**United Nations Federal Credit Union**
Court Square Place, 24-01 44th Road
Long Island City, NY 11101, USA
T: +1 347-686-6000 | F: +1 347-686-6400
email@unfcu.com | unfcu.org

12 May 2024

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

*Submitted via email to* ***regs.comments@federalreserve.gov***

RE: Docket No. R-1818—Debit Card Interchange Fees and Routing

Dear Ms. Misback,

On behalf of the United Nations Federal Credit Union (UNFCU) I would like to thank the Board of Governors of the Federal Reserve System (Board) for inviting comments on the proposed reduction of the interchange fee cap, as proposed in the Federal Register on 14 November 2023 (the Proposal).[1] With assets just over $9 billion, UNFCU is currently below the $10 billion threshold and therefore exempt from the fee cap. Based on projected growth, however, UNFCU is likely to exceed that threshold and become a covered issuer in the relatively near future.

UNFCU respectfully but firmly opposes the Proposal to reduce the interchange fee cap. As discussed herein, the Proposal will result in changes to the debit card payments system that will negatively impact both consumers and issuers, whether those issuers are covered or exempt. In addition, the Proposal is procedurally flawed because (a) it fails to consider recent changes to Regulation II; and (b) its automatic adjustment mechanism would improperly fail to consider either the cap's current effectiveness or the impact of future changes on stakeholders and markets.

**The Proposal Will Negatively Impact Consumers**

The interchange fee cap, first imposed in 2011,[2] has not been a consumer panacea. Though its effects on the many variables involved in the financial landscape make any analysis of the matter complex, the cap has arguably led to considerable consumer harm. Neither regulators nor legislators intended such harm, but both groups failed to anticipate merchants' actual incentives correctly.

---

[1] Debit Card Interchange Fees and Routing, 88 Fed Reg 78100 (Nov. 14, 2023) (the "Proposal").

[2] Debit Card Interchange Fees and Routing, 76 Fed Reg 43394 (July 20, 2011) (the "Interchange Cap Rule").

Commenting in support of the initial interchange fee cap, merchants and their trade groups argued that lower interchange fees would result, among other benefits, in savings “which could be passed on to consumers as lower retail prices.”[3] The ensuing decade has provided data that disprove this assertion. In fact, merchants have not passed on the savings they have realized due to the interchange fee cap. To the contrary, at least one study conducted by the Richmond Federal Reserve in the years following the imposition of the cap concluded that 77% of merchants maintained their prices as the cap went into effect—essentially pocketing the savings themselves—and that 22% of merchants actually *increased* their prices.[4] Only 1% of merchants passed savings on to consumers in the form of lower prices.[5] Unsurprisingly, merchants chose to adhere to their basic profit incentive rather than suddenly adopt a sense of consumer-friendly altruism. As a rule, when the costs of debit increase for merchants they raise prices for consumers, limit debit opportunities, or both. When their costs decrease, however, they do not correspondingly lower prices or add debit opportunities. Rather, the profit motive rationally motivates them to realize the difference as a gain for their business.

By contrast, card issuers and payment networks commented that the interchange fee cap would result in “increased cardholder fees or decreased availability of debit card services. . . .”[6] The data show that these concerns were warranted. If a financial institution wishes to remain competitive in the modern world, it cannot realistically elect not to offer a basic service such as debit card payments. This means that with interchange fees capped, issuers have been forced to reduce consumer offerings to account for the cost of providing debit services. A 2022 report from the US Government Accountability Office (GAO) detailed that “[d]ebit card interchange fee limits imposed by the Durbin Amendment and Regulation II are associated with increases in the costs of checking accounts. . . .”[7] The studies the GAO surveyed found that issuers responded to the loss of interchange fee revenue by increasing checking account service fees,[8] and either eliminating free checking accounts entirely or imposing minimum balances for consumers to avoid a monthly fee.[9]

Consumers seeking the most convenient means of making payments in the modern marketplace find

---

[3] Interchange Cap Rule at 43402.

[4] *See* 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.

[5] *Id.*

[6] Interchange Cap Rule at 43402.

[7] BANKING SERVICES – Regulators Have Taken Actions to Increase Access, but Measurement of Actions’ Effectiveness Could Be Improved, GAO-22-104468 (February 2022) at 22 (*available at* https://www.gao.gov/assets/gao-22-104468.pdf).

[8] *Id.* at 22-23 (*citing* Mark D. Manuszak and Krzysztof Wozniak, “The Impact of Price Controls in Two-sided Markets: Evidence from US Debit Card Interchange Fee Regulation,” Finance and Economics Discussion Series, 2017-074 (Washington, D.C.: 2017).

[9] *Id.* (“[T]he researchers found that before the implementation of Regulation II, about half of noninterest checking accounts offered by covered banks were free, compared with less than one-third after implementation.”).

themselves caught between the banking institutions who provide those means and the merchants who take advantage of them. According to one analysis of data from the Federal Reserve, the interchange cap cost banking institutions nearly $106 billion between 2012 and 2021, displacing that revenue in favor of merchants.[10] As discussed above, those merchants did not, in turn, pass any of their savings on to consumers. Rather, consumers found themselves doubly disadvantaged: first by higher prices, and then again by the increased fees and reduced services that the banks' lower revenue necessitated. There is no reason to believe that the Proposal will yield a different result. Merchants will continue to retain any savings that they realize from the lower cap, and financial institutions further squeezed by that cap will be forced either to raise fees elsewhere or cease offering certain services. Ultimately, though, consumers will pay the price.

In the case of credit unions—member-owned entities chartered to serve specific communities—that price will spread beyond individual consumers to their communities. Unlike either merchants or banks, credit unions are not-for-profit entities that allocate their earnings into member benefits like increased yields on deposits, debit rewards, and reinvestment into the local community. A reduction of the interchange fee cap will hurt consumers by driving credit unions to mothball such rewards programs and curtail or limit community reinvestment. For example, faced with the Proposal's lower cap UNFCU would likely limit some of the benefits its members enjoy as part of the member loyalty rewards program, such as fee rebates. UNFCU would also be forced to consider imposing new fees associated with international card services to account for the lowered interchange fee cap.

In addition to the increased costs and reduction of services that consumers are likely to experience due to a lower interchange fee cap, consumers are also likely to experience more instances of fraud. Interchange fees serve to cover costs associated with fraud, albeit only partially. They also fund advances in detecting and preventing fraud. Reducing the *ad valorem* component from 5 to 4 basis points means less revenue to dedicate to such advances. Consumers are therefore likely to experience more fraud as the cap limits issuers' ability to keep pace with fraudsters and their innovations.

Additionally, the proposal fails to address issuers' fraud losses properly. The Proposal notes that the ratio of fraud losses *to transaction value* among covered issuers declined in the decade between 2011 and 2021, "despite the overall increase in fraud losses to all parties."[11] The ratio of fraud losses to *total transactions*, however, has increased considerably.[12] As discussed at greater length below, questions of scale skew the impact of such metrics because the largest three banks account for nearly 50% of

---

[10] The Cost of the Durbin Amendment, Electronic Payments Coalition (Aug. 9, 2021) (*available at* https://electronicpaymentscoalition.org/resources/the-cost-of-the-durbin-amendment/).

[11] 88 Fed Reg 78100 at 78108.

[12] *See* Economic Analysis of the Board of Governors of the Federal Reserve System's Proposed Rulemaking on Debit Card Interchange Fees and Routing, Andrew Rodrigo Nigrinis, Ph.D, (2024), attached as Appendix A to Comments of America's Credit Unions, Debit Card Interchange Fees and Routing (Docket No. R-1818; RIN: 7100-AG67) ("Nigrinis Analysis") at P133.

debit transaction volume.[13] For the lower-volume issuers that make up the majority, fraud-per-transaction is a more relevant metric because it reveals the issuers' exposure to greater fraud losses.

Larger-scale issuers' transaction volume allows them to mitigate losses over a wide swath of transactions, but such mitigation is not available to lower-volume issuers. The reduction of the cap as proposed will therefore likely cause lower-volume issuers to limit their exposure by reducing their risk appetite. To accomplish this, they will decline transactions that show any indication of potential fraud. This will likely lead to reduced opportunities for consumers to use debit services, increased transaction delays, and the significant frustration that accompanies a transaction being unexpectedly declined. Consumers who engage in international transactions, in particular, are likely to see significant limitations, but consumers of all kinds will feel the negative impact.

**The Proposal Will Negatively Impact Covered Issuers**

Though issuers must exceed the $10 billion asset threshold for the interchange fee cap to apply, not all covered issuers are similarly situated. As mentioned above, the largest three issuers process nearly half the volume of debit transactions.[14] The gulf in scale between this handful of issuers and the remaining majority complicates how any fee cap methodology will impact the sector. As written, the Proposal's methodology misapplies the statutory directive to bias the market unfairly in favor of the few high-volume issuers.

The Dodd-Frank Act amended the Electronic Funds Transfer Act (EFTA) to require that "any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction shall be reasonable and proportional to the cost incurred by the issuer with respect to the transaction"[15] and empowered the Board to pass regulations implementing that requirement.[16] The statute's text strongly suggests that Congress envisioned a regulatory regime that allows issuers to recover the costs they incur by providing debit services as long as their fees are reasonable and proportional to those costs. Nothing in the text suggests that Congress expected the Board to compel certain issuers to offer such services at a deficit. Nevertheless, the methodology the Interchange Cap Rule used to determine the interchange fee cap does exactly that.

To arrive at the current interchange cap, the Board added together each covered issuer's base component costs and then divided that amount by the total number of that issuer's debit card transactions to determine an average per-transaction cost.[17] The Board then arranged these averages

---

[13] *See* The 50 Largest US Debit Card Issuers, The Nilson Report, Issue 1240 (May 2023).

[14] *Id.*

[15] 15 U.S.C. § 1693o-2(a)(2).

[16] *Id.* at § 1693o-2(a)(1).

[17] Proposal at 78104.

in ascending order and set the base component cap at the point of highest concentration—21 cents.[18] The current cap does not afford higher-cost issuers a means of recovering their costs by imposing a fee greater than that amount, even if their actual costs are greater and their fee is reasonable and proportional to those costs. Rather, the Board recognized that its application of the cap would prevent 1 in 5 issuers from recovering their base component costs.[19]

The statutory text uses only singular references: any singular fee that any singular issuer charges must be reasonable and proportional with respect to any singular transaction. Congress did not lump all issuers together by referencing a collective market of *issuers*, plural, nor to their collectively considered *transactions*. It is therefore an improper understanding of the statute's requirement to structure a rule that blocks certain issuers from recovering their costs by considering their costs only on a collective, aggregated basis.

According to the Board's own data, the current Rule's application of such a methodology already envisions nearly a quarter of covered issuers operating debit services at a deficit.[20] The Proposal would exacerbate this issue by further reducing the cost-recovery target to 98.5%. The Proposal indicates that fully one-third of covered issuers would fail to recover their costs under such a regime.[21] Indeed, the Proposal hints that the cap may prevent an even greater number of market participants from recovering their costs when it admits that "the proposed approach would not guarantee this precise level of cost recovery in any particular year."[22]

Moreover, economies of scale allow the few high-volume institutions to reduce their per-transaction costs in a way that the majority of covered issuers cannot, making the consideration of aggregated per-transaction data inherently unfair. The Proposal's methodology sets the cap based on the skewed picture caused by these behemoths' distortion of the market, forcing the majority of issuers to compete on a field slanted to favor the larger players. Such distortions prevent fair competition, and over time will contribute to pressures on smaller institutions to consolidate or simply lose out to those larger players. Increased consolidation and a lack of fair competition not only hurt smaller-volume issuers, but ultimately hurt consumers as well when the market lacks competitive alternatives to the large incumbents.

---

[18] *Id.*

[19] *See id.* ("Had [a] base component [of 21 cents] been in effect in 2009, approximately 80 percent of covered issuers that responded to the Board's voluntary survey would have fully recovered their base component costs.").

[20] *See* Proposal at 78113 (stating that only 77% of covered issuers would have fully recovered base component costs in 2021 under the current cost-recovery target, implicating 23% that would not fully recover those costs).

[21] *Id.* (stating that only 66% of covered issuers would fully recover their costs, leaving 34% short of full cost recovery).

[22] Proposal at 78107.

## The Proposal Will Negatively Impact Exempt Issuers

Competitive principles are also key to understanding how the interchange fee cap in general and the Proposal in particular impact exempt issuers. Although financial institutions with less than $10 billion in assets are not subject to the cap, those institutions lack an effective means to set interchange fees. The networks providing debit services set the fees and, due to their lack of scale, exempt issuers are not generally able to negotiate those fees. Thus, market forces effectively compel exempt issuers either to accept interchange fees relatively close to those of covered issuers or to stop providing debit services due to high costs. Exempt issuers cannot hope to remain competitive in the financial services market if they simply do not offer debit services. Consequently, to the extent they are able, exempt issuers are more likely to accept reduced interchange fees and offset costs elsewhere.

One way in which exempt issuers offset the costs associated with offering competitive interchange fees is by changing the features of other products. For example, the data from the years following the initial imposition of the current cap show that exempt issuers reduced free accounts by 15.5%.[23] For smaller institutions such as credit unions, such accounts are often the hallmark of a culture centered on member service, differentiating them from larger, more impersonal banks. A need to charge fees for these core products therefore raises an existential question for many exempt issuers and adds to the pressure toward consolidation—merging with one or more other smaller organizations to achieve scale can become the most rational direction for an exempt issuer to take. As discussed above, such consolidation ultimately hurts consumers by reducing competition.

Exempt issuers also experience negative impacts from the cap on interchange revenue due to how the cap restricts the broader industry's resources for fighting fraud. Advances in combating fraud, though often developed by larger organizations, benefit all stakeholders—including exempt issuers. To the extent, therefore, that the Proposal's reduction of the interchange fee cap will further restrict those resources it will certainly have a downstream effect on exempt issuers. Due to differences of size and scale, however, exempt issuers will feel the impact of increased instances of fraud far more acutely than covered issuers as the amounts they fail to recover will represent a larger percentage of their overall assets.

## The Proposal Contains Arbitrary Procedural Provisions

In addition to its substantively negative impacts, the Proposal also contains a number of key procedural deficiencies. Most notably, the Proposal's data does not reflect recent amendments to Regulation II that will likely provide a different picture of the interchange landscape. Furthermore, the automatic

---

[23] Comments of America's Credit Unions at 13 (citing 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).

adjustment of the cap in future years will improperly deprive stakeholders of a mechanism to determine whether circumstances warrant a change to the interchange fee methodology.

In October of 2022, the Board adopted a rule amending Regulation II to clarify that each debit card transaction must be capable of being processed on at least two unaffiliated payment card networks, and that the requirement applies to card-not-present (CNP) transactions as well as those when a card is present.[24] The requirement that issuers allow merchants to access two unaffiliated networks now affords merchants a means of routing transactions over their preferred network. Unsurprisingly, when provided a choice merchants tend to select the lower-cost network.

This recent change in the routing of debit card transactions came with its own implications. Perhaps most notably, lower-cost networks can be more vulnerable to fraud. Consequently, giving merchants the option of choosing their preferred network means that as CNP fraud has increased the routing of those CNP transactions over lower-cost, single-message networks has led to a decline in the percentage of fraudulent debit transactions that issuers can recover.[25]

The impact of the Regulation II amendments on issuers, particularly as that impact relates to fraud, is therefore particularly salient in determining whether an interchange fee is reasonable and proportional. The amendments, however, did not actually go into effect until 1 July 2023.[26] The Proposal only considered data through calendar year 2021.[27] The data that forms the basis for the proposed fee reduction therefore does not reflect the impacts of the Regulation II amendments. Particularly given the material difference that a simultaneous rise in instances of fraud and decline in the percentage of recoverable transactions is likely to make on issuers' need for (and use of) interchange fees, the Proposal's failure to incorporate post-amendment data is both arbitrary and capricious.

Additionally, the Proposal would implement an automatic adjustment to the interchange fee cap on a biennial basis, determined only by "data collected by the Board from large debit card issuers. . . ."[28] As discussed above, the vast difference in scale between large issuers and small issuers radically distorts the relative experience of those distinct cohorts in the market for debit services. Automatic adjustment of the interchange fee cap on this basis would mean that the Board would have no opportunity to consider the cap's impact on smaller issuers. Moreover, removing a standard notice-and-comment

---

[24] Debit Card Interchange Fees and Routing, 87 Fed Reg 61217 (Oct. 11, 2022).

[25] *See* Nigrinis Analysis at P92.

[26] *See* Debit Card Interchange Fees and Routing, 87 Fed Reg 61217 (Oct. 11, 2022).

[27] *See* Proposal at 78105 ("Through [its] biennial surveys, the Board has collected data from covered issuers concerning the costs incurred by those issuers in connection with debit card transactions performed in calendar years 2011, 2013, 2015, 2017, 2019, and 2021. The Board has reviewed the interchange fee standards in § 235.3 in light of both the most recently collected data from 2021 and the cumulative data collected from covered issuers since the original Regulation II rulemaking.").

[28] *Id.* at 78101.

period would improperly limit the public's ability to have the Board consider whether broader circumstances might necessitate a change in the overall methodology or standards used to determine the fee cap. The automatic nature of the Proposal's future updates thus deprives stakeholders of an appropriate mechanism to consider the cap's current effectiveness or the impact of, or need for, future changes.

**Conclusion**

Over a decade of experience with an interchange fee cap has provided data that reveal the cap's actual impacts on the financial landscape. For consumers and issuers, those impacts have largely been negative: instances of fraud have increased, issuers have raised other fees to offset the costs of providing debit services, merchants have either maintained or raised prices while pocketing interchange savings, and unfair competition has increased consolidation pressure on smaller issuers. It is logical to presume that the Proposal's further reduction of the cap will only exacerbate these outcomes.

Furthermore, the Proposal would amend Regulation II without taking into account critical data from changes to that Regulation that have only recently taken effect. It also improperly envisions this as the last opportunity for stakeholders to comment on a methodology that will be set indefinitely, regardless of how circumstances in financial markets and the provision of debit services may change.

UNFCU respectfully urges the Board not to proceed with the Proposal. Thank you for the opportunity to comment and for your consideration of UNFCU's comments on this matter.

Respectfully,

**Bill Thomas**
Chief Global Channels & Operations Officer

cc: John Lewis, President/CEO, UNFCU