



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: Comment Letter – Debit Card Interchange Fees & Routing
Docket No. R-1818**

Dear Secretary Misback,

The Ohio Credit Union League (OCUL) represents the collective interests of Ohio’s 211 credit unions and their more than 3.2 million members. Of those 211 credit unions, 116 are federally-chartered; 55 state-chartered, federally insured; and 40 state-chartered, privately insured, with an average asset size of \$219 million. OCUL appreciates the opportunity to comment on the Board of Governors of the Federal Reserve System’s (Board) notice of proposed rulemaking related to the reasonableness and proportionality of any interchange fee received by a debit card issuer.

This proposed rule, much like the original Durbin Amendment¹, operates under the same guise of providing benefit or monetary relief to consumers. Regardless of amounts, definitions, or illusory exemptions, OCUL is concerned that the proposed changes to the interchange fee cap, if enacted, would negatively impact all Ohio credit unions. Studies continue to demonstrate that the Durbin Amendment did not result in lower consumer prices, and that government-mandated interchange price caps disproportionately harm local, community financial institutions like credit unions. Specifically, the Durbin Amendment’s exemption of smaller financial institutions, less than \$10 billion in assets, has proven to be largely ineffective, as a study by the Federal Reserve of Richmond indicated that regulatory thresholds in the interchange market do not insulate smaller issuers from harm.²

This proposal will change the interchange fee framework as it is based on an antiquated, incomplete methodology that disregards the real cost born by all issuers, especially smaller credit unions, which will result in a wide-ranging ripple outcome affecting all financial institutions, regardless of size.

I. Background & Summary

Interchange has long been a fractional transaction cost paid by merchants to a cardholder’s bank or credit union to reimburse the financial institutions for the cost of creating, securing, and protecting the debit payment system, which includes offering debit cards, managing the technology, providing customer support, and implementing fraud prevention measures. When the Dodd-Frank Act³ was passed in 2010, it included a requirement that the Board assess whether the amount of any interchange received by a debit card issuer is “reasonable and proportional” to the cost incurred by the debit card issuer. The Board first implemented this statutory requirement in 2011, setting an interchange fee cap for debit card issuers that do not qualify for a statutory exemption, the most significant of which is the

¹ 15 U.S. Code § 1693o-2

² Wang, Zhu, Schwartz, Scarlett and Mitchell, Neil, “The Impact of the Durbin Amendment on Merchants: A Survey Study.” (2014) Federal Reserve Bank of Richmond Economic Quarterly, Volume 100, Number 3.

³ *Dodd-Frank Wall Street Reform and Consumer Protection Act*, 2010. 124 Stat. 1376

exemption for debit card issuers with consolidated assets of less than \$10 billion.

The Board developed the current interchange fee cap using data reported to the Board by covered issuers on a voluntary survey that the Board conducted in 2010 during the original Regulation II rulemaking.⁴ As such, the current base component, *ad valorem* component, and fraud-prevention adjustment are based on the costs incurred by covered issuers in connection with debit card transactions performed in 2009. Since that time, the Board has collected data from covered issuers on a mandatory basis every other year, as required by the Durbin Amendment. The Board now alleges that this data shows that the costs incurred by covered issuers in connection with debit card transactions have changed significantly over time. Specifically, claiming;

1. transaction-processing costs on which the Board based the base component have nearly halved,
2. the issuer fraud losses on which the Board based the *ad valorem* component have fallen, and
3. the fraud-prevention costs on which the Board based the fraud-prevention adjustment have risen.⁵

The Board asserts that the adjustments in the proposed rule will allow for full cost recovery over time for a significant majority of transactions across covered issuers through a formula that relates the base component to a key metric of covered issuer costs.⁶

Lastly, in addition to updating the interchange fee cap for the first time since the original rulemaking, this proposal would codify in Regulation II an approach for updating the three components of the interchange fee cap every other year going forward based on the latest data reported to the Board by covered issuers, thereby granting the Board unilateral authority to change the interchange fee cap annually outside of any formal rulemaking, stakeholder engagement, or public commentary process.⁷ For the following reasons, OCUL not only opposes this rulemaking, but also urges the Board to halt this rulemaking so that the true effect of existing regulations can be adequately analyzed before further action is taken on new rules related to debit card interchange.

II. Any objective analysis of the interchange system over the last decade has proven that government-mandated price fixing does not, and will not, result in a benefit to the consumer, but will harm smaller financial institutions.

While the mission behind the Durbin Amendment was noble, its promulgation was unsuccessful as the concerns raised initially turned out to be the true outcome: no consumer benefit was achieved and financial institutions experienced an unnecessary loss in vital revenue. To put the Durbin Amendment's futility in perspective, a Government Accountability Office (GAO) study ranked the Durbin Amendment among the top five laws and regulations most cited as having significantly affected the cost and availability of basic banking services.⁸ The study further concluded that the regulation was associated

⁴ Regulation II, Debit Card Interchange Fees and Routing, codified at 12 CFR part 235. See 76 FR 43393 (July 20, 2011)

⁵ *Federal Reserve Board Memo*, pg. 2. <https://www.federalreserve.gov/aboutthefed/boardmeetings/reg-ii-memo-20231025.pdf>

⁶ *Id.*, pg. 3

⁷ 88 FR 78100; See also Petition for Rulemaking, <https://www.federalreserve.gov/regreform/rr-commpublic/trade-association-letter-20221222.pdf> (calling for the use of a fixed cost multiplier and automated indexing to avoid future notice and comment rulemaking).

⁸ GAO-22-104468 (February 2022), available at <https://www.gao.gov/assets/gao-22-104468.pdf>.

with an increase in the costs of checking accounts and a decrease in the availability of noninterest checking accounts without monthly fees.⁹

Specifically, the notion that consumers did not benefit from the Durbin Amendment was again found in a study conducted by the Richmond Federal Reserve. This study further concluded that current Regulation II yielded limited positive effects for consumers, holding:

- 77% of merchants did not change prices following the implementation of debit card price caps;
- 22% of merchants chose to increase prices; and,
- 1% passed on savings to customers.¹⁰

Moreover, the economics of providing checking and debit card services were negatively impacted through the introduction of the Durbin Amendment. A key metric to study is the availability of free checking accounts at covered institutions with no minimum balance and no monthly maintenance fee. At covered institutions, this dropped from 60% to 20% in the initial few years after the Durbin Amendment.¹¹ This research also found that:

- Average checking fees increased from \$4.34 to \$7.44 per month;
- Monthly minimums increased on 25% of noninterest-bearing checking accounts; and
- Monthly maintenance fees increased 13% on interest-bearing checking accounts.¹²

From 2012 to 2022, issuers collectively lost nearly \$106 billion in interchange revenue, a figure that largely represents what merchants kept in their own pockets.¹³ Based on historical precedent, a higher cost of basic banking services resulting from downward adjustments to the interchange fee cap will not be offset by lower costs of goods. Research shows that merchants sharing their savings is unlikely, yet the proposal offers a more equivocal assessment: “[m]easuring the extent to which merchants pass on cost savings to consumers, including any decrease in the costs of accepting certain forms of payment, is generally difficult.”¹⁴ The Board catalogues a few studies that actually reveal lack of consumer savings, but offers little analysis regarding the extent to which different empirical approaches might correspond with different consumer outcomes.¹⁵ However, there are studies that can provide this analysis; specifically, a study conducted by Cornerstone Advisors found that the Durbin Amendment not only resulted in merchants saving an estimated \$7.3 billion in 2012, but it also cost consumers between \$22 billion and \$25 billion, based on the present discounted value of their losses over time.¹⁶

Furthermore, the single study presented by the Board as counterargument to evidence that most merchants pocketed their Durbin Amendment-related savings does not actually challenge that finding;

⁹ Id.

¹⁰ Supra, n. 2.

¹¹ See Cornerstone Advisors, *The True Impact of Interchange Regulation*, 20 (June 2023)

¹² Id.

¹³ Id.

¹⁴ 88 Fed. Reg. 78100, 78115 (November 14, 2023); see also Mukharlyamov, V., & Sarin, N. “The impact of the Durbin Amendment on banks, merchants, and Consumers” (2019) U of Penn, Inst for Law & Econ Research Paper.

¹⁵ 88 Fed. Reg. 78155 (observing merely that the extent to which merchants would pass on such savings to consumers “may depend on many factors”).

¹⁶ Supra, n. 11; Evans, D. S., Chang, H. H., & Joyce, S. (2013). *The Impact of the US debit card interchange fee caps on consumer welfare: An event study analysis*. University of Chicago Coase-Sandor Institute for Law & Economics Research Paper (658).

instead, it examines the extent to which merchants passed on the cost of interchange to consumers—a consideration that might be relevant if the Board were proposing to raise the cap rather than lower it.¹⁷ Despite this historical, objective evidence, the Board, reminiscent of the Durbin Amendment’s flawed goal, continues to operate under the misguided assumption that merchants are likely to pass on a large portion of their cost savings—a finding that is completely unsupported by any kind of empirical analysis.¹⁸

Lastly, the impact on financial institutions was studied extensively in the past decade since the implementation of the Durbin Amendment. Specifically, the GAO reports the Durbin Amendment resulted in a 25% reduction of annual interchange revenue for covered issuers.¹⁹ While exempt institutions were not subject to price caps, the financial impact from routing mandates decreased the revenue used to support the cost to deliver and service checking accounts. For many financial institutions, strategic consolidation to increase their customer base—debit card account holders—was a likely financial consideration given the impact to revenue from the implementation of Regulation II. In Q3 2011, there were 14,204 banks and credit unions under \$10 billion in assets. By the end of 2022, this number decreased to a combined 9,043 institutions.²⁰ In the period from after Regulation II to 2019, covered institutions experienced a per-transaction revenue decrease from \$0.31 to \$0.25, according to Federal Reserve reports on debit interchange.²¹

Federal Reserve data goes on to demonstrate that between 2011 and 2019, exempt credit unions and community banks below the \$10 billion threshold lost 19.3% in revenue on debit card interchange transactions processed on single-message networks.²² Policymakers in 2010 when considering the \$10 billion asset threshold in the Durbin Amendment were examining a banking landscape that is far different from what it is today. While this data does not directly reflect the adjustments being proposed by this rule, it does reflect the very same reality, and likely consequences, of misguided, miscalculated, and unnecessary changes to the current interchange system.

Understandably, policymakers do not have the luxury of a time machine to see the future, the banking landscape, and how consumers interact with their financial institutions; however, policymakers can look backwards in time to avoid making the same miscalculations and undermining the progress that a competitive, free market has created. This proposal is not new as it seemingly appears to be the Durbin Amendment promulgated under a new name and regulatory avenue. The outcomes of this Regulation II proposal will be negative as characterized herein, following the known pattern of the Durbin Amendment itself. Based on the empirical evidence and concern for future financial impact, OCUL does not support this rulemaking and urges the Board to further examine how to positively help consumers without harming community-based financial institutions that prioritize their needs and protect their interests.

¹⁷ Efraim Berkovich & Zheli He, *Rewarding the Rich: Cross Subsidies from Interchange Fees* (Hispanic Leadership Fund, May 3, 2022)

¹⁸ See 88 Fed. Reg. 78116.

¹⁹ *Supra*, n. 11

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

III. The proposed rule fails to adequately consider the real, direct and indirect, costs associated with interchange, the subsequent impact on both covered issuers and exempted issuers, and the effect on consumer optionality.

First, the Board opines that even with a drastic reduction in overall interchange revenue, the fraud-prevention adjustment remains sufficient to provide financial institutions the ability to offer safe, secure, and reliable debit card services.²³ United States merchant payments in 2021 totaled more than \$9 trillion in purchase volume and grew by 24% from 2020; moreover, fraud followed similar growth, specifically:

- In 2021, fraud losses of nearly \$12 billion in the United States were associated with total card volume of more than \$11 trillion;
- Total fraud volume in 2021 increased 18% from 2020; and
- By 2031, total card volume is projected to hit \$19 trillion, and fraud losses are expected to be \$19 billion. This equates to almost 10 cents for every \$100 in purchase volume.²⁴

Responding to accelerating fraud and determined to protect their members, credit unions are investing more resources into fraud prevention activities.²⁵ Yet the fraud prevention costs that the Board deems allowable and recoverable are narrowing. More generally, the Board should not proffer a lack of historical data as a basis for excluding costs that are specific to particular debit transactions. Excluding any calculable costs understates the true operational expense of maintaining debit card programs and overstates issuer cost recovery targeted under both the current and proposed fee cap.

Under the Board's current interchange fee standard, fraud costs are only partially recovered through the *ad valorem* component, which is the median ratio of issuer fraud losses to transaction value among covered issuers. While the Board proposes no changes to the way this component is calculated, it does propose a downward adjustment, observing that the median ratio of issuer fraud losses to transaction value among covered issuers has declined from 2011 to 2021, despite an overall increase in fraud losses to all parties.²⁶ In this regard, the Board downplays the *ad valorem* component's most obvious shortcoming; namely, that it forces half of covered issuers to settle for less than full recovery of actual fraud costs.

Second, as shown above, the asset threshold fails to adequately insulate those institutions allegedly outside the direct purview of the proposed rule. The size of financial institutions plays a significant role in terms of funding, preventing, and mitigating fraud losses. For smaller covered credit union issuers, lack of scale makes it harder to absorb fraud losses while maintaining net margin within debit card programs. While the median ratio of issuer fraud losses to transaction value has declined, data collected by America's Credit Unions shows that the ratio of fraud losses to total transactions is increasing for covered credit unions.

Moreover, Regulation II's current interchange fee cap has already proven to harm even exempt issuers due to the competitive dynamic that exists between large covered issuers representing the vast majority of transactions and smaller issuers who account for a small share of total debit market volume and lack

²³ Supra, n. 7

²⁴ Supra, n. 11.

²⁵ Id.

²⁶ Supra, n. 7, at 78108.

equivalent bargaining power.²⁷ Exempt credit unions, due to their smaller size and community-focused operations, do not have the high volume of transactions or broad infrastructural base to spread out the fixed costs associated with issuing debit services. Credit unions often incur higher per-transaction costs, which can be largely attributed to their limited scale of operations. Furthermore, credit unions with comparable debit transaction volume to banks tend to have fewer total assets. For small, low volume credit union issuers, a reduction in debit interchange revenue is likely to impact other areas of operations, as most cannot afford to simply abandon debit card programs if they hope to offer a minimally viable banking experience.²⁸ Consequently, credit union debit card program costs that are already exceeding interchange revenues today may be even more expensive to maintain should the Board adopt the proposal.

The Board vastly understates the potential impact of the proposal on exempt issuers. Following the introduction of the current fee cap, free noninterest checking accounts offered by exempt financial institutions declined by 15.5%.²⁹ Research published by the Federal Reserve Bank of Richmond also found that both large and small debit card issuers substantially reduced free deposit account products and services after 2011.³⁰

While OCUL appreciates the Board's attempt to bifurcate the market and protect those institutions that could be disproportionately impacted, we do not believe this proposed rule meets that goal. As seen in historical, and objective data, arbitrarily bifurcating the market does not only end up costing consumers more, but it unintentionally harms all financial institutions, regardless of size. Thus, OCUL cannot support this rulemaking as it does not consider the unintended downstream effects of interchange fee modifications on exempt, community-based issuers like credit unions.

IV. The proposed rule lacks adequate justification to warrant allowing the Board to make annual adjustments to the interchange caps outside of the public comment process.

As a frequent and long-standing submitter of public comment on federal agency rulemaking, OCUL has serious concerns regarding the Board's attempt to unilaterally grant itself the authority to adjust the interchange cap bi-annually without the need for public input. This potential violation of 5 U.S.C. 553 represents a stark deviation from agency public commentary requirements.³¹ The importance of public input cannot be overstated, as industries are best served when regulators and the regulated work together to form a regulatory environment that fosters competition, innovation, safety, and trust.

Specifically, the law requires public notice except "when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and

²⁷ See Board of Governors of the Federal Reserve System, "Statement on Proposed Revisions to Regulation II's Interchange Fee Cap by Michelle W. Bowman" (Oct. 6, 2023), available at <https://www.federalreserve.gov/newsevents/pressreleases/bowman-statement-20231025.htm>

²⁸ See *id.*

²⁹ Manuszak, Mark D. and Krzysztof Wozniak, "The Impact of Price Controls in Two-sided Markets: Evidence from US Debit Card Interchange Fee Regulation" 5-6 (2017), available at <https://doi.org/10.17016/FEDS.2017.074>

³⁰ See Wang, Zuh, "Price Cap Regulation in a Two-sided Market: Intended and Unintended Consequences," Working Paper No. 13-06R, The Federal Reserve Bank of Richmond (2015), available at https://www.richmondfed.org/-/media/RichmondFedOrg/publications/research/working_papers/2013/pdf/wp13-06r.pdf.

³¹ 5 U.S. Code § 553



public procedure thereon are impracticable, unnecessary, or contrary to the public interest.”³² The idea that the Board considers future public comment on interchange adjustments to be “impractical, unnecessary, or contrary to public interest” is alarming. The Board glosses over this requirement highlighting that it does not “intend” to seek public comment as it would be using the latest data.³³ The Board highlights the fact that it has been collecting the very information necessary to make these adjustments for over a decade yet opines that public comment is unlikely. The Board makes no justification in the proposed rule as to why future adjustments cannot follow the same process, using the same data. Without the ability for impacted stakeholders to comment on proposed changes, there is little opportunity to ensure a holistic analysis and complete data set determine adjustments and any potential impact. In regard to Regulation II, we note that the negative consequences of the absence of stakeholder input and public commentary fall most heavily on smaller market participants lacking the brute force of scale. The interests of credit unions and their members are not well served by this proposal’s extinction of stakeholder analysis and commentary. Therefore, OCUL requests the Board rescind this portion of the rule as it recklessly broadens the exceptions by law to bypass public comment and sets an untenable precedent that federal agencies can change regulations as they unilaterally deem appropriate without public input.

While OCUL understands the intent to keep interchange fees reasonable and proportional, it is critical to consider the broader impact on smaller financial institutions like credit unions and, by extension, on the people, families, businesses, and communities they serve. Therefore, OCUL urges the Board to rescind this proposal until an adequate study assessing the proposal’s impact on consumers’ access to low-cost or free checking accounts, fraud prevention, and merchants’ costs of accepting debit cards can be conducted.

OCUL appreciates the opportunity to engage with the Federal Reserve on and provide comments on this proposed rule; however, we respectfully write in opposition to this rule.

Respectfully,

A handwritten signature in black ink, appearing to read "Paul L. Mercer".

Paul L. Mercer
President

A handwritten signature in black ink, appearing to read "Sean M. Brown".

Sean M. Brown, Esq.
Director, Regulatory Affairs

³² 5 U.S. Code § 553(b)(4)(B)

³³ Supra, n. 7, at 78109.