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Implications of the Proposed Credit Card Competition Act of 2023

How Durbin 2.0 Could Adversely Impact Credit Unions

A White Paper

By

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Executive Summary

The Credit Card Competition Act of 2023 (a.k.a. Durbin 2.0) currently being debated in Congress applies to credit-issuing financial institutions with assets over $100 billion. At the crux of this controversial legislation are merchant-related fee changes and new protocols for card issuers. If the bill were to become law, the rippling effects could adversely impact credit unions and community banks.

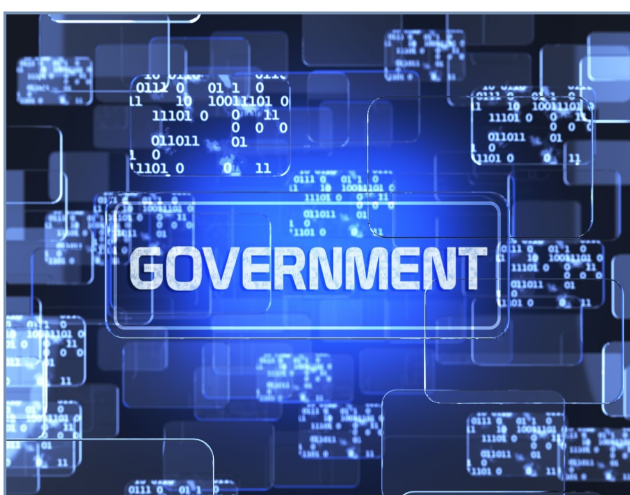
The bi-partisan bill was first introduced in 2022 by Senator Richard Durbin (D-Illinois) and Roger Marshall (R-Kansas). When the proposed legislation failed to pass, it was reintroduced in June 2023 with additional bipartisan sponsors. The Federal Reserve Board is currently reviewing Durbin 2.0 requirements, which will likely impact when the legislation is put forth for a vote, although Durbin and Marshall purport it could be voted on before yearend.

Lessons from Dodd-Frank

To better understand the possible implications of Durbin 2.0 on the credit card industry, it's important to study the impact that the Dodd–Frank Wall Street Reform and Consumer Protection Act has had on debit cards.

Soon after Dodd-Frank was passed in July 2010, the Durbin Amendment was adopted requiring the Federal Reserve to limit fees charged to retailers for debit card processing, which had negative repercussions on the debit card industry. Take, for example, research findings from The University of Chicago's report, The Impact of the U.S. Debit Card I Interchange Fee Caps on Consumer Welfare: An Event Study Analysis (2013).

"The cost to merchants of taking payment on debit cards declined by more than $7 billion annually as a result of the Durbin Amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, while the effective cost to issuers of providing debit card services to consumers increased by a corresponding amount," the report noted.



If the Durbin 2.0 were to become law, the rippling effects could adversely impact credit unions and community banks.

Supporters of Durbin 2.0, conversely, believe that the legislation will create more competition between credit card networks and limit merchant discount fees, while providing more savings to the American consumer by breaking up the Visa-Mastercard duopoly. In a summary of the proposed legislation, Senator Durbin offered the following data points to support passage:

- Visa-Mastercard controls over 80 percent of the U.S. credit card network market – more than 576 million cards. Every time a Visa or Mastercard credit card is swiped, approximately 2% to 3% percent is deducted out of the transaction amount the merchant receives (a merchant typically ends up receiving $98 or $97 on a $100 sale).
- In 2022, Visa, Mastercard and respective card-issuing banks charged merchants a total of $93 billion in credit card fees that were passed onto consumers in the form of higher prices at the grocery store and gas pump, among other retail market increases.

The Complexities of Dual-Network Routing

Under Durbin 2.0, every credit card transaction will require two unaffiliated networks to route transactions (one of them cannot be Visa or Mastercard). This would require large banks (more than $100 billion in assets) to select a second competitive unaffiliated network for their credit cards, including, but not limited to, Pulse, NYCE and STAR. The merchant would choose which of those networks to use to process a transaction. Durbin 2.0 proponents contend that by allowing merchants to choose between two unaffiliated networks, the result would be improved service and lower costs.

Two leading dual-network provisions:

- Network exclusivity: Financial institutions will be required to provide a second unaffiliated network.
- Routing restrictions: An issuer or card network will be prohibited from limiting or directly routing merchant transactions over an issuer-enabled network.

The practical implications of this approach, however, are complex and surround the infrastructure of dual-network routing. The point-of-sale devices at the merchant location, for instance, may require programming for two networks. While banks operating with less than $100 billion would be exempt from the law, costly structural changes to credit card chip technology could likely trickle down to mid-size banks, community banks and credit unions.

Understanding Payment Flow

When a credit union or bank issues a credit card to a member or customer, the member or customer transacts at a merchant's physical or virtual location. The merchant's acquirer (i.e., its bank or credit union) will then route the transaction via a network to an issuer that processes and authorizes the transaction on behalf of the cardholder's credit union or bank. The merchant then incurs a cost (a discounted fee) distributed amongst the acquirer, network and issuer.

Under current laws, the transaction is sent via a single route because the financial institution's identification number (BIN) that is assigned to the issuer is most likely tied to either Visa or Mastercard. Under the proposed legislation, a multi-network routing framework would require that a transaction take the single network route via a different network at the discretion of the merchant or the customer at the point of payment. Issuers would be responsible for ensuring these transactions are routed through two unaffiliated networks.

Changes to existing technology platforms could require entire ecosystem upgrades and the need for a third party to oversee implementation and related project management oversight. Potentially, issuers could be required to reissue their credit cards with updated technologies. Additionally, there could be a potential loss in revenue from interchange should these transactions route through the second network.

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Five Potential Impacts of Durbin 2.0

- **Changing Card Technology:** While the proposed law is aimed at financial institutions of $100 billion in assets and above, credit cards issued today run on one network. Thus, under Durbin 2.0, every issuer, regardless of asset size, may need to upgrade systems to support the additional unaffiliated network. If the entire ecosystem is upgraded to support two unaffiliated networks, for example, all card issuers may need to reissue their entire card portfolio to allow the two networks to operate on a single card.

- **Fraud:** With the bulk of the current fraud cases resulting from card-not-present (CNP) transactions, under the proposed legislation fraud rates, and related operational costs, could potentially increase. Additionally, the industry standard "zero liability" offered by Visa and Mastercard could no longer be available to financial institutions. Thus, any network that processes card transactions could be held accountable to a yet-to-be-determined standard for fraud protection and data security.

- **Access to Credit:** If the proposition is passed, some credit card volume could be routed through a second unaffiliated network with transactions potentially clearing at a lower cost. As such, financial institutions could lose non-interest income revenue, which, in turn, may cause financial institutions to lower credit limits.

- **Removal of Rewards**: Currently, consumers and members enjoy using the vast benefits of credit card loyalty reward programs. Under the new proposition, there could be an impact to non-interest income from interchange fees, consequently, this may eliminate rewards program benefits due to revenue losses. As a result, merchants may be impacted as consumers could adjust spending habits when rewards are removed.

- **Data Security:** While Visa and Mastercard have are widely trusted by consumers, under the proposed legislation, Visa and Mastercard may not have the opportunity to participate as a network causing concerns over the security of consumer and member data. Smaller networks, for example, may have fewer fraud protection measures. Additionally, if there is a data breach, the proposed legislation doesn't indicate if the issuers or acquirers will be held responsible.

Parting Thoughts on the Credit Card Competition Act

Given the magnitude and complexity of the Credit Card Competition Act, both credit union senior leaders and members should understand the bill's proposed proposition and potential impact. While the fate of Durbin 2.0 remains unclear, the concerns raised by the bill's opponents around data security, fraud, access to credit, changing card technologies and removal of reward programs remain critical topics actively being debated.

What remains clear is that passage of Durbin 2.0 would mandate significant changes for financial institutions, including credit unions whose leaders are vested in educating, advocating and propelling the industry forward for the enrichment of its members. By proactively planning for the forecasted Durbin 2.0 changes with an experienced technology consulting firm, credit union executives can be assured that any required change to their fundamental card operations will be a streamlined, successful process.

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