# DURBIN'S DEFECT: THE IMPACT OF POST-RECESSION LEGISLATION ON LOW-INCOME CONSUMERS

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*In 2010, the economy was reeling from an economic recession that particularly affected low-income consumers. One law, known as the Durbin Amendment, sought to protect consumers by regulating the fees that financial institutions charge merchants each time a customer uses a debit card. This Note examines the amendment's effects, arguing that it has ultimately raised the costs of banking for low-income consumers. Due to complex banking disclosures and the structure of the regulations, these increased costs have not been offset by increased transparency or lower retail prices. This Note recommends specific changes to the Durbin Amendment that will better support its stated goals. However, because these changes cannot entirely mitigate the negative effects, this Note recommends that Congress also pass legislation to improve access to banking for low-income consumers.*

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## Introduction

In 2010, the global economy was reeling from what many believe was the worst financial crisis since the Great Depression.[1] The recession led to massive losses of household wealth and high unemployment rates.[2] Some people were affected more than others: In the United States, working-class and low-income consumers were more likely to find that the recession disrupted their lives.[3]

In July 2010, Congress responded by passing the Dodd-Frank Wall Street Reform and Consumer Protection Act, which aimed to "improv[e] accountability and transparency in the financial system, to end 'too big to fail', to protect the American taxpayer by ending bailouts, [and] to protect consumers from abusive financial services practices . . . ."[4] This legislation represented "the most fundamental set of regulatory reforms in [the financial sector] since the New Deal."[5]

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[1] *See, e.g.*, Int'l Monetary Fund, World Economic Outlook 9 (2009), *available at* http://www.imf.org/external/pubs/ft/weo/2009/01/pdf/text.pdf.

[2] *Id.* at 3, 13.

[3] *See* Sylvia A. Allegretto, Econ. Policy Inst., The State of Working America's Wealth 2 (2011), *available at* http://epi.3cdn.net/002c5fc0fda0ae9cce_aem6idhp5.pdf (stating that less-wealthy and black households were hit the hardest during the economic recession); Michael S. Barr, No Slack: The Financial Lives of Low-Income Americans 280 (2012) (arguing that low- and moderate-income families were least prepared to handle the shock of the recession).

[4] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[5] Saule T. Omarova, *The Dodd-Frank Act: A New Deal for a New Age?*, 15 N.C. Banking Inst. 83, 84 (2011).

Much has been written about the effects of such legislation on the financial industry and the country's economy, but one question in particular has rarely been asked: How has this legislation affected access to the financial sector for "ordinary" citizens?

Access to financial services is particularly critical to low-income consumers because it is a vital prerequisite to social mobility. Bank accounts allow consumers to cash paychecks and deposit earnings, pay bills by check and online, and save money in a safe location without worrying about theft or loss. Low-income consumers are sometimes "unbanked," meaning they do not use traditional financial products such as bank accounts. Consumers who have trouble accessing bank accounts may find it more difficult to save and plan for the future.[6] They are particularly prone to abrupt fluctuations in income[7] and often "lack the financial 'slack' that [permits] other households to ride out tough times."[8] While some "slack" can be generated by increasing work or reducing expenditures, many households also rely on the financial system to facilitate slack.[9] Research shows that consumers who have bank accounts can better weather economic troubles and save more money than those who do not.[10] Unbanked consumers bear other costs as well: A worker earning $12,000 a year will pay around $250 annually to cash paychecks at a check cashing outlet.[11] The unbanked also have a harder time accessing credit because it is more difficult and more costly to qualify for loans (including home mortgages) without a bank account.[12]

For many, it is difficult to imagine being unbanked today, as banking has become so ubiquitous. Still, about 8.2% of U.S.

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[6] Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. 121, 121 (2004).

[7] *See* BARR, *supra* note 3, at 1 (noting that low-income consumers suffer income fluctuation as a result of job changes, instability in hours worked, medical emergencies, changes in family composition, and other factors).

[8] *Id.* at 1–2 (describing "slack" as the "breathing room provided to households by the ability to make relatively costless adjustments to align resources with needs").

[9] *See id.* at 2 (noting that consumers use the financial system to generate slack by holding savings, accessing credit, or buying insurance). Inability to maintain slack "too often means that small problems can escalate rapidly and undermine the fragile financial stability of these households." *Id.*

[10] *See* Pew Health Grp., The Pew Charitable Trusts, Slipping Behind: Low-Income Los Angeles Households Drift Further from the Financial Mainstream 13 (2011), *available at* http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Safe_Banking_Opportunities_Project/Slipping%20Behind.pdf ("In times of economic decline, the Banked fare better.").

[11] Barr, *supra* note 6, at 123.

[12] *Id.* at 24.

households—nearly ten million households—lack a bank account.[13] In particular, some marginalized groups are less likely to use bank accounts or other mainstream financial products: Twenty-two percent of families earning less than $25,000 per year lack bank accounts.[14] While twelve percent of the adult population overall is unbanked, thirty-one percent of lower-income households, twenty-eight percent of African Americans, and thirty percent of Hispanics are unbanked.[15] Furthermore, over twenty-five percent of households complete some or all transactions outside of the mainstream banking system[16]—a status I will refer to as "underbanked."

The reasons reported for not having a bank account include high minimum balances (7.4%), high service charges (10.6%), insufficient funds (10.3%), and credit problems (4.2%).[17] One study in Los Angeles found that thirty-two percent of unbanked consumers who previously held accounts cited "unexpected or unexplained fees" as the reason for account closure.[18]

Given the importance of banking services in today's society, improving access should be a priority for legislators. "[W]ell-designed and appropriately regulated financial services could help [low-income consumers] build greater financial stability. Better access to transactional services . . . would give households useful tools to manage their finances."[19]

This Note will examine a recent piece of legislation known as the Durbin Amendment ("the Amendment")[20] in order to determine the effect it has had on low-income consumers and their relationships with the mainstream banking system. The Amendment regulates the fees—commonly called "swipe fees" or "interchange fees"—that debit card issuers charge retailers each time a consumer uses a debit card to make a purchase. This legislation has a potentially huge impact. In

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13 FED. DEPOSIT INS. CORP., FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 3–4 (2011), *available at* http://www.fdic.gov/household survey/2012_unbankedreport_execsumm.pdf.

14 Barr, *supra* note 6, at 123.

15 FIN. INDUS. REGULATORY AUTH., INC., FINANCIAL CAPABILITY IN THE UNITED STATES: NATIONAL SURVEY 10 (2009), *available at* http://www.finrafoundation.org/web/groups/foundation/@foundation/documents/foundation/p120535.pdf. The primary reason given for not having a bank account is that consumers did not have enough money. *Id.*

16 *See id.* at 5 (measuring the prevalence of non-bank borrowing such as payday loans).

17 Jesse Bricker et al., *Changes in U.S. Family Finances from 2007 to 2010*, 98 FED. RES. BULL. 2, 32 (2012). The most common reason given was that consumers do not like dealing with banks (27.8%). *Id.*

18 PEW HEALTH GRP., *supra* note 10, at 7.

19 BARR, *supra* note 3, at 3.

20 15 U.S.C. § 1693o-2(a) (2012). For a detailed discussion of the Durbin Amendment, see *infra* Part I.B.

recent years, debit cards have become more and more common: Between just 2006 and 2009, debit card usage increased by almost fifteen percent.[21] There were approximately 37.9 billion debit transactions in 2009,[22] the year before the Amendment was enacted, costing retailers a whopping $16.2 billion in fees.[23] Because debit cards are ubiquitous in today's society, this regulation has the potential to reshape the banking industry in ways that are likely to affect all consumers.

Scholars have analyzed the Amendment's impact on small businesses[24] as well as small banks and credit unions[25] and have questioned its constitutionality.[26] However, there has been no comprehensive study of its potential impact on low-income, marginalized consumers.[27] This Note addresses this gap in the literature by

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21 FED. RESERVE SYS., THE 2010 FEDERAL RESERVE PAYMENTS STUDY 4 (2010), *available at* http://www.frbservices.org/files/communications/pdf/press/2010_payments_study.pdf.

22 *Id.*

23 Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722, 81,725 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235) [hereinafter Proposed Rule].

24 *See, e.g.*, Harry Allford, *The Durbin Amendment Is Hurting Small Businesses*, AM. BANKER (Mar. 14, 2012, 4:31 PM), http://www.americanbanker.com/bankthink/the-durbin-amendment-is-hurting-small-businesses-1047525-1.html ("These changes to the electronic payments system have hurt small businesses in a big way.").

25 *See, e.g.*, ADAM J. LEVITIN, FILENE RESEARCH INST., INTERCHANGE REGULATION: IMPLICATIONS FOR CREDIT UNIONS 33–41 (2010), *available at* http://ssrn.com/abstract-1726206 (reviewing the potential implications of the Amendment on credit unions based on an original survey of credit unions' debit and credit card programs); Laura H. Brown & Robert W. Savoie, *The Durbin Derby: Are There Any Winners?*, BUS. L. TODAY 1, 4 (Mar. 2012), http://apps.americanbar.org/buslaw/blt/content/2012/03/all.pdf ("[T]oo many unknowns still exist to be able to accurately predict how smaller banks will be ultimately impacted."); M. Pierce Sandwith, *Debit Card Interchange Fees and the Durbin Amendment's Small Bank Exemption*, 16 N.C. BANKING INST. 223, 240–41 (2012) (evaluating the potential negative effect the Amendment will have on small banks despite the exemption); Andrew Kahr, *Never Mind the Lobbyists, Durbin Amendment Helps Small Banks*, AM. BANKER (Mar. 3, 2011, 12:28 PM), http://www.americanbanker.com/bankthink/never-mind-the-lobbyists-durbin-amendment-helps-small-banks-1033898-1.html ("One of the arguments made against the Durbin restriction on interchange is that it will hurt community banks. Poppycock.").

26 *Compare* Lisa Farrell, Comment, *A Step in the Right Direction: Regulation of Debit Card Interchange Fees in the Durbin Amendment*, 15 LEWIS & CLARK L. REV. 1077, 1077 (2011) (arguing that the Amendment was an appropriate and constitutional response to high swipe fees), *with* Richard A. Epstein, *The Constitutional Paradox of the Durbin Amendment: How Monopolies Are Offered Constitutional Protections Denied to Competitive Firms*, 63 FLA. L. REV. 1307, 1308 (2011) (arguing that the Amendment was unnecessary and has resulted in an unconstitutional taking).

27 The Amendment's potential impact on these consumers has been discussed, if only briefly. *See, e.g.*, Scott D. Strockoz, Dodd-Frank and the Durbin Amendment—Is It Working as Intended? 17–18 (2012) (unpublished manuscript), *available at* http://www.abastonier.com/stonier/wp-content/uploads/2012-Capstone-Strokoz.pdf (noting the impact on the fees that low-income consumers pay).

examining how the Amendment may prove costly for low-income consumers and offers policy recommendations to help mitigate its impact.

This Note focuses on low-income consumers[28] who were banked or underbanked prior to the enactment of the Amendment. It then considers the likely changes in low-income consumers' banking patterns as a result of the Amendment, including the possibility that they will be unable to continue participating in the mainstream banking system altogether. The Note also addresses the ways in which the Amendment potentially makes it more difficult for low-income consumers who were previously unbanked to enter the mainstream banking system.

This Note proceeds in three parts. Part I explains the purpose and function of the Amendment, including the regulations the Federal Reserve subsequently passed pursuant to the Amendment. Part II examines the actual effects of the Amendment on low-income consumers. It argues that these consumers in particular face rising banking costs as a result of lower minimum balances, higher fees, and inability to access credit. Part II also rejects the possibility that the Amendment has encouraged transparency and competition in the financial sector and has led to lower retail prices. Part III recommends specific changes that could be made to the Amendment that would better serve Congress's goals. It suggests that Congress regulate credit cards as well as debit cards, address the lack of transparency in banking contracts, and permit the Federal Reserve to consider all relevant costs when setting fee caps. It argues that even under this improved regime, low-income consumers will encounter obstacles to banking access, and that therefore Congress should also pass legislation to mitigate the harmful effects on low-income consumers.

## I
## The Durbin Amendment and Subsequent Regulations

Part I begins by describing the structure of the debit card system prior to the Durbin Amendment and then reviews the Amendment itself. Part I goes on to explain how the Federal Reserve Board ("the Board") interpreted Congress's statute in a proposed rule, capping fees in a way that systematically undervalues debit card usage. Finally,

[28] As this Note is largely theoretical and does not undertake a statistical analysis of its own, it is not necessary to define low-income with specificity. However, it is worth noting that the government has defined "low-income" families as those households "whose incomes do not exceed 80 percent of the median family income for the area." Dep't of Hous. & Urban Dev., FY2007 HUD Income Limits Briefing Material 1 (2007), *available at* http://www.huduser.org/datasets/il/il07/IncomeLimitsBriefingMaterial.pdf.

this Part notes that despite the Federal Reserve's uncertainty about the fee cap's benefits and thousands of comments criticizing the cap, the proposed rule was quickly finalized and enforced.

### *A. Pre-Amendment Mechanics of the Debit Card System*

The Amendment was passed as part of the Dodd-Frank Act. It called for the regulation of interchange fees,[29] which are the fees retailers pay to debit card issuers each time a consumer pays with a debit card. To understand the Amendment, it is necessary to understand how swipe fees work.

This Note focuses on the most common system for processing credit and debit card transactions: the "four-party system." This inaptly named system actually includes five parties: the consumer, the card-issuing bank, the retailer, the retailer's bank, and the network (e.g., Visa or MasterCard).[30] The networks contract with banks, credit unions, and other financial institutions to support the cards that financial institutions issue to consumers.[31] A transaction begins when a consumer presents a debit card as payment. Then, the retailer (through its bank) routes an electronic authorization request to the network, which transfers the request to the card-issuing bank.[32] The card-issuing bank approves or denies the transaction and posts a charge to the customer's account.[33] The retailer is then credited for the amount of the transaction, minus the relevant fees.[34] The networks unilaterally set most interchange fees without any negotiation.[35]

The interchange fee, which generally comprises the majority of the total fee package, is the subject of the Amendment's regulations.[36] While the retailer's bank receives some of the interchange fee, most of

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[29] *See* 15 U.S.C. § 1693o-2(a)(2) (2012) ("The amount of any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction shall be reasonable and proportional to the cost incurred by the issuer with respect to the transaction.").

[30] Robin A. Prager et al., *Interchange Fees and Payment Card Networks: Economics, Industry Developments, and Policy Issues* 10 (Div. of Research & Statistics & Monetary Affairs, Fed. Reserve Bd., Working Paper No. 2009-23, 2009), *available at* http://www.federalreserve.gov/pubs/feds/2009/200923/200923pap.pdf.

[31] *See id.* at 13 (describing the roles of networks and issuers).

[32] *Id.* at 10.

[33] Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,396 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235) [hereinafter Final Rule].

[34] *See* Prager et al., *supra* note 30, at 11 (explaining that a merchant's account is credited "within four days of the transaction").

[35] *See* Final Rule, *supra* note 33, at 43,396 ("The interchange fee is set by the relevant network and paid by the acquirer to the issuer . . . .").

[36] *See id.* (discussing the value of various transaction fees).

it goes to the card issuer.[37] Prior to the Amendment, interchange fees averaged thirty-five to fifty cents per transaction.[38]

### *B. The Amendment*

On its face, the Amendment was designed to accomplish several goals, all aimed at improving the financial industry. Addressing the Senate, Senator Richard Durbin noted that Wall Street reform was designed to "hold[ ] big banks accountable for how they operate and empower[ ] consumers to make good financial choices."[39] He said that his Amendment would "give small businesses and merchants and their customers across America a real chance" in the face of rising swipe fees charged by Visa and MasterCard,[40] which are passed on to consumers via higher retail prices.[41]

When the financial industry opposed the Amendment, Congress responded with some hostility. Senator Durbin stated with disdain that one could "hear the stampede of the Gucci loafers around every corner."[42] Indeed, Congress acted with unusual haste: Only two and a half months after it was proposed, Congress passed the Amendment without holding committee hearings, commissioning studies, or offering a formal opportunity for banks, retailers, or consumers to express their views on the Amendment. In fact, there was very little discussion of the Amendment at all.[43]

Thus, without opportunity for further discussion or development, Congress charged the Treasury Department with promulgating rules for the enforcement of this industry-changing legislation. Specifically, the Amendment requires the Board to establish standards for assessing whether an interchange fee is reasonable and proportional to the cost incurred by the issuer.[44] In somewhat vague terms, the statute requires the Board to distinguish between:

> (i) the *incremental cost* incurred by an issuer for the role of the issuer in the authorization, clearance, or settlement of a particular electronic debit transaction, which cost shall be considered . . . and

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37 Proposed Rule, *supra* note 23, at 81,723–24. The network receives a separate, smaller "switch fee" for its role. *Id*.

38 Prager et al., *supra* note 30, at 12.

39 156 CONG. REC. S4839 (daily ed. June 10, 2010) (statement of Sen. Richard Durbin).

40 *Id.*

41 *See id.* at S4840 ("Debit interchange fee reductions will lead to lower consumer prices at grocery stores, convenience stores, and other retailers that, unlike Visa and MasterCard, have to vigorously compete with one another on price.").

42 *Id.*

43 *See* Farrell, *supra* note 26, at 1078 (noting that Congress did not hold hearings regarding the Amendment, or "solicit any feedback on it . . . in the two-and-a-half months between the legislation's introduction" and passage).

44 15 U.S.C. § 1693o-2(a)(3)(A) (2012).

> (ii) *other costs* incurred by an issuer which are not specific to a particular electronic debit transaction, which costs shall not be considered.[45]

As discussed in Part I.C, these instructions have proved troublesome to the Board.

### *C. Regulations Promulgated by the Federal Reserve Pursuant to the Durbin Amendment*

The plain text of the statute describes what factors the Board should appropriately "consider" in setting fee caps.[46] The Board noted in its request for comment that it believes these factors are indicative of congressional intent, implying that these "considerations" should govern.[47]

The Board thus considered only the *incremental* costs incurred by an issuer for the authorization, clearance, or settlement of a particular transaction. The Board first noted that there is no single definition of the term "incremental cost," and then recommended that incremental costs for the purposes of this statute include "the per-transaction value of costs that vary with the number of transactions (i.e., average variable cost) within the reporting period."[48] The Board found that it was within its discretion to consider any factors other than those specifically prohibited by the statute and ultimately considered all other factors before raising the proposed cap to twenty-one cents.[49] This cap nonetheless effectuates a dramatic reduction in revenue from fees, which averaged forty-four cents per transaction in 2009.[50]

As a result, the Board's regulations capped debit transaction fees at an amount that is too low to cover the true costs associated with debit card use. The Board found that the statute explicitly prohibited it from considering any costs that are shared with an issuer's other products, as well as many common fixed costs.[51] The Board specifically excluded from its consideration costs associated with corporate overhead, establishing and maintaining an account relationship, card production, delivery, marketing, and non-sufficient funds handling.[52]

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[45] 15 U.S.C. § 1693o-2(a)(4)(B) (2012) (emphasis added).

[46] *Id*.

[47] *See* Proposed Rule, *supra* note 23, at 81,734 (finding that these factors are "indicative of Congressional intent . . . , and therefore provide a useful measure for which costs should and should not be included").

[48] *Id.* at 81,735.

[49] 12 C.F.R. § 235.3(b)(1) (2013).

[50] Final Rule, *supra* note 33, at 43,397.

[51] *Id.* at 43,424.

[52] *Id.* at 43,427.

It also explicitly excluded any profit or rate of return.[53] Indeed, the Board itself acknowledged the insufficiency of its cap:

> [T]he Board recognizes that excluding fixed costs may prevent issuers from recovering through interchange fees some costs associated with debit card transactions. However, . . . the Board also recognizes that issuers have other sources, besides interchange fees, from which they can receive revenue to help cover the costs of debit card operations.[54]

The Board thus recognized—even before issuing its final regulations—that banks would likely raise prices elsewhere to recoup the costs of providing debit card service.[55]

Not only do these regulations underprice the use of debit cards, but they prohibit any consideration of the role of debit cards within the banking system as a whole. Debit cards are not independent from other banking services, and they are not paid for separately. Over the past decade, the pricing of banking services has transformed: Banks have moved away from traditional flat monthly service fees toward "a combination of free checking and other bundled banking services, offset by growing debit card interchange and overdraft revenues."[56] A representative of the American Bankers Association confirmed this, noting: "[I]t costs us $230 for a checking account. And lots of these costs are revolving around debit."[57] He stated: "[I]f we are going to lose tens of millions of dollars of revenue and *we are going to start losing* . . . on every checking [account] as a whole, we will price that up. . . . [T]he bottom line answer is fees will go up significantly to consumers . . . ."[58] Given the Board's statutorily imposed limitations, the resulting Rule was bound to have effects outside the four-party system.

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[53] *See id.* at 43,427 n.119 (noting that even if such profit or rate of return is a cost, it is not "specific to a particular transaction").

[54] Proposed Rule, *supra* note 23, at 81,736.

[55] The Board also acknowledged this in its Final Rule: "Covered issuers may offset some or all lost interchange fee revenue through a combination of customer fee increases . . . , reductions in debit card rewards programs, and cost reductions." Final Rule, *supra* note 33, at 43,461.

[56] Todd J. Zywicki, *The Economics and Regulation of Bank Overdraft Protection*, 69 WASH. & LEE L. REV. 1141, 1178 (2012).

[57] *Understanding the Federal Reserve's Proposed Rule on Interchange Fees: Implications and Consequences of the Durbin Amendment: Hearing Before the Subcomm. on Fin. Insts. & Consumer Credit of the H. Comm. on Fin. Servs.*, 112th Cong. 53 (2011) [hereinafter *Hearing*] (statement of David W. Kemper, Chairman, President, and CEO, Commerce Bank).

[58] *Id.* at 65 (emphasis added).

### *D. Subsequent Congressional Hearing and Public Debate*

Commenters warned that these regulations would have a negative impact on consumers, and particularly low-income consumers.[59] The Board acknowledged that it did not know what the impact would be and that it would be too difficult to speculate.[60] Although the Board is required, to the extent possible, to "demonstrate that the consumer protections of the proposed regulations outweigh the compliance costs imposed upon consumers and financial institutions," the Board held that it was not possible to determine whether the benefits to consumers would exceed the possible costs.[61] The Board conceded that it could not predict the market response to the final rule.[62]

After the Board received more than 11,500 comments, a hearing was eventually held before the House Subcommittee on Financial Institutions and Consumer Credit.[63] Many participants noted concerns with the potential outcome of excluding such costs. Representative James Renacci expressed concern that the Board did not have the ability under the statute to consider all costs, noting that the Board's "hands [were] tied."[64] Representative Ed Perlmutter agreed, saying to a Board member: "I feel like you are in a box because you have been prescribed with language that really makes it, in my opinion, impossible for the network and the banks and the credit unions to recover

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[59] Final Rule, *supra* note 33, at 43,459 ("A number of commenters . . . asserted that consumers would be harmed by the proposed rule, contrary to the statutory intent."). Commenters predicted that the sizable loss of interchange fee revenue would lead card issuers to "raise fees charged to deposit account customers, reduce benefits for users of debit cards . . . , not authorize the use of debit cards for high-risk or high-value transactions, or restrict or eliminate the issuance of debit cards," and that these changes would likely be most detrimental to low-income consumers. *Id.* Commenters also recommended that the Board's FRA analysis "take into consideration the effect of the rule on consumers, especially consumer debit card holders and lower income individuals." *Id.* at 43,465. Russell Simmons, co-founder of hip-hop label Def Jam, also publicly condemned the Amendment. *See* Russell Simmons, *Senator Durbin: Don't Dump on the Poor and Call It Rain*, HUFFINGTON POST (June 7, 2010, 12:14 PM), http://www.huffingtonpost.com/russell-simmons/senator-durbin-dont-dump_b_603004.html (noting his grave concern about the potential unintended consequences of the Amendment).

[60] *See* Final Rule, *supra* note 33, at 43,464 ("[T]he net effect on low income consumers will depend on various factors, including each consumer's payment and purchase behavior, as well as market responses to the rule.").

[61] *Id.*

[62] *Id.*

[63] *See Hearing*, *supra* note 57, at 4 (statement of Sarah Bloom Raskin, Gov., Fed. Reserve) ("We have already received thousands of comments raising a variety of issues and expect to receive many more in the next several days."). Raskin also noted that the subject had been "indeed very controversial." *Id.* at 16.

[64] *Id.* at 19.

their costs. . . . [Y]ou are in a pickle."[65] Board member Sarah Raskin conceded, "[W]e have done best with what we have been given . . . ."[66]

Following the hearing, proposed legislation that would have delayed the Board's regulations for twenty-four months—pending a full study on the impact of regulating interchange fees—never made it to a vote.[67] The Board was therefore statutorily mandated to enact the regulations within mere months of beginning the process.[68]

The potential effects of the Amendment have been debated at length, with all parties purporting to have consumers' interests in mind.[69] This Note argues that the Amendment has in fact proven harmful to low-income consumers.

## II
## The Durbin Amendment's Effects on Low-Income Consumers

This Part argues that, as anticipated, the Durbin Amendment has led to rising banking costs for low-income consumers, including higher monthly fees, higher overdraft fees, and higher minimum account balances. It further argues that the Amendment has not led to increased transparency and competition in banking products, or lower retail prices.

### *A. Rising Banking Costs for Low-Income Consumers*

After having their debit card interchange fees capped, it was rational for financial institutions to seek to recover costs elsewhere. Although direct causality may be difficult to prove empirically, the available evidence supports the hypothesis that banks have responded

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[65] *Id.* at 27.

[66] *Id.* at 22.

[67] S. 575, 112th Cong. (2011). This bill, proposed by Senator Jon Tester, did not make it out of committee after being referred to the Committee on Banking, Housing, and Urban Affairs.

[68] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, §1075(a)(2), 124 Stat. 1376, 2068 (2010) (codified as amended at 15 U.S.C. § 1693o-2(a)(3)(A) (2012)) ("The Board shall prescribe regulations in final form not later than 9 months after the date of enactment of the Consumer Financial Protection Act of 2010 . . . .").

[69] *Compare Hearing*, *supra* note 57, at 44 (statement of Joshua R. Floum, Gen. Counsel of Visa) (noting that consumers will pay the costs of this regulation), *and id.* at 40–41 (statement of David W. Kemper, Chairman, President, and CEO of Commerce Bank) (noting that the Proposed Rule will "cost great harm to consumers" and will "force a number of our customers out of the protection of the banking system"), *with* 156 Cong. Rec. S4839 (daily ed. June 10, 2010) (statement of Sen. Richard Durbin) (stating that the bill is "a major victory for small business and merchants and consumers").

to the Amendment by raising personal banking fees, and that these changes tend to hurt low-income consumers in particular.

### 1. *Fee Caps Eliminate Subsidization of Low-Balance Checking Accounts*

Prior to the Amendment, the debit card system helped make banking more accessible to low-income consumers. First, banks were able to make money on debit card fees charged to retailers, which helped cover the costs of otherwise unprofitable low-balance checking accounts.[70] Second, the pre-Amendment debit card system encouraged a dynamic whereby the accounts of higher-income consumers subsidized accounts for low-income consumers. Not only do higher-income account holders tend to maintain higher balances, which are inherently more profitable for banks, but they also spend more money on their debit cards, generating more fees from retailers.[71] Thus, when debit cards were new and growing, all three groups—low-income consumers, higher-income consumers, and banks—stood to benefit from the widespread use of debit cards because more retailers were incentivized to accept the cards. Legislation that makes debit cards unprofitable to banks logically reduces the incentive to subsidize low-income (i.e., low-profit) accounts with profits from higher-income accounts and encourages banks to recoup the costs of low-balance accounts in other ways.

### 2. *Incentivization of Credit Cards Harms Low-Income Consumers*

Regulations may be ineffective when a regulated entity's incentives are not aligned with regulatory intent and the entity has room to "work creatively" around the changes.[72] For example, card issuers can avoid the effects of the Amendment to the extent that they can incentivize consumers to use credit cards rather than debit cards. Credit card fees remain unregulated, averaging around two to three percent of the value of the transaction.[73] At this rate, credit card transaction

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[70] *See* BARR, *supra* note 3, at 25 (finding that banking the poor is not profitable for many banks).

[71] *See* Julie A. Hill, *Transaction Account Fees: Do the Poor Really Pay More than the Rich?*, 15 U. PA. J. BUS. L. 65, 72 (2012) (noting that high-balance accounts generate more investment income for banks).

[72] *See* MICHAEL S. BARR, SENDHIL MULLAINATHAN & ELDAR SHAFIR, NEW AM. FOUND., BEHAVIORALLY INFORMED FINANCIAL SERVICES REGULATION 3 (2008), *available at* http://www.newamerica.net/files/naf_behavioral_v5.pdf ("In forcing disclosure of hidden prices . . . the regulator often faces non-cooperative firms, whose interests are to find ways to work around or undo interventions.").

[73] *See Hearing*, *supra* note 57, at 51–52 (statement of David Seltzer, Vice President and Treasurer, 7-Eleven Inc.) (noting that on average, retailers' credit card fees are "about 2.2

fees quickly outpace fees for debit transactions of over about ten dollars, despite only a minimal increase in cost to banks.[74] Regulations limiting banks' ability to generate revenue through debit cards therefore create an incentive to shift account holders away from debit cards towards unregulated credit cards.

The evidence indicates that banks did, in fact, shift account holders away from debit cards and towards credit cards in response to the Amendment. Many banks have announced that debit card reward programs will be limited in the future.[75] For example, in 2011, Chase, Wells Fargo, and SunTrust stopped offering debit card rewards.[76] One Wells Fargo spokeswoman noted that the changes were "in response to recent regulatory changes."[77] In a September 2011 brochure, Chase asked its consumers "Debit or Credit?" and explained that credit is a better choice for all purchases.[78] Banks have engaged in the mass marketing and promotion of new credit cards,[79] and observers predict that the market for credit cards will continue to outpace the market for debit cards in coming years.[80]

The campaign to incentivize credit card use over debit card use is harmful to low-income, marginalized consumers on two levels. First,

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percent"); Parija Kavilanz, *Local Merchants Not Crazy About Swipe Fee Deal*, CNN MONEY (July 17, 2012, 11:07 AM), http://money.cnn.com/2012/07/17/smallbusiness/visa-mastercard/ ("Industry experts say the average credit card fee merchants pay banks . . . is 2% to 3% of the total value of the purchase.").

[74] For example, a $1 purchase could incur a 21-cent maximum fee if purchased with a debit card, while a 2% credit card fee would only send 2 cents to the banks. But an $11 credit card purchase with a 2% fee incurs a charge of 22 cents, exceeding the maximum debit card fee. The fee difference grows as purchases become more expensive.

[75] *See* Brown & Savoie, *supra* note 25, at 3 (noting that many banks are limiting or even eliminating debit card rewards programs because they were funded by interchange fees).

[76] AnnaMaria Andriotis, *Another Debit Card Rewards Program Signs Off*, SMARTMONEY (Aug. 22, 2011), http://blogs.smartmoney.com/paydirt/2011/08/22/another-debit-card-rewards-program-signs-off/.

[77] *Id.*

[78] *See* Suzanne Kapner, *Debit or Credit? Citi Places Its Bet*, WALL ST. J. (Sept. 20, 2011), http://online.wsj.com/article/SB10001424053111903374004576581084218444302.html (describing an insert which posed the question "Debit or Credit?" and then made the case that credit cards are a "great choice for making all your purchases big and small").

[79] *See Credit Card Rewards Grow as Debit Rewards Dwindle*, IBTIMES (Feb. 13, 2012, 12:15 PM), http://www.ibtimes.com/articles/297786/20120213/credit-card-rewards-debit-cash-back-points.htm (describing recent efforts to promote credit card usage); Kapner, *supra* note 78 (noting that Citi mailed enough credit card advertisements for every man, woman, and child in the United States).

[80] *See, e.g.*, *Cyber Monday: Javelin Forecasts an Online Payments Shift to Credit Cards at the Expense of Debit Cards*, JAVELIN STRATEGY & RES. (Nov. 27, 2011), https://www.javelinstrategy.com/news/1291/222/Cyber-Monday-Javelin-Forecasts-an-Online-Payments-Shift-to-Credit-Cards-at-the-Expense-of-Debit-Cards/d,pressRoomDetail (projecting that between 2011 and 2016, online credit card usage will climb sixty-three percent while debit card usage will rise only two percent).

marginalized consumers are less likely to have access to these newly attractive credit cards. Reports suggest that while only thirty-one percent of the population does not have a credit card, forty-nine percent of African Americans and forty-two percent of Hispanics lack credit cards.[81] As one study noted, "African-American and Hispanic families are still denied credit more often than white families with the same income, and low-income families are more often denied access to credit than middle-income and higher-income families—*even when low-income families apply for credit in line with their income and creditworthiness.*"[82] Marginalized consumers are thus less likely to be able to shift to newly attractive credit cards, thereby losing the benefits of card rewards programs.[83]

Second, due to force of habit among the general population and because marginalized consumers may be unable to make the switch,[84] banks will be unable to completely avoid the effects of the Amendment by incentivizing credit cards over debit cards. In addition to incentivizing credit cards, banks have therefore been forced to pursue other means in order to recover costs. These new developments, and their impact on low-income consumers, are discussed in the next section.

### 3. *Rising Fees for Low-Income Consumers*

Since 2011, banks have instituted a wave of new fees on personal banking, allegedly in response to the Amendment. After Bank of America introduced new fees, for example, spokeswoman Betty Reiss said, "The economics of offering a debit card have changed with recent regulations."[85] Citizens Bank ended free or discounted fees for check orders on some accounts, stating that the changes were

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[81] FIN. INDUS. REGULATORY AUTH., INC., *supra* note 15, at 16.

[82] CHRISTIAN E. WELLER, CTR. FOR AM. PROGRESS, ACCESS DENIED: LOW-INCOME AND MINORITY FAMILIES FACE MORE CREDIT CONSTRAINTS AND HIGHER BORROWING COSTS 1 (2007), *available at* http://www.americanprogress.org/wp-content/uploads/issues/2007/08/pdf/credit_access.pdf.

[83] This Note takes no normative stance on whether it is beneficial for low-income consumers to have access to credit cards in particular.

[84] Some consumers simply will not be persuaded: For many consumers, the use of the cards they carry is "a product of habit and inertia, rather than of any kind of reflective choice against the use of other cards." Cass R. Sunstein, *Boundedly Rational Borrowing*, 73 U. CHI. L. REV. 249, 265–66 (2006). Also, some debit card users fail to switch to better products because of the high cost of doing so. *See* Paul S. Calem, *The Strange Behavior of the Credit Card Market*, FED. RES. BANK OF PHILA. BUS. REV., Jan.–Feb. 1992, at 3, 12–14 (noting while direct evidence is not yet available, competition among card issuers may be restrained by the difficulties consumers face when switching accounts).

[85] Blake Ellis, *Bank of America to Charge $5 Monthly Debit Card Fee*, CNN (Sept. 29, 2011, 3:51 PM), http://money.cnn.com/2011/09/29/pf/bank_of_america_debit_fee/index.htm.

designed in part "to make [these services] more economically sustainable in light of recent regulatory and legislative changes affecting our industry."[86]

Evidence indicates that personal banking has become more expensive since the Amendment. Only 35.3% of checking accounts were free of monthly charges in the first half of 2012, compared to 38.8% in 2011.[87] Monthly fees have also risen. The average monthly maintenance fee for noninterest-bearing checking accounts rose to a record high of $5.48 in 2012, an increase of 25% since 2011.[88] A survey of fifty of the nation's largest banks found that basic banking costs jumped in just about every category in the first half of 2012.[89] The study notes: "Previous surveys have tended to show more of a mixed bag, with some fees rising and others falling. But the latest survey shows a comprehensive trend toward checking accounts becoming more expensive."[90]

Unfortunately, some of the ways in which banks have pursued new fee revenues are especially harmful to low-income consumers. First, minimum balance requirements have increased. While consumers with sufficient assets can avoid monthly fees by maintaining higher account balances, low-income consumers face an increasingly uphill battle to meet minimum balances. Banks on average now require an account balance of $723.02 to avoid a monthly fee, up 23% from 2011.[91]

Second, overdraft fees continue to be a major source of increased revenue for banks, bringing in $31.5 billion for the fiscal year ending

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[86] Phil Britt, *Big Banks Raising Fees in Wake of "Durbin Amendment*,*"* HEARTLANDER (Mar. 28, 2012), http://news.heartland.org/newspaper-article/2012/03/28/big-banks-raising-fees-wake-durbin-amendment. In some cases, however, consumers have rejected the most blatant, visible fees. For example, just as the Amendment was to go into effect, Bank of America introduced a five-dollar monthly fee on all debit cards. This sparked consumer outrage and ultimately led to the cancellation of the fees. *See* Tara S. Bernard, *Bank of America Drops Plan for Debit Card Fee*, N.Y. TIMES, Nov. 2, 2011, at A1 (reporting that Bank of America abandoned its plan to charge customers a five-dollar monthly, up-front debit card fee in response to an uproar from customers). Other banks, including Wells Fargo and JPMorgan Chase, tested monthly fees in some geographic areas. *See* Ellis, *supra* note 85.

[87] Richard Barrington, *Bank Fees Survey Mid-2012: Checking and ATM Costs Jump Again*, MONEYRATES.COM (Aug. 13, 2012), http://www.money-rates.com/research-center/bank-fees/mid-2012.htm.

[88] Claes Bell, *Checking Fees Rise to Record Highs in 2012*, BANKRATE, http://www.bankrate.com/finance/checking/checking-fees-record-highs-in-2012.aspx#slide=3 (last visited Jan. 24, 2014). An analysis focusing solely on banks that charge a fee revealed that the average monthly costs grew from $11.28 to $12.08 in the first half of 2012. Barrington, *supra* note 87.

[89] Barrington, *supra* note 87.

[90] *Id.*

[91] Bell, *supra* note 88.

on June 30, 2012.[92] Low-income consumers are particularly vulnerable to overdraft fees. Studies show that customers with accounts in low-income areas are more likely than customers with accounts in higher-income areas to have a "non-sufficient funds" transaction.[93] These fees have been steadily growing for several years and have continued to increase since the passage of the Amendment: The average overdraft fee has risen to a record high of $31.26, up from $30.83 in 2011.[94] A higher percentage of checking accounts now charge an extended overdraft penalty fee if the overdraft is not repaid in a timely manner, and the median amount of these fees has increased by 32% since 2010.[95]

### B. *The Durbin Amendment Has Not Increased Transparency*

In theory, higher up-front fees could be mitigated by other benefits. For example, Senator Durbin stated that one purpose of the Amendment was to increase transparency in the financial services market, thus empowering consumers to make good financial choices.[96] The idea is that even if banks are forced to raise fees to offset lost revenue on interchange fees, at least the true cost of the cards will be visible to consumers, rather than hidden within retail prices.

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[92] Press Release, Moebs Servs., Overdrafts Rebound Sharply in 2012 (Sept. 24, 2012), *available at* http://www.moebs.com/Portals/0/pdf/Press%20Releases/120919%20Overdrafts%20Rebound%20Sharply%20In%202012.pdf. Banks charge an overdraft fee each time a customer makes a purchase without enough money in his or her account to cover it. Banks routinely enact policies that cause consumers to spend more money in overdraft fees. For example, all twelve of the biggest banks "reorder withdrawals from highest to lowest dollar amount or reserve the right to do so without notice to the customer, thus maximizing overdraft fees." SUSAN K. WEINSTOCK ET AL., THE PEW CHARITABLE TRUSTS, STILL RISKY: AN UPDATE ON THE SAFETY AND TRANSPARENCY OF CHECKING ACCOUNTS 3 (2012), *available at* http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Safe_Checking_in_the_Electronic_Age/Pew_Safe_Checking_Still_Risky.pdf.

[93] *See, e.g.*, FED. DEPOSIT INS. CORP., FDIC STUDY OF BANK OVERDRAFT PROGRAMS, at v (2008), *available at* http://www.fdic.gov/bank/analytical/overdraft/FDIC138_Report_Final_v508.pdf ("Accounts held by customers in low-income areas . . . were more likely than accounts in higher-income areas to incur overdraft charges. More than 38 percent of low-income accounts had at least one [non-sufficient funds] transaction, compared with 22 percent of upper-income amounts.").

[94] Bell, *supra* note 88, at 5. Fees are rising despite recent regulation of overdraft fees, *see, e.g.*, 12 C.F.R. § 205.17(b) (2013), that prohibits banks from charging overdraft fees unless customers opt for coverage.

[95] WEINSTOCK ET AL., *supra* note 92, at 3.

[96] *See Hearing*, *supra* note 57, at 222 (statement of Sen. Richard J. Durbin) ("Transparency, competition and choice are good for consumers, and the current interchange system is designed specifically to avoid those features.").

Transparency is particularly helpful for low-income consumers, as financial literacy correlates directly to socioeconomic status.[97]

To the extent that the Amendment prevents banks from burying interchange fees within retail prices and forces the true costs of debit cards into the light of day, the regulation acts like a rule mandating disclosure. Mandating disclosure "aspires to improve decisions people make in their economic and social relationships and particularly to protect the naïve from the sophisticated."[98] Disclosure increases the flow of information and therefore "the likelihood that each party will value what it gets more than what it gives up."[99] It is meant to give consumers information that permits them to make optimal choices.

Ideally, increased disclosure and transparency also benefit the consumer by stimulating competition. When consumers have more information with which to compare products, sellers may be forced to compete on price or quality, and may have "better incentives to improve the quality of their offerings."[100]

This Subpart explores whether low-income consumers have actually benefited from increased transparency in financial products as a result of the Amendment.

### 1. *The True Cost Is Hidden in Small, Complex Print*

Unfortunately, despite the cap on interchange fees, the costs of debit card usage are still not obvious or visible to low-income consumers because banks have buried fees within complex agreements. Many fees are never disclosed and cannot be found on banks'

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[97] *See* Annamaria Lusardi & Olivia S. Mitchell, *Financial Literacy and Retirement Preparedness: Evidence and Implications for Financial Education*, 42 Bus. Econ. 35, 39 (2007) (noting that studies in Australia and New Zealand confirm that, as in the United States, consumers with low levels of financial literacy also had low education and income). Studies in the United Kingdom also confirm that "those in low social classes, and those with low incomes were the least sophisticated financial consumers." *Id.*

[98] Omri Ben-Shahar & Carl E. Schneider, *The Failure of Mandated Disclosure*, 159 U. Pa. L. Rev. 647, 649 (2011). It is worth noting that there have been recent debates over the effects of increased disclosure. Some scholars have argued that disclosure "promotes important social values and goals, including efficiency, autonomy, corrective justice, fairness, and the legitimacy of the contract process." Robert A. Hillman & Maureen O'Rourke, *Defending Disclosure in Software Licensing*, 78 U. Chi. L. Rev. 95, 95 (2011). Others are more skeptical, arguing that mandated disclosure "not only fails to achieve its stated goal but also leads to unintended consequences that often harm the very people it intends to serve." Ben-Shahar & Schneider, *supra*, at 647.

[99] Hillman & O'Rourke, *supra* note 98, at 97.

[100] Richard Craswell, *Taking Information Seriously: Misrepresentation and Nondisclosure in Contract Law and Elsewhere*, 92 Va. L. Rev. 565, 587 (2006).

websites; some banks even require customers to visit bank branches in person to request information on fees.[101]

Even when customers do have access to fee disclosures, they are tasked with deciphering lengthy and complex terms. Of the bank account contracts examined in a Pew study, disclosure forms ranged from 21 to 153 pages, with a median of 69 pages.[102] The median number of extra service fees charged by banks was 26, and some accounts included as many as 48 fees.[103] Many disclosures are written in very complex terms. Financial privacy notices, for example, are on average written at a third- to fourth-year college reading level.[104] Consumers in lower income brackets are less likely to have a secondary degree[105] and are therefore less likely to be able to understand such disclosures.

A lack of standard, industry-wide terminology makes it even more difficult to decipher and compare contract terms. For example, a survey of major banks and credit unions revealed a variety of alternative terms for a basic overdraft fee, including "optional overdraft protection service transaction," "courtesy pay fee," "non-sufficient funds [NSF/OD] preauthorized withdrawal," "bounce protection," "overdrawn items," "courtesy clearing," and "paid NSF."[106] These variations present comprehension challenges for even the most educated consumer, not to mention those with limited financial literacy.[107]

Complexity in contracts can be advantageous to issuers. Complexity hides the true cost of a product from consumers, and the imperfectly rational cardholder deals with complexity by ignoring

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[101] *See* WEINSTOCK ET AL., *supra* note 92, at 7 ("In some cases, terms and conditions were accessible on the institution's checking home page or the Web pages of specific accounts . . . . [I]n other instances, details were not disclosed in any of these online locations, requiring customers to visit bank branches in person or request disclosure documents by mail.").

[102] *Id.*

[103] *Id.* at 11.

[104] Adi Osovsky, *The Misconception of the Consumer as a* Homo Economicus*: A Behavioral-Economic Approach to Consumer Protection in the Credit-Reporting System*, 46 SUFFOLK U. L. REV. 881, 916 (2013).

[105] The U.S. Census noted that, in 2009, consumers with Bachelor's degrees earned an average of $56,665, consumers with high school degrees earned an average of $30,627, and consumers without high school degrees earned an average of $20,241. U.S. CENSUS BUREAU, STATISTICAL ABSTRACT 152 tbl.232 (2012), *available at* http://www.census.gov/compendia/statab/2012/tables/12s0232.pdf.

[106] WEINSTOCK ET AL., *supra* note 92, at 10.

[107] For a discussion of the wide variance of relative levels of financial literacy across education and racial groups, see Annamaria Lusardi, *Financial Literacy: An Essential Tool for Informed Consumer Choice?* (Nat'l Bureau of Econ. Research, Working Paper No. 14084, 2008), *available at* http://www.nber.org/papers/w14084.

it.[108] Professor Oren Bar-Gill notes that consumers facing decisions either ignore nonsalient price dimensions (like overdraft fees) or "guesstimate" rather than attempt to calculate potential costs.[109] Ultimately, "limited processing ability might prevent cardholders from accurately aggregating the different price components into a single, total expected price that would serve as the basis for choosing the optimal card."[110]

It is very unlikely that most consumers even attempt to read the terms of their long, complex, and opaque banking contracts. A study that tracked Internet browsing behavior of consumers shopping for online software found that only one or two of every thousand shoppers accessed the license agreement, and those that did spent very little time reading the text.[111] There is little reason to believe that consumers are any more diligent when it comes to banking agreements.

Consumers also suffer from several different cognitive biases that make it difficult or impossible to make completely rational or efficient choices. For example, consumers suffer from myopia, or the preference for immediate benefits at the expense of future costs, as well as optimism, or the underestimation of the probability of triggering contingent costs.[112] These biases explain why rising overdraft fees and minimum balance requirements have attracted so little attention, while Bank of America's decision to levy a five-dollar fee on all debit card users caused an uproar.[113] The repercussions are serious: "[W]hen consumers are imperfectly rational, competition will maximize the *perceived* (net) benefit at the expense of the *actual* (net) benefit. . . . When consumers are imperfectly rational, sellers compete by designing pricing schemes that create an appearance of a lower

[108] OREN BAR-GILL, SEDUCTION BY CONTRACT 53 (2012).

[109] *Id.*

[110] *Id.*

[111] Yannis Bakos et al., *Does Anyone Read the Fine Print? Testing a Law and Economics Approach to Standard Form Contracts* (NYU Ctr. for Law, Econ. & Org., Working Paper No. 09-40, 2009), *available at* http://ssrn.com/abstract=1443256. These scholars estimated the number of "retail software shoppers that access[ ] [the End User License Agreement] at between 0.05% and 0.22%, and the very few shoppers that do access it do not, on average, spend enough time on it to have digested more than a fraction of its content." *Id.* at 36.

[112] *See* BAR-GILL, *supra* note 108, at 21–22 (noting the prevalence of both myopia and optimism bias). Myopia is "driven primarily by short-term payoffs, over the deliberative system, which cares about both short-term and longer-term payoffs." *Id.* at 22. Consumers are also optimistic and "underestimate the likelihood that the contingency will materialize. For example, an optimistic cardholder might underestimate the probability of making a late payment, leading her to underestimate the importance of the late fee." *Id.*

[113] *See supra* note 86 and accompanying text.

price."[114] Thus, it benefits sellers to structure their offerings in ways that conceal the true cost of a good or service.

Consumers' inability to accurately assess the true costs of financial products may lead to inefficient markets. Financial institutions have little incentive to compete on terms that consumers do not understand and prices they cannot compute. Rather than foster competition, the Amendment shifted the costs of debit card use from the hidden realm of retail prices to the similarly obfuscated realm of small print, complex terms, and hidden fees in banking contracts.

### *C. The Durbin Amendment Is Unlikely to Result in Lower Retail Prices*

The Amendment's effects on banking costs could at least be partially mitigated if retailers were to lower prices in response to reduced interchange fees. In theory, market competition should eventually drive retail prices lower than they would have been in the absence of the new regulations.

There are reasons to believe, however, that the regulations will not translate into lower retail prices for consumers. Some critics point to similar legislation enacted in Australia, from which retailers allegedly absorbed all the benefit.[115] Others have observed an increase, rather than decrease, in consumer prices in the year following the Amendment.[116] Furthermore, the actual savings to retailers have been limited by shifts in strategy by card issuers: Banks have made a concerted push to promote the use of credit cards,[117] which carry higher swipe fees than do debit cards,[118] and have eliminated the discounts on swipe fees that were previously extended to retailers for small

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[114] BAR-GILL, *supra* note 108, at 16 (emphasis added).

[115] *See, e.g.*, Anisha Sekar, *Perspectives on the Durbin Amendment: Prof. Todd Zywicki*, NERD WALLET BLOG (Oct. 18, 2011), http://www.nerdwallet.com/blog/2011/perspectives-durbin-amendment-prof-todd-zywicki/ (noting that there was no change in retail prices post–interchange fee reform in Australia, as retailers reaped a windfall from the legislation).

[116] *See, e.g.*, ELEC. PAYMENTS COAL., WHERE'S THE DEBIT DISCOUNT? THE DURBIN EFFECT: RETAILERS GAIN WITHOUT CONSUMER BENEFIT (2012), *available at* http://wheresmydebitdiscount.com/wp-content/themes/epc/media/Durbin%20White%20Paper_092812_small.pdf (comparing prices from September 2011 to September 2012 and finding that, overall, consumers paid more for goods after the rule was implemented). Although the Electronic Payments Coalition is not a neutral source, and there are many other variables that may affect retail prices, the piece demonstrates growing skepticism over the Amendment's effect on prices.

[117] *See supra* Part II.A.2 (examining how banks encourage the use of credit cards over debit cards).

[118] *See supra* note 73 and accompanying text (noting average credit card fees).

transactions.[119] Therefore, even assuming that retail markets are competitive enough to channel swipe fee savings from retailers to consumers, the structure of the Amendment tends to stifle the realization of lower retail prices for consumers.

## III
## Recommended Action

This Note has discussed substantial problems with the Durbin Amendment, including its impact on low-income consumers. The question remains: What should be done to mitigate the harm to marginalized populations, whose positions within the mainstream banking system are already precarious? Simply repealing the Amendment and failing to regulate fees at all is not desirable. Congress's decision to regulate swipe fees seems to reflect a belief that the debit card market, largely dominated by two companies,[120] is uncompetitive and vulnerable to abuse. There is also no reason to believe that banks, having devised and implemented opaque fee structures for personal bank accounts, would abandon these new revenue streams in response to a repeal of the interchange fee cap. This Note therefore proceeds on the assumption that some regulation of the debit card industry is necessary to achieve Congress's desired ends.[121]

Part III of this Note suggests adjustments to the Amendment that would help further its goals. Specifically, I suggest a combination of three changes: regulate credit cards as well, permit the Federal Reserve to consider all costs related to debit card use when setting fees, and improve mandatory financial disclosures on bank accounts. While it may seem counterintuitive to suggest *further* regulation to fix a faulty regulation, the Amendment fails not because it regulates, but because it regulates poorly. This Part concludes that although the

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119 Before the regulations were enacted, financial institutions gave retailers discounts on debit card fees for small transactions, but since fees were capped the banking industry responded by eliminating those discounts and charging the maximum for most transactions, regardless of their size. Robin Sidel, *Debit-Fee Cap Has Nasty Side Effect*, Wall St. J., Dec. 8, 2011, at C1. Many businesses have stated publicly that the Amendment has resulted in higher fees and necessitated raising prices. For example, Redbox, a company long known for its dollar movie rentals, cited the Amendment when it raised rental prices from $1.00 to $1.20. Amy Martinez, *Soon Playing at Redbox: Price Increase for DVDs*, Seattle Times, Oct. 28, 2011, at A10.

120 Epstein, *supra* note 26, at 1315 (noting that Visa has a sixty-six percent market share and MasterCard a further seventeen percent).

121 Whether or not debit card regulation is necessary has been discussed at length elsewhere. *Compare id.* at 1308 ("At this point, there is no justification for any rate regulation, given that the debit card companies are already at the competitive rate . . . ." (emphasis omitted)), *with* Farrell, *supra* note 26 (arguing that the Amendment was an appropriate response to high swipe fees).

Amendment—if implemented successfully—may well achieve its stated goals, any fee regulation under the current regime will necessarily harm low-income consumers and should therefore be accompanied by government initiatives to improve access to banking.

### *A. Regulate Credit Card Fees*

It is critical to ensure that the banks cannot undermine the objectives of the Amendment by sidestepping fee regulations. Congress should therefore regulate credit card fees by incentivizing consumers to use unregulated credit cards rather than debit cards.[122] Whether or not retail prices will, in fact, respond to lower credit and debit card fees, the probability that the Amendment will achieve its stated goal of lower retail prices at least is higher if both types of fees are capped, rather than just one. This would also tend to reduce the incentive for banks to attach benefits to credit cards, which many low-income customers cannot access, rather than debit cards. The legislative history does not reveal why Senator Durbin insisted on regulating debit cards but not credit cards. However, many merchants, including the Merchants Payments Coalition, are pushing for regulating credit card fees as well, hoping to lower their costs of doing business and, ideally, passing savings along to their customers.[123]

Although regulating credit card fees is essential to accomplishing the Amendment's stated goals, this change, implemented alone, would likely force even higher prices in banking.[124] Further, this suggestion would not improve the lack of transparency in personal banking, as fees would likely be shifted into difficult-to-comprehend banking contracts.[125] Therefore, this Note further recommends that Congress permit the Federal Reserve to consider the cost of card use when setting fee caps and also to affirmatively address banking disclosures.

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[122] *See supra* Part II.A.2 and accompanying text (explaining how low-income consumers are harmed when banks incentivize credit cards over debit cards).

[123] In a recent class-action lawsuit, many retailers rejected settlements that did not provide for fee caps, finding them insufficient to protect retailers. The settlement is mired in controversy and politics. *See* Jessica Dye, *Card Fee 'Settlement' Just Start of Legal Battle*, TELEGRAPH-J., Oct. 16, 2012, at B2 (noting that settlement supporters question "whether objecting merchants are trying to create a legal stalemate to pressure Congress for credit-card fee legislation").

[124] *See supra* notes 51–55 and accompanying text (arguing that the cost of debit cards cannot be recovered solely through debit card fees due to the structure of the fee cap).

[125] *See supra* Part II.B.1 (explaining how swipe fees have been shifted to hidden terms in complex banking contracts).

### *B. Permit the Federal Reserve to Consider All Costs Reasonably Related to Debit Card Service*

The Amendment should also be modified to permit the Federal Reserve to include in the price cap additional factors that more accurately reflect the true cost of providing debit card services. A fee cap that represents the true cost of debit card use would reduce the need for banks to recoup the costs of debit cards elsewhere. As noted in Part I.A, Congress did not debate which factors should be included, so it is impossible to know the rationale behind its decision to limit consideration to per transaction costs.

The fee cap should reflect *all* costs: those associated with corporate overhead, establishing and maintaining an account relationship, card production and delivery costs, marketing expenditures, and costs for non-sufficient funds handling. In addition, it should allow a reasonable profit margin. The banks have supported this idea from the beginning, noting that it is necessary to enable them to profitably operate debit card services.[126] As the Federal Reserve noted, banks are unable to cover the costs of debit card use under the current regulations.[127]

Permitting the Federal Reserve to consider additional factors when setting the fee cap would permit card issuers to recover the costs of debit card service. However, it is not clear that banks would stop charging the high fees they instituted in response to the Amendment, given that market failures seem to prevent efficient competition on those terms. The regulation would thus still have a negative impact on low-income consumers, who are more vulnerable to such fees.[128] Congress should therefore also enact new disclosure requirements to improve transparency in banking contracts, which would ideally promote increased comprehension among consumers and more competition among banks.

### *C. Address the Lack of Transparency in Bank Contracts*

Clearer contracts would enable consumers to select the bank accounts and cards that truly offer the best value and would thus force competition among banks. To achieve this end, Congress must succeed in an area where it has stumbled in the past.

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[126] *See supra* notes 57–58 and accompanying text (noting that bank officials predicted they would lose money on every account).

[127] *See supra* note 55 (noting that the Federal Reserve understood that the current regulations would require banks to recover costs of debit card service through means other than swipe fees).

[128] *See supra* Part II.A.3 (explaining why low-income consumers pay higher fees after the enactment of the Amendment).

Congress previously attempted to force transparency in banking when it passed the Truth in Lending Act of 1968 (TILA),[129] which, among other things, required lenders to disclose the annual percentage rates (APRs) of credit cards.[130] Congress spent eight years debating TILA, "a prototype consumer-protection statute" that became the "template" for future consumer-credit legislation.[131] TILA ensures that credit card issuers "disclose all of a contract's terms" and "highlight, in a uniform way, critical terms [such as APRs] and fees."[132] After TILA, "[l]enders could no longer devise their own disclosure strategies for making their loan programs more attractive, because they had to follow a prescribed statutory formula that put everybody on an even playing field."[133] This made it easier for consumers to understand how much they were paying for credit, because the language used was standardized.[134] TILA "has provided consumer lawyers with a litigation handle for ameliorating the problems of their clients"[135] and is viewed by some as an effective mechanism.[136]

TILA's effectiveness, however, has been questioned. Critics have argued that although consumers are aware of APRs, they don't always comprehend the information available to them: Consumers often miscalculate finance charges, misread TILA disclosures, and misunderstand terms TILA did not cover.[137] TILA thus demonstrates the potential challenges in regulating disclosures in order to improve transparency in the banking sector.

Congress should require disclosures in order to reap benefits similar to those realized by TILA, while making a concerted effort to ensure consumer comprehension. In addition, to succeed where TILA stumbled, Congress should reconsider the *type* of disclosures required. For example, Professor Bar-Gill suggests that current disclosures would be more effective if banks were required to disclose consumers' individual use patterns: "[I]n many cases consumers are not mistaken

[129] 15 U.S.C. §§ 1601–1667(e) (2006).

[130] For an explanation of how lenders are required to calculate and disclose an APR, see 15 U.S.C. §§ 1606, 1631–1649.

[131] Ben-Shahar & Schneider, *supra* note 98, at 653, 665.

[132] *Id.* at 654.

[133] Elwin Griffith, *Lenders and Consumers Continue the Search for the Truth in Lending Under the Truth in Lending Act and Regulation Z*, 44 SAN DIEGO L. REV. 611, 612 (2007).

[134] *Id.*

[135] Mark E. Budnitz, *The Development of Consumer Protection Law, the Institutionalization of Consumerism, and Future Prospects and Perils*, 26 GA. ST. U. L. REV. 1147, 1154 (2010).

[136] *See, e.g.*, M. Susan Hale, *Charge Me, Pay Me, but Don't Even Think of Litigating Me: The Dominance of Arbitration in Truth-in-Lending Claims*, 2 PEPP. DISP. RESOL. L.J. 263, 267 (2002) (concluding that despite its shortcomings, TILA is an effective mechanism).

[137] *See, e.g.*, Ben-Shahar & Schneider, *supra* note 98, at 666.

about product attributes; they are mistaken about their future use of the product."[138] Fortunately, card issuers often have this information readily available.[139] If consumers are provided with personal use data, they will be better able to choose the appropriate financial product. Furthermore, when consumers are able to choose the best financial products, competition intensifies and products and services are likely to improve or become more affordable.

### *D. The Potential Impact of These Solutions on Low-Income Consumers*

If the Amendment were modified in the three ways described, Congress would likely further its goal of lowering swipe fees and, ideally, retail prices. However, the swipe fee structure I propose still leads to a reduction in card issuers' profits as compared to the pre-Amendment status quo. As discussed in Part II.A, high debit card swipe fees previously helped finance low-cost checking accounts, particularly those belonging to low-income consumers.[140] The fee limits I propose still only take into account costs reasonably associated with debit card use and would most likely not recreate the dynamic whereby higher-balance accounts subsidized lower-balance accounts. Thus, the extra costs required to maintain unprofitable checking accounts would still be borne by low-income consumers, which would serve as a barrier to entry in banking.[141]

While Congress might justifiably decide not to revive the cross-subsidization of banking through debit cards, it should nonetheless consider further legislation to mitigate the impact on low-income consumers. There are many ways Congress can expand access to banking, including providing tax credits to financial institutions that serve low-income consumers, supporting programs that identify and punish discriminatory activities in banking services, and establishing financial education programs that change consumers' savings behavior. These solutions and many more have been widely discussed elsewhere and are beyond the scope of this Note.[142] This Note serves only to demon-

[138] Oren Bar-Gill, *The Behavioral Economics of Consumer Contracts*, 92 MINN. L. REV. 749, 798 (2008).

[139] *See id.* at 799 (noting that card issuers have detailed statistics about card use in consumers' respective demographic and socio-economic groups, information on individual consumers obtained from the credit card application and from credit bureaus, and specific information about a consumer's use of a specific card due to the business relationship).

[140] *See supra* Section II.A.1 (discussing the cross-subsidization of banking costs).

[141] *See supra* note 70 (noting that banking the poor is not generally profitable for banks).

[142] For a discussion of various means of expanding access to banking, see, for example, Steven Semeraro, *The Reverse-Robin-Hood-Cross-Subsidy Hypothesis: Do Credit Card*

strate that the Amendment has proven costly for low-income consumers and that remedial efforts, though necessary, would still produce a net loss for those individuals. Thus, the amended legislation should be coupled with initiatives that will attenuate this harm.

## Conclusion

When Congress enacted the Durbin Amendment, it presumably had consumers in mind. Unfortunately, the Amendment has fallen short of its goals and has harmed low-income consumers, who are particularly vulnerable to higher bank account balance minimums, rising overdraft fees, and rising monthly charges. These harms have not been mitigated by increased transparency in the financial industry that could have induced competition and better banking products: Instead, banks are hiding new fees in the fine print of lengthy contracts.

Congress should fortify, amend, and supplement the Durbin Amendment by regulating credit cards, permitting the Federal Reserve to consider all relevant costs when setting fee caps, and addressing the lack of transparency in banking contracts. However, even under this improved regime, low-income consumers will encounter obstacles to banking access. Because access to financial services is an important prerequisite to social mobility, Congress should also enact legislation to improve access to banking for low-income consumers.

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*Systems Tax the Poor and Reward the Rich?*, 40 RUTGERS L.J. 419, 449 (2009). Semeraro advocates for educational programs that would teach financial literacy to the unbanked, promotes enhanced efforts to punish discriminatory activities in banking services, and supports the creation of incentives for financial institutions to provide banking services to the unbanked. *Id.*; *see also, e.g.*, Barr, *supra* note 6, at 223 (advocating for tax credits to financial institutions that provide new services to the unbanked, as well as workplace- and community-based financial education).