

TO FEE OR NOT TO FEE?

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Bank of America had barely announced a new fee of \$5 per month for the privilege of using a debit card when it dropped the whole idea in the face of consumer backlash. The story that Bank of America told about why it instituted the fee in the first place tells volumes about the state of consumer banking.

Bank of America blamed Congress for its new debit fee, pointing to antitrust legislation known as the Durbin Amendment that limits its ability to charge merchants uncompetitive fees on debit card transactions. Bank of America argued that if Congress wouldn't let it make money off merchants, then it had to make up the lost revenue from consumers.

That's a convenient argument, but it belies reality. It would imply that Bank of America has just been leaving money on the table all these years by not charging consumers a fee that they would gladly pay. Bank of America's decision to drop the fee shows its argument was wrong all along.

The fees Bank of America proposed had little relation to Congressional action. Congressional action merely provided PR cover for Bank of America to institute a fee it had contemplated for some time. The fee was simply another step in Bank of America's goal of turning its customers into fee-generating machines, itself part of the shift in banking from the bank as partner to the bank as fee extractor.

Traditionally, banks made their money by lending money. The goal was to be repaid the principal and make some money on the interest. The borrower's success was therefore paramount to the bank's. The bank's success was wed to the consumer's, which meant that the bank needed to be careful about the quality of the loans it made. Other services the bank offered to the borrower were incidental to the lending relationship and were often extended as courtesies.

Today, however, the business model of banking is that of a fee machine. Banks look to make money not on loans, but on incidental services. If a bank charges enough inflated fees on enough incidental services, it doesn't really matter if the loan goes bad (especially if the loan is securitized, which is just another way of collecting fees not related to loan performance). The fees will more than make up the losses on the loan. Indeed, this business model is a recipe for moral hazard as it enables banks to make ever riskier loans, ultimately gambling with federally-insured funds.

Bank fees aren't exactly new. Some, like those for late payments on credit cards, ATM withdrawals and overdrafts, have been around for years. But the number and size of new fees has exploded during the past several years. Now some banks have fees for talking to a teller or calling a customer service line, fees for checking your account

balance at an ATM and, even a fee for doing nothing, charged when an ATM denies service to a customer.

As banks have introduced these new fees, they have tried to avoid public ire by deflecting the blame for them onto regulations, such as the Credit CARD Act and the Federal Reserve's opt-in requirement for certain overdrafts. Now debit swipe fee reform has become Bank of America's excuse. Yet, Bank of America and its brethren have been looking to add fees all along.

Revealingly, a Bank of America spokesperson said that the bank had considered starting its debit card fee in 2010, but stopped it because of "confusion from customers." Put differently, Bank of America hadn't found something good to blame for the new fee. Of course customers were confused: why should they suddenly pay for a product they've been getting for free for years?

Debit cards were historically free because they saved banks money. Banks wanted to save on the cost of handling paper checks and having tellers handling paper withdrawal slips. Electronic transactions initiated with a debit card were the answer. And, as you would expect, banks originally didn't charge merchants or consumers for these transactions. The only reason the cards were introduced was because the bank wanted to save on the processing cost. Banks even paid some merchants to entice them to accept the cards.

Then Visa—an interbank association—got into the debit card processing business and pooled the power of all of its member banks together. With a huge share of the debit card market (and a requirement that merchants accept the cards to be able to accept credit cards), Visa and its banks were able to lather on fee hike after fee hike on merchants. The rapid explosion of fees obscured that banks were better off with debit cards (even when earning no fees from them) than they had been when handling paper transactions.

Once they started making a windfall on debit, Bank of America and its brethren had to justify it. So, Bank of America waited for the right excuse and decided debit swipe fee reform was it.

Bank of America, however, misjudged the competitive landscape. Congressional reform of debit swipe fees forced banks to be more competitive on *consumer* fees, as many other banks started advertising free checking accounts with debit cards. Some are actually offering to pay their customers \$5 per month for opening new accounts. Not surprisingly, the banks offering to pay customers \$5 aren't crediting Congress with this development.

Consumers want to work with their banks, not be exploited by them. That will only happen when banks have to compete for their customers, and not take them for granted. As Bank of America learned, that is just starting to happen.

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