WASHINGTON UPDATE

Incentive Federation, Inc. George B. Delta, Esq.

June 21, 2024 (703) 582-7040 gdelta@verizon.net

The Proposed Credit Card Competition Act of 2023 Might

Make It Easier to Eliminate Credit Card Rewards Programs

On June 7, 2023, a bipartisan group of legislators led by Sen. Dick Durbin (D-IL), Sen. Roger Marshall, M.D. (R-KS), Sen. Peter Welch (D-VT), and Sen. J.D. Vance (R-OH) introduced H.R. 3881/S.1838, the Credit Card Competition Act of 2023 (the “CCC Act”), in an effort to change the way credit card transactions are processed thereby lowering credit card processing fees. The duopoly of Visa and Mastercard controls over 80 percent of the U.S. credit card network market, and every time someone uses a Visa or Mastercard credit card, an average fee of 2 to 3 percent is imposed on and deducted from the transaction amount the merchant actually receives. Visa and Mastercard keep some of that fee for themselves as a network fee, but most of it is an interchange fee that is fixed by Visa and Mastercard but paid to the bank that issued the card. As a result, a merchant typically ends up receiving $97 or $98 on a $100 sale.

In contrast, such credit card fees are lower in other countries. The EU regulates consumer credit cards strictly, and in 2015 the European Parliament imposed a cap of 0.3 percent on interchange fees. (Corporate cards do not have caps on interchange fees.) (<https://ec.europa.eu/commission/presscorner/detail/en/IP_15_4585>) According to a multi-country survey published by Fumiko Hayashi and Jesse Leigh Maniff, two payments policy advisors/specialists at the Federal Reserve Bank of Kansas City, “Public Authority Involvement in Payment Card Markets: Various Countries” (August 2020 Update), China and Australia have similar regulations resulting in interchange fees of 0.45 percent and 0.5 percent, respectively. Canada has no formal regulation of fees, but Canada’s Department of Finance convinced Visa and Mastercard to voluntarily cap their interchange fees at 1.4 percent. Brazil has capped interchange fees at 0.8 percent while requiring that the average of such fees not exceed 0.5 percent. In the US, there are no fee constraints, voluntary card network agreements, or network routing competition on credit cards, which makes the US an outlier in this regard and US credit card interchange fees among the highest in the world. Moreover, the variation among credit cards is considerable, with some credit cards (*e.g.*, rewards cards) costing merchants up to twice as much as other cards.

The CCC Act aims to correct this situation regarding high interchange fees. It would require the largest credit card issuers, defined as those with assets over $100 billion, to allow at least two credit card networks to be used on their credit cards instead of just one. In addition, at least one of those networks would have to be outside the Visa and Mastercard duopoly. After a transition period during which the Federal Reserve would write implementing regulations, the large, too big to fail banks that issue the overwhelming majority of Visa and Mastercard credit cards would have to choose a second competitive network to process transactions on each credit card, and then merchants would be allowed to determine which of those networks to use to process a transaction. The sponsors of the CCC Act envision the additional network(s) as creating competition between networks and providing better service at a lower cost. Sens. Durbin and Marshall point to a similar federal law that has been in effect since 2010 requiring debit cards to carry at least two debit networks as creating increased competition by mandating a choice of debit networks. They assert that the federal law applying to debit cards also led to innovation in the debit card network market and has helped hold down debit card fees. It is worth noting, however, that banks recouped most of the lost debit card fees estimated to be around $14 billion annually by increasing fees on checking accounts. Such is the nature of our fundamentally extractive financial institutions.

The CCC Act would apply to roughly the 30 largest banks and credit unions in the US; the vast majority of financial institutions would not be subject to the bill’s requirement to add a second credit card network. Additionally, credit cards where the network itself is the card issuer (such as American Express and Discover cards) would not be required to add a second network, although AmEx and Discover could serve as a second network on credit cards issued by other banks). The CCC Act does not mandate the use of any specific network to the cards that a bank may issue. Banks would be free to select which second network to add, as they currently do for debit cards, based on the service, security, and value that networks offer. The CCC Act does direct the Federal Reserve to identify a list of card networks that could not be added because they pose a national security threat or are owned or operated by foreign state entities, however. If the proposed law acts as envisioned, the second network would create competition, and all networks would have an incentive to hold down their merchant fees to convince merchants to choose to route transactions over their network instead of the other network on the card.

The additional competition may sound good in theory, but the ultimate consequences of the CCC Act are unclear. The high interchange fees that the Visa and Mastercard duopoly charge is proof enough that the current system is anti-competitive. That is beyond dispute. If lowering such fees is the goal, however, the simplest approach would be to do what most of the rest of the world has done and impose some statutory caps. Apparently, such an approach would be too simple and targeted, so the CCC Act seeks to create competition that may or may not materialize.

If the CCC Act becomes law, the total annual savings to merchants from lower interchange fees should be meaningful. Various estimates put that amount at about $11-15 billion, which should help merchants and retailers (especially the big box retailers), but it should not have much of an effect on banks and credit card issuers, as it represents less than 10 percent of total annual interchange fees of about $172 billion. If one had to guess, the effect on prices charged to consumers would be minimal, at least initially, as merchants would probably retain most of the cost savings.

Perhaps the most important consequence of the CCC Act, intended or not, would be on credit card reward programs. As matters stand now, the largest component of the network interchange fee merchants pay goes to finance credit card rewards programs. In turn, these rewards programs generate more transactions on such rewards cards. This means that merchants end up financing rewards programs, albeit indirectly, but they derive no tangible benefit from them. Instead of producing additional sales for merchants, rewards programs reduce merchant profits by motivating consumers to shift transactions from cheaper payment systems to the more expensive cards with rewards programs. Even though they finance rewards programs, Visa and Mastercard often prohibit merchants from charging consumers higher prices based on means of payment due to merchant restraint rules that prevent them from accepting certain cards selectively or charging higher prices to customers who use them. According to Georgetown University commercial and bankruptcy law expert Professor Adam Levitin, merchant restraint rules “encourage more credit card transactions at a higher price than would occur in a perfectly efficient market. The restraints also permit card issuers to externalize the costs of rewards programs to merchants and, ultimately, to consumers who do not use rewards cards.” Likewise, a working paper from the Federal Reserve Bank of Boston argues that reducing merchant fees and card rewards would save consumers money and improve consumer welfare, especially for lower income households that typically do not use but indirectly subsidize rewards cards. (Scott Schuh, Oz Shy, and Joanna Stavins, “Who Gains and Who Loses from Credit Card Payments? Theory and Calibrations,” Federal Reserve Bank of Boston, August 31, 2010, <file:///C:/Users/Chris%20Delta/Downloads/ppdp1003.pdf>) A staff working paper published by the Federal Reserve Board in 2023 has reached similar conclusions. (<https://www.federalreserve.gov/econres/feds/files/2023007pap.pdf>)

If the recent experience with the effort to mandate more competition for debit card fees is any indication, it seems unlikely that interchange fees will be reduced much. Moreover, as noted above, banks are likely to raise fees in other areas to recoup any reduced debit card fees. A 2017 report from economists at the Federal Reserve Board concluded that banks subject to reduced debit card fees were less likely to offer free checking accounts and increased their monthly fees on checking accounts while increasing the monthly minimum balance requirements for avoiding such fees. The number of debit card rewards programs dropped considerably. (Mark Manuszak and Krzysztof Wozniak, “The Impact of Price Controls in Two-sided Markets: Evidence from US Debit Card Interchange Fee Regulation,” 2017, <https://www.federalreserve.gov/econres/feds/files/2017074pap.pdf>)

If history were to repeat itself, we could look at countries that cap interchange fees to guess what the likely effects of lower fees would be on rewards programs. For example, the UK has capped fees at 0.5 percent for several years. The cap has saved merchants a considerable amount of money in fees, but it has also resulted in fewer rewards programs and at lower amounts. Currently, UK card issuers pay rewards rates of 0.5 to 1 percent, and they impose an annual fee on cards that pay higher rewards rates. Australia capped its interchange fees in 2003, and it has witnessed similar outcomes for rewards programs. A 2012 report from the Reserve Bank of Australia noted that issuers reduced rewards points earned from spending on credit cards while increasing fees on cardholders. There is no reason to believe there would be a different outcome in the US, though interchange fees here are so high that some reduction in such fees might not have much of an effect on rewards programs.

Regardless, even if the CCC Act becomes law (which is unlikely this year) credit card rewards programs should not disappear entirely. After all, countries with much lower fees than those US banks charge still maintain rewards programs, even if they do so at much lower amounts. Another likely potential effect of the CCC Act would be that consumers would probably carry fewer credit cards because various credit card offers would be less enticing. One way or another, because American consumers have become used to credit card rewards programs, card issuers will probably have to maintain some reward programs while being more creative in trying to entice customers. That may require issuers to find ways other than points or cash back (for example, providing access to airport lounges or faster ways to attain status for various airlines) to retain cardholders. Given how much consumers love their rewards programs, and how much credit card issuers have encouraged their proliferation, it seems likely that issuers will find a way to keep some version of their rewards programs going. If they do not do so, consumers may start focusing on the high fees that could remain at 2 percent or more, while the cash back or other rewards are at 1 percent, and conclude that rewards cards may not be as good a deal for them as their debit cards. At any rate, even though the ultimate effects of the CCC Act are difficult to gauge in advance with any certainty, it would be bound to change the landscape for rewards cards if it is ever enacted.

Even if one were to question the sagacity of those who support the CCC Act, it is worth remembering the rapacious and anticompetitive nature of Visa and Mastercard. In March 26, 2024, the two companies agreed to pay approximately $30 billion to settle an antitrust suit filed against them in 2005 while also agreeing to reduce debit and credit card fees for merchants. While that was a good start, the settlement did not go far enough, nor did it reduce interchange fees by a meaningful amount (just 0.04 percent for three years while ensuring an average rate that is 0.07 percent below the current average for five years). The settlement agreement would also give merchants more discretion to offer discounts or to impose surcharges on credit cards with higher fees. Many merchants already warn customers that they will pay higher amounts if they use cards instead of paying in cash. The $30 billion settlement came about a year after the U.S. Appeals Court for the Second Circuit upheld a $5.6 billion class action settlement with Visa and Mastercard that covered about 12 million merchants. (Some merchants opted out of that settlement, but they would be bound by the one reached on March 26, 2024 if the court were to approve it later this year.) The $30 billion settlement is in peril, however, because U.S. District Court Judge Margo Brodie, who is overseeing the antitrust litigation against Visa and Mastercard, told the lawyers in the case on June 13, 2024 that she is not inclined to approve it. A person of ordinary cynicism might say that Judge Brodie is correct to be skeptical of the terms of the settlement given the fact that Mastercard lauded the settlement as a “fair resolution” and Visa called it an “appropriate resolution” of all claims. Those who disagreed and objected to the settlement included the National Retail Federation, which called the settlement “manifestly insufficient” and its benefits “meager and temporary.” It would be difficult to disagree with the judge or the NRF because the settlement would still leave in place exorbitant interchange fees while imposing a practically unlimited ban on future claims by aggrieved merchants. The case is *In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*, No. 05-md-01720 (E.D.N.Y.), and the judge’s ruling regarding the tentative settlement is due later this year.

Due to an abdication of governmental regulatory responsibility, Visa and Mastercard have been able to impose high interchange fees on merchants and consumers without fear of consequences. The antitrust litigation and the proposed CCC Act might be incipient signs that Visa and Mastercard may start to see the balance of power shift ever so slightly in favor of merchants and consumers in the near future.

The text of S.1838 is here: <https://www.congress.gov/bill/118th-congress/senate-bill/1838/text>