

Debit Card Interchange Fees and the Durbin Amendment's Small Bank Exemption

I. INTRODUCTION

In the film *The Graduate*, Mr. McGuire advises Benjamin Braddock – a recent college graduate struggling with his future plans – that “there’s a great future in plastics.”¹ While Mr. McGuire meant plastic *products*, another form of “plastic” – debit cards – has emerged as “the most frequently used noncash payment method” in the United States.² With debit cards accounting for 37.9% of noncash payments in 2009,³ banks receive a significant amount of their revenue from debit card interchange fees.⁴ However, according to Illinois Senator Richard Durbin, the interchange system “is entirely unregulated” with “no competition and no recourse for merchants exploited by the rate structure and fees.”⁵

Senator Durbin was influential in placing a last minute addition to the Dodd-Frank Wall Street Reform and Consumer Protection Act,⁶ which was signed into law on July 21, 2010.⁷ This addition, known as

1. THE GRADUATE (Embassy Pictures 1967).

2. See Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,395 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), available at <http://federalregister.gov/a/2011-16861>.

3. See Nancy Donahue et al., The 2010 Federal Reserve Payments Study, Fed. Reserve Sys. 4 (Apr. 5, 2011), http://www.frbservices.org/files/communications/pdf/press/2010_payments_study.pdf.

4. See Letter from Trade Ass’n on Fed. Reserve’s Proposed Rule on Section 920 of the Dodd-Frank Act to Jennifer J. Johnson, Sec’y, Bd. of Governors of Fed. Reserve Sys. 10 (Feb. 22, 2011) [hereinafter Trade Ass’n Letter], available at [http://electronicpaymentscoalition.org/downloads/Trade%20Associations%20Comment%20Letter%20on%20Federal%20Reserve's%20Proposed%20Rule%20on%20Section%20920%20of%20the%20Dodd-Frank%20Act\[1\].pdf](http://electronicpaymentscoalition.org/downloads/Trade%20Associations%20Comment%20Letter%20on%20Federal%20Reserve's%20Proposed%20Rule%20on%20Section%20920%20of%20the%20Dodd-Frank%20Act[1].pdf) (stating that debit card interchange fees amounted to \$16.2 billion in bank revenue in 2009).

5. See Letter from Senator Richard J. Durbin, U.S. Senate, to Camden Fine, President and CEO of Indep. Cmty. Bankers of Am. and Dan Mica, President and CEO of Credit Union Nat’l Ass’n (June 11, 2010), <http://durbin.senate.gov/public/index.cfm/pressreleases?ID=d9c42bd5-b945-4bee-b025-55aab2fd586a> [hereinafter Durbin Letter].

6. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (to be codified in scattered sections of the U.S. Code).

7. See Tim Chen, *What the Durbin Amendment Means for You*, U.S. NEWS (July 12,

the “Durbin Amendment,” attempts to make interchange fees charged for debit card purchases “reasonable and proportional” to the cost incurred by the issuer with respect to the transaction.⁸ The final rule from the Federal Reserve Board (Fed) requires the interchange transaction fees on debit card purchases to be a base of twenty-one cents plus a small *ad valorem* fee,⁹ and if the debit card issuer is eligible, one cent per transaction can be added to cover fraud prevention costs.¹⁰ Previously, interchange fees had averaged forty-four cents per transaction for all debit cards.¹¹

This Note will examine the effect the implementation of the Durbin Amendment will have on the banking industry, focusing on the Fed’s lack of regulatory power over debit card payment networks and its potential negative impact on the exemption for banks with under \$10 billion in assets. Part II will provide a brief overview of the debit card industry and interchange fees.¹² Part III will analyze the effect of the Durbin Amendment on debit card interchange fees and on the relationship between banks – forced to cope with the loss of transaction fee revenue – and customers, as well as the small bank exemption within the Durbin Amendment.¹³ Part IV will evaluate the potential negative effect the Durbin Amendment could have on small banks despite the exemption,¹⁴ while Part V will take a look at the future of the Durbin Amendment.¹⁵ This Note will demonstrate that the Fed’s failure to require payment card networks to have a two-tier interchange system could negate the proposed benefits from the exemption for smaller banks. Payment card networks – such as MasterCard¹⁶ and

2011), <http://money.usnews.com/money/blogs/my-money/2011/07/12/what-the-durbin-amendment-means-for-you>.

8. 15 U.S.C. § 1693o-2 (Supp. IV 2010).

9. *See* Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,420 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), *available at* <http://federalregister.gov/a/2011-16861>.

10. *See id.* at 43,404.

11. *See id.* at 43,397.

12. *See infra* Part II.

13. *See infra* Part III.

14. *See infra* Part IV.

15. *See infra* Part V.

16. *See MasterCard Says It Will Implement Two-Tier Interchange System*, Michigan Credit Union League & Affiliates (Aug. 18, 2011), http://www.mcul.org/News_Article_888.html?id=4697.

Visa¹⁷ – that have committed to a two-tier interchange structure, but even with the FTC examining their implementation of the small bank exemption,¹⁸ these networks could ultimately reevaluate their decisions.

II. DEBIT CARDS AND INTERCHANGE FEES

A. *Evolution of Debit Cards*

Automatic Teller Machines (ATMs) were introduced in the late 1960s and 1970s to provide customers with a new way to spend the money in their deposit accounts.¹⁹ These machines were accessed by cards, which allowed banks to process fewer checks and customers to access their money without dealing with bank tellers.²⁰ By the 1980s, banks began issuing debit cards that could be used at ATMs and that could be used for purchases at retailers, with the funds deducted directly from the customer's deposit account.²¹

Unlike credit cards, which allow for short-term borrowing by the customer from the issuing bank, these bank-issued debit cards draw funds directly from the bank account linked to the card.²² Therefore, instead of having to pay off a balance at the end of the month or being subject to interest charged by the issuing bank for the extension of credit, the amount of money in your account decreases with each debit

17. See Sean Sposito, *Visa Plans Two-Tiered Interchange Rates After Fed Rules*, AM. BANKER, Jan., 2011, available at <http://www.americanbanker.com/bulletins/-1031142-1.html>.

18. See Kevin Wack, *Durbin Seeks to Beef Up Small-Bank Interchange Exemption*, AM. BANKER, Nov. 1, 2011, available at http://www.americanbanker.com/issues/176_212/durbin-interchange-debit-fee-ftc-collusion-1043734-1.html.

19. See Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,395 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), available at <http://federalregister.gov/a/2011-16861>.

20. See Stephen Craig Mott, *Industry Facts Concerning Debit Card Regulation Under Section 920, 2* (Oct. 29, 2010) (unpublished report) http://www.federalreserve.gov/newsevents/files/merchants_payment_coalition_meeting_20101102.pdf [hereinafter Mott Report].

21. See Stan Sienkiewicz, *The Evolution of EFT Networks from ATMS to New On-Line Debit Payment Products*, Payment Cards Center of the Fed. Reserve Bank of Philadelphia (Apr. 2002), http://www.philadelphiafed.org/payment-cards-center/publications/discussion-papers/2002/EFTNetworks_042002.pdf (illustrating that debit cards allowed consumers to receive cash back in addition to paying for their purchases at supermarkets).

22. See Jennifer Barrett, *Credit and Debit Cards: What You Need to Know*, N.Y. TIMES (Jan. 6, 2009), <http://www.nytimes.com/2009/01/06/your-money/credit-and-debit-cards/primercards.html>.

card transaction.²³

B. Growth of Debit Card Volume

Over the past decade, debit card use has increased “more than any other form of electronic payment.”²⁴ In 2003, the worldwide aggregate dollar volume of Visa debit cards exceeded that of Visa credit cards.²⁵ Also, as of 2006, Visa debit cards accounted for more transactions than Visa credit cards.²⁶ From 2006 to 2009, debit cards use increased from 25% to 37.9% of all non-cash payments, with a compound annual growth rate of 14.8%.²⁷

Debit cards clearly have a very significant impact on the U.S. payment system.²⁸ Debit cards are used more than every other payment method besides cash and are accepted at about eight million merchant locations in the U.S.²⁹ The percentage of U.S. households using debit cards increased from 20% in 1995 to 71% by 2007.³⁰ In 2009, there were 37.7 billion debit and prepaid debit card transactions worth \$1.45 trillion.³¹ The number of debit cards in circulation has grown from 235 million in 2000 to a projected 585 million in 2011.³²

Of these projected 585 million debit cards, there are two

23. See *id.*; Fukimo Hayashi et al., *A Guide to the ATM and Debit Card Industry*, Fed. Reserve Bank of Kansas City (April 7, 2003), http://info.worldbank.org/etools/docs/library/83934/Hayashi_April2003.pdf (noting that debit card usage has recently increased because of the ease in adding a debit function to an ATM card, aggressive marketing by banks, and the emergence of offline debit cards from MasterCard and Visa).

24. See Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,395 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), available at <http://federalregister.gov/a/2011-16861>.

25. See Arnold S. Rosenberg, *Better Than Cash? Global Proliferation of Payment Cards and Consumer Protection Policy*, 44. COLUM. J. TRANSNAT'L L. 520, 525 (2006).

26. *Id.* at 526.

27. See *Donahue*, *supra* note 3, at 4.

28. See Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,395 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), available at <http://federalregister.gov/a/2011-16861>.

29. *Id.*

30. See Trade Ass'n Letter, *supra* note 4, at 2.

31. See Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722, 81,725 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235), available at <http://federalregister.gov/a/2010-32061>.

32. See Statistical Abstract of the United States: 2011, U.S. Census Bureau, <http://www.census.gov/compendia/statab/2011/tables/11s1186.pdf> (last visited Jan. 12, 2012).

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primary types of debit authentication: Personal Identification Number (PIN)-based and Signature-based.³³ “Online” PIN debit cards, which require a PIN to be entered, allow for money to be immediately withdrawn from a customer’s bank account.³⁴ PIN debit networks, which carry authorization and clearing information in a single message, are the natural evolution from the original intent of the debit card – to be an ATM card.³⁵

“Offline” Signature debit cards, while first introduced in 1975, were used far less than PIN-based debit cards until the early 1990s.³⁶ These transactions carry authorization and clearing information in separate messages³⁷ and typically take at least two days to clear and for money to be debited.³⁸

C. Debit Card Interchange Fees

1. Debit Card Transactions and Fees

In a typical debit card transaction, the cardholder provides either a bank-issued debit card or debit card information – including a PIN, if a PIN debit transaction – to a merchant.³⁹ Then, an electronic authorization request is sent from the merchant through the acquirer (the merchant’s bank) to the payment network (such as Visa, Discovery, or

33. See Debit Card Interchange Fees and Routing, 75 Fed. Reg., 81,722, 81,723 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235), available at <http://federalregister.gov/a/2010-32061>.

34. See Rosenberg, *supra* note 25, at 528.

35. See Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,395 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), available at <http://federalregister.gov/a/2011-16861>.

36. Mott Report, *supra* note 20, at 5-6 (noting that payment card networks saw a limited future in signature debit cards because of security issues until Visa, realizing it could lose \$813 million in interchange income if the debit market became entirely PIN debit cards, created strategies in the early 1990s to push the debit market toward signature debit cards through “honor all cards” rules that forced merchants accepting Visa credit cards to accept Visa signature debit cards as well).

37. See Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,395 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), available at <http://federalregister.gov/a/2011-16861>.

38. Rosenberg, *supra* note 25, at 528.

39. See Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,395 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), available at <http://federalregister.gov/a/2011-16861>.

MasterCard).⁴⁰ Next, for PIN debit cards, the network contacts the customer's bank to make sure that sufficient funds exist for the transaction's value and that the card is not stolen or reported lost.⁴¹ However, for signature-based cards, the payment network determines whether the customer's total purchases over the previous two or three days are within the bank's preset limit.⁴² Finally, a message either approving or declining the transaction is sent back up the chain to the merchant quickly after the request.⁴³ If approved, PIN-based debit cards allow for an immediate deduction of funds, but signature debit cards do not debit a customer's account for two to three days.⁴⁴

Within this process, debit card interchange transaction fees, which the Durbin Amendment defines as "any fee established, charged or received by a payment card network for the purpose of compensating an issuer for its involvement in an electronic debit transaction," can be difficult to understand fully.⁴⁵ When a retailer accepts a debit card as a customer's form of payment, the merchant pays a "merchant discount fee" of usually around two percent, of which a portion – interchange – goes to the bank that issued the debit card.⁴⁶

With interchange, the customer's bank sends the merchant's bank the transaction price minus the interchange rate, which is either the rate set by the payment network or a rate negotiated by the customer's bank, and the customer's bank keeps the interchange fee.⁴⁷ Interchange may also be included when the merchant's bank sends the merchant the transaction price minus the merchant discount fee, which is negotiated

40. See *id.*; John P. Caskey & Gordon H. Sellon, Jr., *Is the Debit Card Revolution Finally Here?*, Fed. Reserve Bank of Kansas City (Fourth Quarter 1994), <http://www.kansascityfed.org/PUBLICAT/ECONREV/EconRevArchive/1994/4Q94CASK.pdf> (noting that the network links the merchant's bank to the bank issuing the debit card).

41. See Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,396 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), available at <http://federalregister.gov/a/2011-16861>.

42. See Caskey & Sellon, Jr., *supra* note 40.

43. See Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,395 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), available at <http://federalregister.gov/a/2011-16861>.

44. See Caskey & Sellon, Jr., *supra* note 40.

45. 15 U.S.C. § 1693o-2(c)(8) (Supp. IV 2010).

46. See *Interchange: What is the Issue?*, Electronic Payments Coalition, <http://electronicpaymentscoalition.org/theIssue> (last visited Jan. 12, 2012).

47. See *Interchange: What it is. How it works.*, Visa Inc., <http://www.usa.visa.com/download/merchants/interchange-brochure.pdf> (last visited Jan. 12, 2012).

between the merchant and the merchant's bank.⁴⁸ Merchants are willing to pay this discount fee to gain access to the payment networks, and the revenue from interchange is integral in maintaining a debit card program.⁴⁹

2. Fees Based on Type of Debit Card

Because PIN-based debit cards are inherently less risky than signature debit cards or credit cards,⁵⁰ limited interchange fees on PIN debit transactions became the rule when debit cards were first promoted for purchasing at the point of sale.⁵¹ For most transactions in the 1980s and early 1990s, the PIN debit networks set interchange fees "at par" with no monetary advantage for merchants or issuers.⁵² However, in the 1990s, the interchange fee system began to change.⁵³ Realizing that the low interchange fees were not encouraging banks to issue PIN-based debit cards, payment card networks – primarily Visa and MasterCard – took efforts to increase debit card use and issuance.⁵⁴

In the early 1990s, Visa began to actively promote its signature debit card that charged higher interchange fees more comparable to

48. *Id.* (noting that the merchant's bank generally pays interchange); *see also Understanding Visa MasterCard Interchange*, Merchant Services Inc., <http://www.merchantservices.cc/topline-moneymakers/understanding-visa-mistercard-interchange/understanding-visa-mastercard-interchange/> (last visited Jan. 12, 2012) (illustrating that Visa and MasterCard realize profit from the fees associated with the debit card process).

49. *Interchange: What is the Issue?*, *supra* note 46 (pointing out that interchange funds reimburse card issuers for such risks as the float on funds and the risk of nonpayment).

50. *See* Mott Report, *supra* note 20, at 3 (demonstrating that PIN debit cards allow for less incidents of fraud, as well as thwarting potential thieves because of the requirement for a PIN to be entered, and thus, the inherent risk costs associated with PIN debits were low).

51. Rosenberg, *supra* note 25, at 531 (demonstrating that customers were also not interested in paying fees for using money from their own accounts); *see also* Mott Report, *supra* note 20, at 4 (noting that "negative," "reverse," or "issuer-paid" interchange fees originally went from the debit card issuer to the merchant's bank to help repay merchants for purchasing PIN terminals).

52. Mott Report, *supra* note 20, at 4 (demonstrating that an "at par" approach to debit card transactions meant that no subsidy or interchange fee was given to either issuers or merchants and that this approach was the norm in the debit card industry in the 1980s through the early 1990s).

53. *See* Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,396 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), *available at* <http://federalregister.gov/a/2011-16861>.

54. Rosenberg, *supra* note 25, at 532.

those of a credit card.⁵⁵ Motivated by the potential revenue from the higher interchange fees of signature debit cards, banks began to push customers away from PIN debit cards and their low interchange fees.⁵⁶ MasterCard soon followed Visa's lead and introduced its own signature debit card.⁵⁷ By 1998, signature debit cards were being used in the majority of debit card transactions in the United States.⁵⁸ However, with signature debit card interchange fees higher than PIN debit cards because of an increased risk of fraud,⁵⁹ some merchants were upset with the higher costs associated with these cards.⁶⁰

While tension between merchants and payment card networks issuing signature debit cards was not ultimately resolved until 2005,⁶¹ the interchange structure changed soon after signature debit cards became dominant.⁶² Debit card holders' banks began charging merchants' banks an interchange fee to pay for keeping up the debit card network and for allowing the transaction to occur.⁶³ The network

55. *See id.*; Mott Report, *supra* note 20, at 7 (showing that the payment network "honor all cards" rules forced merchants to accept Visa or MasterCard signature debit cards with their inherent risks of fraud, and as a result of these risks, merchants were subjected to higher interchange fees).

56. *See* Mott Report, *supra* note 20, at 8-9 (illustrating that bank issuance of signature debit cards increased greatly in the mid-1990s and that some banks even went as far as to charge customers a fee for PIN debit cards to force use of signature debit cards).

57. *Id.* at 7-8.

58. *Id.* at 12 (stating that signature debit cards accounted for about sixty percent of all debit card transactions in 1998 and that signature debit cards remain the preferred debit card in the United States as of 2009).

59. *Id.* at 8 (noting that MasterCard's signature debit card had the highest interchange rates in the debit market when introduced); *see also* Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722, 81,740-41 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235), *available at* <http://federalregister.gov/a/2010-32061> (illustrating that approximately \$1.15 billion of fraud losses came from signature debit card transactions and approximately \$200 million fraud losses came from PIN debit card transactions in 2009).

60. *See* Rosenberg, *supra* note 25, at 532.

61. *See id.* at 533 (citing *Wal-Mart Stores, Inc. v. Visa U.S.A. Inc.*, 396 F.3d 96 (2d Cir. 2005)) (noting that the payment card network's use of the "honor all cards" rules resulted in an antitrust lawsuit settlement of \$3 billion).

62. *See* Mott Report, *supra* note 20, at 12-13 (illustrating that Visa drove up PIN debit interchange after their signature debit card became issued in large numbers by banks); Steven C. Salop et al., *Economic Analysis of Debit Card Regulation Under Section 920 Exhibit 6* (Oct. 27, 2010) (unpublished report) [hereinafter *Salop Report*], *available at* http://www.federalreserve.gov/newsevents/files/merchants_payment_coalition_meeting_20101102.pdf (demonstrating that since 1995, signature debit cards have been used in a majority of debit card transactions with signature cards accounting for 67% of all debit card transactions in 2009).

63. *See* Todd J. Zywicki, *The Economics of Payment Card Interchange Fees and the Limits of Regulation* (Geo. Mason L. & Econ. Research, Working Paper No. 10-26, 2010),

then accounted for the debit card interchange fee in determining each issuer's and acquirer's "net settlement position."⁶⁴

Beginning with Visa's purchase of Interlink, a leading PIN debit network, in 1991, the gap between PIN based debit card interchange fees and signature fees has narrowed greatly by increases in PIN fees.⁶⁵ Because Visa increased interchange fees for PIN based debit cards to a level more comparable with signature based cards, other PIN debit networks raised their interchange fee level to keep banks issuing their particular debit card.⁶⁶ However, for most of the 1990s, the fees for PIN-based debit cards remained much lower than the fees associated with signature debit cards.⁶⁷

Around 2000, PIN-based debit card issuers and networks began to incorporate an ad valorem component – a percentage based on the value of the overall transaction – to their traditionally low interchange fees.⁶⁸ Throughout the 2000s, the levels of both fixed and ad valorem fees were raised.⁶⁹ Both signature and PIN debit fees have increased since 2004, with PIN fees increasing at a faster pace.⁷⁰ As of 2010, the difference between signature and PIN debit card interchange rates has greatly diminished.⁷¹

Debit card interchange fees have been a significant source of profit for debit card issuing banks, including credit unions.⁷² Payment

available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1624002.

64. See Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,396 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), available at <http://federalregister.gov/a/2011-16861>.

65. See Mott Report, *supra* note 20, at 12-13 (noting that at the time of Visa's purchase of Interlink, all competing PIN networks either had issuer-based interchange or at par interchange, but Visa moved Interlink's debit interchange from at par to a fixed value of \$0.45).

66. See *id.* at 12-14.

67. See Salop Report, *supra* note 62, at 9.

68. See Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,396 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), available at <http://federalregister.gov/a/2011-16861>; Mott Report, *supra* note 20, at 14 (noting that interchange fees increased by 234% between 1998 and 2006).

69. See Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,396 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), available at <http://federalregister.gov/a/2011-16861>.

70. See *Id.*

71. See Salop Report, *supra* note 62, at 10 fig. 6.

72. See Adam J. Levitin, *Interchange Regulation: Implications for Credit Unions*, FILENE RESEARCH INST., Nov. 24, 2010, at 21-26, http://www.federalreserve.gov/newsevents/files/levitin_filene_paper.pdf.

card networks reported that, in 2009, \$16.2 billion debit card interchange fees were collected with \$12.5 billion from signature debit card transactions, \$3.2 billion from PIN debit, and \$0.5 billion from prepaid cards.⁷³ As of 2009, the average interchange fee for any debit card was forty-four cents per transaction, or 1.15% of the average transaction amount.⁷⁴ Debit card issuers received an average of fifty-six cents per transaction in debit card interchange fees for signature cards, and an average of twenty-three cents per transaction for PIN debit cards.⁷⁵

III. THE EFFECT OF THE DURBIN AMENDMENT ON INTERCHANGE FEES

A. *Reasons for the Durbin Amendment*

Senator Durbin's amendment regulates a system that has allowed, according to Durbin, for "virtually no competition and no recourse for merchants exploited by the rate structures and fees" from payment card networks.⁷⁶ To regulate the interchange fee system, the Durbin Amendment intends to set fees at a level "reasonable and proportional" to the cost of a debit card transaction.⁷⁷

The Durbin Amendment broadly defines a debit card as any card "issued or approved for use through a payment card network to debit an asset account for the purpose of transferring money between accounts or obtaining goods or services, whether authorization is based on signature, PIN, or other means."⁷⁸ However, Senator Durbin

73. See Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,397 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), available at <http://federalregister.gov/a/2011-16861>.

74. *Id.*

75. *Id.*

76. Durbin Letter, *supra* note 5. But see *Durbin Amendment on Debit Interchange*, ELECTRONIC PAYMENT COALITION, <http://www.electronicpaymentscoalition.org/interchange/fedrule/durbinamendment/> (last visited Jan. 12, 2012) (stating that there were no hearings, studies, or careful examination of the Durbin Amendment; no vote in the House of Representatives; no consideration in any Congressional Committee; and very little discussion of the amendment in the Senate).

77. See Adam J. Levitin, *Symposium: Data Security and Data Privacy in the Payment System: Article: Private Disordering? Payment Card Fraud Liability Rules*, 5 BROOK. J. CORP. FIN. & COM. L. 1, 37 (2010) (quoting Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (to be codified in scattered sections of the U.S. Code)); 15 U.S.C. § 1693o-2(c)(8) (Supp. IV 2010).

78. 15 U.S.C. § 1693o-2(c)(8).

narrowly defines his purpose in proposing the Durbin Amendment as hoping to “help small businesses, merchants, and consumers by providing relief from high interchange fees for debit card transactions.”⁷⁹ Durbin believed that the current system for interchange fees created by Visa and MasterCard was “not sustainable” and only incentivized banks to issue more Visa and MasterCard debit and credit cards.⁸⁰

B. Fed’s Proposed and Final Rule

In its proposed rule published in December 2010, the Fed presented two options for implementing the Durbin Amendment: (1) issuer-specific fees up to a cap with a safe harbor⁸¹ or (2) a stand-alone cap for all issuers.⁸² Under either alternative, debit card interchange fees were capped at twelve cents per transaction.⁸³ The Fed determined that a twelve cent cap was adequate to permit a majority of issuers to recover all costs incurred in a debit card transaction.⁸⁴

After publishing its proposed rule, the Fed received over 11,000 comments from payment card networks, merchants, issuing banks, advocacy groups, and members of Congress.⁸⁵ While merchants and groups representing such merchants hoped the Fed would lower the maximum interchange fee cap even lower,⁸⁶ payment card networks and issuers protested the lower cap of twelve cents because of lost revenue and diminished debit card services.⁸⁷ Ultimately, the Fed’s final rule settled on a higher stand-alone cap.⁸⁸

79. 156 CONG. REC. S3695 (daily ed. May 13, 2010) (statement of Sen. Richard Durbin).

80. *Id.*

81. *See* Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722, 81,736 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235), *available at* <http://federalregister.gov/a/2010-32061>.

82. *Id.* at 81,738.

83. *Id.* at 81,726.

84. *See id.* at 81,737 (demonstrating that the Fed conducted a survey of issuers that showed the average per-transaction cost for a debit card purchase was thirteen cents).

85. *See* Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,402 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), *available at* <http://federalregister.gov/a/2011-16861>.

86. *See id.*

87. *See id.* at 43,420.

88. Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,404 (stating that the Fed was adopting a modified form of Alternative 2, the stand-alone cap).

To set the limitation on interchange fees in the final rule, the Fed conducted a survey of institutions covered by the new interchange fee regulation to determine costs related to issuers' debit card programs.⁸⁹ Based on the results of this survey,⁹⁰ the Fed rule limits interchange fees to a base fee of twenty-one cents per transaction plus five basis points of the transaction's value.⁹¹ For eligible issuers,⁹² an additional cent per transaction can be added to cover fraud prevention costs.⁹³ The Fed's final rule became effective October 1, 2011.⁹⁴

C. *Durbin Amendment's Small Bank Exemption*

The Durbin Amendment provides an exemption for issuers that, together with its affiliates, have assets of less than \$10 billion as of the end of the previous calendar year.⁹⁵ The purpose of this exemption was to prevent "smalltown banks, regional banks, banks that are not the big boys on Wall Street" from being hurt by the regulation of interchange

89. *Id.* at 43,432.

90. *See id.* at 43,432-34. (stating that the Fed included costs incurred in processing debit transactions, chargeback, and other similar transactions, including processing fees and monitoring costs, as well as fraud losses, in determining the twenty-one cent base fee; also demonstrating that the twenty one cent figure corresponds to the eightieth percentile of an issuer's average per-transaction costs and that five basis points is approximately the median of issuer fraud losses as determined from the Fed's survey).

91. *Id.* at 43,404.

92. *See* Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,478, 43,483 (to be codified at 12 C.F.R. pt. 235) (interim final rule, July 20, 2011) (stating that an eligible issuer must develop and implement policies and procedures designed to prevent fraud and loss of debit card and cardholder data, and review its fraud-prevention policies and procedures annually); Bud Hollenkamp, *Final Durbin Amendment "Caps" Debit Card Interchange Fees*, FINANCIAL REFORM INSIGHTS (Aug. 2, 2011), [http://www.financialreforminsights.com/2011/08/02/final-durbin-amendment-"caps"-debit-card-interchange-fees](http://www.financialreforminsights.com/2011/08/02/final-durbin-amendment-) (noting that "an issuer can be eligible if they implement policies and procedures that identify and prevent fraudulent electronic debit transactions, monitor the incidence of, reimbursements received for and losses incurred from fraudulent electronic debit transactions, respond appropriately to suspicious electronic debit transactions to limit fraud losses and prevent the occurrence of future fraudulent electronic debit transactions, and secure debit card and cardholder data").

93. *See* Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,420 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), *available at* <http://federalregister.gov/a/2011-16861>; Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,478, 43,483 (to be codified at 12 C.F.R. pt. 235) (interim final rule, July 20, 2011) (demonstrating that the fraud prevention adjustment of one cent represents the difference between the median fraud-prevention cost of nearly two cents and the median transactions-monitoring cost of nearly one cent).

94. 15 U.S.C. § 1693o-2 (Supp. IV 2010).

95. *Id.*

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fees.⁹⁶

The \$10 billion threshold will be determined based not merely by domestic assets, but by worldwide assets.⁹⁷ The Fed will compile and publish a list of banks above and below the exemption threshold, as well as collect information about the collection of debit card interchange fees.⁹⁸ These published documents should enable debit card issuers and Congress to evaluate whether the \$10 billion exemption is having any meaningful effect.⁹⁹

The small bank exemption covers almost all American community banks, credit unions, and savings banks.¹⁰⁰ The exemption from the interchange fee limit applies to 99% of banks, 99% of credit unions, and 97% of savings banks.¹⁰¹ An interchange fee exemption is not permanent, and if an exempt issuer becomes a covered issuer because of changes in asset size or affiliates, then that debit card issuer

96. 156 CONG. REC. S3697 (daily ed. May 13, 2010) (statement of Sen. Richard Durbin).

97. Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,435 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), *available at* <http://federalregister.gov/a/2011-16861> (stating that a debit card issuer qualifies for the exemption if its worldwide banking and nonbanking assets, including assets of affiliates, other than trust assets under management, are less than \$10 billion).

98. *Id.*

99. *See id.*

100. *See Small Banks and the Durbin Amendment*, MERCHANTS PAYMENTS COALITION, INC., <http://www.nacsonline.com/NACS/Government/CreditCardFees/Documents/SmallBanksandDurbinAmdt.pdf> (last visited Jan. 12, 2012)[hereinafter *Small Banks and the Durbin Amendment*]; DOB: The ABCs of Banking – Banks, Thrifts, and Credit Unions, CONNECTICUT DEPARTMENT OF BANKING, <http://www.ct.gov/dob/cwp/view.asp?a=2235&q=297886> (last visited January 12, 2012) (illustrating that commercial banks are chartered and regulated by the Office of the Comptroller of the Currency, obtain insurance from the Federal Deposit Insurance Corporation, and all commercial banks are members of the Federal Reserve System; that thrift banks are chartered by the Office of Thrift Supervision or state government regulators, insured by Savings Association Insurance Fund or the Bank Insurance Fund, and have declined in popularity after the 1980s Savings and Loan scandal; and that credit unions are formed by people with a common bond, insured by the National Credit Union Share Insurance Fund, and are usually chartered by the National Credit Union Administration).

101. *Small Banks and the Durbin Amendment*, *supra* note 100, at 1 (covering all but 86 banks, 3 credit unions and 19 savings banks in the United States). *But see* David Morrison & Claude H. Marx, *In a First, Interchange Gained Federal Regulation*, CREDIT UNION TIMES (Dec. 21, 2011), <http://www.cutimes.com/2011/12/18/in-a-first-interchange-gained-federal-regulation?t=debit-atm-shared-branching> (noting that the Raleigh, North Carolina-based State Employee's Credit Union is not exempt from the regulations of the Durbin Amendment).

must begin complying with the Durbin Amendment interchange standards no later than July 1 of the following year.¹⁰²

D. Non-Exempt Bank Reaction to the Final Rule

While some see the implementation of the Durbin Amendment as a step in the right direction, non-exempt banks are scrambling to make up for revenues lost from the almost fifty percent reduction in interchange fee revenue.¹⁰³ Many banks considered elimination of free checking or imposing explicit charges for using debit cards to make purchases to try to recoup lost interchange fee revenue.¹⁰⁴ In 2009, roughly 96% of large banks offered some form of free checking, but these free accounts typically had some restrictions, such as minimum balances of a relatively large amount.¹⁰⁵ In 2011, however, only 34.6% of big banks offered free checking.¹⁰⁶ Banks, such as JPMorgan Chase, SunTrust, and Bank of America, removed their rewards programs, stopped offering certain types of accounts, or contemplated charging customers for deposit accounts that previously were free.¹⁰⁷ By September 2011, Wells Fargo had begun testing a \$3 a month debit card usage fee in some states,¹⁰⁸ but by the beginning of November, Wells

102. See Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,437 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), available at <http://federalregister.gov/a/2011-16861>.

103. See Maria Aspan, *Small Banks Still Bracing for Durbin, Despite Exemption*, AM. BANKER, Sept. 6, 2011 [hereinafter *Small Banks Bracing*], available at http://www.americanbanker.com/issues/176_173/debit-interchange-exemption-free-checking-small-banks-1041938-1.html; Citigroup, *Bank of America struggling*, UNITED PRESS INT'L (Jan. 16, 2009), http://www.upi.com/Business_News/2009/01/16/Citigroup-Bank-of-America-struggling/UPI-10611232115107 (noting that regardless of this recent regulation on interchange fees, banks have been struggling to maintain revenues in recent times).

104. *Small Banks Bracing*, *supra* note 103.

105. Maria Aspan, *Free Checking Thrives at Smaller Banks, Durbin Notwithstanding*, AM. BANKER, Aug. 29, 2011 [hereinafter *Free Checking*], available at http://www.americanbanker.com/issues/176_168/free-checking-durbin-debit-interchange-1041641-1.html?zkPrintable=1&nopagination=1.

106. *Id.*; see also Sandra Block, *Like Your Free Checking Account? Prepare To Say Goodbye*, USA TODAY (Sept. 26, 2011), <http://www.usatoday.com/money/perfi/credit/story/2011-09-23/checking-account-fees/50548182/1> (noting that banks are offering customers fewer free checking accounts and have increased fees associated with checking accounts).

107. *Free Checking*, *supra* note 105.

108. Will Hernandez, *Wells Fargo Tests a \$3 Monthly Debit Card Fee in Five States*, AM. BANKER, Aug. 17, 2011, available at http://www.americanbanker.com/issues/176_160/wells-fargo-debit-fee-1041282-1.html.

Fargo ended this monthly fee test.¹⁰⁹

However, because of intense public backlash, most banks have backed off on proposed monthly charges for the use of debit cards.¹¹⁰ Some banks have not completely removed fees, but instead have changed the requirements to make it easier for consumers to avoid the fees.¹¹¹ While these banks have made concessions because of consumer backlash, some fear that banks will now make up the lost revenue in less obvious ways¹¹² and that the proposed monthly fees were actually better for consumers.¹¹³

For example, banks are now considering limiting the size of transactions possible with their debit cards.¹¹⁴ These debit card transaction caps would prevent customers from purchasing expensive items with low interchange fees.¹¹⁵ Both Bank of America and Chase have threatened to limit debit transactions to somewhere between \$50 and \$100.¹¹⁶

109. Marcia Kaplan, *Banks React to Durbin Amendment*, PRACTICAL ECOMMERCE (Nov. 4, 2011), <http://www.practicalecommerce.com/articles/3142-Banks-React-to-Durbin-Amendment> (noting that all banks, including SunTrust, Bank of America, Wells Fargo, and J.P. Morgan, that threatened to implement fees have backed off from that position).

110. See Martha C. White, *Banks Back Off Unpopular Debit Card Fees*, TIME MONEYLAND (Oct. 31, 2011, 3:30 PM), <http://moneyland.time.com/2011/10/29/banks-back-off-unpopular-debit-card-fees/>.

111. *Id.*

112. See Laurie Winslow, *Banks Likely to Look for New Ways to Replenish Revenue*, TULSA WORLD (Nov. 13, 2011), http://www.tulsaworld.com/business/article.aspx?subjectid=51&articleid=20111113_51_E1_ULNSan677104&allcom=1 (including raising existing fees or introductory rates on credit cards). But see Claude R. Marx, *Durbin Calls on CFPB to Mandate Checking Fee Disclosures*, CREDIT UNION TIMES (Nov. 3, 2011), <http://www.cutimes.com/2011/11/03/durbin-calls-on-cfpb-to-mandate-checking-fee-disclosure> (noting that Senator Durbin has asked the Consumer Financial Protection Bureau to require banks to disclose all fees related to checking accounts).

113. See Neil Weinberg, *Why I Love Bank Fees and Regulators Should Too*, AM. BANKER, Jan. 4, 2012, available at <http://www.americanbanker.com/bankthink/Why-I-Love-Bank-Fees-So-Should-Regulators-1045441-1.html> (illustrating that the upfront fee that many banks tried to charge customers is a much better method than the traditional sneaky approach of indirect fees); Kalyan Nandy, *Are Banks Charging You on the Sly?*, ZACKS INV. RESEARCH (Nov. 15, 2011), <http://www.zacks.com/stock/news/64682/Are+Banks+Charging+You+on+the+Sly%3F> (illustrating that some banks, such as Bank of America and Citi, have increased costs for amenities associated with checking accounts that are less transparent than the proposed upfront fees).

114. See R. Christian Bruce, *Retailers Vow Challenge to Fed Debit Rule As Bankers, Payment Firms Tweak Strategy*, BANKING DAILY (BNA), July 1, 2011.

115. See *id.*

116. Chen, *supra* note 7.

The purpose of putting a ceiling on the dollar amount of debit card purchases is solely to help the bottom line of banks, as consumers would be forced to use credit cards – which still carry higher interchange fees – rather than debit cards for big ticket purchases.¹¹⁷ Thus, debit card issuers are actively trying to push customers from debit cards to credit cards or prepaid debit cards.¹¹⁸ These payment cards do not fall under the Durbin Amendment’s regulation of interchange fees.¹¹⁹ An unseen battle is emerging between retailers that hope consumers use debit cards because of low interchange fees and banks hoping to push consumers to payment cards with higher fees.¹²⁰

E. Dilemma for Exempt Banks Post-Durbin Amendment

While larger banks are more willing to drop customer rewards programs and add fees, small banks are hesitant to raise fees related to checking accounts and debit cards.¹²¹ Community banks and credit unions simply “cannot afford to alienate customers by charging for services that are now free.”¹²² Free checking has allowed smaller community banks and credit unions to set themselves apart from large banks.¹²³ Thus, smaller banks may have the chance to obtain new customers who leave larger banks because of new fees.¹²⁴

117. See *Banks May Limit Debit Card Transaction Size to Fight Fee Limit*, CREDIT CARD PROCESSING BLOG (Mar. 14, 2011, 9:42 AM), <http://blog.unibulmerchantservices.com/banks-may-limit-debit-card-transaction-size-to-fight-fee-limit/>.

118. See Chen, *supra* note 7; Jim Kim, *More Banks Push Customers to Credit Cards*, FIERCEFINANCE (Sept. 22, 2011, 10:30 AM), <http://www.fiercefinance.com/story/more-banks-push-customers-credit-cards/2011-09-22> (noting that Citi has sent more than 346 million card offers in North America and that almost 15 million new credit cards have been issued in the first five months of 2011).

119. See Chen, *supra* note 7 (predicting that banks will “try to push customers toward credit cards and prepaid debit cards, which escaped interchange fee regulation”); Daniel F.C. Crowley et al., *5th Annual Judicial Symposium on Civil Justice Issues: George Mason Judicial Education Program: Dec. 5-7, 2010: Edited Transcripts: Perspectives on Dodd-Frank Wall Street Reform and Consumer Prot. Act*, 7 J.L. ECON & POL’Y 307, 319 (2010).

120. See Jean Chatzky, *Debit Card Fees a Rising Issue as Banks Implement New Charges for Cashless Exchanges*, NYDAILYNEWS.COM (Sept. 21, 2011), http://www.nydailynews.com/money/2011/09/21/2011-09-21_land_of_the_fee_bank_on_it.html.

121. See *Small Banks Bracing*, *supra* note 103.

122. *Id.*

123. *Id.*

124. *Id.*

However, small banks may have no choice but to change their debit card issuing process to maintain efficiency.¹²⁵ These banks fear that if they offer banking services below actual cost, such as free checking, then fees will have to be added to other products.¹²⁶ If forced to drop their free checking programs, these banks believe that some low-income customers may have to use check cashing or small loan firms instead of the banking system.¹²⁷

Losing interchange fee income would have a significant impact on smaller banks' ability to make enough profit to cover their debit card programs.¹²⁸ These smaller banks are concerned that costs will have to be passed on to the consumer.¹²⁹ The Federal Deposit Insurance Corporation (FDIC) is also worried that the interchange fee limitations of the Durbin Amendment will cause smaller banks to recoup their losses by charging customers more.¹³⁰ The Durbin Amendment, according to the FDIC, will put pressure on "community bank bottom lines, as well as their competitive positions."¹³¹

IV. THE DURBIN AMENDMENT'S POTENTIAL NEGATIVE IMPACT ON SMALL BANKS

While most small banks are exempted from the debit interchange fee ceiling, payment card networks are not required to

125. See Bruce, *supra* note 114.

126. See Letter from Mark S. White, President and CEO, Osage Fed. Bank, to Jennifer Johnson, Sec'y, Bd. of Governors of the Fed. Reserve Sys. (Jan. 31, 2011), *available at* <http://electronicpaymentscoalition.org/downloads/Osage%20Federal%20Bank.pdf>.

127. See *id.*; Tim Chen, *Why 7.7% of Americans Are Unbanked*, FORBES (Jan. 3, 2011), <http://www.forbes.com/sites/moneybuilder/2011/01/03/why-7-percent-of-americans-are-unbanked> (demonstrating that the unbanked tend to be minorities that have been turned away from banks in the past and now rely on alternative financial services, including cash checking businesses payday loans, that can charge high levels of interest and are not FDIC-insured).

128. See Letter from Karen Frilseth, Vice President Compliance, City and County Credit Union, to Ben S. Bernanke, Chairman, Bd. of Governors of the Fed. Reserve Sys. (Jan. 21, 2011), *available at* <http://electronicpaymentscoalition.org/downloads/City%20and%20County%20Credit%20Union.pdf>.

129. *Id.*

130. See Letter from Shelia C. Bair, Chairman, Fed. Deposit Ins. Corp., to Ben S. Bernanke, Chairman, Bd. of Governors of the Fed. Reserve Sys. 2 (Mar. 10, 2011) [hereinafter FDIC Letter], *available at* http://www.fsround.org/fsr/dodd_frank/pdfs/FDICInterchangeCommentLetter3.10.11.pdf.

131. *Id.*

create a two-tier debit card interchange fee structure.¹³² The Fed has no specific authority to require payment card networks to implement the small bank exemption in any particular way.¹³³ Ultimately, the effectiveness of the Durbin Amendment's exemption is in the hands of the payment card networks, especially Visa and MasterCard, and will depend on whether they are willing to maintain two-tier interchange structures long-term.¹³⁴

Smaller banks are afraid that networks, such as Visa and MasterCard, will simply cap fees at the interchange fee of non-exempt banks because of "market-driven factors not addressed" in the Fed's final rule.¹³⁵ While Visa acknowledged that a two-tier system would be "hard to implement operationally,"¹³⁶ the payment card network has created an interchange fee structure for exempt and non-exempt banks.¹³⁷ MasterCard followed Visa's lead and announced in August 2011 plans for a two-tier interchange fee structure for exempt and non-exempt banks.¹³⁸ However, smaller banks still fear that even though payment card networks have decided to establish two-tiered systems in the abstract, the realities of maintaining this system will be too much¹³⁹ and that the true impact of the Durbin Amendment will not be immediately felt.¹⁴⁰ Presently, both MasterCard¹⁴¹ and Visa¹⁴² have

132. Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,436 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), available at <http://federalregister.gov/a/2011-16861>.

133. *Id.*

134. See *Small Banks Bracing*, *supra* note 103.

135. See FDIC Letter, *supra* note 130, at 1; *The Durbin Amendment "Carve-Out" for Small Banks and Credit Unions Will Not Work*, ELECTRONIC PAYMENTS COALITION, <http://www.electronicpaymentscoalition.org/downloads/whythecarveoutwontwork21511.pdf> (last visited January 12, 2012) (noting that market pressure will result in one fixed rate being applied to all issuers).

136. *Visa Commits to a Two-Tier Debit Card Interchange Structure*, DIGITAL TRANSACTIONS (Jan. 7, 2010), <http://www.digitaltransactions.net/news/story/2861>.

137. Sposito, *supra* note 17.

138. *Small Banks Bracing*, *supra* note 103.

139. See FDIC Letter, *supra* note 130; Trade Ass'n Letter, *supra* note 4, at 46.

140. See *Small Banks Bracing*, *supra* note 103; Andrew Jennings, *Adapting to New Interchange Rules on Debit Cards*, FICO BANKING ANALYTICS BLOG, (Dec. 15 2011, 10:00AM), <http://bankinganalyticsblog.fico.com/2011/12/adapting-to-new-interchange-rules-on-debit-cards.html> (demonstrating that experts believe that, within two or three quarters, competitive market forces will force the interchange fees paid by exempt banks to be closer to those paid by non-exempt banks).

141. *MasterCard Worldwide: U.S. and Interregional Interchange Rates*, MASTERCARD WORLDWIDE, (October 2011), http://www.mastercard.com/us/merchant/pdf/MasterCard_Interchange_Rates_and_Criteria.

two-tiered interchange fee rates in place.

Nothing in the Durbin Amendment prevents payment card networks from “unilaterally reduc[ing] interchange fees on credit unions and banks.”¹⁴³ Without specific authority granted to the Fed, MasterCard and Visa have wide latitude to adjust their fee structures to maximize their own profits to the detriment of small banks.¹⁴⁴ For example, MasterCard and Visa have recently decided to raise the fees that merchants have to pay for small debit purchases.¹⁴⁵ Merchants may discourage customers from using debit cards for small purchases because of these increased fees.¹⁴⁶ The payment card networks have acknowledged that these changes for small value purchases are a primarily a result of the Fed’s final rule on the Durbin Amendment.¹⁴⁷

Payment card networks are trying to “strike that right balance between driving value to the consumer and the merchant on small ticket” purchases.¹⁴⁸ Some merchants where small purchases are the norm, such as coffee shops, have already had issues with the cap on interchange fees.¹⁴⁹ While Visa and MasterCard had previously

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142. Visa U.S.A. Interchange Reimbursement Fees, VISA, (October 2011), <http://usa.visa.com/download/merchants/visa-usa-interchange-reimbursement-fees-october2011.pdf>.

143. Durbin Letter, *supra* note 5 (illustrating that small banks are fearful that Visa and MasterCard may choose to use their market power against them).

144. See Trade Ass’n Letter, *supra* note 4, at 46; Eamon Murphy, *How Durbin’s Debit Card Fee Backfired on Small Merchants*, DAILYFINANCE (Dec. 8, 2011, 4:15PM), <http://www.dailyfinance.com/2011/12/08/how-durbins-debit-card-fee-cut-backfired-on-small-merchants> (noting that MasterCard’s president for U.S. markets said “[t]here will always be some unhappy parties when the government gets in the way of the free-market system.”).

145. See Andrew R. Johnson, *MasterCard, Visa Raising Small Debit Buy Fees*, MARKETWATCH (Sept. 22, 2011, 3:11 PM), <http://www.marketwatch.com/story/mastercard-visa-raising-small-debit-buy-fees-2011-09-22>.

146. See *id.*

147. See *id.*

148. *Id.*

149. See *Durbin Amendment has Unintended Consequences for Some Businesses*, CREDIT CARD PROCESSING (Dec. 14, 2011, 11:19 AM), <http://www.creditcardprocessing.net/durbin-amendment-has-unintended-consequences-for-some-businesses/> (noting that before the Durbin Amendment, merchants only paid between six and seven cents of interchange for a one dollar transaction, but now must pay the maximum fee of around twenty one cents and also that while bigger businesses may be able to directly negotiate with payment networks to get better fees, smaller businesses do not do enough business to influence MasterCard or Visa); Emily Jed, *USAT Ends MasterCard Debit Transactions*, VENDING TIMES (Dec. 6, 2011), <http://www.vendingtimes.com/ME2/dirmod.asp?sid=EB79A487112B48A296B38C81345C8C7F&nm=Vending+Features&type=Publishing&mod=Publications::Article&mid=8F3A7>

provided special pricing for small-amount debit transactions, these payment card networks have now set interchange fees at the maximum amount allowed under the Durbin Amendment even for small purchases.¹⁵⁰ Therefore, while the two-tiered structure seems to be in place, changes can swiftly happen as merchants, consumers, debit card issuers, and payment card networks must deal with the consequences of regulating interchange fees.¹⁵¹

The Federal Reserve Chairman Ben Bernanke has stated that the Fed is not exactly sure how effective the exemption will be for smaller banks.¹⁵² These uncertainties emerge because multiple factors will affect the exemption's functionality and cost-effectiveness for both payment card networks and merchants.¹⁵³ While the Fed adopted its final rule after Visa – which processes more than eighty percent of debit card volume – announced its intention to have a two-tiered fee structure, the Fed still lacks the regulatory power to compel payment networks to maintain these structures long-term.¹⁵⁴

Payment card networks also have expressed issues with differentiating between a card issued by an exempt bank and a card from a non-exempt bank because smaller bank-issued cards use the same Bank Identification Numbers (BINs) as larger banks.¹⁵⁵ According to Visa CEO Byron Pollitt, his company “do[es] not have the capacity to differentiate those BINs at the point of sale.”¹⁵⁶ Because of

027421841978F18BE895F87F791&tier=4&id=7DFA2EC87D29460DA1E632840193C153 (demonstrating that the hard cap on interchange fees has a disproportionate impact on merchants who sell products for less than \$11).

150. Jennings, *supra* note 140 (illustrating that some convenience stores and fast food restaurants have begun asking customer not to use debit cards as a method of payment); *see also Another Durbin Amendment Side Effect Gets the Limelight*, CREDIT CARD PROCESSING BLOG (Dec. 12, 2011, 10:30 AM), <http://blog.unibulmerchantservices.com/another-durbin-amendment-side-effect-gets-the-limelight>.

151. *See* Johnson, *supra* note 145; Thecla Fabian, *Fed Ignores Competitive Impact Analysis Required for Interchange Rule, Experts Say*, BANKING DAILY (BNA), Mar. 8, 2011 (stating that the Federal Reserve has not prepared a competitive impact analysis of the interchange fee regulation).

152. *See* Trade Ass'n Letter, *supra* note 4, at 47.

153. *See id.*

154. *See* Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,436 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), *available at* <http://federalregister.gov/a/2011-16861>.

155. *See Small Institutions to Durbin Amendment: Thanks, But No Thanks*, DIGITAL TRANSACTIONS (June 9, 2010), <http://www.digitaltransactions.net/index.php/news/story/2551>.

156. *Id.*

this inability, payment card networks will have to solve this problem before implementing any two-tiered interchange fee structure.¹⁵⁷ An alternative – to “simply issue new cards with specific BINs to smaller institutions” – has been dismissed as cost-prohibitive.¹⁵⁸ Thus, payment card networks have been forced to develop the ability to identify exempt debit cards when exempt banks use the same BINs and agents as larger issuers of debit cards.¹⁵⁹ However, some have claimed that payment card networks overstated these issues as a tactic to make credit unions and non-exempt banks continue to lobby Congress to not implement the Durbin Amendment.¹⁶⁰

The goal of the Durbin Amendment is to set interchange fees at a level reasonable for merchants.¹⁶¹ However, small banks are concerned that merchants will pick and choose which card they accept in order to minimize larger interchange fees.¹⁶² Even with major payment card networks adopting two-tier interchange fee structures, merchants may merely decide to make consumers not use debit cards issued by smaller bank debit cards.¹⁶³

Although small banks are nervous, the Fed has assured these banks that no part of the Durbin Amendment can be interpreted to allow any person or merchant to discriminate between debit cards based on the card’s issuer.¹⁶⁴ Merchants would face a negative backlash from

157. *See id.*

158. *Id.*

159. *See* California Bankers Association Compliance Bulletin, *Analysis of Dodd-Frank Act: The Durbin Amendment (Debit Card Interchange Fee Regulation)* (Aug. 16, 2010), <http://www.calbankers.com/compliance-bulletin/analysis-dodd-frank-act-durbin-amendment-debit-card-interchange-fee-regulation>.

160. Sposito, *supra* note 17.

161. *See* Durbin Letter, *supra* note 5.

162. *See id.*; Robin Sidel, *Debit-Fee Cap Has Nasty Side Effect*, WALL ST. J. (Dec. 8, 2011),

<http://online.wsj.com/article/SB10001424052970204319004577084613307585768.html> (noting that Dairy Queen has told franchises to steer customers away from using their debit cards as a method of payment, especially for purchases under \$10).

163. Martin Baily & Robert E. Litan, *Toward Reasonable Regulation of Debit Card Interchange Fees: The Case for Modifying the Fed’s December 16, 2010 Proposals*, THE FINANCIAL SERVICES ROUNDTABLE (Feb. 22, 2011), http://www.fsround.org/fsr/dodd_frunk/pdfs/ReasonableInterchangeFeeRegulationExecutiveSummary.pdf. *But see* Durbin Letter, *supra* note 5 (stating that the Durbin Amendment requires a merchant who accepts a debit card from a large bank to also accept a debit card from small banks and credit unions).

164. *See* Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,436 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235), *available at* <http://federalregister.gov/a/2011-16861>.

customers if they refused to accept debit cards from certain banks.¹⁶⁵ The merchant's top priority is not minimizing debit card interchange fees, but instead to make as many sales as possible.¹⁶⁶ No portion of the Durbin Amendment explicitly allows merchants to treat bank issuers differently.¹⁶⁷

V. THE FUTURE OF THE DURBIN AMENDMENT

The implementation of the Fed's final rule has created a great deal of complaints from consumers and from Congress¹⁶⁸, and even from merchants – the group the Amendment was supposed to help.¹⁶⁹ Backlash from customers has already resulted in non-exempt banks backing off of the idea of proposed monthly fees for debit card use.¹⁷⁰ Customers were upset with banks charging usage fees for their existing checking accounts and debit cards.¹⁷¹ Additionally, customers may not see any benefits in the form of lower prices from merchants.¹⁷² Despite

165. *Id.*

166. See Andrew Kahr, *Never Mind the Lobbyists, Durbin Amendment Helps Small Banks*, AM. BANKER, Mar. 3, 2011, available at <http://www.americanbanker.com/bankthink/never-mind-the-lobbyists-durbin-amendment-helps-small-banks-1033898-1.html> (demonstrating that selective acceptance of cards by merchants been an extremely rare occurrence).

167. See *Small Banks and the Durbin Amendment*, *supra* note 100, at 3.

168. Halah Touryalai, *New Bill Aims to Kill Durbin's Debt Card Fees*, FORBES (Oct. 13, 2011), <http://www.forbes.com/sites/halahtouryalai/2011/10/13/new-bill-could-kill-durbins-debit-card-fees>.

169. Ernest Patrikis, *Both the Merchants and the Fed Misread Durbin*, AM. BANKER, Dec. 15, 2011, available at <http://www.americanbanker.com/bankthink/both-the-merchants-and-the-fed-misread-durbin-1044930-1.html> (noting that a group of retailers and retail associations have brought suit against Fed because requirements of the Durbin Amendment are 'arbitrary, capricious and an abuse of discretion'); see also *Retailers Taking Legal Action Against Federal Reserve over Durbin Amendment*, CREDIT CARD PROCESSING (Dec. 23, 2011, 11:53 AM), <http://www.creditcardprocessing.net/retailers-taking-legal-action-against-federal-reserve-over-durbin-amendment/>.

170. Kalyan Nandy, *BofA Calls Off Debit-Card Fee*, ZACKS INVESTMENT RESEARCH (Nov. 2, 2011), <http://www.zacks.com/stock/news/63909/BofA+Calls+Off+Debit-Card+Fee>.

171. Maria Aspan, *Wells Fargo Abandons Debit-Fee Plans Amid Backlash*, AM. BANKER, Oct. 28, 2011, available at http://www.americanbanker.com/issues/176_210/wells-fargo-debit-card-fees-checking-bank-of-america-1043641-1.html.

172. *Fast Facts: Impact of the Durbin Amendment for Consumers*, THE FINANCIAL SERVICES ROUNDTABLE (Nov. 2011), www.fsround.org/fsr/pdfs/fast-facts/2011-11-16-impactdurbinamendmentconsumers.pdf (noting that merchants are not legally required to pass on savings from the Durbin Amendment to consumers and that forty-one percent of merchants reported they will not pass on lower debit card costs to consumers); see also David Morrison, *New Research Charges Retailers With Pocketing Interchange*,

these consumer complaints, debit cards continue to help banks' bottom lines and play an important part in bringing customers into banks, and thus, banks will work within the new regulations to maintain their debit card programs.¹⁷³

With much of the focus on customer issues with non-exempt banks, the bipartisan Consumer Debit Card Protection Act¹⁷⁴ has been introduced in the House of Representatives and would repeal the Durbin Amendment because of its harmful impact on customers and banks.¹⁷⁵ The bill has currently been referred to the House Financial Services committee, as well as the House Financial Services' Subcommittee on Financial Institutions and Consumer Credit.¹⁷⁶ However, while customer protests were successful in getting non-exempt banks to change course, the bill may have a difficult time receiving the sixty votes needed for approval in the Senate.¹⁷⁷

Groups, such as the Merchants Payment Coalition, oppose a possible repeal of the Durbin Amendment, claiming that members of Congress are in the pocket of big banks.¹⁷⁸ However, the American Bankers Association has come out in support of the bill asserting that government price-fixing has merely transferred the cost of items from retailers to consumers.¹⁷⁹ Others in support of the repeal of the Durbin Amendment argue that the Amendment inaccurately measures the cost of debit cards by each transaction, and that debit card transactions are actually advantageous for merchants.¹⁸⁰

CREDITUNION TIMES (Dec. 9, 2011), <http://www.cutimes.com/2011/12/09/new-research-charges-retailers-with-pocketing-inte> (demonstrating that consumers are paying more for items after the implementation of the Durbin Amendment).

173. Kate Fitzgerald, *Debit Still Drives Overall Profits, Big Bank Execs Say*, AM. BANKER, Nov. 4, 2011, available at http://www.americanbanker.com/issues/176_215/debit-card-profitability-formula-pricing-durbin-1043831-1.html.

174. 157 CONG. REC. H6853 (daily ed. Oct. 12, 2011).

175. Touryalai, *supra* note 168.

176. 157 CONG. REC. H6853 (daily ed. Oct. 12, 2011).

177. See Kevin Wack, *New Anti-Durbin Effort Starts in House*, AM. BANKER, Oct. 12, 2011, available at http://www.americanbanker.com/issues/176_198/durbin-amendment-repeal-bill-jason-chaffetz-1043095-1.html (noting that it was unclear whether the bill would lead to a serious push in Congress to repeal the Durbin Amendment).

178. Touryalai, *supra* note 168.

179. *Id.*

180. Richard A. Epstein, *Dick's Debit-card Dud*, NEW YORK POST (Oct. 6, 2011, 4:26 AM),

http://www.nypost.com/p/news/opinion/opedcolumnists/dick_debit_card_dud_w1VfZwHwJTR79g8s8go06H (noting that the Amendment also causes perverse market dynamics because large banks are forced to raise fees and lose customers or keep fees low and lose

While attempts to repeal his amendment are ongoing,¹⁸¹ Senator Durbin has attempted to strengthen the small bank exemption by directing the Federal Trade Commission (FTC) to report on the success of the exemption.¹⁸² The language of FTC oversight was inserted into a regulatory funding bill, which was passed by the Senate.¹⁸³ The FTC report would discuss whether the payment card networks are preventing exempt banks from competing with non-exempt and whether the networks are working together with non-exempt banks in an anti-competitive fashion.¹⁸⁴ However, because the provision was merely report language, the FTC's report about the success of the small bank exemption and any evidence of collusion would have no legal effect.¹⁸⁵

VI. CONCLUSION

The Fed's final rule on the Durbin Amendment became effective October 1, 2011. As a result, it is not yet clear how issuing banks and merchants will respond. So far, many large banks have decided not to eliminate free checking for their customers, and the payment networks have committed to a two-tiered fee structure to accommodate smaller banks not subject to the interchange fee cap. While the Durbin Amendment exempts banks with less than \$10 billion in worldwide assets from the fee cap, the lack of authority for the Fed to mandate a two-tier interchange fee system increases the possibility that this exemption will be ineffective. If the Fed had interpreted the Durbin Amendment to give them this regulatory power, many of the issues that small banks have with the exemption would be eliminated. While the

revenue on each transaction).

181. *Bold Predictions, Part I – Durbin Rewrites Durbin*, AM. BANKER, December 29, 2011, available at http://www.americanbanker.com/bankthink/Bold-Predictions-2012-Durbin-Rewrites-His-Rule-1045289-1.html?ET=americanbanker:e9273:2295048a:&st=email&utm_source=editorial&utm_medium=email&utm_campaign=AB_Intraday_010312 (illustrating that some experts believe that the Durbin Amendment will either be repealed or rewritten in 2012).

182. Kevin Wack, *Durbin Seeks To Beef Up Small-Bank Interchange Exemption*, AM. BANKER, Nov. 1, 2011, available at http://www.americanbanker.com/issues/176_212/durbin-interchange-debit-fee-ftc-collusion-1043734-1.html.

183. *Id.*

184. *Id.* (noting that Durbin may trust the FTC more than the Fed to be tough on payment card networks and large banks).

185. See *Congress Reaches Appropriation Agreement*, AM. BANKERS ASS'N (Dec. 16, 2011), <http://reformtracker.aba.com/2011/12/congress-reaches-appropriations.html>.

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Fed rightly has placed itself in charge of publishing lists of exempt banks and monitoring annually the progress of its final rule, it should have extended its authority to regulate the two-tier interchange structure within its regulatory power. It is illogical that the Durbin Amendment would attempt to regulate an industry that has greatly lacked regulation, but then back off when it is possible to really make the Durbin Amendment's goal a reality. In passing the Durbin Amendment, Congress has decided to interfere with free market in setting a maximum interchange fee, but has not reserved the power to regulate the payment card networks in establishing and maintaining a two-tiered system.

Therefore, the ultimate success of this exemption depends on the payment card networks, especially Visa and MasterCard that have dominated the debit card market, living up to what they have promised. Senator Durbin has increased the likelihood of these payment card networks playing by the rules through the inclusion of an FTC report on the effectiveness of the small bank exemption. However, these payment card networks can still decide, based on any number of factors, to destroy at any time the exemption's purpose and intent by abandoning a two-tier interchange fee model. While the Fed did make its final rule less drastic than originally proposed, the Fed will regret not giving itself more strength to force payment card networks to maintain the small banks exemption in the post-Durbin financial landscape.

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