The Federal Reserve seeks feedback on a proposal to reduce the maximum interchange fee that large debit card issuers earn for processing debit card transactions.[1] Please include my comment opposing the proposal as part of the official record.

The Durbin Amendment, which Congress enacted in 2010 as part of the Dodd-Frank "Wall Street Reform and Protection Act," charges the Federal Reserve with limiting the interchange fees associated with processing debit card transactions.[2] Not only have the promised benefits of limiting these failed to materialize, but they have also led to lower-income Americans losing access to benefits such as free checking and paying higher fees for other services. Meanwhile, large retailers have reaped a massive financial windfall. Given the consequences of limiting interchange fees, it's unsurprising that Federal Reserve Governor Michelle Bowman described this policy as "regressive in its impacts."[3]

Background

Congress added the Durbin Amendment to the Dodd-Frank "Wall Street Reform and Protection Act," which President Obama signed into law on July 21, 2010. At the time, Mr. Durbin, along with the other proponents of limiting interchange fees, claimed that retailers would pass along the money they saved from lower processing fees to consumers in the form of lower retail prices.

The Federal Reserve issued a final rule establishing a standard for debit card interchange fees the following year. The rule established the maximum permissible interchange fee a debit card issuer could receive. The Federal Reserve set the maximum at 21 cents per transaction and five basis points multiplied by the value of the transaction.[4]

Consumers Worse Off

Scholars investigating the effects of the Durbin Amendment have found that it had the predictable effect of raising the prices consumers pay for financial services. In response to the interchange fee limits, financial institutions increased fees on other services, eliminated popular reward programs, and reduced the availability of free checking programs that, in the past, were an effective way to encourage lower-income Americans to participate in the banking system.[5] For example, Mark D. Manuszak and Krzysztof Wozniak found that "banks subject to the cap raised checking account prices by decreasing the availability of free accounts, raising monthly fees, and increasing minimum balance requirements, with different adjustment across account types."[6]

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[1] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231025a.htm
[2] https://www.law.cornell.edu/uscode/text/15/1693o-2
[3] https://www.federalreserve.gov/newsevents/speech/bowman20231107a.htm
[4] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20110629a.htm
[5] https://www.nbcnews.com/id/wbna42459217#.W3dEyZNKgWo
[6] https://www.federalreserve.gov/econres/feds/files/2017074pap.pdf

These consequences are another sad reminder that price controls do not make people better off. Instead, price controls harm consumers by raising the full price they pay for goods and services, as this episode clearly illustrates. Moreover, these higher prices are often born by those who can least afford to do so–namely, the poor.

Retailers Profited

In addition to the harm imposed on consumers stemming from the higher prices for financial services caused by the Durbin Amendment, the alleged benefits never materialized. The limits on interchange fees were supposed to increase retail industry revenue by $7 billion, a portion of which retailers would pass along to consumers in the form of lower prices, but this never happened.[7] A Richmond Federal Reserve Bank study found that 98% of retailers raised or kept prices constant. That same study concluded that the Durbin Amendment "produced unintended consequences for some merchants in terms of raising costs."[8]

New Prosed Rule

Given the failure of the initial rule, it is difficult to understand why the Federal Reserve is now considering further lowering the limits on interchange fees. The new proposal would reduce the base component of the interchange fee from 21 cents per transaction to 14.4 cents and reduce the ad valorem component from five basis points to four.[9]

By further lowering the interchange fees, this proposal would only result in even larger losses for consumers. In short, the new proposal will only make matters worse.

Conclusion

If adopted, the Federal Reserve's new proposal will double down on failure. It will raise the prices consumers pay for financial services, reduce the quality of those services, and do little to reduce retail prices. I urge that policymakers reject this proposal.

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[7] https://reason.org/commentary/consumers-to-dick-durbin-walmart-th/
[8] https://www.richmondfed.org/-/media/RichmondFedOrg/publications/research/economic_brief/2015/pdf/eb_15-12.pdf
[9] https://www.federalreserve.gov/aboutthefed/boardmeetings/frn-reg-ii-20231025.pdf