

Proposal: 1818(AG67) Debit Card Interchange Fees and Routing

Description:

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From: University of Michigan-Flint, Chris Douglas

Proposal: 1818(AG67) Debit Card Interchange Fees and Routing

Subject: 1818(AG67) Debit Card Interchange Fees and Routing

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Comments:

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Proposal: Regulation II: Debit Card Interchange Fees and Routing [R-1818]

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Your comment: My name is Chris Douglas and I am a professor of economics at the University of Michigan - Flint. I am submitting this comment in opposition to proposed Regulation II, which would impose stricter price controls on interchange fees for debit card purchases. On the surface, regulations limiting credit and debit card interchange fees would appear to benefit consumers. Upon closer examination, these regulations, as is the case with price controls in general, result in unintended consequences that harm consumers on net. Federal Reserve officials were aware of this in 2011 when limits to debit card interchange fees were first being considered. Governor Elizabeth Duke noted that a likely consequence of these limits is that banks would be less likely to offer free checking accounts. Low balance, high activity free checking accounts are costly service for a bank to offer and banks are less likely to offer them if they cannot recover these costs through interchange fees. Robin Prager, the Assistant Director of Research and Statistics for the Federal Reserve also noted that it was likely banks would increase debit card fees or reduce benefits in response to these limits, and that it was impossible to know if the benefits of lower merchant prices to consumers would be high enough to offset these costs. Federal Reserve vice-chair Janet Yellen noted that an economic analysis of the proposed limits showed that the "ultimate welfare effects are impossible to ascertain in advance" and called for a careful assessment of the impact rule will have to groups affected by it and to the efficiency of the payment system. Despite the calls for caution and more time to conduct studies, Congress mandated the Federal Reserve implement limits on debit card interchange fees; the so-called "Durbin Amendment." Subsequent research failed to find consumers benefited and in instead, were harmed. Research from the University of Chicago found that consumers lost more from higher costs and fewer services from banks than they gained from lower prices from merchants and on net, the Durbin Amendment cost consumers between \$22 and \$25 billion. Researchers from the University of Pennsylvania found little evidence of consumers saving though lower retail prices but there was a substantial reduction in the availability of free checking accounts. Research by the Federal Reserve similarly found that merchants failed to pass on savings from the lower interchange fees to consumers through lower prices. Despite this, the Federal Reserve seeks to double-down on these limits.

Regulation II will reduce the base component of the interchange fee cap to 14.4 cents (down from the current 21 cents), reduce the ad valorem component to 4.0 basis points (down from the current 5.0 basis points), and increase the fraud-prevention adjustment to 1.3 cents (up from the current one cent). Regulation II tightens the ratchets on government-imposed price controls, which will likely further harm consumers and the efficiency of the payments system. This is a policy error that the Federal Reserve initially seemed to recognize as a danger. The Federal Reserve should reject this proposal and save consumers billions of dollars.