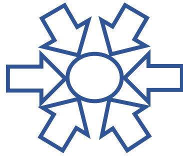

Financial Services Management

Credit-Card Networks

Cite
S. 4674, Credit Card Competition Act of 2022

Recommended Distribution:
Credit Cards, Payment Services, Retail Finance
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Website:
https://www.congress.gov/117/bills/s4674/BILLS-117s4674is.pdf

Impact Assessment

- Banks could experience significant reductions in card-fee income and increases in operational risk. Preventing these could lead to significant changes to credit-card offerings and pricing adverse to credit availability and consumer or merchant cost.
- Although aimed at increasing payment-network competition, requirements for Fed regulation terminate if new networks achieve Visa and Mastercard's market dominance, perhaps heightening fair-competition concerns because of the ability of new networks to cross-sell or otherwise leverage consumer financial data in affiliated retail or commercial ventures.
- Fed standards mandating new networks appear to bar banks from deciding against certain providers based on security or operational-risk concerns.
- The CFPB is expressly barred from regulating new payment networks, making it possible for only the bank regulators to do so under their more limited authority over third-party service providers.

Overview

Two senators have reopened questions about the manner in which card-related payments are handled, tackling those applicable to credit cards with a bill mandating that merchants must be given a network choice that is not either Visa or Mastercard in order to, the sponsors argue, increase competition and lower credit-card transaction costs. Although the multi-network requirement would apply only to banks with assets over $100 billion, it would likely have the effect of lowering swipe fees across the sector because exempt banks would be compelled by market forces to find lower-cost networks. The extent to which these lower-cost networks are also sound and resilient under stress is uncertain as no safety-and-soundness or operational requirements directly apply to card-

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processing networks. Further, current consumer-protection standards related to card-processing would generally cease because new networks would be exempt from CFPB regulation and supervision. Banks receiving less credit-card fee income are likely to respond by diminishing reward programs and raising interest rates or otherwise revising offerings to higher-risk consumers. Co-branded merchant cards could also be adversely affected, offsetting the benefits some retailers expect via reduced interchange fees due to the lower sales resulting from fewer store discounts or other card-related incentives.

Impact

This measure is modelled after one requirement in the "Durbin Amendment" related to debit cards included in the 2010 Dodd-Frank Act.[1] That law mandated both a direct interchange-fee cap under price controls set by the Federal Reserve as well as greater network options. The Federal Reserve finalized these rules in 2011,[2] leading to significant reductions in debit-card swipe fees that studies suggest led to lower merchant costs that were generally not passed on to consumers. Studies have also shown that reductions in debit-card fee income led to a sharp reduction in no or low-cost transaction accounts for consumers with smaller account balances.

The 2011 Rule has remained largely as finalized, although the Federal Reserve in 2021 proposed to extend network-choice options to online debit-card payments, suggesting then that it might also lower permissible fees.[3] The manner in which the Fed finally acts on this proposal will affect the current balance between debit and credit cards in terms of consumer choice and merchant impact, perhaps increasing use of credit cards in online transactions absent final action on this legislation.

As noted, this bill does not tackle credit-card interchange fees directly even though one of its sponsors, Sen. Durbin (D-IL), held a hearing earlier this year pressing hard for statutory change to accomplish this.[4] Instead, it focuses on requiring additional network choice akin to that mandated for debit cards, a change both banks and retailers agree should reduce interchange fees because new networks are likely to be less costly.

Where banks and retailers strongly disagree is on whether these new networks would pose additional fraud and operational risk. Perhaps anticipating bank reluctance to make use of new networks, the measure would require the Fed to prohibit network choice based on factors such as judgments about a network's security or resilience. There are currently few existing networks seeking to challenge Visa and MasterCard in the credit-card sector which would have needed to demonstrate resilience to attract new users. This bill would surely encourage new networks which would face far fewer barriers to entry, but these might well be willing and able to skimp on operational standards since banks

[1] See **CONSUMER14**, *Financial Services Management,* July 19, 2010.

[2] See **INTERCHANGE7**, *Financial Services Management,* July 11, 2011.

[3] See **INTERCHANGE8**, *Financial Services Management*, May 18, 2021.

[4] See *Client Report* **INTERCHANGE9**, May 4, 2022.

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would not be protected by regulatory safeguards for rejecting these networks and card issuers – not networks – are usually liable for fraudulent and other inappropriate or even risky uses of a consumer's credit. The extent to which issuers would be willing to bear such costs without significant changes in the terms and conditions in credit cards not subject to this bill – e.g., interest rates, minimum-payment requirements – is uncertain, but it seems likely that the overall construct of credit-card offerings would materially change at cost not only to banks, but also to merchants who rely on the ease of credit-card transactions to support sales volume and even pricing.

Although some interchange issues cross both debit and credit products, credit cards also pose unique challenges due to the rewards on which many consumers count for an array of benefits and discounts, some of which then support purchases of discretionary items such as airline tickets and hotel rooms cardholders might defer or disdain without these incentives. Many large retailers and service providers in fact have branded cards that generate sales by virtue of discounts and other benefits offset by card fees. New restrictions that lead banks to reduce these benefits could also lead consumers to alter the way they pay for goods or services, with affluent consumers switching from credit to debit cards or even demanding that merchants accept checks. Less-affluent consumers could increase their use of cash for smaller-dollar transactions, increasing merchant costs at convenience stores, gas stations, and other venues. These consumers might also reduce consumption based on lower "points" for purchases such as gasoline and, when it comes to online merchandise, switch to buy-now/pay-later models that may pose an array of risks as well as significantly higher credit costs.

As noted, this bill's rationale is that forcing network choice will increase competition at benefit to consumers and merchants. However, the bill's pro-competition provisions would apply only while Visa and Mastercard are dominant. The bill also does not apply to any arrangements in which a merchant is also a network nor does it allow the Fed to force change should current payment networks be replaced by one or two new firms that enjoy like-kind dominance. As a result, it could well result in the same competitive landscape or even a more concentrated one in which credit-card network incentives are driven not by bank or current card-network profitability concerns, but instead by the ability of a network affiliated with a bigtech firm to leverage its market power in ways that may harm consumers and further disadvantage smaller, unaffiliated merchants.

What's Next

S. 4674 was introduced on July 28 by Sens. Durbin and Marshall (R-KS). It was referred to the Senate Banking Committee; neither sponsor sits on that panel and there appear to be no plans to take up the bill through regular order in this Congress. There is also no companion House bill. Given strong opposition from banks, it will prove very difficult to pass this bill unless another measure provides a venue for action in this Congress.

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Analysis

A. Coverage

As noted, the bill's provisions apply only to banks or credit unions with assets over $100 billion.

Cards issued in three-party arrangements are exempted. These are credit cards issued also by a payment-card network for the relevant card or under common ownership with the network with respect to this card. This would appear to exempt novel arrangements in which a credit-card bank is owned by or affiliated with an entity that comes to be a network (i.e., a bigtech company).

B. Restrictions

Within one year of enactment, the FRB would need to issue rules effective 180 days thereafter barring credit-card issuers or payment-card networks from directly or indirectly limiting the number of payment-card networks on which an electronic credit-transaction (including those where a card is presented in person or online) may be processed to any affiliated network or those owned by firms with the two largest marketshares in this arena (determined by the FRB). Notably, even restrictions related to technological capacity would be barred, suggesting that standards that appear to exclude unaffiliated or non-dominant networks on what issuers might think solely technical grounds would be prohibited.

Three years after these rules and at least every three years thereafter, the Board would also be required to evaluate network dominance. If at any point in this process the networks initially deemed dominant have changed, then all of the bill's restrictions would cease to apply.

In addition, the Board within one year would need to issue rules governing covered card issuers or networks to bar them directly or indirectly from accepting any card designed to limit routing choices as long as the network is able to handle the transaction and is not a dominant provider during the years in which the FRB designates them. Again, this would bar limitations based on technology, including those related to tokenization or security that could not be used by all payment-card networks able by some measure (the bill does not make clear what) to process the relevant card transaction.

C. National Security

No later than one year after enactment, the Fed in consultation with Treasury would issue a list of payment-card networks deemed to pose a risk to national security and those owned, operating, or sponsored by foreign states or their entities.

D. CFPB

In sharp contrast to debit-card interchanges, the CFPB would have no authority to enforce these rules to the extent it deemed practices in compliance with Fed standards still to undermine consumer protection or fair competition.

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