banked survey participants to mark all that applied from a list of potential reasons for closing their banks accounts. However, whereas the 2013 survey listed "do not have enough money to keep in an account or meet a minimum balance requirement" as a single reason for closing an account, the 2009 survey broke this into two options: "minimum balance requirement is too high," and "do not have enough money to need an account," respectively selected by 11% and 34% of previously banked survey participants. Taking into consideration that was possible for survey participants to check multiple options, this indicates that at least 34%, but no more than 45% of respondents closed their accounts due to these factors.

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[52] Hubbard, B. (2013), 34.

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[59] Pierce, H., Robinson, I., Stratman, T. (2014). *How are Small Banks Faring Under Dodd-Frank?* Mercatus Center at George Mason University, 41 and 85.

[60] In its 2013 Annual Report, Whitney bank stated, “"Bank card and ATM fees totaled $45.9 million in 2013, a $3.2 million, or 6% decrease from 2012, reflecting the full impact of restrictions on debit card interchange rates arising from the implementation of the Durbin amendment to the Dodd-Frank Act." Similarly, in 2013 First Citizens Community Bank reported, “"Service charge fees related to customers’ usage of their debit cards decreased by $60,000 which we believe is directly attributable to the implementation of certain regulations issued as part of the Durbin amendment, which resulted in lower fees being earned by the Bank." See First Citizens Community Bank. (2014). *Annual Report*; Whitney Bank. (2015). *Annual Report*.

[61] In its 2017 annual report, Banner Corporation stated, “[D]eliberately reducing our assets below $10 billion at year-end ran counter to our instincts…[but] the financial benefits of doing so couldn’t be ignored. By being under $10 billion in assets on a single day, the last day of the year, we delayed the impact of the Durbin Amendment cap on debit card interchange fees one more year to July 2019 — preserving about $12 million in pre-tax income.” Similarly, Eastern Bank asked large customers to move deposits from the bank’s balance sheet in order to remain under the $10 billion threshold. See Banner Corporation. (2018). *2017 Annual Report* and Chesto, J. (2018). “For Eastern Bank, Joining the Big Time Comes at a Cost,” The Boston Globe.

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