State Employees' Credit Union

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 Ms. Misback:

This letter is submitted by State Employees' Credit Union (SECU) of Raleigh, North Carolina to provide comments on the Notice of Proposed Rulemaking (NPRM[1]) issued by the Board of Governors of the Federal Reserve System (Board) concerning the Board's proposed amendment to Regulation II and its commentary (the Proposed Rule[2]) addressing Debit Card Interchange Fees and Routing.

SECU is the nation's second largest credit union serving over 2.7 million members through 275 branch offices, more than 1,100 ATMs, 24/7 Member Services via phone, a website (www.ncsecu.org) and a mobile app. Founded in 1937, SECU has grown in asset size from $437 to more than $50 billion today. As a member-owned, not-for-profit financial cooperative, SECU provides vital consumer financial services to its members—predominantly North Carolina state employees, teachers and their families. SECU is particularly proud to provide these services to its members who would otherwise be part of "underbanked" or "non-banked" populations. Without SECU, many of these members—whether due to income, credit score, or geographical limitations—are unable to receive financial services from other traditional depository institutions.

SECU's debit card program is one of the most utilized financial services that the credit union offers. In the previous fiscal year alone, SECU members initiated hundreds of millions of debit transactions worth tens of billions in cumulative total value. SECU's debit card program is vital to the credit union because it both constitutes a crucial financial service to members, and also generates income that supports the credit union's overall service offerings, as well as its safety and soundness.

[1] Board of Governors of the Federal Reserve System, Notice of Proposed Rulemaking, Debit Card Interchange Fees and Routing [Regulation II; Docket No. R-1818], RIN 7100-AG67, 88 Fed. Reg. 78100 (Nov. 14, 2023).

[2] NPRM at 78121-32 (proposed revised 12 C.F.R. Part 235, including 12 C.F.R. Part 235, Appendix A).

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For the reasons discussed below, SECU ***respectfully requests that the Board withdraw the Proposed Rule.*** Alternatively, to the extent the Board retains any part of the Proposed Rule, SECU respectfully requests that the Board modify the Proposed Rule by enacting a reduction in the interchange cap that is far less severe, delaying the effective date of any new interchange cap to give institutions sufficient time to prudently react, and subjecting any new interchange caps to notice and comment rulemaking as opposed to an automatic biennial adjustment.

As detailed below:

- The Proposed Rule will almost certainly lead to a massive drop in interchange income, which is crucial for SECU and other credit unions to maintain low costs for critical financial services. Initial projections suggest SECU's annual interchange income could fall by **tens of millions of dollars**.
- SECU is a not-for-profit financial cooperative owned by its members. While banks or other for-profit institutions could potentially push this interchange income loss onto shareholders, this loss will be borne ultimately by SECU's members.
- As a result of the inevitable drop in interchange income, and because SECU cannot push this loss to shareholders, the Proposed Rule may have the unintended consequence of negatively impacting the products and services SECU is able to offer to its members, particularly those who would otherwise be "unbanked" or "underbanked."
- The extremely short period for implementing the interchange cap—both for the Proposed Rule's initial enactment, as well as biennial updates—leaves far too little time for credit unions such as SECU to reasonably adjust their policies, investments, and product offerings in response to a new interchange cap.
- The Proposed Rule is simply not necessary at this stage given the Board's own data regarding debit card program costs, which remain in line with benchmarks dating back to the passage of the Durbin Amendment. Further, the Proposed Rule should not be enacted at this time given substantially increased fraud in the current financial environment and the increased regulatory burden on financial institutions from recent, major rulemakings.

Interchange income is vital to credit unions such as SECU. It allows SECU to make investments to maintain a high quality debit program and maintain low costs for other critical financial services.

SECU reinvests a portion of interchange income into its debit program. SECU takes pride in its debit card service and especially its dedication to high-quality member services. Given the high priority SECU and its members place on the debit card program, SECU has invested substantial amounts in this program to ensure the program's high quality and member security. In particular, SECU has invested in debit fraud prevention measures, technology, and resources to respond to cardholder fraud claims—which have increased substantially in recent years—and general member inquiries and services.

Non-interest income, especially interchange income, contributes to SECU offering high-quality products and services that benefit our members at fair, reasonable costs. These low-cost services are vital to our members, especially those who are a part of underserved populations that could not receive similar services from other financial institutions at the same cost—or perhaps not receive services at all. Put simply, debit interchange income keeps the costs of providing services down, and helps ensure SECU's overall safety and soundness as a credit union.

The Proposed Rule is projected to cause a *massive* decline in interchange income, and credit unions cannot push this loss onto shareholders.

The Board proposes a ***sharp*** decline in both the base and *ad valorem* components of the interchange cap. Under the Proposed Rule, the base component would decrease over 31 percent—from 21.0 cents to 14.4 cents—and the *ad valorem* component would decrease 20 percent—from 5.0 basis points to 4.0 basis points.[3] Perhaps not surprisingly, SECU has projected that the Proposed Rule will result in a ***significant*** decrease in debit interchange income to the credit union. Initial projections suggest that the Proposed Rule will result in SECU ***losing tens of millions of dollars in interchange income annually***.

SECU has recently made significant investments in technology, including technology designed to enhance account security and to reduce debit fraud, which has surged in recent years. SECU's debit program has also become more expensive to operate given increased costs due to dispute resolution, risk mitigation and card issuance. This projected decline in debit interchange income will lessen our ability to make these important investments and will increase our expense for operating our card program.

The Board could argue that traditional for-profit financial institutions should accept this resulting decrease in profit. But as member-owned, not-for-profit cooperatives, credit unions such as SECU do not have this option. Unlike other financial institutions, ***SECU cannot simply push these inevitable losses in interchange income onto shareholders***. Instead, the losses **will *adversely impact SECU's members***—many of whom are members of populations that are most in need of low-cost financial services.

The Proposed Rule will likely impact the products and services SECU is able to offer its members.

SECU's mission is to be the trusted provider of financial services to its members. In order to carry out this mission, SECU must also operate the credit union and offer products and services in a way that is financially responsible and sustainable.

As discussed above, if SECU's interchange income drops—and it almost certainly will under the Proposed Rule—SECU cannot simply push that loss onto shareholders. For not-for-

[3] NPRM at 78101.

profit credit unions, basic economics and math dictate that the decrease in interchange income will need to be made up in one of two ways—either increasing revenue in other areas or by reducing costs or services.

In order to increase revenue in other areas, SECU could be forced to modify fees—whether by increasing existing fees or beginning to charge fees on products that have not historically been subject to fees. Or SECU could be forced to increase its lending interest rates and decrease deposit rates in order to increase net interest income. Or in order to reduce costs, SECU may be forced to modify its product features and service offerings and/or future investments serving other critical areas of the credit union.

Reduced interchange caps resulting in a reduction in consumer offerings and an increase in account fees is not some uncertain, hypothetical possibility. This ***exact pattern*** followed the implementation of debit interchange caps after the original passage of the Durbin Amendment. These results have been extensively documented—not just by the financial services industry, but also by neutral federal agencies such as the Government Accountability Office.[4]

It is not yet clear which of these undesirable options SECU could be forced to choose. But one thing is certain no matter which courses of action might be taken—***SECU's members lose***.

The Proposed Rule does not provide credit unions such as SECU with sufficient time to adjust their policies, investments, and product and service offerings in response to changed interchange fee caps.

If any final rule issued by the Board reduces interchange caps—and certainly if interchange caps are reduced to the levels set forth in the Proposed Rule—credit unions such as SECU will need time to appropriately respond. This appropriate response time is necessary given the importance of SECU's debit card program and the significance of debit interchange income to SECU. In particular, SECU's Board of Directors and senior management will require extensive time to adjust SECU's investment plans, policies, product offerings, and general operations in response to the very likely sharp decline in credit union income that would result. These adjustments cannot be made instantaneously.

Under the Proposed Rule, financial institutions would have ***as few as 60 days*** to react to a new interchange cap.[5] Worse, this process of uncertainty over interchange fee caps and an

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[4] *See, e.g.*, U.S. Government Accountability Office, Report to Congressional Requesters, *Banking Services: Regulators Have Taken Actions to Increase Access, but Measurement of Actions' Effectiveness Could Be Improved* (Feb. 2022) at 22-25, *available at* https://www.gao.gov/assets/gao-22-104468.pdf.

[5] NPRM at 78102 ("The Board proposes that the revisions would, if adopted, take effect on the first day of the next calendar quarter that begins at least 60 days after the final rule is published in the Federal Register.").

ensuing lack of time to effectively respond would continue indefinitely. For each future biennial adjustment, financial institutions would have ***as few as 3 months*** to react from the date interchange fees are announced.[6]

This issue is exacerbated by the fact that the data which the Board will use to automatically calculate biennial adjustments is potentially flawed for numerous reasons. First, the basis of the data is reported costs by debit issuers, who may calculate costs inconsistently. Second, the Board's calculations are only based on "allowable" costs, not the full, "true" costs that debit issuers incur when operating a debit card program. Finally, the data the Board uses to calculate the interchange caps—both this initial revised cap under the Proposed Rule, as well as early biennial adjustments—does not fully factor in the increased costs that debit issuers have incurred as a result of very recent regulatory changes that make operating a debit program more expensive, including the Board's recent revision to Regulation II regarding card networks. For these reasons, it is particularly problematic that new biennial caps will not even be subject to notice and comment rulemaking in potential violation of established administrative law.

The timelines set forth in the Proposed Rule between the interchange fee cap's announcement and implementation provide ***far too little time*** for SECU to respond meaningfully to new interchange caps that will significantly impact its income and will accordingly impose ***major (and unnecessary) operational burdens*** on SECU.

Enacting the Proposed Rule is unnecessary at this time.

SECU respectfully submits to the Board that enacting the Proposed Rule is unnecessary at this time given the Board's own debit issuer cost data. SECU maintains that cost data has certainly not shifted significantly enough to warrant the ***major*** interchange fee cap decline the Board proposes.

In its 2011 Final Rule implementing the Durbin Amendment (2011 Final Rule[7]), the Board justified its decision to impose the current 21 cent base component of the interchange fee cap by explaining that this amount represented the fee at which 80 percent of debit issuers could recover ***allowable*** costs.[8] Yet the Board's data set forth in the NPRM confirms that—even under the ***current*** interchange cap—***a smaller percentage of issuers*** (77 percent)

[6] NPRM at 78114 ("[G]oing forward, the Board would publish the base component, *ad valorem* component, and fraud-prevention adjustment in the Federal Register no later than March 31 for an applicable period beginning July 1.").

[7] Board, Final Rule, Debit Card Interchange Fees and Routing [Regulation II: Docket No. R-1404], RIN 7100 AD 63, 76 Fed. Reg. 43394 (July 20, 2011).

[8] *Id.* at 43422 ("The standard's base amount per transaction is 21 cents, which corresponds to the ***per-transaction allowable cost, excluding fraud losses, of the issuer at the 80th percentile***, based on data collected by the Board in a survey of covered issuers.") (emphasis added).

would fully recover their ***allowable*** costs today.[9] This data hardly suggests that a decrease in the interchange fee cap is necessary at all—much less a ***significant*** decrease in the base component to 14.4 cents, under which ***only 66 percent of issuers would fully recover costs.***[10]

The argument that the Proposed Rule is unnecessary at this time is only strengthened by the numerous additional burdens that debit issuers face today compared to the 2011 Final Rule's enactment. Debit fraud has increased substantially during that time—dramatically so since the start of the COVID-19 pandemic. And financial institutions are already in the process of adjusting their operations and procedures in response to numerous other major rulemakings (for example, rules regarding overdraft, credit card late fees, accounting changes, and prior revisions to Reg. II regarding payment card networks).

SECU respectfully requests that the Board withdraw the Proposed Rule.

For the reasons discussed in this comment letter, SECU respectfully requests that the Board withdraw the Proposed Rule. If enacted, the Proposed Rule will almost certainly lead to a significant decline in interchange income for financial institutions. While for-profit financial institutions could potentially choose to pass such losses onto their shareholders, that is not an option for credit unions such as SECU. The impact will instead be borne by our member-owners in the form of higher lending rates, higher fees, lower deposit rates, fewer products and services, and/or decreased investments in critical credit union infrastructure and technology. Many of SECU's member-owners are members of underserved and underbanked communities who are in the greatest need of quality, low-cost financial services and who could least afford these impacts. Worse yet, the Proposed Rule provides credit unions such as SECU with too little time to meaningfully and prudently adjust operations and policies to the likely sharp decline in interchange income. Finally, for the reasons stated above, SECU respectfully submits that the Proposed Rule is unnecessary to enact at this time given current cost data, as well as the current financial and regulatory environment.

Alternatively, to the extent the Board retains any part of the Proposed Rule that involves a reduction in interchange fee caps, SECU respectfully requests that the Board enact a reduction in the interchange cap that is far less severe. This will limit the negative impact that a decrease in interchange income will have on financial institutions, and is particularly warranted given that the cost data the Board relied upon in drafting the Proposed Rule does not include all of the costs that credit unions such as SECU incur when operating a debit card program. Further, SECU respectfully requests that the Board delay the effective date for any new interchange cap to give credit unions such as SECU sufficient time to prudently adjust their policies, investments, processes, and member services in response to any new caps. Finally, SECU respectfully requests that the Board eliminate the Proposed

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[9] NPRM at 78113.

[10] *Id.*

Rule's automatic, biennial interchange cap adjustment. The data that may be used to calculate revised interchange caps may be flawed, inconsistent, and not properly reflect recent increased costs. SECU respectfully requests—to the extent the Board deems it necessary to further adjust interchange caps—that such further adjustments be enacted through notice and comment rulemaking.

SECU again thanks you for the opportunity to provide comments on the Board's Proposed Rule.

Sincerely,

/s/ Jennifer Hamrick

Jennifer Hamrick
Chief Operations Officer