NSBA
National Small Business Association®

America's small business advocate

ISSUE BRIEF

Interchange "Swipe" Fee Reform

Congress must support efforts to infuse fairness and transparency in the interchange system

The 2010 *Restoring American Financial Stability Act* (*S. 3217*) included an NSBA-supported amendment, introduced by Sen. Dick Durbin (D-Ill.), which directed the U.S. Federal Reserve (Fed) with addressing interchange "swipe" fees.

In Dec. 2010, the Fed proposed its new rules limiting the size of swipe fees, which are the fees banks charge businesses every time a debit card is used to pay for a good or service. The Fed announced it was considering a number of options that would result in reduced swipe fees for debit-card transactions. On June 28, 2011, the Fed adopted a final swipe-fee reform rule that significantly varied from its proposed rule from Dec. 2010. The final rule, which went into effect on October 1, 2011, included a base of 21 cents per transaction and no set cap. The final rule also exempted banks with less than $10 billion in assets, a provision included in the Fed's proposed rule.

Although NSBA supports no interchange fees being charged on debit-card transactions—since they clear, like checks, at par—the final rule represented significant progress. According to the Fed, the average swipe fee in 2009 was 44 cents.

According to one bank, a swipe-fee cap of seven cents per transaction still would produce a profit margin of about eight percent, compared to the retail industry's average profit margin of one to three percent.

While small businesses, merchants of all size, and consumer groups reacted relatively positively to the rule, the reaction from the banking industry—which collected $16.2 billion from debit-card swipe fees last year alone—was anything but as it embarked on a tremendous lobbying and publics relations campaign. Spending tens of millions of dollars and arguing that the proposed rule represented governmental interference in the private market, the banking industry made some progress in its efforts to roll-back the Durbin amendment.

For more than 40 years, Visa and MasterCard centered their business models on their ability to centrally set the swipe fees card-issuing banks charge the merchants who accept their cards. Since merchants pay these fees to the banks, the banks sought to issue the cards with the highest fees.

This, of course, lead to a price war of sorts between Visa and MasterCard of who could set the highest fees. This perverse form of "competition" resulted in swipe fees skyrocketing by more than 300 percent since 2001—all while technological advances have reduced the costs of actually processing debit and credit card transactions.

In a functioning market, competition drives efficiency. To be successful, one firm must offer a better quality product or service to a customer at an equal price, or provide the equivalent quality at a lower price. Businesses succeed or fail based on their ability to compete in such a market and consumers benefit from the outcome. In the broken electronic payments market, the incentives were reversed and the market failed. The Durbin amendment was an important step in returning competition to this broken market.

NSBA urges Congress to protect the improvements to the interchange market provided by the Durbin Amendment.