SchoolsFirst
FEDERAL CREDIT UNION

May 6, 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, Docket No. R-1818, RIN 7100-AG67

Dear Ms. Misback,

I am writing on behalf of SchoolsFirst Federal Credit Union (SchoolsFirst FCU), which serves school employees and their family members in California. At this time, we have more than 1,400,000 Members and over $30 billion in assets.

SchoolsFirst FCU appreciates the opportunity to provide comments on the proposed Debit Card Interchange Fees and Routing rule ("the proposed rule"). We have profound concerns about the proposed revisions to Regulation II regarding debit card interchange fees. This proposal, which seeks to significantly reduce the overall interchange fee cap for debit card issuers with $10 billion in assets or more, presents considerable risks to the financial health of all credit unions and could detrimentally impact the economic welfare of credit union members.

Topics of Concern

Inadequate Justification for Fee Reduction:

The Federal Reserve's data strongly supports maintaining the current interchange fee structure, indicating that significant reductions are unwarranted. According to the Federal Reserve's own memo, the data used to evaluate the current interchange fee structure under Regulation II mirrors the market conditions when the regulation was initially introduced in 2011. At that time, the 21-cent base amount per debit card transaction was designed to cover the typical allowable costs, excluding fraud losses, for issuers at the 80th percentile. This aimed to meet the needs of most issuers, specifically those below the top 20% in terms of transaction costs.

Recent evaluations indicate that this base amount now covers the costs for 77.4% of issuers[1], a slight dip from the original 80% coverage goal. Despite this slight decrease, the cap effectively supports most issuers' transaction costs. This effectiveness is further highlighted by the fact that, both in 2011 and in 2021, the base cap exceeded the actual transaction costs (Allowable Cost Standards, ACS) for 99.5% of all transactions[1]. This means that the cap not only meets, but often surpasses the transaction costs for nearly all transactions processed by issuers.

Given this extensive coverage, there seems to be little rationale for the proposed reduction in interchange fees. The current data does not support a drastic 30% reduction in the debit interchange fee cap as it continues to adequately reimburse issuers for the costs associated with processing debit card transactions. Enforcing such a substantial cut could potentially underpay issuers, especially smaller ones who heavily rely on these fees for their operational sustainability. This could potentially lead to financial difficulties for these institutions, jeopardizing the stability and service provision of smaller financial players in the industry.

[1] Mastercard (December 2023), Engagement Playbook

Insufficient Fraud Prevention Adjustment:

While the Federal Reserve's data shows that the current base component of the interchange fee cap covers most transactions and should be maintained, the proposed rule's fraud prevention adjustment from 1 cent to 1.3 cents is grossly inadequate given the current economic realities and the rising cost of fraud prevention. In 2011, the average fraud prevention costs were approximately 1.3 cents for mid-volume issuers and 5.5 cents for low-volume issuers. Recent data[2] from 2021 indicates that these costs have escalated to 2.3 cents and 12.4 cents, representing a 125% increase, reflecting the increased intensity and sophistication of fraud attempts. Given these figures, a more substantial increase in the fraud-prevention adjustment is necessary to deflect and mitigate the costs incurred by issuers like SchoolsFirst FCU in maintaining robust anti-fraud measures.

In 2023, SchoolsFirst FCU invested millions of dollars in upgrading its entire ATM network. This significant investment was aimed at improving the usability and security of our ATM services and mitigating the rising incidentsof fraud that threaten our members' financial security. The proposed changes to Regulation II need to consider these substantial expenditures to combat fraud by credit unions like ours on such critical infrastructure enhancements. The current fraud prevention adjustment proposal significantly underestimates the actual costs associated with combating increasingly sophisticated fraud, thereby increasing the risk of all debit card users becoming victims of fraud.

Effective fraud prevention is crucial for safeguarding consumers from financial theft and maintaining trust in the economic system. An adequate adjustment would equip issuers with the necessary resources to enhance their security measures, thereby contributing to the overall stability and security of the financial system. By adequately compensating issuers for their actual fraud prevention costs, the Federal Reserve will play a pivotal role in maintaining a robust, fair, and secure financial marketplace for all participants. This protects individual consumers and supports the integrity of the financial transactions system as a whole, reducing the widespread impact of fraud on the economy.

Need to Sustain and Build Capital:

The proposed rule to reduce interchange fees threatens the foundational capital essential for the sustainability of credit unions like SchoolsFirst FCU. Capital is not merely a financial metric but the bedrock of our daily operations and the fuel for our strategic growth initiatives. By expanding service offerings, enhancing digital platforms, and broadening geographic reach, we strive to serve our members better. However, reducing these fees would significantly diminish our operational funds, which are crucial for maintaining liquidity and funding these essential services. Such a financial impact could directly undermine our ability to meet the National Credit Union Administration's (NCUA) capital adequacy standards. These standards are not arbitrary benchmarks but are critical to ensuring that credit unions remain robust and capable of managing risks and absorbing potential losses. The ability to uphold these standards is paramount in preserving institutional health and service capability, thus safeguarding the interests and investments of our members.

As interchange fees form a substantial part of our revenue, diminishing these fees would likely necessitate offsetting revenue shortfalls by increasing service fees or reducing product benefits. This could result in higher loan rates, increased costs for account services, and lower returns on savings accounts, actions that would directly contradict our mission of providing financial relief and support to our members. These additional burdens could significantly reduce members' financial benefits and exacerbate their economic strain during times of economic uncertainty. Consequently, meeting the NCUA's capital adequacy standards becomes increasingly challenging under these financial constraints.

[2] Mastercard (December 2023), Engagement Playbook

Furthermore, unlike banks, credit unions typically do not have extensive options for alternative income sources or for raising capital that can compensate for the loss of revenue due to reduced interchange fees. Our reliance on these fees is heightened due to our not-for-profit model that prioritizes member benefits over profit generation. Additionally, federal credit unions are limited by the National Credit Union Administration (NCUA) in terms of the amount of interest they can charge on loans, further restricting their ability to generate revenue through traditional banking means. The proposed rule change disproportionately impacts credit unions by curtailing this revenue stream without providing adequate adjustments for fraud-prevention costs associated with maintaining and upgrading payment infrastructure like ATMs. This scenario could compel us to increase fees or reduce services, adversely affecting our members' financial health and diminishing the overall value we offer compared to traditional banks.

Negative Impact to our Members:

SchoolsFirst FCU has consistently delivered substantial financial benefits to its members, significantly enhancing their economic well-being. In 2022, SchoolsFirst FCU provided $277.3 million in direct financial benefits to our 1.3 million members. These benefits, which equate to an average of $224 per member or $470 per member household, underscore the tangible savings our members enjoy. This is due to our favorable loan rates, enhanced savings returns, and reduced fee structures.

In 2023, despite facing a challenging economic climate marked by an inverted yield curve, regulatory pressures from new rules targeting financial institutions, and a volatile financial environment, SchoolsFirst FCU successfully increased the total direct financial benefits to $396.2 million. This escalation represents a significant increase, translating to an average benefit of $300 per member and $629 per household. These figures reflect our steadfast dedication to financial inclusivity and member service and our capability to enhance member benefits year-over-year amidst external economic pressures.

The proposed reduction in the interchange fee cap poses a significant threat to the sustainability of these member benefits. The adjustments would not only reduce our revenue from debit card transactions, which fundamentally support the competitive rates and additional benefits we offer our members, but also need to adequately compensate for the rising costs associated with implementing advanced security measures necessary to safeguard member transactions. The potential decrease in interchange fee revenue could force SchoolsFirst FCU to reconsider our fee structure and the benefits offered. Maintaining these rates at competitive levels with reduced revenue from interchange fees becomes financially straining. Increasing other fees or reducing certain benefits would directly affect our members, countering the foundational credit union principles of prioritizing member welfare structure and the benefits offered.

Government-mandated price controls:

The proposed revisions to Regulation II, which aim to reduce the debit interchange fee cap without a rational basis, are tantamount to government-mandated price control. Historically, such controls have led to a range of unintended consequences that deviate significantly from their intended outcomes, often exacerbating the issues they aim to address. For example, while minimum wage laws are designed to increase the income levels of low-wage workers, research[3] suggests that these increases may result in job losses among low-skilled workers, thereby undermining the benefits of higher wages. Similarly, rent control, intended to make housing more affordable, often results in reduced availability and quality of rental units[4] ultimately harming the tenants it aims to help.

In the context of Regulation II, the government's intent in reducing interchange fees is aimed at assisting consumers by lowering the cost of debit card transactions. However, this elusive cost savings is predicated on the

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[3] David Neumark and William L. Wascher (2007), "Minimum Wages and Employment"
[4] Epstein, R. A. (1998), The Case Against Rent Control: Bad Housing Policy at a Time of Shortage

flawed assumption that merchants will pass on cost savings resulting from a reduction in their interchange costs to consumers in the way of lower product/service costs despite the fact that there is no statutory or legal requirement that they do so. This argument was flawed when the Durbin Amendment to the Consumer Financial Protection Act was passed in 2011, and the data over the past 14 years has proven the fallacy of the premise. As such, this regulatory intervention must be approached with caution, as it could lead to a series of unintended and counterproductive consequences. For instance, in response to reduced revenue from interchange fees, credit unions and other financial institutions might introduce new banking fees to offset losses. Such measures could lead consumers to reduce their use of debit cards, which contradicts the policy's objective of promoting electronic payments for their convenience and security.

Research examining the initial effects of the current fee cap introduced by the Board in 2011 shows that the resulting decline in debit interchange revenue translated into reduced access to free accounts, higher fees, and a rise in the number of unbanked consumers.

Moreover, these price controls can have severe impacts on the financial health and stability of credit unions, which are known for their focus on member services. The proposed reduction in interchange fees could force these institutions to navigate financial shortfalls, increasing their vulnerability to economic downturns and potentially raising credit union failure rates reducing competition in the sector. This destabilization not only affects the institutions themselves but also their members, who might face higher fees and reduced access to services.

Therefore, these government-mandated price controls, rather than benefiting consumers, could paradoxically lead to a regression in financial inclusivity and consumer protection. This undermines the very goals of ensuring fair and accessible financial services, harming those it was intended to assist.

Bi-annual Adjustment of the Cap:

The unprecedented proposal to biennially adjust the debit card interchange fee cap based on survey data without public comment introduces significant unpredictability and challenges for credit unions, primarily because it excludes crucial stakeholder insights. Public commentary is necessary to ensure input from crucial parties such as credit unions, consumer advocacy groups, and industry experts, who could provide essential data and perspectives to ensure that fee adjustments are aligned with actual economic conditions and the operational realities of financial institutions. With this stakeholder feedback, adjustments may be better calibrated, leading to strategies that could destabilize credit unions financially and increase their administrative burdens, diverting focus and resources away from core member services.

Furthermore, the lack of stakeholder engagement risks overlooking the broader impacts of such regulatory changes on the financial ecosystem. Stakeholders are often best positioned to highlight potential unintended consequences of policy shifts, offering a more comprehensive view that could prevent negative outcomes. Therefore, the regulatory process must include a mechanism for robust stakeholder input, ensuring that any adjustments to the interchange fee cap are made with a complete understanding of their implications for the credit union's financial stability and service quality. This inclusive approach would help maintain the trust and reliability of the financial services provided to millions of members nationwide.

Lack of Statutory Mandate:

The Board's 2011 rule fulfilled the statutory requirement to adopt standards for reasonable interchange transaction fees. Accordingly, there is no legal requirement to pursue a new rule now or in the future.

Conclusion

In conclusion, the potential consequences of this proposal, as outlined, present a concerning scenario for both credit unions and the members they serve. We strongly urge the Federal Reserve to reconsider these changes, considering the significant economic impact and operational challenges that could arise from such regulatory adjustments, as well as the utter lack of necessity of implementing such a change at this time. It is imperative that a more inclusive approach be adopted, incorporating substantial stakeholder input to ensure that any new regulations foster rather than hinder the stability and health of the financial services sector. By doing so, we can safeguard the interests of consumers and maintain the integrity of financial institutions that play a critical role in our economy.

We recommend that the Federal Reserve conduct a thorough reassessment of the proposed fee adjustments, focusing on maintaining a balance that supports the operational sustainability of credit unions while genuinely enhancing consumer protection. This process must be transparent and collaborative, involving all relevant parties to craft fair, realistic, and beneficial regulations for all stakeholders. This approach will prevent negative impacts on credit unions and their members and contribute to a more robust, resilient financial system.

In short, SchoolsFirst Federal Credit Union strongly opposes this proposal in its current form, as well as any reduction in the debit interchange fee cap. Thank you for the opportunity to provide comments on this important proposal.

Sincerely,

SchoolsFirst Federal Credit Union

Bill Cheney
Chief Executive Officer