Proposal: 1818(AG67) Debit Card Interchange Fees and Routing

Description:

Comment ID: 159824

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May 10, 2024

Dear Federal Reserve Board Members,

I am writing to bring to your attention several concerns regarding the proposed interchange fee cap and its potential impact on various stakeholders. After thorough analysis, it has become evident that the current proposal is fraught with issues that must be addressed before any implementation takes place.

First, the utilization of outdated data poses a significant problem. The proposed interchange fee cap is founded on data from 2021, neglecting crucial developments such as the dual routing requirement for card-not-present transactions introduced by Regulation II on July 1, 2023. Failing to account for these changes undermines the accuracy and relevance of the proposed cap.

Furthermore, it has become apparent that smaller issuers stand to suffer adverse consequences despite supposed exemptions. Contrary to expectations, data from the Federal Reserve indicates that regulatory thresholds do not shield smaller issuers from harm. In fact, the average per transaction interchange fee for "exempt" single-message transactions has plummeted by nearly 31% in inflation-adjusted dollars from 2011 to 2021, highlighting the ineffectiveness of current regulations in protecting smaller financial institutions.

The proposed changes to the interchange fee cap outlined in the letter include several adjustments that seem, at first glance, to benefit merchants by reducing their interchange fees. However, upon closer examination, these adjustments may disproportionately affect certain stakeholders, particularly smaller issuers and consumers.

The reduction in base fees from 21 cents to 14.4 cents may appear beneficial on the surface, as it potentially lowers costs for merchants, however, this reduction will significantly impact smaller debit card issuers who rely on interchange fees as a source of revenue. For these smaller financial institutions, a decrease in interchange fees results in a substantial loss of income, potentially leading to higher checking account fees or reduced services for consumers.

Similarly, the decrease in the ad valorem component from 5 basis points to 4 basis points might seem like a minor adjustment. Still, it will have a notable impact when considered in conjunction with other changes. Again, while this adjustment may benefit larger merchants by reducing their overall interchange fees, it could further strain smaller issuers' financial viability.

Moreover, the fraud adjustment increase from 1 cent to 1.3 cents could further exacerbate the situation for smaller issuers. While this adjustment aims to account for the costs associated with fraud prevention, it places an additional burden on issuers, particularly those with limited resources to invest in robust security measures. This increase in the fraud adjustment component could contribute to higher operational costs for smaller issuers, further squeezing their margins.

Additionally, the proposal to automatically update each component of the cap every two years based on reported issuer costs raises concerns about transparency and fairness. Without notice and comment, this process may lack accountability and overlook potential unintended consequences for stakeholders. It could lead to arbitrary changes that disproportionately benefit certain parties while harming others.

The crucial assessment of the cascading repercussions of reducing interchange fees is not being taken into consideration. Such reduction is likely to increase checking account and service costs, disproportionately affecting lower-income individuals and undermining the very concept meant to aid them. The reduction in interchange fees and the automatic updating process without adequate oversight may exacerbate existing disparities within the financial industry, ultimately undermining the proposal's intended objectives.

Furthermore, there's warranted doubt concerning the alleged advantages filtering down to consumers. Despite claims from the Federal Reserve Board that the suggested revisions would decrease costs for merchants and possibly result in savings for consumers, past evidence presents a contrasting view. Research conducted by the Richmond Fed indicated that merely 1% or so of merchants transferred their savings to consumers via lowered prices, while more than 20% opted to raise their prices instead. Given the range of concerns I've outlined here, along with similar apprehensions voiced across the financial sector, I advocate for the withdrawal of the Federal Reserve's Proposal.

Thank you for your attention to these matters; I trust you will give due consideration to the points raised.

Respectfully,
Karen C. Harbin, CPA, CGMA
President/CEO
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