INDIANA BANKERS ASSOCIATION

May 10, 2024

Ms. Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

BY ELECTRONIC MAIL (regs.comments@federalreserve.gov)

Re: **NPRM on Debit Card Interchange Fees and Routing (Regulation II)**
Docket No. R-1818, RIN 7100-AG67

Dear Ms. Misback:

On behalf of the Indiana Bankers Association (the "***IBA***"), a trade association representing 114 banks in Indiana, we write in strong opposition to the Board of Governors of the Federal Reserve System's (the "***Board***") proposal to reduce the regulated interchange cap under Regulation II, and we respectfully request that the proposal be withdrawn. As discussed below, the IBA is greatly troubled by the avoidable consequences which will result from the Board's proposal. Although Regulation II is technically applicable to only those institutions larger than $10 billion in assets, all bank issuers are impacted by this proposal due to the competitive nature of the market.

As background, the Durbin Amendment imposed an obligation on the Federal Reserve to implement standards to determine if the interchange fee was "reasonable and proportional to the cost incurred by the issuer" with respect to the subject transaction. Based upon this, the Board adopted Regulation II in 2011 in which the Board identified three components of "allowable costs" to be considered to establish the appropriate fee, specifically: (i) the base component of 21 cents, (ii) an *ad valorem* component of 5 basis points multiplied by the value of the transaction, and (iii) a fraud prevention component of 1 cent per transaction (subject to certain conditions). When the Durbin Amendment was adopted, Sen. Durbin stated that it "would enable small business and merchants to lower their costs and provide discounts for their customers."

The proposal by the Board would significantly reduce the interchange fee by approximately 1/3 by (i) lowering the base component from 21 cents to 14.4 cents, (ii) decreasing the *ad valorem* component from 5 basis points to 4 basis points (multiplied by the value of the transaction), and (iii) increasing the fraud prevention component from 1 cent to 1.3 cent per transaction (subject to certain conditions).

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IMPACT ON CONSUMERS

The reduction of the income from the interchange fee, at a time when the banking industry is already fighting margin compression, will force financial institutions to off-set the lost revenue through an increase in other fees (such as no-fee checking accounts) or minimum account balances. This must be viewed in light of a GAO study which found "the existing debit card interchange fee regulations increased the cost of checking accounts." This study also found a decrease in the availability of free accounts, increased fees and increased minimum balance requirements. If interchange fees are further reduced, the impact on the unbanked/underbanked portion of the population will only worsen. This is not the result intended by the Durbin Amendment. In this respect, this same concern was voiced in the dissent of Federal Reserve Governor Michelle W. Bowman.

It is also worth noting that several studies have found little evidence to support a claim that the any "savings" resulting from the cap on interchange fees has been passed on to and enjoyed by the consumer, contrary to the intent of Sen. Durbin (as set forth above).

IMPACT ON COSTS and FRAUD PREVENTION

If the income from interchange fees is decreased, financial institutions will also be forced to eliminate cost (in addition to the revenue side responses discussed above) to off-set the lost revenue. This would limit the amount of funds available for securing systems and fraud prevention. Further, Governor Bowman indicated in her dissent that almost 1/3 of the bank issuers would not be able to cover their costs if the reductions are implemented. This would only further adversely impact the consumers, as discussed above. All of this would occur at a time of increasing attacks on IT systems and increasing consumer fraud. As recently reported by the FTC, consumers reported losing more than $10 billion from fraud in 2023. The intent of the Durbin Amendment was not to reduce funds available to financial institutions to combat this fraud.

IMPACT ON BANK CONSOLIDATION

The increased pressure on earnings resulting from any reduced interchange fee income could lead to increased bank consolidation. This is especially impactful to smaller community banks and the consumers they serve, which are often "unbanked" by the larger national institutions.

INCOMPLETE DATA

The data utilized by the Board for a "covered cost" is incomplete and outdated. The existing data was collected in 2021 and only covers a narrow band of bank costs, ignoring considerations financial institutions must respect in running a business. For example, neither the current nor the proposed Regulation II calculations consider:

- Costs of card production and delivery,
- Transaction monitoring costs,
- Costs of establishing and maintaining checking/demand deposit accounts,
- Non-sufficient funds losses,
- International transaction fraud costs/losses,
- Statement production and delivery costs,
- International transaction fraud costs/losses,
- Non-sufficient funds handling costs, or

- Customer inquiry costs.

These are real costs incurred by every financial institution, yet these costs are ignored in the methodology of the Board. Further capping the interchange fee only increases the distance between revenue and actual costs incurred.

Also, the data utilized by the Board does not account for the recently effective debit card routing rule and its impact on costs and network fees, which went into effect in July 2023. Ignoring this impact ignores the real-world experience of the financial institutions.

REQUEST

Based upon the above, the IBA is deeply concerned that the Board is proceeding with a proposal which ignores certain real-world facts and costs, assumes a benefit to consumers which is highly debatable, ignores the aggressively adverse impact on the unbanked, ignores the impact on consumer fraud, and ignores the impact on community banking and its customers. The IBA shares Governor Bowman's concerns, which she expressed when she voted against issuing this proposal in 2023 and urges the Board to immediately withdraw the rule in its entirety. In this respect, we also request that the Board conduct additional research (that calculates costs to consumers and reflects the real-world experience of covered financial institutions) prior to reproposing further rulemaking in this area and undertake a meaningful analysis of all of the costs and benefits of the proposal.

Sincerely,

Amber R. Van Til

President & CEO
Indiana Bankers Association