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 – Docket No. R-1818, RIN 7100-AG67

Dear Secretary Misback:

The Community Bankers Association of Illinois ("CBAI"), which proudly represents 261 Illinois community banks, appreciates the opportunity to provide our observations and recommendations to the Board of Governors of the Federal Reserve System ("Federal Reserve" or "Fed") regarding debit interchange fees and routing ("Proposal"). Specifically, the Proposal recommends a significant reduction in the interchange fee cap and permits the Board to amend the fee cap every other year without engaging in formal rulemaking. For all the reasons stated in this comment letter, CBAI strongly urges the Federal Reserve to withdraw this Proposal and constructively engage particularly with community banks so that they can inform the Fed about how this misguided Proposal would harm them and their ability to serve their customers and communities.

To provide a historical perspective, CBAI opposed the Durbin Amendment because we oppose government imposed price controls and debit interchange had nothing to do with the cause or solution to the Great Financial Crisis which the Dodd-Frank Act was meant to address. Regardless, Regulation II became law, was implemented by the Federal Reserve, and included a $10 billion asset exemption along with a dual routing requirement. Both the asset exemption and routing requirement were ostensibly meant to protect community banks and ensure competition in the routing of debit transactions. Not unexpectedly from our perspective, over a decade later, community banks have experienced a net decrease in debit interchange income and the debit card routing market remains uncompetitive.

Now, at the behest of merchants, the Federal Reserve has embarked on a revision to the Regulation II interest rate cap which it is not legally required to do. The Fed proposes a significant reduction in interchange fee income based on dated, incomplete and faulty data which favors the larger issuers, and gives itself the unilateral authority to change the interchange cap every other year without going through a formal rulemaking process. This misguided Proposal, if implemented, will again inevitably meet with economic reality and community banks and consumers will be the ones to suffer.

CBAI continues to point out to the Federal Reserve, as we have done with other banking and financial services regulators, the harm being inflicted on community banks by a disregard for the cumulative effects of regulations being approved and implemented. While individually these regulations represent an additional challenge, cumulatively they represent a crushing and unsustainable regulatory burden. This unrelenting burden will hasten consolidation among community banks which is contrary to what the financial regulators should be assiduously encouraging, namely a growing and vibrant community banking profession that is desperately needed to offset the risks and potential harm caused by the too-big-to-fail banks and financial firms.

CBAI strongly associated itself with the October 25, 2023, comments by Governor Michelle W. Bowman in opposition to this Proposal when she said, "I am concerned that the cumulative effect of regulatory changes – including a lowering of the interchange fee cap, higher capital requirements, new debt-funding requirements, increase data collection requirements, and many others – could pose ongoing risks to the health of certain financial institutions and the overall U.S. banking system." Governor Bowman continued, "Before finalizing any rule, it is incumbent upon policymakers to understand the intended and unintended consequences of our revisions."

The many other recent regulatory requirements that Governor Bowman was referencing include the incessant maligning of bank service charges and fees by the Administration and CFPB Director Chopra and their attempts to decrease overdraft/NSF fees, representment fees, and even prohibit the nonexistent fees for instantly declined transactions. They also include Section 1071 small business data collection requirements, Section 1033 data sharing requirements, a "modernized" Community Reinvestment Act (CRA) and being not relieved from the duplicative beneficial ownership reporting requirements which should be completely transferred to FinCEN. This avalanche of new regulations is layered on top of community banks already being harmed by rampant check fraud. The regulators, particularly the OCC, have done little to address the compliance failures of the largest banks to prevent fraudulent accounts from being opened. No wonder community bankers feel like they are under siege, and they continue to be disappointed by their regulators who seemingly turn a blind eye to their many struggles.

More specifically, CBAI opposes the Proposal because the hoped for benefits to the consumer of a reduction in interchange fees will not be realized. A Richmond Federal Reserve Bank and a University of Chicago study found that the savings to merchants from the original setting of the cap on debit interchange (estimated at over $100 billion) were not passed on to the consumer. Rather, the primary beneficiaries were the big-box retailers and large e-commerce merchants. It defies logic to believe that another reduction in debit interchange will result in a different outcome.

The harmful impact of debit interchange regulations on community banks is manifold. While the original exemption for banks under $10 billion in assets may have maintained the gross debit interchange income, inflation has significantly eroded its value today, and increased expenses over the past decade have resulted in a reduction in net interchange income. Community banks do not have the high volume of debit transactions to put them in a strong bargaining position or benefit from economies of scale. Rather, what has and will happen is the largest banks and financial firms that do have an economy of scale and increased bargaining power from larger transaction volumes will use those advantages to increase their size, profitability and influence. Increasing the size and influence of the megabanks has proven at great cost to be a foolish decision that has threatened the banking and financial system and our economy in the past and may do so again in the future.

With reduced community bank income from debit interchange and other threats to their income as well as increased compliance costs, something must suffer and unfortunately, it's the consumer. Other fees have been added to offset this loss of income including monthly account service fees, increased minimum balances, the reduction or elimination of free checking, or operating their debit card program at a loss to provide this important service to their customers. It is a proven fact that bank fees impact those who are least likely to be able to afford them, So, implementing a Proposal that would reduce interchange income and/or increase costs will be counterproductive to the regulators' stated objective of financial inclusion and reducing the population of the un or underbanked.

Fed Governor Bowman confirmed our observations in the statement in opposition to the Proposal when she said, "Under the proposed rule, nearly one-third of bank issuers would not be able to recover even the subset of costs that factor into the interchange fee cap, let alone those debit card programs that are disregarded in the cap." Governor Bowman also cautioned about the harmful impact on the payments system and the most vulnerable when she said, "Because debit card programs are important to the functioning of the payments system, any increase in price or reduction in the availability of debit cards could be harmful to bank customers, particularly low-income customers who may not qualify for credit card products or other alternatives."

In summary, the Federal Reserve is not required to revisit and change the interchange cap. Consumers will not benefit from a reduction in the cap – only the big-box retailers and giant e-commerce merchants will benefit. Community banks and their customers will be harmed by the reduction in the cap, particularly those that are the most vulnerable. Accordingly, CBAI strongly urges the Federal Reserve to withdraw this flawed and misguided Proposal and engage with community banks on this important matter.

CBAI thanks you for this opportunity to provide our observations and recommendations regarding debit interchange fees and routing. If you have any questions or need additional information, please do not hesitate to contact me at (847) 909-8341 or davids@cbai.com.

Sincerely,

/s/

David G. Schroeder
Senior Vice President
Federal Governmental Relations