May 12, 2024

The Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue N.W.
Washington, D.C. 20551

Re: Proposed Rule for Regulation II (Debit Card Interchange Fees and Routing)
Document ID: R-1818

Dear Board of Governors:

On October 25, the Federal Reserve Board of Governors ("Fed" or "the Board") proposed substantial changes to the Interchange Fee Cap as provided by Regulation II (Debit Card Interchange Fees and Routing). On behalf of Minnesota credit unions, please accept this correspondence in comment to the Board's proposed rule. The Minnesota Credit Union Network (MnCUN) thanks you for the opportunity to provide a response on this proposed rule on behalf of our member credit unions.

MnCUN, working in conjunction with the America's Credit Unions works to ensure the success, growth, and vitality of our 86-member credit unions by creating a positive public environment through leadership, political advocacy, education, awareness, and regulatory assistance. All our member and affiliates currently fall under the small institution designation of being below $10 billion in asset size.

First, we strongly urge the Board to retain the Small Issuer Exemption on interchange fees. We agree with the Board's belief that interchange fees in the present economy have changed since they were first adopted and last studied.

However, reopening of Regulation II as proposed will not create a safer and healthier consumer benefit by decreasing necessary fees for debit-card transactions relying on big box retailers and merchants to pass on the benefit to consumers as there is no evidence that merchants have ever passed along any savings to consumers through price cuts since Reg II's original implementation.

The significant changes proposed to the interchange fee cap components directly threatens the financial well-being of millions of consumers, businesses, and credit union members in Minnesota and across the United States. It does so because the current proposal does not include necessary information from all stakeholders (large and small card issuers), to accomplish the intended benefit of price savings and fraud protection for consumers. This likely adverse consumer impact will disproportionately harm lower income, underrepresented and underserved communities and their consumers already feeling the impact of inflation on everyday essentials.

We request this rulemaking process to include critical studies on the impact of fraud looking at present market conditions on smaller financial institutions. This requested process is provided for by the Administrative Procedures Act (APA) for rulemaking which will have impact on smaller financial institutions as well as large financial institutions alike:

1. **Further studies on interchange fees are needed for all financial institutions big and small.**

   The American economy is based on a strong, vibrant, and secure credit card transaction payment and settlement system which protects consumers regardless of their socio-economic status or where they get banking services.

   Not all financial institutions are alike and credit unions are fundamentally different not-for-profit member-owned cooperatives serving nearly 140 million Americans,[i] many who might struggle to obtain banking services from covered larger financial institutions. All credit unions are bound by the NCUA's interest rate ceiling of 18%, unlike other larger financial institutions that can freely raise rates to offset any losses.

   The last report conducted by the Board for small institutions began in 2012, culminating in a May 2013 report. The Board's proposed rule primarily centers only on the 2021 larger covered issuers. The 2013 Board report further concluded that the average interchange fee per PIN debit transaction for exempt issuers was already 1.3 times higher than non-exempt issuers.

   Economic and market conditions have drastically changed since 2012. Small institutions have faced myriad challenges in the intervening years, including the 2020 pandemic, which has already strained the ability of smaller institutions to weather the operating costs related to fraud (check, identity theft, etc.) outside of interchange related transactions. Invariably, the impact of this proposed rule on larger financial institutions will impact smaller institutions like credit unions.

2. **Further studies on the Impact of evolving fraud are necessary in the aftermath of Card Not Present (CNP) Rule of 2023.**

   The current proposed rule was based on information before the recent implementation of the Board's Card Not Present Rule effective July 1, 2023, requiring card issuers to have at least two unaffiliated networks to process the transaction.

   As early as 2016, the Federal Reserve Banks of Boston and Atlanta had found that effectiveness of chip security on cards at point-of-sale terminals had already begun to shift fraud to move to CNP transactions[1]. With the ever-evolving specter of AI assisted fraud, now more than ever, the increase in fraud adds to the regulatory compliance and oversight costs for smaller financial

[1] "Enabling EMV chip card acceptance at POS reduces card-present counterfeit fraud by removing the opportunity for fraudsters to compromise payment card credentials. However, this is driving fraudsters to attack the more vulnerable online and mobile card-not-present (CNP) channels with weaker authentication protocols, at a time when consumers are increasing their use of mobile phones to make CNP purchases." Crowe, Marianne and Susan Pandy, and David Lott (2016). "Getting Ahead of the Curve: Assessing Card-Not-Present Fraud in the Mobile Payments Environment" Federal Reserve Bank of Boston and Federal Reserve Bank of Atlanta.

institutions to offer safe, secure, and affordable debit-card services to members often not able to obtain financial services from larger covered financial institutions.

In a limited financial fraud study by Alloy, it was found that 79% of credit union and community bank decision-makers surveyed experienced more than $500,000 in direct fraud losses in 2023. This was higher than any other segment compared to 65% of mid-market banks, 63% of enterprise fintech's, 62% of enterprise banks, 57% of online/pure play lending banks, 32% of both regional banks and mid-market fintech's, and 28% of strategic fintechs whose decision-makers (reporting fraud losses of $500,000 or more in 2023).

The Alloy study is merely a glance and supports the need for more comprehensive studies of how fraud is currently impacting small financial institutions operationally as they have far less resources to meet those exploding costs. If the Board does conduct the requested research studies as a part of this rulemaking, the financial security of millions of Americans and their families who are members of smaller financial institutions will be harmed by the current rulemaking disproportionately to those at covered institutions.

The additional costs of technology development by Fintechs and other third-party vendors to combat rapidly growing and evolving CNP frauds is essential to consider. Moreover, the added human resources required to facilitate implementing that security technology for smaller institutions is yet to be determined, making it even more critical for the Board to research and study these factors before a final rule is made.

3. **Specificity in rulemaking is critical for America's economy and all consumers rather than just those able to bank at covered larger financial institutions.**

   Without further impact studies on how the proposed rule impacts smaller financial institutions and their consumers further threatens this critical pillar to the American economy and their ability access to secure high quality financial services. This could lead to a disparate harm on millions of Americans who are least able to afford it.

   Again, the last interchange study conducted by the agency was in 2012 and has not been reviewed since. Since 2014, the Federal Reserve of Richmond has issued research finding that 77.2% of merchants did not change their prices after the Durbin Amendment and Regulation II were implemented and that 21.6% of merchants increased their prices.

   Conversely, there is ample evidence to show how the proposed Credit Card Competition Act (CCCA) for credit card transactions and Regulation II have increased the regulatory burden while reducing income necessary to operate safe and secure debit-card programs. A 2020 report from the National Association of Federally Insured Credit Unions (formerly NAFCU now America's Credit Unions) showed that 24% of credit union staff time dedicated to regulatory compliance with IT compliance rising by 72% since 2016.

   Additionally, the methodology used for the formula on the Board's website for the base component, ad valorem and fraud components are based on only the transaction-weighted average of the largest covered issuers which can afford to compensate their for-profit products to make up for any losses resulting from the current proposed rule.

Not-for-profit member-owned credit unions cannot simply raise interest rates and fees to make up for losses due to the NCUA's 18% interest rate ceiling. Current data show that smaller covered and exempt financial institutions cannot cover consumer fraud losses on the existing Reg II unlike the largest covered institutions.

Moreover, the proposed biennial automatic adjustment of the fee cap is solely based on large debit card issuers survey data and side steps the comment required for administrative rulemaking (amendments). This myopic lens overlooks and threatens one of the greatest stabilizing aspects of the post-pandemic American economy by small businesses and the uncovered financial institutions that serve them.

Further impact studies in today's economy are critically necessary for this proposed rule and its effect on all financial institutions and their respective consumers. The documented reports already show that the original goals of Regulation II and the Durbin Amendment were not achieved lowering prices for America's consumers passed on by large retailers.

Doubling down on the unwarranted need to augment Regulation II as a part of Dodd-Frank solely focused on the largest covered institutions benefitting only large retailers during a time of economic uncertainty for consumers would be an avoidable disaster for the economy and the American people.

4. **The data presented by the Board to support the proposed rule is limited to only the 2021 Report for Covered Issuers.** The interchange fee marketplace is complex and involves more than covered issuers as card using consumers are what should drive this proposed rulemaking regardless of the size of the card issuer. The 2021 report is incomplete as it derives its data from the beginning of the pandemic and not the current economy.

   The focus on unfair fees imposed by covered institutions must be separated from the interests of large retailers who do not have to pay towards combatting ever evolving fraud with debit-card transactions. Invariably, the impacts of the proposed rule on larger banks and retailers will have a direct impact on smaller financial institutions impacted by market forces that do not delineate between covered and noncovered financial institutions.

   The costs of combatting fraud and its evolution with the assistance of AI requires constant innovation, cyber and human resources diligence to combat. According to the Identity Theft Resource Center, the number of major data compromise events more than doubled from 2015 to 2021 and rose 68 percent from 2020 to 2021. In the retail sector alone, more than seven million consumers were victims of data breaches[2].

5. **Given the significant interplay between this proposed rule and proposed interchange rate legislation (Durbin amendment) in the Senate, it is critical to collect current financial information from all stakeholders.**

   Few proposed rules will have more impact on the daily lives of consumers, small businesses/merchants, nonprofits, government agencies, and businesses as the interchange fee

[2] Identity Theft Resource Center (2022). 2021 Data Breach Annual Report. https://notified.idtheftcenter.org/s/2021- data-breach-report

cap. The Board should consider input from a broad array of stakeholders such as smaller financial institutions like credit unions giving equal consideration and time to compile and share accurate and meaningful information to best address fraud threats for all American consumers.

For credit unions, these debit-card interchange fees are essential to protect the fiduciary interests of members through free checking, related free debit card services (reissuance of lost and compromised debit cards) and community investment especially programs helping low-income persons obtain financial inclusion.

The fraud losses absorbed by credit unions are not even remotely covered from the fees generated from debit-card interchange fees. Any credit union debit-card interchange fees are fully disclosed and voluntary and extend to underserved and underrepresented communities throughout Minnesota which banks do not offer financial services to.

The impact of this proposed rule jeopardizes these critical free services for credit union members and their underserved and underrepresented communities. The fees collected from debit card programs are used directly on all members of credit unions and not to pay for refueling the private jets of few millionaire and billionaire shareholders.

Added considerations for this rulemaking should involve looking at the how it will work along with regulations on credit card late fees and delinquent payments, prepaid accounts under the Electronic Fund Transfer Act (EFTA), and the Truth in Lending Act (TILA). These areas of regulatory law have substantial impact over hybrid debit card transaction and should not be siloed for rule-making expediency.

6. The True Impact of Interchange Legislation

According to a 2023 report by Cornerstone Advisors:

• All issuers of debit cards—including those under the $10 billion asset threshold—had significant negative revenue impacts.

• Most financial institutions addressed revenue shortfalls through higher monthly fees and increased minimum balance requirements.

• The availability of free checking was reduced to consumers, and an increased number of Americans became unbanked in the years following the rollout of the Durbin Amendment.

• All payment networks are not equal. Significant differences exist between single-message and dual message networks that impact operation and fraud costs for issuers.

• Card not present (CNP) fraud is growing faster than payments, and the cost to fight fraud is larger than reported figures.

These documented facts provide a body of evidence to remind regulators and legislators of the harm from introducing new debit card regulations without further impact studies which accurately consider metrics that stakeholders from all varying asset sizes face.

Most concerning is that the current proposed changes to Reg II will further the economic harm the intended beneficiary, the American consumer, has already suffered since Reg II and the Durbin Amendment were first implemented.

We respectfully encourage and request the Board of Governors to mandate and conduct further impact studies including those focused on smaller financial institutions like credit unions and our approximately 140 million members nationwide.

Respectfully submitted,

DANIEL S. LE

Daniel S. Le
General Counsel

cc: MnCUN Regulatory Review Committee

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[i] NCUA 3rd Quarter Report.