

PASSING THE BUCK:
A LOOK INTO THE DURBIN AMENDMENT
TO THE DODD-FRANK ACT

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"After years of raking in excess profits off an unfair and anticompetitive interchange system, Bank of America is trying to find new ways to pad their profits by sticking it to its customers. It's overt, unfair, and I hope their customers have the final say."¹

Introduction

On July 21, 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act.² Section 1075 of the Act, known as the “Durbin Amendment,” amended the Electronic Fund Transfer Act, 15 U.S.C. § 1693 *et seq.*, by adding several provisions regulating debit card interchange fees.³ The Durbin Amendment also sought to increase competition in payment processing. “On its surface, the provision seems very simple and even pro-consumer. It directs the Federal Reserve to regulate the fees that banks charge businesses when consumers pay for a purchase with a debit card.”⁴ The Durbin Amendment sought to require banks to charge debit card interchange fees that are “reasonable and proportional to the actual cost” of processing the transaction.⁵

Nevertheless, there has been a good deal of debate surrounding the Durbin Amendment. In fact, Democratic Senator John Tester of Montana proposed a bill seeking to repeal the Durbin Amendment.⁶ Interestingly, the bill seeking to repeal the Durbin Amendment received almost as much support as the Durbin Amendment itself—

¹ Press Release, Senator Dick Durbin, *Durbin Statement on Bank of America Fee Announcement*, (available at: <http://durbin.senate.gov/public/index.cfm/pressreleases?ID=11a1b2ca-6b82-4e18-b39c-60e778ee7df7>).

² *TCF Nat'l Bank v. Bernanke*, 643 F.3d 1158, 1161 (2011).

³ *Id.*

⁴ David John, *The Durbin Debit Card Interchange Fee Cap Hurts Consumers*, THE HERITAGE FOUNDATION (March 17, 2011), <http://www.heritage.org/research/reports/2011/03/debit-card-changes-how-the-durbin-interchange-fee-hurts-consumers>.

⁵ 15 U.S.C.A. §1693o-2(a)(3)(A).

⁶ Debit Interchange Fee Study Act of 2011, S. 575, 112th Congress (2011).

sixty-three senators voted in favor of the Durbin Amendment in 2010; whereas fifty-four voted to delay its implementation in 2011.⁷ However, the Durbin Amendment continued to receive support, and is currently being implemented today.

Put simply, debit card interchange fees are the fees 7-Eleven pays to Bank of America when a consumer purchases something with a debit card at 7-Eleven. An interchange fee is assessed on a merchant every time you swipe your debit or credit card. Depending on the card and the merchant, a fee will vary widely. Debit card interchange fees are established by payment card networks and ultimately paid by merchants to debit card issuers for each electronic debit transaction.⁸ The fee is imposed to offset the costs of fraud prevention and processing the transaction.⁹ Part of the fee goes back to the network, while part remains with the issuing bank.

Visa and MasterCard are the two major card networks. Visa and MasterCard essentially have a “duopoly on debit card transactions and can dictate the interchange fees they charge.”¹⁰ “Swipe fees” have risen substantially in the past decade, and now amount to nearly \$48 billion a year, with \$17 billion coming from debit cards.¹¹

Analysis of the Text of the “Durbin Amendment”

The Durbin Amendment to the Dodd-Frank Act amended the Electronic Fund Transfer Act. The Durbin Amendment was principally concerned with debit card interchange fees, and the alleged “duopoly” with respect to payment card network systems. The Federal Reserve Board was obligated to propose rules requiring banks to engage in fair, reasonable and competitive conduct with respect to the processing of debit cards and the fees charged therewith.¹²

⁷ Stacie E. McGinn and Mark Chorazak, *Debit Interchange Regulation: Another Battle or the End of the War*, HARVARD BUSINESS LAW REVIEW (July 23, 2011), n. 13, (available at: <http://www.hblr.org/2011/07/debit-interchange-regulation-another-battle-or-the-end-of-the-war/>).

⁸ Press Release from the Board of Governors of the Federal Reserve System, (June 29, 2011) (available at: <http://www.federalreserve.gov/newsevents/press/bcreg/20110629a.htm>).

⁹ Tim Chen, *What the Durbin Amendment Means for You*, U.S NEWS AND WORLD REPORT “My Money Blog” (July 12, 2011), <http://money.usnews.com/money/blogs/my-money/2011/07/12/what-the-durbin-amendment-means-for-you>.

¹⁰ *Id.*

¹¹ *Id.*

¹² See 15 U.S.C.A. §1693o-2(a).

Specifically, under §1693o-2, the Board of Governors of the Federal Reserve System was authorized to set the “interchange transaction fee that an issuer [of debit cards] may receive or charge with respect to an electronic debit transaction.”¹³ Further, by statute, the Federal Reserve was charged with prescribing regulations first, “to establish standards for assessing whether the amount of any interchange transaction fee [...] is reasonable and proportional to the cost incurred by the issuer with respect to the transaction.”¹⁴ Second, the Durbin Amendment requires that “the amount of any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction shall be reasonable and proportional to the cost incurred by the issuer with respect to the transaction.”¹⁵

However, by statute, the Durbin Amendment applies only to those financial institutions that have assets over \$10,000,000,000.¹⁶ Thus, the regulations imposed on debit card interchange fees as a result of the Durbin Amendment are inapplicable to a majority of the banking industry.¹⁷

The Federal Reserve Board’s Implementation

On December 16, 2010, Federal Reserve Board Chairman Ben Bernanke proposed a 12-cent ceiling on debit-card interchange fees.¹⁸ It was estimated that at the 12-cent ceiling, large banks would lose approximately \$14 billion in profits annually.¹⁹ Subsequent to the Fed’s proposed rule, considerable amounts of lobbying by both the banking industry and merchants took place. Ultimately, “[t]he long-anticipated Federal Reserve ruling on the Durbin Amendment swung decisively in favor of the banks...”²⁰

¹³ 15 U.S.C.A. §1673o-2(a)(1).

¹⁴ 15 U.S.C.A. §1693o-2(a)(3)(A).

¹⁵ 15 U.S.C.A. §1693o-2(a)(2).

¹⁶ 15 U.S.C.A. §1693o-2(a)(6)(A).

¹⁷ “Majority” in terms of the number of banking institutions within the banking industry; not “majority” in terms of possession of assets by banking institutions.

¹⁸ Press Release from the Board of Governors of the Federal Reserve System, (December 16, 2010) (available at: <http://www.federalreserve.gov/newsevents/press/bcreg/20101216a.htm>).

¹⁹ <http://education.cardhub.com/interchange-fee-study-2010/>.

²⁰ <http://www.nerdwallet.com/blog/2011/federal-reserve-issues-final-ruling-durbin-amendment/>.

On June 29, 2011 the Federal Reserve Board announced the final rule establishing standards for debit card interchange fees.²¹ The “maximum permissible interchange fee that an issuer may receive for an electronic debit transaction will be the sum of 21 cents per transaction and 5 basis points multiplied by the value of the transaction.”²² In addition to publishing the final rules on debit card interchange fees restrictions, the Fed announced prohibitions on network exclusivity arrangements and routing restrictions. The focus of this paper, however, is the new restriction on debit card interchange fees, the response by the banking industry, and an analysis of the impact on consumers.

TCF National Bank v. Ben S. Bernanke, et al.

On October 12, 2010, TCF National Bank filed a lawsuit against the Federal Reserve Board in Federal District Court in South Dakota challenging the constitutionality of the Durbin Amendment.²³ “Concerned about the impact of these new provisions, which may result in a reduction of fees to twelve cents or less per transaction under proposed regulations by the Board, TCF filed suit to enjoin the Durbin Amendment.”²⁴ TCF brought suit alleging that the Durbin Amendment was facially unconstitutional because the provisions would require the Board to set an interchange rate below the cost of providing debit card services. Further, TCF alleged that the Durbin Amendment arbitrarily exempts small issuers from the Board’s rate regulations. The Court noted, “A facial challenge to a legislative Act is, of course, the most difficult challenge to mount successfully, since the challenger must establish that no set of circumstances exist under which the Act would be valid.”²⁵

The Eighth Circuit ruled against TCF and upheld the district court’s decision. The Eighth Circuit agreed with the district court’s finding that, “Congress’s decision to link interchange fees to issuing banks’ actual costs bears a reasonable relationship to two proper legislative purposes: (1) to ensure that such fees are reasonable and (2) to prevent retailers and consumers from having to bear a disproportionate amount of costs of the

²¹ Press Release from the Board of Governors of the Federal Reserve System, (June 29, 2011) (*available at*: <http://www.federalreserve.gov/newsevents/press/bcreg/20110629a.htm>).

²² *Id.*

²³ *TCF Nat’l Bank*, 643 F.3d at 1162.

²⁴ *Id.*

²⁵ *Id.*, at 1163 (quoting *United States v. Salerno*, 481 U.S. 739, 745 (1987)).

debit card system.”²⁶ Further, the Eighth Circuit agreed with the district court’s finding that the “Durbin Amendment’s distinction between larger and smaller issuers of debit cards is rationally related to the government’s legitimate interests in protecting smaller banks [...] and ensuring consumer access to debit cards.”²⁷

Market Responses by the Commercial Banking Industry

As discussed above, the ceiling on debit card interchange fees was placed at 23 cents, instead of the originally proposed 12-cents. Notwithstanding the increase from the original proposed ceiling, banks proposed meeting the new regulations with increased fees on consumers. In fact, to date “many banks have eliminated or scaled back debit-rewards programs, added monthly fees for checking accounts and raised minimum balance requirements for customers to avoid certain fees.”²⁸

As a result of the cap on debit card interchange fees, the U.S. banking industry expects an estimated \$6.6 billion a year in lost revenue.²⁹ Specifically, Bank of America has said it expects the new cap on debit card interchange fees will cost the company \$2 billion in revenue annually.³⁰ Wells Fargo has said it expects to lose \$250 million each quarter.³¹ “Faced with sharply lower profits from debit card use, card issuers are almost certain to react by doing one or more of the following: imposing an annual fee on debit cards; raising other fees that would be paid by consumers; or reducing the interest rates paid on consumer deposits,”³² a prediction which was largely accurate.

Bank of America’s desire to keep operating at the pre-Durbin Amendment profit rate led it to consider imposing a \$5 fee each billing cycle a consumer uses a debit card to make a purchase. However, the fee would have only applied to standard checking accounts, and not most premium accounts held by wealthier customers.³³ Wells Fargo announced that it planned on charging a \$3 fee for some debit card customers as part of a

²⁶ *Id.* at 1164-65.

²⁷ *Id.* at 1165.

²⁸ Andrew R. Johnson, *Banks Plan New Fees for Using Debit Cards*, THE WALL STREET JOURNAL (Sept. 30, 2011) (*available at*: <http://online.wsj.com/article/SB10001424052970204138204576600800330404330.html?KEYWORDS=banks+plan+new+fees+for+using>).

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

³² David John, *supra* note 4.

³³ Johnson, *supra* note 29.

“pilot-program” in Nevada, Washington, Oregon, New Mexico and Georgia, which was scheduled to begin October 14.³⁴ J.P. Morgan has been testing a \$3 fee since February in Wisconsin.³⁵ Citigroup has announced that it would not charge fees for using debit cards, but it is raising fees on certain checking accounts.³⁶

The sponsors of the Durbin Amendment apparently operated under the idea that card issuers would absorb the lost profit from reducing debit card fees.³⁷ However, the result was clearly the opposite. Banks announced they would move to recoup the expected loss in profits resulting from the regulation. In fact, some authors have contended that the end result of the Durbin Amendment will be that the American consumer will be stuck “with \$12 billion each year in fees and less services.”³⁸

Nonetheless, the backlash from consumers with respect to the increased fees did not fall on deaf ears. Bank of America announced on November 1, that it had abandoned plans to charge \$5 a month for debit cards.³⁹ Bank of America reversed its decision after other large banks: JPMorgan Chase & Co., Wells Fargo & Co., U.S. Bancorp, and Citigroup Inc., decided against introducing fees to recoup the cost of the Durbin Amendment. In addition, SunTrust Banks Inc. and Regions Financial Corp. eliminated check-card fees implemented in part because of the new regulations on October 31.⁴⁰ Thus, debit card issuers will be forced to find other ways to replace revenue lost as a result of the Durbin Amendment.

Banks have seemingly responded as the Durbin Amendment sponsors have hoped by absorbing lost profits because of the regulation. However, the basic critique of the Durbin Amendment remains: the regulation has moved the cost of debit card use from merchants to banks, without a demonstrative benefit to consumers. Moreover, although banks have decided against imposing fees directly tied to the Durbin Amendment, banks may still recoup the lost profits through cost-cutting moves ultimately to the detriment of

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ David John, *supra* note 4.

³⁸ Comment, *Panel 2: Banking Reform*, 7 N.Y.U. J. L. & Bus. 479, 494-95 (2011).

³⁹ Hugh Son, *Bank of America Eliminates Plan for \$5 Debit-Card Fee*, Bloomberg.com (Nov. 1, 2011, 3:59 PM), <http://www.bloomberg.com/news/2011-11-01/bank-of-america-drops-plan-for-5-debit-fee-as-competitors-scrap-charges.html>.

⁴⁰ *Id.*

consumers. Thus, the Durbin Amendment may still have detrimental effect to consumers, the banks' decision to forego fees notwithstanding.

Implications for Consumers

Consumers would have been discouraged from using debit cards because of the increased fees imposed as a result of the Durbin Amendment.⁴¹ The fees would not have been levied equally over each type of account that a bank offers. Banks typically exempt their premium accounts from many fees because they tend to be more profitable than standard accounts with lower balances.⁴² Thus, those that would most likely be hit with paying the cost would have been those consumers that could least afford the increased fees.

Consumers were urged to respond to the increased fees by changing banks and shopping around. However the cliché: "it's easier said than done," is certainly applicable here. Many consumers are already familiar with the transaction fees in place when they attempt to use an ATM associated with a bank they do not belong to. So, for example, switching to a smaller bank that is not subject to the Durbin Amendment may only result in a consumer substituting a \$5 monthly fee for a \$3 charge each time they use an ATM.

Moreover, switching banks is even more inconvenient when consumers have established automatic pay accounts with their current bank. Switching banks would require many consumers to go through the process of re-establishing automatic payments for things as small as magazine subscriptions, or as large as monthly car loan or mortgage payments. Furthermore, in the post-911 and PATRIOT Act era, banks have begun to ask more prying questions when a consumer has attempted to open a new bank account.⁴³ For example, if deemed necessary, a bank may ask a consumer about the following: other accounts with links to the consumer, the nature of the consumer's business and occupation, the consumer's wealth, the source of consumer's income, and the consumer's

⁴¹ David John, *supra* note 4.

⁴² Johnson, *supra* note 29.

⁴³ Laura Bruce, *Patriot Act Make Banks Pry Into New Accounts*, BANKRATE.COM, (Sept. 30, 2003), <http://www.bankrate.com/brm/news/bank/20030930a1.asp>.

investment objective, among many other questions.⁴⁴ Thus, for many consumers, it is not as easy to “vote with their feet” and walk out on their current banks.

In the wake of several banks’ decisions not to impose fees directly related to the Durbin Amendment, it should be noted that the banks did not decide against imposing increased fees because consumers “voted with their feet.” Banks decided against imposing the increased fees because of market competition—one bank decided against imposing fees, and the rest followed. Nevertheless, regulation aimed at improving the marketplace for consumers should not require those very consumers to have to choose between either absorbing increased cost, or facing the inconvenience of avoiding the increased cost.

Perhaps the Durbin Amendment will result in lower prices for products. This was certainly an original goal of the legislation. It is reasonable to conceive that by reducing the cost to merchants to provide a service (e.g., processing debit cards), the merchant need not charge as much for a product to recoup the cost. The proposition is theoretically sound, however, what is most evident is that the Durbin Amendment has indirectly transferred the cost of using a debit card from the merchant to the consumer. That is, rather than the merchant paying for the convenience of the debit card through a 44-cent interchange fee, the consumer now pays for the convenience of using a debit card. Originally, consumers would have directly paid for the convenience through a bank’s monthly fee for debit card use. Although now it appears that banks have dropped the decision to pursue those fees, banks may move to recoup the cost in other ways. For example, banks may remove rewards programs, or cut back other services to recoup the lost profits.

Also, it must be considered that the increase in profits (or rather, decrease in operating costs) that merchants will now experience will not be passed to the consumer. Merchants, like banks, may become comfortable with receiving increased profits and choose to hold those profits. A result all the more possible given the current state of the economy and depressed spending levels. Thus, the end result is that merchants pay less money to banks, and in return banks seek to recoup lost profit by cost-cutting measures detrimental to consumers.

⁴⁴ *Id.*

The Winners

Merchants, not consumers, have been the main beneficiaries of the cap on fees. “From October 1 through the 3rd, Heartland [Payment Systems], which processes debit and credit card payments for merchants, says it passed along \$1,779,568 in debit interchange reductions to its merchants across the country.”⁴⁵ As a result of the regulation, the average signature debit regulated interchange fee per transaction is \$.23, compared to \$.44 for each non-regulated interchange transaction.⁴⁶ Therefore, retailers have been experiencing a “savings” at an average of \$.21 per transaction from what they paid to process debit cards just days ago.⁴⁷

The Durbin Amendment’s beneficial impact for merchants may have been clear from the beginning. If only for the fact that when the debate over the Amendment was taking place, it was “retailers like Wal-Mart on one side and big banks on the other.”⁴⁸

Conclusion

Debit cards allow consumers to spend their own money, whereas credit cards require the consumer to borrow money from the card issuer. An unintended consequence of the Durbin Amendment has been the increased cost to the consumer in using a debit card. Subsequently, more consumers may be driven to credit cards because of the fees associated with debit card use; notwithstanding the fact that millions of consumers have dug themselves deep into debt from careless or irresponsible credit card use.⁴⁹

Some may argue that the Durbin Amendment really has no impact in the end. That is, consumers were paying the price for the interchange fees because of higher prices for products as a result of merchants passing the cost. Now, with certain banks receiving less of a profit, the banks have passed the cost to the consumer to recoup those lost profits. In the end, the consideration may just be *to whom* the consumer is paying the cost of using debit cards: a merchant or a bank.

⁴⁵ Halah Touryalai, *The “Durbin Tax” Is Paying Off... For Retailers*, FORBES.COM, (October 5, 2011, 7:32 PM), <http://www.forbes.com/sites/halahtouryalai/2011/10/05/the-durbin-tax-is-paying-off-for-retailers/>.

⁴⁶ *Id.*

⁴⁷ *Id.* (citing Heartland Payment Systems data).

⁴⁸ *Id.*

⁴⁹ David John, *supra* note 4.

The Durbin Amendment was part of the larger Dodd-Frank Wall Street Reform and *Consumer Protection Act*. (*emphasis added*). Thus, the goal of the Durbin Amendment—presumably—was neither to shift the cost of debit card processing to consumers, nor increase profits for merchants. Yet, that appears to be the primary impact of the regulation on debit card interchange fees. Senator Durbin may *hope* Bank of America’s customers have the final say, but the banks have already demonstrated that the increased cost of regulations will be passed to consumers. Unfortunately, at least initially, the Durbin Amendment has fallen short of its goal to protect consumers.