BY KATRINA MULLEN

Should Credit Card Fees Be Regulated?

Shoppers are increasingly being greeted with a new sign at the register: "A surcharge will be added to all credit card transactions." This surcharge is meant to cover the interchange fee (typically ranging between 1 percent and 3 percent of the transaction total) plus a processing fee that merchants must pay for all purchases made with a credit card.

When a customer makes a card purchase, the merchant's payment terminal sends information about the transaction to the bank that issued the customer's card. That issuing bank checks that the customer's account has the funds to cover the transaction and then sends the money — minus an interchange fee — to an acquiring bank. The acquiring bank also takes a fee from the transaction and pays the remaining amount to the merchant. The interchange fee amount is determined by several factors, including the type of card used, whether the purchase was made in person or online, and the type of business. The total deducted fees that merchants pay to accept credit cards typically range from 1.5 percent to 3.5 percent of the value of each transaction. Merchants argue that the fees exceed the costs for processing such transactions.

Credit card interchange fees are currently unregulated. In 2023, Sen. Dick Durbin, D-Ill., along with cosponsors from both parties, introduced the Credit Card Competition Act (CCCA), which would require the Federal Reserve Board of Governors to regulate network competition in credit card transactions. Previously, Durbin introduced an amendment that was added to the Dodd-Frank Act of 2010, which mandated that the Fed's Board of Governors regulate debit card fees for banks with $10 billion or more in assets. The Durbin amendment requires that regulated interchange fees are "reasonable and proportional to the cost incurred by the issuer with respect to the transaction." Before the legislation, debit card fees for merchants averaged around 45 cents per transaction; now, they are capped at 21 cents plus 0.05 percent of the transaction value.

The cap on debit card fees, which applies to signature, PIN debit, and PINless transactions, allowed merchants to save around $8.5 billion in the year following its implementation, according to research by Richmond Fed economist Zhu Wang. Some of the savings to merchants were expected to be passed on to consumers, but the regulation also produced unintended consequences.

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Before the Durbin amendment to Dodd-Frank, merchants paid smaller fees for small-value transactions. In response to the regulation, card networks raised the fees on small-value purchases to the cap level, so merchants now pay the same fee regardless of transaction size.

"An issuer-cost based regulation ignores the two-sided nature of the market and may risk either undershooting or overshooting," says Wang. "In a two-sided payment card market, the socially optimal interchange fee should reflect the costs and benefits to merchants and consumers of the card service and therefore may not necessarily align with the issuer's own cost."

In a 2014 article that examined the impact of the Durbin amendment on merchants, Wang and his co-authors investigated how the regulation affected merchants' costs of accepting debit cards as well as how merchants reacted to the regulation. They found "a limited and unequal impact on merchants' debit acceptance costs," with two-thirds of merchants in the sample reporting little to no change in debit costs. A quarter of merchants reported an increase in debit costs due to small-value transactions, and fewer than 10 percent of merchants reported a decrease in debit costs. Most merchants who faced increased debit costs chose to raise prices and pass the costs on to consumers, while few merchants reduced prices if their debit costs decreased.

This experience may provide some useful lessons for future efforts to regulate credit card interchange fees. The proposed CCCA bill would require large credit card issuers (i.e., banks with more than $100 billion in assets) to enable at least two unaffiliated payment card networks to process their credit card transactions. This would increase routing competition and aim to reduce merchant swipe fees.

Credit cards have been consumers' most used method of payment since 2022, according to the Fed's Diary of Consumer Payment Choice. Between 2017 and 2023, the survey showed that consumers preferred credit cards because of security, acceptance, payment records, and convenience. It's possible that reward programs, which are partly funded by interchange fees, have also played a role in the growth of credit cards. If policymakers decide to regulate how credit card interchange fees are assessed, it remains to be seen what impact that may have on the popularity of this payment instrument. **EF**