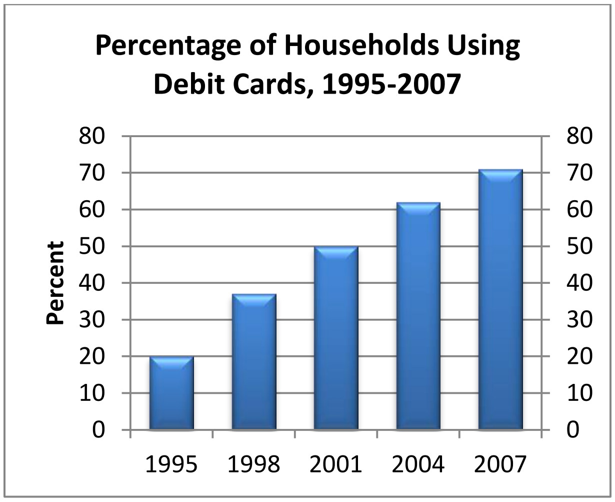
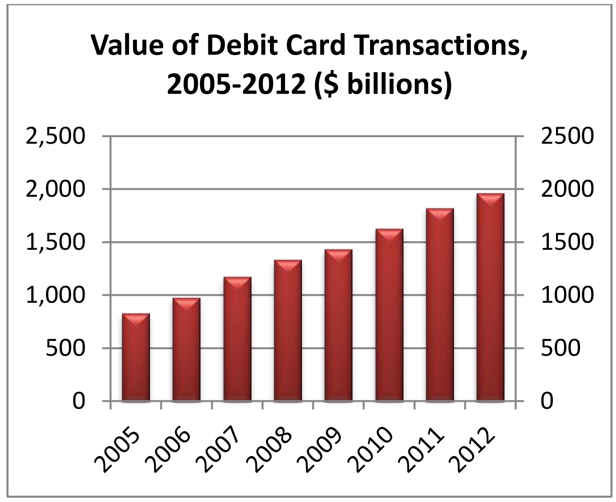
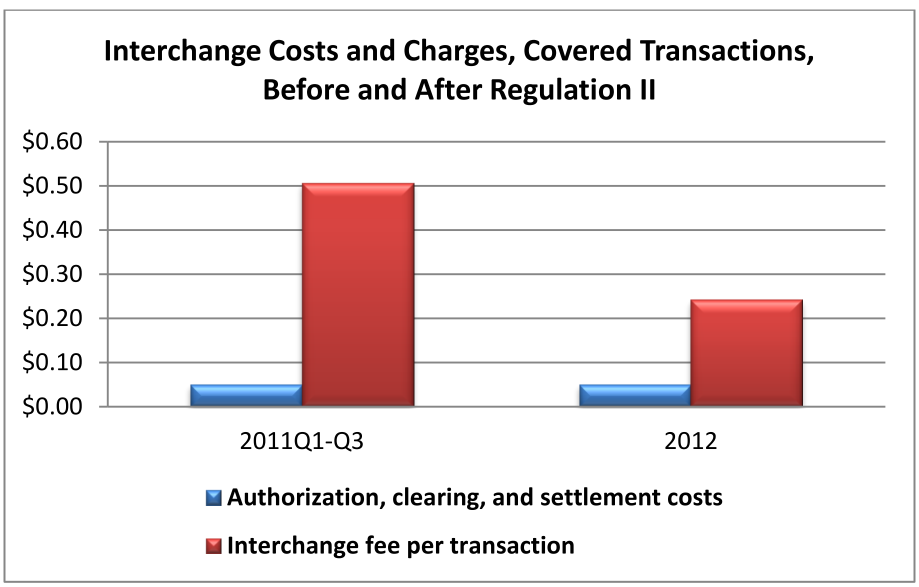
The Costs and Benefits of Half a Loaf:
The Economic Effects of Recent Regulation of Debit Card Interchange Fees

The charges applied by debit card networks and the banks issuing debit cards have become matters of broad interest and import, as the numbers of Americans using debit cards and the value of debit card transactions have both risen sharply and steadily.

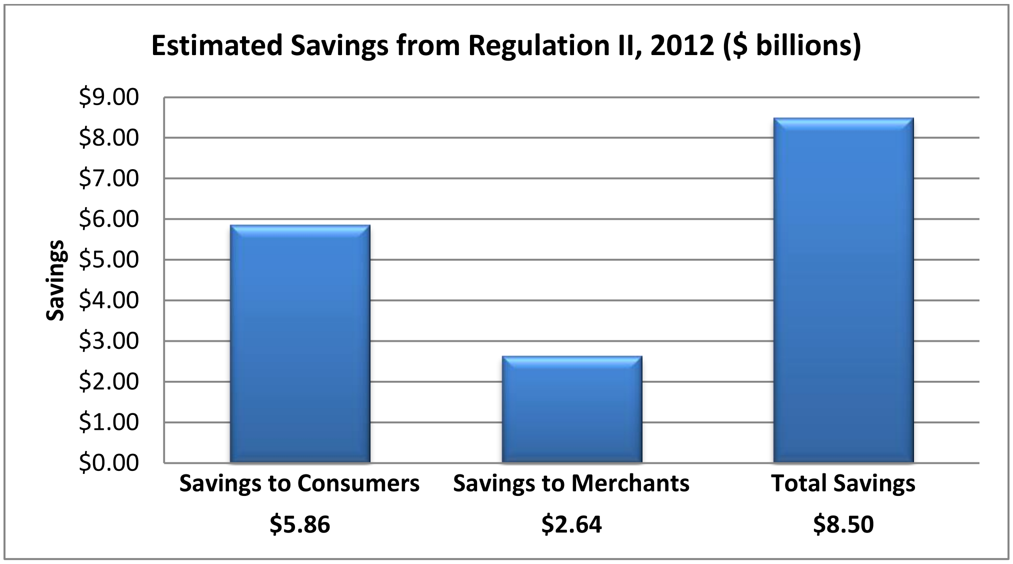




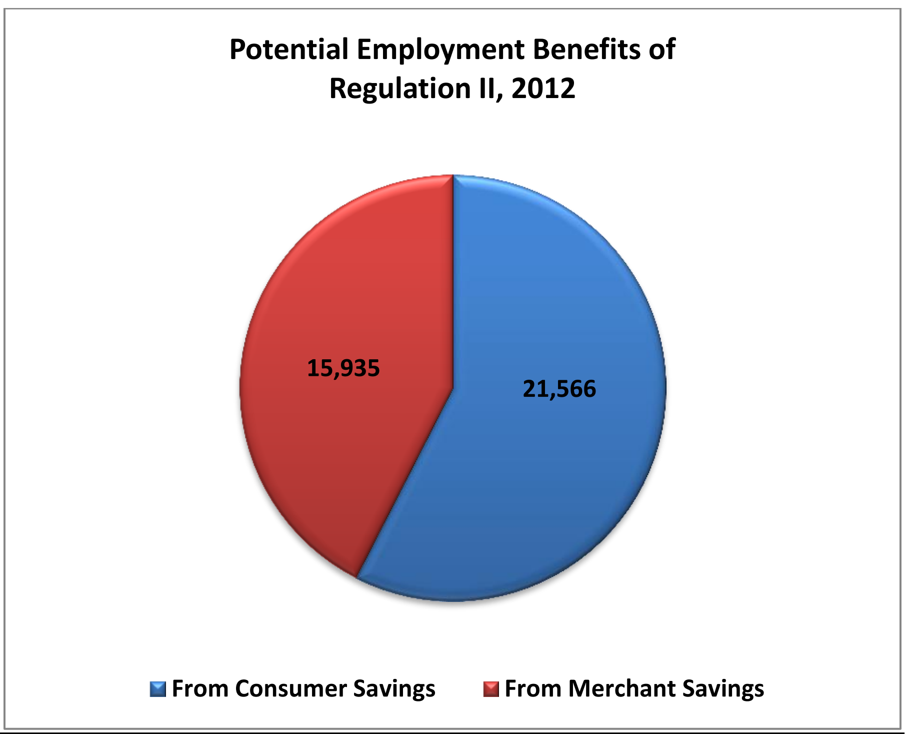
In 2010, Congress directed the Federal Reserve to issue regulations covering the "interchange" fees that debit-card issuing banks charge merchants, fees largely passed on to American consumers through higher prices. Before the Fed's new rules, "Regulation II," took effect, it cost the card networks and card-issuing banks an average of $0.05 to process a debit transaction, or about 10 percent of the average $0.48 interchange fee they charged merchants to do so. Under Regulation II, the average interchange fee fell to $0.24 per transaction.



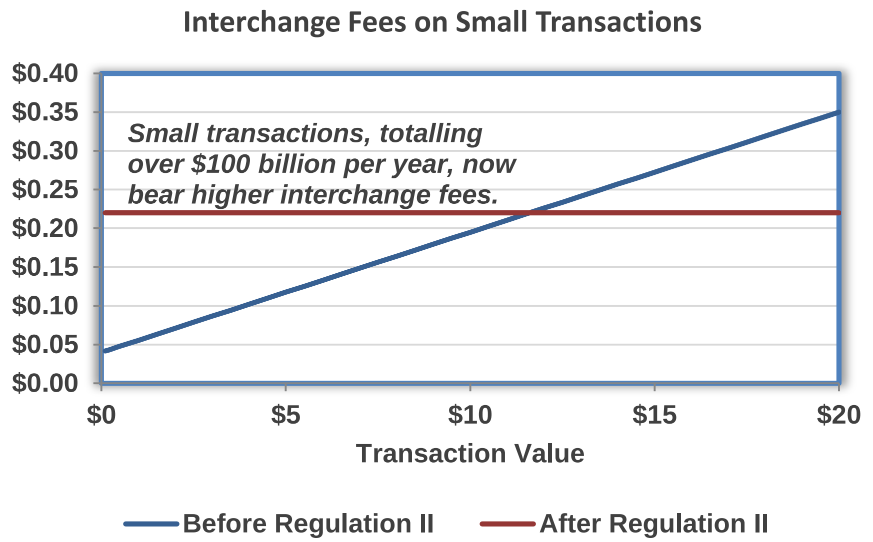
Regulation II saved Americans $8.5 billion in its first full year, 2012, through lower interchange fees: $5.86 billion of those savings passed through to consumers in lower prices, and merchants received the remaining savings of $2.64 billion.

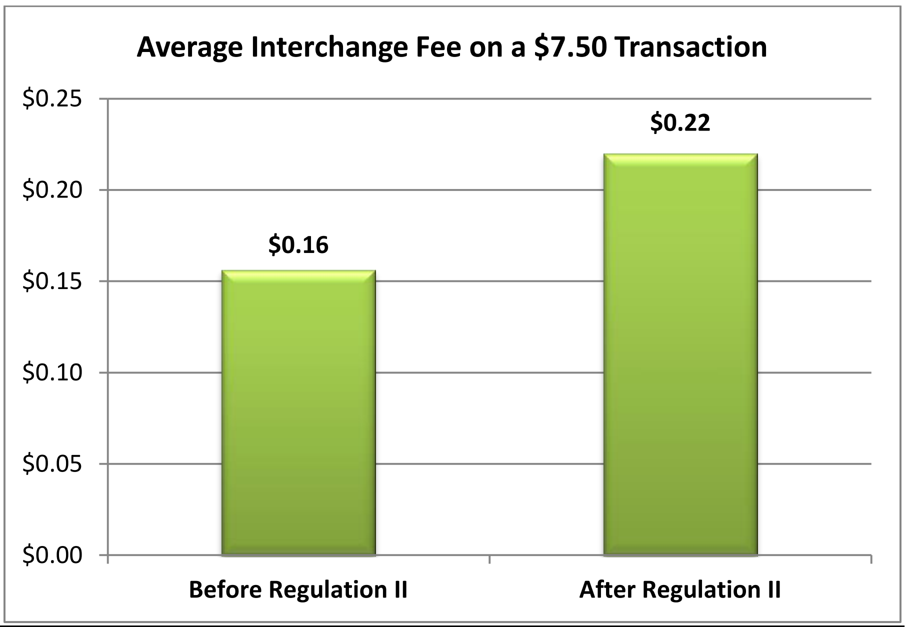


The savings from lower interchange fees have positive economic effects. The savings by consumers expand their consumption and purchases, which supports the creation of new jobs. Similarly, the savings for merchants lead to more purchases, investments and hiring. The $5.86 billion in Regulation II savings for consumers in 2012 were sufficient to support 21,566 new jobs, and the savings for merchants in 2012 could support an additional 15,935 jobs.



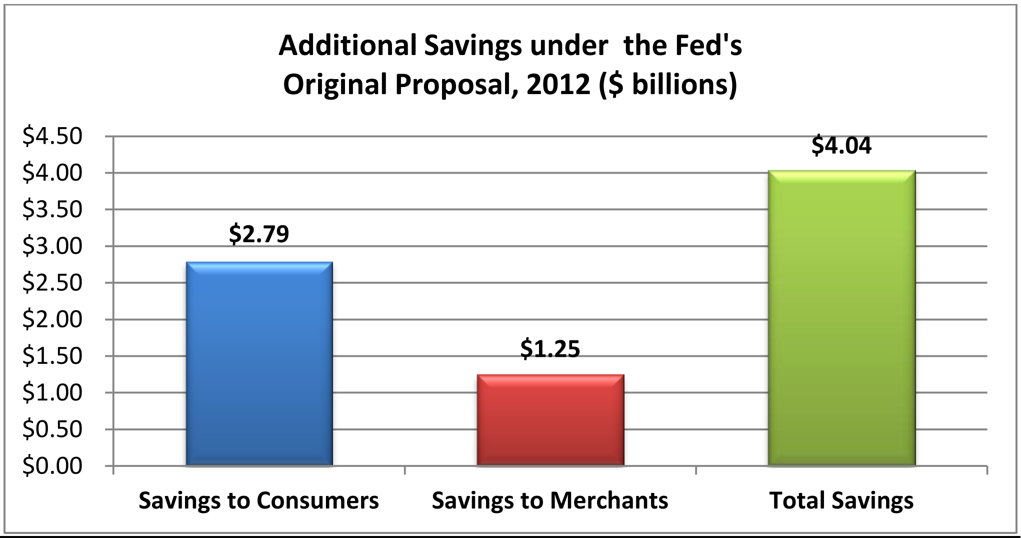
Regulation II also includes features that impose unnecessary costs on American consumers and merchants. First, the terms of the new rules have actually allowed the card networks to increase the fees on more than $100 billion in small debit transactions every year: Before Regulation II, the interchange fee on a $7.50 purchase by debit card was less than $0.16; after it took effect, that fee rose to $0.22, greater than the profit margin of many merchants on a $7.50 transaction.



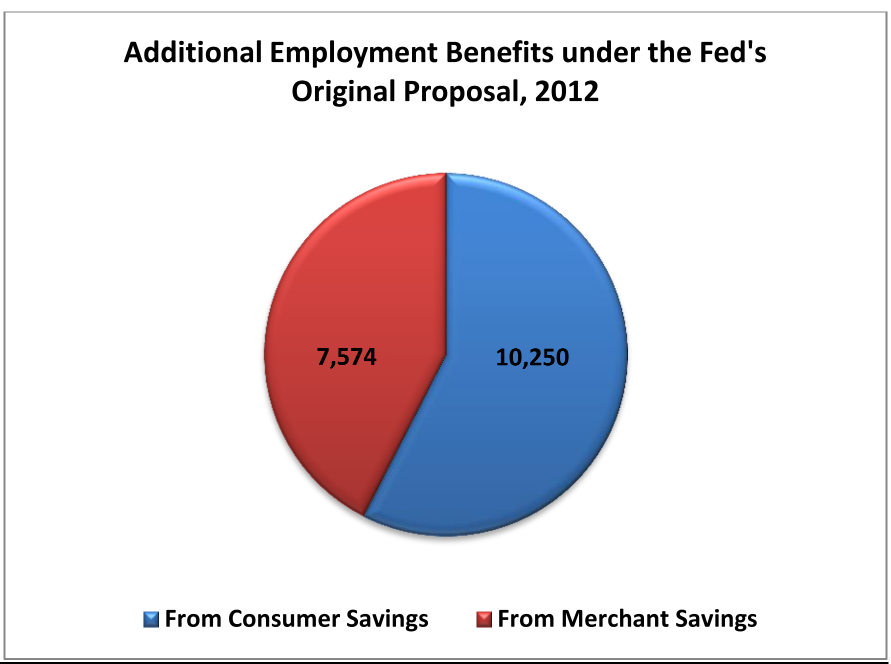


If Regulation II were revised so that interchange fees on small purchases did not increase, Americans would have saved an additional $690 million in 2012, sufficient to support the creation of an additional 3,044 jobs in that year.

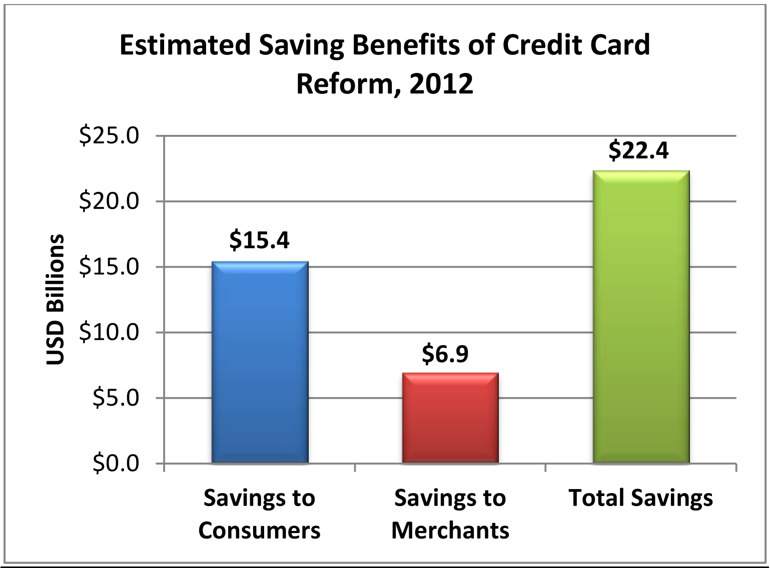
Regulation II also did not follow the terms set down by Congress, which directed the Federal Reserve to limit interchange fees on debit transactions to the costs of processing those transactions. The Fed's proposed rule recommended limiting the fees to $0.12 per transaction. After lobbying by financial institutions, the Fed issued a new final version that resulted in fees of $0.24. The original proposal would have saved an additional $4.04 billion in 2012.



These additional savings would have had additional employment benefits. The additional savings for consumers could have supported another 10,250 new jobs in 2012, and the additional savings for merchants could have supported another 7,574 new jobs.



In addition, Regulation II applies only to debit card transactions: It does not apply to credit card transactions. In 2012, Americans used their credit cards 25.4 million times to charge $2.4 trillion, paying an estimated $41.2 billion in interchange fees or $1.62 per-transaction. If the $0.24 cap on debit interchange fees covered credit cards interchange fees on four-party payment networks like Visa and MasterCard, consumers and merchants would have saved an additional $22.4 billion in 2012.



The savings derived from applying the Regulation II cap to credit card interchange fees also would have supported additional employment: The $15.4 billion in projected savings for consumers in 2012 could have supported an additional 56,733 jobs, and the $6.9 billion in projected merchants' savings could have supported 41,918 more jobs.