



**National
Consumer Law
Center**

*Fighting Together
for Economic Justice*

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May 10, 2024

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, 88 Fed. Reg. 78100 (Nov. 14, 2023)

Dear Ms. Misback,

The National Consumer Law Center, on behalf of its low-income clients, submits these comments on the Federal Reserve Board's (FRB's) proposed rulemaking regarding Debit Card Interchange Fees and Routing.

We take no position on the appropriate level of interchange fees. Instead, we write to ask the Federal Reserve Board (FRB) to:

- consider the impact on low-balance accounts,
- broaden the exemption for prepaid cards to remove functionality limits and encompass overdraft fee-free accounts, and
- prevent evasions by covering large nonbank banking apps by the interchange fee rules.

1. Consider the impact on low-balance accounts

We take no position on where the interchange fee cap should be set. Both low and high fees pose potential pros and cons for low-income consumers. Theoretically, low fees could result in lower merchant prices or fewer future price increases, while potentially raising costs of or restricting access to low-balance bank accounts; but neither outcome is certain. Conversely, higher fees could in theory raise merchant prices, but subsidize low-balance bank accounts and provide funding for fraud mitigation; but here again, whether such predictions would come to pass is uncertain. We do not opine on which outcome is more likely or where the appropriate balance should be struck.

We do ask, however, that the FRB keep in mind the potential impact on low-balance accounts in setting the interchange fee. That is not to say that it is necessarily the case that banks will raise fees or restrict access by low-income consumers if interchange fee revenue is lowered, or that they will adequately serve low-income consumers if they recoup higher interchange fees. Measures that prevent hidden, back-end junk fees do not necessarily result in equivalent front-end fees.¹ Moreover, under the Community Reinvestment Act, financial institutions have a duty to serve their entire communities even if certain populations are less profitable. And customers who have low-balance accounts today could become profitable customers over the longer-term course of a banking relationship. Nonetheless, we ask the FRB to consider the economics of low-balance accounts and the potential impact on those accounts in setting the interchange fee. Potential impacts include not only monthly fees and minimum balance requirements, but also the extent to which banks market and promote low-fee accounts.

We also urge the FRB to consider ways to specifically encourage banks to meet the needs of low-income consumers, as discussed in the following sections.

2. The functionality limits on the prepaid card exemption harm low-income consumers

Under the interchange fee provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act (better known as the “Durbin Amendment”), prepaid cards are exempt from the interchange fee limits.² To be exempt, the prepaid card must not have any overdraft or shortage fees and cannot charge a fee for the first in-network ATM fee each month.³ The purpose of the prepaid card exemption and the associated protections for exempt prepaid cards is to promote and provide revenue to support safe, low-balance accounts that do not generate revenues through overdraft fees.

At the time that Regulation II was adopted in 2011, the CFPB had not yet issued its Prepaid Rule under Regulation E,⁴ and there was no existing definition of prepaid card. Thus, the FRB felt the need to define “prepaid card” and to do it in a way that did not invite evasions.

In its final 2011 rule, the FRB added restrictions to the prepaid card exemption that are not in the statute and were not in the proposed rule and thus did not receive the benefit of notice and comment. Those restrictions severely limit the functionality that prepaid cards may have without losing their exemption from the interchange fee limits.

The final rule permits a prepaid card account to be eligible for an exemption from the interchange fee cap only if the card is the sole means of accessing the account.⁵ The card may

¹ See Darren Bush et al., “[Overdraft Fees, Credit Card Late Fees, and the Lump of Profit Fallacy](#),” Institute for New Economic Thinking (Apr. 15, 2024).

² 15 U.S.C. § 1693-o2(7)(A)(ii); Reg. II, 12 C.F.R. § 235.5(c).

³ 15 U.S.C. § 1693-o2(7)(B).

⁴ 81 Fed. Reg. 83934 (Nov. 22, 2016) (final rule).

⁵ Reg. II, 12 C.F.R. § 235.5(c)(1).

not permit person-to-person money transfers,⁶ transfers to savings accounts, online bill payment features,⁷ ACH transactions,⁸ or pre-funded checks.⁹ The exemption also requires the prepaid card account to be set up as a master-subaccount structure, and prohibits the prepaid card from accessing an account held directly by the cardholder.¹⁰

The prohibited features are important for the low-income consumers who use prepaid cards. Under Regulation II, consumers who obtain prepaid cards from banks that are subject to Regulation II may not link savings accounts to their prepaid accounts or participate in automated savings programs. They cannot pay landlords who do not accept cards. They cannot receive money from, or send money to, family members.

While the FRB adopted these limitations to prevent evasions of the interchange fee rules, none of the prohibited functions generate interchange fees. Ironically, banks can permit consumers to transfer funds from a Durbin-covered checking account to a prepaid card – where the funds can generate higher interchange fees – but they cannot permit consumers to spend or access prepaid card funds through a method that does not generate those fees.

3. Fintech evasions undermine the Durbin Amendment and harm consumers

The prepaid card Regulation II exemption is too narrow, but the Regulation II coverage of nonbank banking apps is also too narrow. The interchange fee caps apply to financial institutions with over \$10 billion in assets. At the time that Regulation II was being written, banking-as-a-service platforms and nonbank banking apps were nonexistent or in their infancy. Yet today, nonbank bank account portfolios that are or may soon be as large as those of covered financial institutions evade interchange fee limits by splitting the deposits they manage among multiple, smaller banks.¹¹ Chime, for example, splits its deposits among the Bancorp Bank, N.A. and Stride Bank, N.A.¹² Chime is reported to have \$8 billion per month in transactions.¹³

While the nonbank partner in these relationships is technically merely a servicer for the bank, managing accounts held at the bank, these are actually accounts of the nonbank. The nonbank designs, markets, operates and effectively controls the significant aspects of the account. The

⁶ See Federal Reserve Board, Frequently Asked Questions About Regulation II (Debit Card Interchange Fees and Routing), 235.5(c) General-Use Prepaid Card Exemption, A6 (“Prepaid Card FAQs”).

⁷ See Prepaid Card FAQs, A3.

⁸ See Prepaid Card FAQs, A7.

⁹ See Prepaid Card FAQs, A4.

¹⁰ Reg. II, 12 C.F.R. § 235.5(c)(1)(i).

¹¹ See The Clearing House, Comment Letter to the Board of Governors on Partnerships Between Small Banks and Large Fintech Companies That Appear to Circumvent Reg. II (Oct. 23, 2023), https://www.theclearinghouse.org/advocacy/Articles/2020/10/TCH_Comments_Reg_II_Circumvention_Letter_10_23_2020 (“The Clearing House Fintech Letter”).

¹² See <https://www.chime.com/>.

¹³ See Jason Mikula, Fintech Business Weekly, [We Now Know Chime Has Seven Million Users. How Does That Stack Up?](#) (May 5, 2024).

bank's role is behind the scenes and fungible. The nonbanks charge and benefit from interchange revenue. Thus, these portfolios should be measured in their entirety rather than in segments depending on the size of the depository bank.¹⁴

This fintech evasion is not only unfair to merchants who pay higher interchange fees and to large financial institutions that must compete on an uneven playing field; it also operates as an evasion of the prepaid card rules and thus harms consumers.

These nonbank bank accounts are effectively prepaid cards. Before banks began issuing demand deposit account (DDA) bank identification numbers (BIN) for accounts offered by nonbanks, accounts offered, marketed, and serviced by a nonbank would have been issued using a prepaid card BIN. As discussed below, there are several other reasons why these nonbank bank accounts should be viewed as prepaid cards.

Yet these nonbank bank accounts make revenue from overdrafts and are not complying with the overdraft rules that apply to prepaid cards. They collect overdraft fees directly¹⁵ or in the form of purportedly voluntary "tips" for overdraft coverage.¹⁶ And they do not comply with the Regulation E overdraft fee rules that apply to prepaid cards.¹⁷

Thus, these fintechs get to have their cake and eat it too. They avoid interchange fee limits but profit from overdrafts.

4. To protect low-income consumers and prevent evasions, the FRB should expand the prepaid card exemption while subjecting large nonbank fintechs to interchange fee limits

The previous sections discuss several concerns:

- The potential impact of interchange fee limits on the cost and availability of low-balance accounts;
- The unduly narrow scope of the prepaid card exemption, which limits the functionality of prepaid cards;
- Evasions of the Durbin Amendment limits by large fintechs;

¹⁴ The FRB may need to develop a different way of measuring the size of a nonbank fintech than through its asset base. Bank assets are the credit portfolios they own, not the deposits they hold, which are liabilities. Yet the nonbank fintechs may not have significant credit portfolios. Thus, the FRB could come up with an equivalent liability measurement. Or, the FRB could devise other ways of prevent evasions, such as that proposed by The Clearing House. See The Clearing House Fintech Letter, *supra*.

¹⁵ See NCLC, [Comments on CFPB's Proposed Rule Governing Overdraft Lending at Very Large Financial Institutions](#) at 57-58 (Apr. 1, 2024) ("NCLC Overdraft Rule Comments").

¹⁶ See *id.* at 58-61.

¹⁷ For example, they offer overdraft credit structured as a negative balance in a way prohibited by the Prepaid Rule. See 12 C.F.R. § 1026.61(b).
§ 1026.61(b)

- Large fintechs that encourage and profit from overdrafts while avoiding the letter or spirit of the overdraft fee limits of Regulations II, E and Z.

All these concerns can be addressed by a combination of a broader prepaid card exemption and a broader scope of Regulation II that encompasses large fintechs.

a. Safe bank accounts that have no overdraft or nonsufficient funds fees should be viewed as prepaid cards.

The FRB should define the prepaid card exemption to include any account that is a safe bank account without overdraft fees, nonsufficient funds fees, or other revenue sources tied to overdraft credit or negative balances. That exemption could be tied to the Bank On National Account Standards.¹⁸ Expanding the exemption in that manner would meet the purpose of the exemption: to provide revenue to support safe, low-balance accounts that do not earn revenue from overdraft fees. The only functionality limits that are necessary to the prepaid card exemption are those directly related to the inherent nature of a prepaid card – a safe account for consumers harmed by overdrafts and negative balances – and the overdraft fee ban in the statute.

Given the developments in the market and the rise of banking-as-a-service platforms, the exemption does not need to conform to an antiquated view of what a “prepaid card” is. The line between a prepaid card and a checkless checking account is increasingly blurry to nonexistent. Bank accounts offered by nonbanks are effectively prepaid cards, as discussed above. “Cards” also do not need to be physical plastic cards, and instead can be a mobile app or other form of access device.¹⁹

If the FRB fears evasions, it could focus the exemption around lower balance accounts. For example, the amount of regular direct deposits or average balance that an exempt prepaid card account may have could be capped, such as at \$5,000 per person per month in regular deposits²⁰ or an average daily balance of no more than \$600.²¹ The FRB could also prohibit rewards on exempt prepaid cards in order to prevent banks from offering an incentive to steer consumers to those accounts and to avoid giving an exemption to an account that has enough revenue to pay rewards.

¹⁸ Cities for Financial Empowerment Fund, [BANK ON NATIONAL ACCOUNT STANDARDS \(2023 – 2024\)](#).

¹⁹ See Reg. Z, 12 C.F.R. § 1026.2(a)(15).

²⁰ The Financial Health Network reports that the financial health of only 21% of households with income below \$60,000 fell into the “healthy” category, with the others coping or vulnerable. Kennan Ceba et al., Financial Health Network, [Financial Health Pulse, 2023 U.S. Trends Report](#) at 31 (Sept. 2023). Even for those in the \$60,000 to \$99,999 category, only 33% were “healthy.”

²¹ In 2017, the CFPB found that at 79% of bank overdraft and NSF fees were borne by only 9% of accounts, and the median account balance of this group is less than \$350. CFPB, [Data Point: Frequent Overdrafters](#) at 5 (Aug. 2017). The FRB should permit occasional exceptions in order to permit lower income consumers to receive tax refunds, back payments of public benefits, and other one-time payments. The consumer could be required to spend those funds or transfer them to another account within a reasonable period of time.

b. Alternatively, the FRB could define “prepaid card” to conform to the Regulation E definition of “prepaid account.”

An alternative approach would be to adopt the CFPB’s definition of “prepaid account.”²² That definition did not exist at the time Regulation E was promulgated, but it now makes sense to adopt it under Regulation II. Doing so has the benefit of simplifying compliance by using a common definition, while avoiding the unnecessary functionality limits of the Regulation II exemption. That might encourage big banks to issue prepaid cards with no overdraft fees and fully functional features.

However, it is a second-best option because the market has moved away from prepaid cards. Fintech nonbank bank accounts are not only evading Regulation II, but are also evading the Regulation E and Z rules for prepaid accounts. In addition to the “tips” and subscription fee evasions discussed above, prepaid card companies that formerly charged overdraft fees are now offering “bank accounts” with overdraft fees that are not allowed under the CFPB prepaid rules.²³ Thus, a combination of a broader definition of prepaid card and closing the fintech loopholes in Regulations II, E, and Z is preferable.

c. The FRB and CFPB should work together to close the fintech loopholes in Regulations II, E and Z.

If the FRB both closes the large fintech loophole and expands the prepaid card exemption, large fintechs would either have to comply with the Durbin Amendment limits or with the overdraft fee rules of the CFPB’s prepaid rules. That would prevent evasions and protect consumers.

At the same time, the FRB should encourage the CFPB to close the nonbank bank account loophole in its prepaid card rule. As we have described in comments to the CFPB,²⁴ accounts offered by a nonbank should be considered to be prepaid accounts. If the CFPB’s prepaid rules were broader, fintechs could still avoid interchange fee limits by splitting their deposits, but at least they could not collect overdraft revenue.

Policymakers across the country are working to promote financial inclusion of the millions of underserved consumers. The FRB should ensure that updates to Regulation II promote those efforts at inclusion. Thank you for the opportunity to submit these comments. Please contact me at lsaunders@nclc.org if you have any questions.

Yours very truly,



Lauren Saunders
Associate Director

²² Reg. E, 12 C.F.R. § 1005.2(b)(3).

²³ See NCLC Overdraft Rule Comments, *supra*, at 61-64.

²⁴ See NCLC Overdraft Rule Comments, *supra*, at 61-64.