The Dick Durbin Bank Fees

Bank branches close while banking becomes more expensive and less consumer-friendly.

By TODD ZYWICKI

This Saturday, government price controls on debit card interchange fees (which card issuers charge to merchants) go into effect. The controls are the result of the Durbin amendment to last year's Dodd-Frank financial reform legislation. They were enacted at the behest of big-box retailers such as Wal-Mart and Walgreen's, which stand to gain a multimillion-dollar windfall. But the controls are already transforming the retail banking landscape.

The Durbin amendment tasked the Federal Reserve with establishing the allowable maximum interchange fees. It originally intended to slash them by 70%-80%. In response to a firestorm of criticism, the Fed cut the fees about in half, to about 24 cents per transaction from an average of 44 cents per transaction, including a one-penny allowance for fraud prevention. The new fee limits apply to any bank with more than $10 billion in assets.

Faced with a dramatic cut in revenues (estimated to be $6.6 billion by Javelin Strategy & Research, a global financial services consultancy), banks have already imposed new monthly maintenance fees—usually from $36 to $60 per year—on standard checking and debit-card accounts, as well as new or higher fees on particular bank services. While wealthier consumers have avoided many of these new fees—for example, by maintaining a sufficiently high minimum balance—a Bankrate survey released this week reported that only 45% of traditional checking accounts are free, down from 75% in two years.

Some consumers who previously banked for free will be unable or unwilling to pay these fees merely for the privilege of a bank account. As many as one million individuals will drop out of the mainstream banking system and turn to check cashers, pawn shops and high-fee prepaid cards, according to an estimate earlier this year by economists David Evans, Robert Litan and Richard Schmalensee. (Their study was supported by banks.)

Consumers will also be encouraged to shift from debit cards to more profitable alternatives such as credit cards, which remain outside the Durbin amendment's price controls. According to news reports, Bank of America has made a concerted effort to shift customers from debit to credit cards, including plans to charge a $5 monthly fee for debit-card purchases. Citibank has increased its direct mail efforts to recruit new credit card customers frustrated by the increased cost and decreased benefits of debit cards.

This substitution will offset the hemorrhaging of debit-card revenues for banks. But it is also likely to eat into the financial windfall expected by big box retailers and their lobbyists. They likely will return to Washington seeking to extend price controls to credit cards.

Prepaid cards, also exempt from the Durbin amendment's price controls, may also become a more attractive alternative to debit cards for many consumers. These cards were once the province of low-income consumers without bank accounts, but over the summer American Express rolled out a new prepaid card aimed at higher-income consumers looking for alternatives to debit cards.

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The Durbin amendment may cause more customers to use credit cards instead of debit cards.

Finally, retail banks will be looking for new ways to cut costs to offset the expected loss of revenues from the Durbin amendment. The past decade saw a dramatic increase in bank services and innovation, as banks have provided longer hours, more days of service and more branches, while rolling out products such as online banking, mobile banking and debit reward cards—and all for free.

This trend has been reversed in anticipation of the price controls. Banks have already eliminated rewards on debit cards. Future product innovation, including security, can be expected to decline or stop as banks avoid making investments they will be unable to recoup thanks to lost revenue from interchange fees.

The most noticeable change will likely be the closure of bank branches, reversing a decade-long growth. Branches today serve as customer-recruitment centers, as customers, once enrolled, do much of their banking electronically, by ATM or online. By making many new customers unprofitable, however, the Durbin amendment eliminates the incentive to compete by offering more branches.

Citing the negative impact of the Durbin amendment and other regulations on customer profitability, Texas-based IBC bank recently announced its decision to close 55 supermarket-based branches, eliminating 500 jobs, rather than increasing banking fees. Other banks will inevitably follow suit.

Conceived of as a narrow special-interest giveaway to large retailers, the Durbin amendment will have long-term consequences for the consumer banking system. Wealthier consumers will be able to avoid the pinch of higher banking fees by increasing their use of credit cards. Many low-income consumers will not. Banking will become less innovative and consumer-friendly.

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