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MID-SIZE BANK COALITION OF AMERICA

May 9, 2024

Via Electronic Mail
Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Debit Card Interchange Fees and Routing; RIN 7100–AG67

Ladies and Gentlemen:

On behalf of the Mid-Size Bank Coalition of America (the **MBCA**), I appreciate the opportunity to submit this letter in response to the request of the Board of Governors of the Federal Reserve System (the **Federal Reserve**) for comment on its notice of proposed rulemaking regarding Debit Card Interchange Fees and Routing (the **Proposal**), published in the Federal Register on November 14, 2023.

The MBCA is a non-partisan financial and economic policy organization comprising the CEOs of mid-size banks doing business in the United States. Mid-size banks are defined as banks with assets between $10 and $100 billion.[1] Mid-size banks play a vital economic role in many local communities, holding more than $2.24 trillion in loans for local communities.[2] Further, mid-size banks issued 25% of PPP loans and currently hold nearly $130 billion in small-dollar loans for small businesses, commercial real estate, farmland, and agricultural production.[3]

Founded in 2011 to represent the views of mid-size banks, the MBCA has more than 100 members and educates lawmakers about the financial regulatory issues and policies affecting the ability of mid-size banks to compete fairly and to support and contribute to the growth of the U.S. economy more fully. The MBCA has more than 100 member banks, which average approximately $20 billion in size and serve customers and

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[1] *See Who We Are*, MBCA, https://midsizebanks.com (last visited May 7, 2024).

[2] *Midsize Banks Fuel America's Economy*, AMERICAN BANKERS ASSOCIATION, https://www.aba.com/news-research/analysis-guides/midsize-banks-economy-infographic (last visited May 7, 2024).

[3] *Id.*

communities through more than 13,000 branches in all 50 states, the District of Columbia, and three U.S. territories.[4]

The MBCA supports and joins the comment letter submitted by the American Bankers Association (the **ABA**). The MBCA writes separately to emphasize certain issues that are addressed by the ABA letter, which indirectly questions whether the Proposal is reasonable and proportional for mid-size banks:

- ***The Proposal is not proportional to the costs incurred by mid-size banks.*** Regulation II stipulates that "[t]he 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*."[5] However, neither the existing interchange rule nor the Proposal is proportional to the costs incurred by mid-size banks.
    - While the Federal Reserve's 2011 interchange rule[6] (the **2011 Rule**) may have been proportional for the largest of issuers at the time, it was not proportional for average issuers. The Federal Reserve's publicly available data suggests that its imposed $0.22 interchange cap per transaction allowed the largest issuers by volume (25th percentile) to earn an implied net revenue (to cover other associated costs) of $0.13 per transaction in 2009, while the average issuer could earn only $0.09, approximately 30% less.[7]
    - This disparity between large and average issuers has likely only increased since the 2011 Rule was finalized. For instance, the Federal Reserve's public data suggests that while costs for the largest issuers by volume (25th percentile) have fallen by 36% since 2009, the average issuer's costs have fallen by only 8%.[8]
    - Because the Federal Reserve does not release cost data by bank asset size, the MBCA conducted an internal survey of its mid-size bank members' costs. The MBCA's survey further indicates that mid-size banks have not enjoyed the falling costs that larger banks have enjoyed. As examples:

[4] *See Members*, MBCA, https://midsizebanks.com/members/ (last visited May 7, 2024).

[5] 12 C.F.R. § 235.3(a) (emphasis added).

[6] *Debit Card Interchange Fees and Routing*, 76 Fed. Reg. 43478 (Jul. 21, 2011).

[7] *See 2009 Interchange Revenue, Covered Issuer Cost, and Covered Issuer Merchant Fraud Loss Related to Debit Card Transactions*, BD. OF GOVERNORS OF THE FED. RESERVE SYS. (Jun. 2011), https://www.federalreserve.gov/paymentsystems/files/debitfees_costs.pdf.

[8] *See 2021 Interchange Revenue, Covered Issuer Cost, and Covered Issuer Merchant Fraud Loss Related to Debit Card Transactions*, BD. OF GOVERNORS OF THE FED. RESERVE SYS. (Oct. 2023), https://www.federalreserve.gov/paymentsystems/files/debitfees_costs_2021.pdf.

        - Approximately half of respondents (47.5%) indicated that their Authorization, Clearing, and Settlement (**ACS**) costs per transaction have risen or remained unchanged since the 2011 Rule.

        - Nearly all respondents (92.5%) indicated that their third-party vendor expenses account for more than half of total ACS expenses.

        - Approximately three-quarters of respondents (75.6%) indicated that their total fraud prevention and security investment costs have increased by more than 40% since 2011.

        - Approximately three-quarters of respondents (78.6%) indicated that their cost of cardholder inquires has increased by more than 30% since 2011.

    - While the MBCA's survey results and the limited public data from the Federal Reserve suggest that mid-size banks face disproportionate costs, relying on indirect data sources should not be necessary. The Federal Reserve should release cost data by bank asset size so that the cost disparities between large and mid-size banks can be better measured. Doing so would fully reveal how the Proposal's one-size-fits all approach to interchange fees is not proportional to the cost structures of mid-size banks.

- ***The Federal Reserve should adopt a tiered approach to interchange fees.*** Given the disproportionate costs mid-size banks face and the important role mid-size banks play in the economy, the Federal Reserve should revise its interchange fee approach to account for cost disparities.

    - Given the steep costs and thin margins mid-size banks face, the Proposal would devastate mid-size bank profitability by preventing mid-size banks from recovering their costs through proportional interchange fees.

    - Thus, while the Federal Reserve previously declined to implement an interchange structure that aligns costs to each specific issuer, it should strongly consider a tiered structure to account for the cost disparities between large and mid-size banks described above.

    - Limiting the scope of the Proposal to large banks with $100 billion or more in assets would make the revised interchange fees relatively more proportional to the costs incurred by issuers, consistent with Regulation II. Further, this tiered approach would allow mid-sized banks to sustainably serve their customers and local communities.

- ***The Proposal's cost-recovery target is flawed.*** The largest banks, while few in number, account for a disproportionally large share of debit transactions. This small group of large banks enjoy the cost-saving advantages described above, while the larger group of mid-size banks does not. Thus, while the Federal Reserve targeted cost recovery for 98.5% of covered issuer *transactions*,[9] a much smaller percentage of covered *issuers* will achieve cost recovery under the Proposal. If a tiered approach is not adopted, the proposed interchange rate should be adjusted to target cost recovery for a larger number of issuers.

- ***More consolidation.*** The Proposal may lead to more consolidation of mid-size banks, as banks near the Proposal's asset threshold of $10 billion will be disproportionately affected by reductions of millions of dollars revenue in the first year of the rule's implementation.

- ***Jeopardizing free checking.*** Unlike many large banks, many mid-size banks offer free checking accounts that are good for consumers. For instance, three-quarters of MBCA survey respondents indicated that they offer free checking accounts. However, under the Proposal, many mid-size banks would struggle to profitably operate their existing free checking accounts. Indeed, 90% of MBCA survey respondents that currently offer free checking accounts indicated that they would consider eliminating free checking accounts if the Proposal is adopted.

The MBCA appreciates the opportunity to provide commentary, and respectfully requests that the Federal Reserve consider adopting the recommendations made in this letter and in the ABA letter. If you have any questions concerning this comment letter or would like the MBCA to provide other information, please do not hesitate to contact me at
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Respectfully submitted,

Brent Tjarks
Executive Director
Mid-Size Bank Coalition of America

[9] *Debit Card Interchange Fees and Routing*, 88 Fed. Reg. 78100, 78113 (Nov. 11, 2023).