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Limiting debit card swipe fees: losers and winners

WRITTEN BY: FRANK KALMAN ON JULY 1, 2010 NO COMMENT

Source: www.Debit-Machines.com

With the biggest overhaul of the country's financial rules successfully passed by the U.S. House of Representatives Wednesday, and a vote in the Senate expected after the brief July 4 recess, some clear winners and losers are emerging on at least one of the provisions tucked into the historic legislation.

That is, the rule on merchant interchange fees, also known as "swipe fees," or the amount of money a lender gets from a merchant when a consumer uses a lender-issued debit card at a store. For instance, if I buy a pack of gum with my debit card at the grocery store, the grocer is paying the bank—the institution that issued me that debit card—a small fee for the transaction, typically 1 to 2 percent of the transaction.

What the provision in the financial overhaul bill would do—if it becomes law, of course—is set a limit on debit swipe fees, which generated $20 billion in revenue for Visa and Mastercard banks in 2008. The provision in the bill would require these institutions to reduce swipe fees to "reasonable and proportional" levels.

Losers of the swipe fee provision: credit unions and community banks

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Smaller banks and credit unions that don't typically get involved in high stakes investment securities as a source of income are highly dependent on the revenue they generate from fees, such as swipe fees.

The Independent Community Bankers of America, a community banking lobbying firm, highlights the distaste small lenders have toward the provision in a recent statement:

> This 'compromise' proposal will only compound the harm to consumers and Main Street by imposing new and onerous burdens on debit card issuers, and will fail in any way to adequately account for the significant operational costs and losses incurred by community banks due to fraud and merchant data breaches.

However, as Robert Livingstone, owner of Ideal Cost, a merchant consulting firm, reminded me: Community banks and credit unions with under $10 billion in assets will be excluded from the debit interchange limits.

Despite this, he noted in an e-mail Thursday, "if larger bank chains have to limit their debit interchange fees and smaller banks do not, merchants are going to seek out whichever solution is cheaper for them to accept." He said because of this, "merchants will ask customers to use another credit card from a major bank instead of their community bank," or credit union.

Livingstone notes smaller lenders often outsource their processing capabilities for these transactions, therefore they wouldn't be losing direct revenue from from their own debit interchange fees, he said, "but rather referral commissions to the third party processor."

Credit unions face similar stress on their fee income. A credit union is a non-profit, financial cooperative, basically running a break-even business (profits are put back into the system instead of paid out as dividends to shareholders).

"There are going to have to be some hard, difficult choices," stressed Fred Becker, president of the National Association of Federal Credit Unions, a credit union lobbying arm based in Arlington, Va.

"In the end, they have to make money," Becker said, "It's a business. You won't be around for long if you don't [make money]," he said in a phone interview Wednesday.

Last month, I profiled First Northern Credit Union—a small, $250 million asset credit union based in Chicago—and interviewed CEO Ed Berg and Senior Vice President Alex Malone. Both executives voiced concern over how the potential of limits on interchange fees would pressure the business model of all credit unions.

"I do think free checking accounts may become a thing of the past," Berg responded in an e-mail Thursday. "It is just too early to tell. Competition and economics will dictate what we do."

If big banks decide to eliminate their free checking account options as a result of the new rules, credit unions may be forced to follow suit.

"Credit unions have often had to follow what occurs in the industry, anyhow," Malone said last month.

Winners of the interchange fee rule: merchants

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No surprise here that retailers and small businesses are rejoicing at the idea of a swipe fee limit on lender-issued debit cards, which the National Retail Federation has called "unfair" and "outrageously out of proportion."

"This legislation will reduce debit card swipe fees and, in turn, help retailers hold down prices for their customers. It will also make it easier for retailers to give a discount to customers who choose to save money in return for not using a credit card," said Mallory Duncan, senior vice president and general counsel of the National Retail Federation.

The National Small Business Association said the potential increase in revenues generated by the interchange fee limitation should–in theory– be a boost to small businesses still fighting off the worst of the recession.

Unknowns

The Durbin amendment, named after its author, Illinois Democratic Sen. Dick Durbin, doesn't specify the actual amount businesses would save, Livingstone said, but "only states that the Fed [The Federal Reserve] will make sure interchange fees are not 'unreasonable.'"

Also, since the law would only limit the fees imposed on debit card transactions, merchants that accept a higher volume of credit card transactions "will actually be losing *more* money in this scenario," Livingstone wrote in the e-mail.

"Someone is going to have to pay the Fed to do all of this work. The money will either come from American tax payers or there will be some kind of additional tax or fee passed onto merchants by processors to compensate the Fed."

Tags: community banks, credit unions, financial reform, First Northern Credit Union, free checking accounts

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