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IN FOCUS

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How the Credit Card Competition Act of 2023 Could Affect Consumers, Merchants, and Banks

When a consumer makes a payment with a credit card, a small portion of the transaction is used to compensate the merchant's bank, the payment processors, the payment network, and the consumer's bank—each of which play a role in facilitating the transaction. (More on transaction fees, or "swipe fees" can be found at CRS In Focus IF11893, *Merchant Discount, Interchange, and Other Transaction Fees in the Retail Electronic Payment System*, by Andrew P. Scott.)

Credit card fees have been a long-standing subject of debate, including in the 118th Congress. Merchants argue that card network operators use market power to charge higher-than-competitive fees. The industry argues that participants are in tight competition and fees closely reflect the costs of providing fast, reliable, and secure transactions. Proposed legislation—including the Credit Card Competition Act of 2023 (S. 1838/H.R. 3881 or CCCA)—is aimed at lowering the fees. This In Focus explains how credit card transactions are processed, examines competition in the industry, and analyzes the proposed changes in the CCCA.

Retail Payments Infrastructure

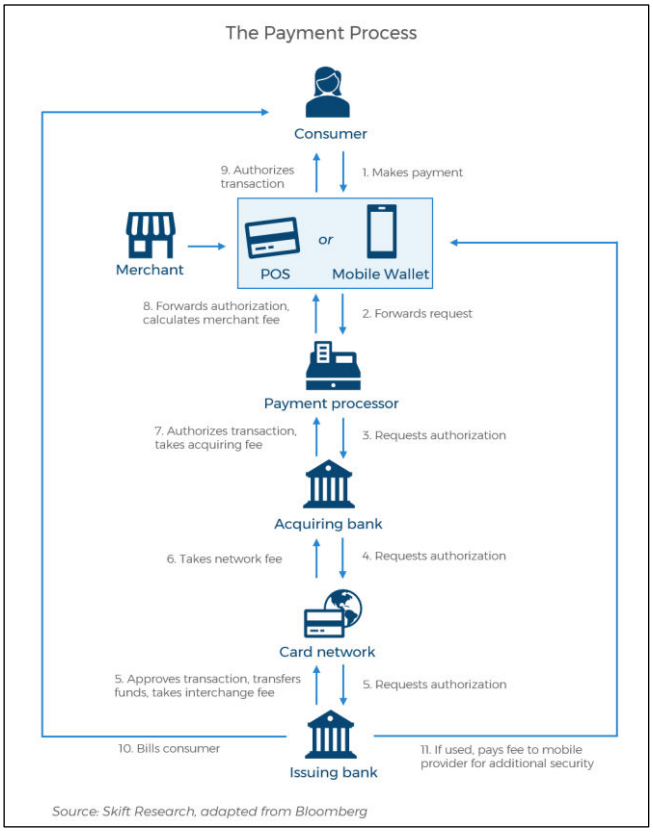
The basic structure of a card payment involves a customer, the customer's bank (called the issuing bank), a card network, the merchant, the merchant's bank (called the acquiring bank) and payment processors that facilitate the flow of transaction data. Before a transaction occurs, these parties make several decisions about how payments will be accepted. For example, when a merchant starts a business, it needs to decide how to accept payments. Most merchants want to accept electronic payment cards (as opposed to just cash) due to their popularity among consumers. Further, merchants generally choose to accept cards that can be run on at least one of the most popular networks, such as Visa, MasterCard, Discover, or American Express. (There are also a number of smaller networks.) In order to accept certain cards, it needs to procure the hardware (e.g., a card reader), software (e.g., payment app), and services necessary to use a certain payment network. Accepting payments for multiple networks is also an option, but these services cost money and so there is a trade-off between the costs and benefits of accepting payments over more than one or two card networks.

Before a consumer can use a card, a bank or credit union has to issue one to him or her. The financial institutions that issue credit cards belong to credit card networks. A bank that is a member of the Visa network would issue a Visa card, for example. Issuers can belong to multiple card networks, however, and they would issue cards specific to a particular network in accordance with their membership agreements. (Discover and American Express each own both a network and a bank and issue their own cards, so a number of topics discussed below do not apply to them. The rest of this In Focus concentrates on Visa and MasterCard.)

Credit Card Processing

Although a retail purchase appears instantaneous, there are a number of discrete steps involved in processing a single transaction that take place over the course of a few days. (See **Figure 1**.)

Figure 1. The Credit Card Payment Process



Source: Skift Research, "The State of Hotel Payments 2021," September 2021, https://research.skift.com/report/the-state-of-hotel-payments-2021/.

First, the cardholder provides his or her credit card information to the business. For in-person transactions, this means swiping, inserting, or tapping the card. Then, the business's point of sale system or payment gateway (the online payment portal) captures the transaction details and securely transmits this information to the credit card processor, which forwards the transaction data to the

acquiring bank and on to the appropriate card network, which then routes the authorization request to the issuing bank. The issuing bank verifies the cardholder's account, checking for sufficient funds and any potential fraud or security issues.

If the transaction is approved, the business completes the sale and provides the goods or services to the customer. The processor also forwards the transaction details to the respective card networks. The card networks coordinate with the issuing bank to transfer the funds to the acquiring bank, which receives the funds in the merchant account. The acquiring bank then transfers the funds into the business's regular business bank account, minus any processing fees. This entire process usually takes one to three business days.

Who Chooses the Network?

Merchants can choose which payment processor(s) they want to use for certain payments. In some cases, the merchant can direct the processor to route different types of payments over different networks. In more simplified cases, the merchant may choose a service provider that makes these decisions on behalf of the merchant. (For example, the processor may work with only certain acquiring banks and card networks.) Ultimately, when a payment is made, the processor will send information to the acquiring bank, which will route the transaction over the chosen network to communicate with the issuing bank.

Credit Card Network Competition

There are four major credit card networks. Merchants want to accept the cards consumers have. Banks want to issue cards that consumers want. Consumer want cards that merchants accept. This circular demand structure creates a market whereby the networks can gain market power and set higher prices, and merchants have limited options to choose competing networks on the basis of price.

Routing restrictions on transactions are a feature of contracts between the networks and banks that could potentially lead to higher prices by limiting competition in the market. Payment cards possess the technological capacity to run on multiple networks. However, the membership agreements for Visa and MasterCard generally prevent card issuers from routing transactions over competing networks. Further, the networks restrict merchants' ability to process cards over competing networks.

Competitive Routing Requirements

Policymakers can influence transaction fees by (1) directly imposing a fee structure such as a cap—the approach taken in the Durbin Amendment (15 U.S.C. §1693o-2) with respect to debit card interchange fees—or (2) indirectly influencing the market through incentivizing competition. The Durbin Amendment also contains a competition feature, but its caps are considered more impactful. (See CRS Report R41913, *Regulation of Debit Interchange Fees*, by Darryl E. Getter for more details.) Encouraging competition is the approach taken by the CCCA to influence swipe fees.

Section 2 of the CCCA would prohibit banks and card networks from restricting the network over which a transaction is processed. This means that card networks could not require banks to issue cards that would run only on their networks. Merchants are generally proponents of this type of regulation, as they would benefit from paying lower transaction fees. Networks and generally most banks (although the provision would apply only to the largest banks) are opposed to measures that might lower those fees.

Potential Issues for Consideration

One issue is that the ultimate impact of routing restriction prohibitions is not certain. For example, even if an issuing bank ensures that cards can be routed over multiple networks, merchants would still want to choose the most popular ones, and consumers would still want cards that are accepted everywhere. So this does not necessarily incentivize merchants to switch networks. Further, it is unlikely a small business would be aware of a smaller network, and even if it did offer payment on that network, the odds that a bank would issue a card enabled for that exact network are relatively small.

Second, if it is impactful, it is unclear who would benefit. Both opponents and proponents argue that this would affect customers. Banks argue that rewards programs—a major incentive for card issuers to attract consumers generally funded through interchange fees—may disappear if interchange revenue falls. Issuing banks might lose fee revenue, but a case could be made that by having more network options they could negotiate more favorable terms for themselves. Retailers stand to benefit from lowers fees. However, they might face higher incidences of fraud if payment security is weakened. In addition, it is not clear whether retailers would pass interchange savings on to consumers.

Third, to the extent that the major networks invest in making their infrastructure secure in order to attract customers and profits, if cards are effectively required to be interoperable, networks may be less willing to invest as much in secure payment technologies, as part of the benefit would accrue to their competitors.

Fourth, there may be unintended consequences of this bill. For instance, there is nothing stopping the major retailers from creating a payment network that cuts out the major payment networks and lowers interchange costs. However, this would tighten links between commerce and banking and potentially lead to conflicts of interest.

Finally, while the banking agencies have enforcement authority for interchange regulation, there is not a clear mechanism for the regulators to ensure that banks are making these networks available to merchants.

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