May 11, 2024

VIA ELECTRONIC DELIVERY

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

Re: IBC Comment Letter on the Federal Reserve Board's Proposed Rulemaking on Debit Card Interchange Fees under Regulation II (Docket No. R-1818: RIN 7100-AG67)

Dear Ms. Misback:

Thank you for your service to the Board of Governors of the Federal Reserve System. The following comments are being submitted by International Bancshares Corporation ("IBC"), a publicly traded, multi-bank financial holding company headquartered in Laredo, Texas. IBC maintains 166 facilities and 256 ATMs, serving 75 communities in Texas and Oklahoma through five separately chartered banks ranging in size from approximately $470 million to $8.9 billion, with consolidated assets totaling over $15 billion. IBC is one of the largest independent commercial bank holding companies headquartered in Texas.

This letter is in response to that certain Notice of Proposed Rulemaking (the "Notice") published by the Board of Governors of the Federal Reserve System (the "Board") regarding modifications to Regulation II and the Official Board Commentary on Regulation II related to debit card interchange fees.[1] IBC is submitting these comments in support of, and in agreement with, the certain joint trades letter prepared by the American Bankers Association, the Bank Policy Institute and the Clearing House Association L.L.C. on May 10, 2024 (the "Joint Letter"),[2] and submitted on behalf of themselves and other trade associations representing financial institutions that serve hundreds of millions of American consumers (collectively, the "Associations")[3] to the Board in opposition of, the Board's proposed rulemaking regarding certain modifications to Regulation II, implementing the Dubin Amendment, which would reduce the existing deficient price cap on debit card interchange fees (the "Proposal" or "Proposed Rule").[4]

In general, IBC's comments are presented and discussed in the Joint Letter as submitted to the Board. Thus, as further discussed herein, IBC shares the Associations' position in urging the Board to withdraw

[1] *See* FRB, Regulation II; Docket No. R–1818, *Debit Card Interchange Fees and. Routing; Extension of Comment Period* (Jan. 26, 2024), https://public-inspection.federalregister.gov/2024-01612.pdf (extending the original comment period to May 12, 2024, to provide additional opportunity for interested parties to consider the Proposal and prepare comments).

[2] *See* https://www.aba.com/about-us/press-room/press-releases/federal-reserves-debit-card-proposal.

[3] Notably, the Associations which joined the letter represent the majority of debit card issuers in the United States: the American Bankers Association, the Clearing House Association L.L.C., the Bank Policy Institute, the Independent Community Bankers of America, America's Credit Unions, the Electronic Payments Coalition, and the Consumer Bankers Association.

[4] *See* Debit Card Interchange Fees and Routing, 88 Fed. Reg. 78100 (Nov. 14, 2023).

its Proposal to substantially lower the cap on debit card interchange fees for the following reasons: (i) the Proposal will cause significant harm to consumers, financial institutions and the security of U.S. payment systems; (ii) the Proposed Rule violates the Durbin Amendment and likely creates constitutional issues; (iii) the Proposal is unsupported by reasoned decision making; and (iv) the Board is not legally compelled, by either the Durbin Amendment or any current regulation, to issue the Proposal.

The Durbin Amendment was passed in 2010 as part of the Dodd-Frank Act in response to the 2008 financial crisis. Its purpose was to make the financial system safer and prevent a repeat of the crisis. The Durbin Amendment created the Consumer Financial Protection Bureau to ensure fair treatment of American consumers by financial institutions. However, it also introduced regulations that affected debit card transactions.

The first aspect of the Durbin Amendment is the regulation of debt card interchange fees, which are fees paid by merchants to the issuing bank for each debit card transaction. The Durbin cap affected financial institutions with assets of $10 billion or more. This regulation was aimed to reduce fees for merchants and, in turn, lower prices for consumers. The second aspect of the Durbin Amendment requires card-issuing banks to use at least two unaffiliated network sources for debit card transactions. This provision was intended to promote competition among networks, potentially reducing fees for merchants and consumers. By offering more routing options, it was anticipated that merchants would have the ability to choose the most cost-effective path for their transactions. However, the Joint Letter emphasizes there is no evidence that merchants passed on cost savings from capped interchange fees to consumers after the promulgation of the Regulation II as promulgated in 2011 (the "2011 Rule"). Thus, it is highly unlikely that merchants would pass on any additional savings realized if the Proposal is finalized.

IBC echoes the sentiments expressed by the Associations in the Joint Letter as it pertains to the harm that will be caused to American consumers as a direct result of implementing the Proposed Rule. The Joint Letter discussed the existing interchange fee cap under Regulation II while analyzing the Board's proposed modifications to further reduce the interchange fee cap, which would consist of a base component, an *ad valorem* component, and a fraud prevention adjustment. The Associations argue the Proposal ignores evidence showing the current interchange fee cap has increased costs for basic deposit accounts, harming American consumers, particularly low-income and minority consumers. Furthermore, reductions would exacerbate these harms and undermine the policy goal of promoting financial inclusion.

Under the Electronic Fund Transfer Act, the Board must conduct a cost-benefit analysis that analyzes the extent of how the reduced cap affects American consumers, especially low-income consumers, as well as financial institutions.[5] Such an analysis should inform all aspects of the Proposal. The Board states it is unable to determine if benefits to consumers outweigh potential harms. However, the Joint Letter disagrees, and IBC supports such dispute. Research shows the 2011 Rule resulted in many American consumers being priced out of traditional banking. This is evident by the substantial growth in the amount of recently unbanked consumers, which were highest in states most affected by the cap. As such, the Board should withdraw its Proposed Rule, as it fails to adequately evaluate the impact of safe deposit accounts on consumers, in direct contradiction of the federal government's longstanding public policy goal of reducing unbanked and underbanked individuals.

Moreover, further reducing the cap by over 30% will likely exacerbate harm to consumers, particularly those consumers who are low-to-moderate income ("LMI"). Reducing the cap will likely result in more expensive, less attractive products, driving more consumers to risky alternatives like check cashing and payday loans. Even those products specifically designed to be safe and affordable to LMI consumers, such as "Bank On" accounts, would also likely be affected. In its Comment Letter to the Board, the Cities

[5] 15 U.S.C. § 1693b(a)(2).

for Financial Empowerment Fund ("CFE Fund") highlighted that the aim of the Bank On National Account Standards is to address consumer concerns like transparent pricing and surprise fees, while also being economically sustainable for partner financial institutions.[6] Such accounts allow for limited monthly fees and account opening deposits, and the CFE Fund emphasized to the Board that the interchange fees are a critical component of that market sustainability. Indeed, the Proposed Rule will increase costs for basic deposit accounts, disproportionately harming low-income, minority and underserved consumers. Myriad evidence demonstrates the 2011 Rule has already resulted in such fee increases, causing many American consumers to be compelled to resort to riskier, more expensive banking alternatives. Thus, it is irrefutable that imposing a further reduction to issuer interchange recovery will exacerbate this harm. The Proposal estimates consumers will pay an additional $1.3 billion to $2 billion in annual account fees but provides no evidence that merchants will pass on any cost savings.[7] The Board must not turn a blind eye to such obvious and significant harm to millions of American consumers and the negative public policy consequences which would result if the Proposal were finalized.

The Joint Letter also argues that the Proposal fails to consider the impact on exempt issuers, which have already experienced revenue declines. This will further reduce availability of free checking accounts and make it harder for exempt issuers to serve their communities. Indeed, the Joint Letter articulates how the Proposal fails to consider effects on exempt issuers under $10 billion in assets and on competition between exempt and covered issuers. Moreover, reduced interchange revenue will also disincentivize investments in fraud prevention and security at a time of increasing threats, undermining payment system safety, soundness, and innovation by restricting this revenue source.

The Durbin Amendment requires the Board to establish standards for assessing whether the amount of any interchange transaction fee received or charged by a debit card issuer is *reasonable* and *proportional* to the cost incurred by the issuer with respect to the transaction.[8] The Joint Letter asserts that the Proposal violates the Durbin Amendment by denying reasonable cost recovery and a reasonable return to many covered issuers. IBC agrees. The Proposal excludes costs the Board could consider under the Durbin Amendment without justification. Further, it denies reasonable cost recovery to issuers and excludes significant costs like cardholder inquiries and non-sufficient funds, which likely violates the Takings Clause. The proposed methodology outweighs the costs of the largest issuers, ignoring the statutory text requiring consideration of costs of the substantial majority of issuers.

Furthermore, IBC agrees with the Associations argument that the Board's cost calculations, methodology changes, and 98.5% cost recovery target are arbitrary and lack factual support or reasoned explanations. The biennial adjustment process is also legally deficient. Comparisons to voluntary 2009 data are flawed. Reported transaction cost declines are only due to largest issuers' scale efficiencies. The 2021 data is skewed by the pandemic. The Board has not explained its data methodology. Moreover, there is no legal requirement to revisit the existing rule. The Board fails to explain retaining existing ad valorem and fraud adjustment methodologies that deny many issuers full recovery. Biennial recalculation is substantively

[6] CFE Fund, https://cfefund.org/wp-content/uploads/2024/01/FRB-Reg-II-Comment-Letter-final.pdf ("At the same time the Standards' designated features, guardrails, and fee limitations are designed to meet those critical consumer needs, we also designed them to be economically sustainable for partner financial institutions, if not even somewhat profitable, rather than dependent upon more ephemeral charitable motivations.").

[7] Nick Bourke, *How Proposed Interchange Fee Caps Will Affect Consumer Costs* (Jan. 2024), https://ssrn.com/abstract=4705853, building on the work of Vladimir Mukharlyamov and Natasha Sarin, *Price Regulation in Two-Sided Markets: Empirical Evidence from Debit Cards* (Nov. 2022), https://scholarship.law.upenn.edu/faculty_scholarship/2885/.

[8] 15 U.S.C. § 1693o-2(a)(3)(A) (emphasis added).

and procedurally deficient. Overall, the Proposal arbitrarily selects methodologies to achieve a predetermined goal of lowering interchange fees.

The Board claims that the Proposed Rule will save consumers money, create jobs, and increase the availability of free checking accounts. However, in reality, the 2011 Rule has led to higher costs for consumer banking and an increase in unbanked individuals. Additionally, compliance costs for community banks and credit unions have risen, and businesses with low to average sale amounts have seen their costs increase. Large retailers can negotiate lower merchant service charges, and their market dominance reduces the incentive to pass on savings to consumers.

The Dodd-Frank Act is aimed to regulate interchange fees and promote competition in debit network routing. However, the reality is that since the implementation of the Durbin cap, financial institutions have not benefitted from lower fees and consumers have seen limited savings. In fact, the Durbin Amendment has resulted in higher costs for consumer banking and an overall increase in unbanked individuals, which runs counter to the longstanding public policy goals of the federal government and financial institutions to reduce the numbers of unbanked and underbanked consumers through the delivery of safe and affordable deposit accounts. Ultimately, large merchants have benefitted from the Durbin cap while low-income consumers bear the cost. Thus, the Board must not disregard the extensive legal and public policy reasons for withdrawing the Proposal, as described in detail by the Associations in the Joint Letter, and as reiterated by IBC herein.

Thank you for your consideration of this critical request and for your continued efforts to protect the American peoples' financial well-being, and our Nation's economy. If you have any questions, please contact the undersigned.

Respectfully submitted,

INTERNATIONAL BANCSHARES CORPORATION

Jeffrey C. Gifford

Jeffrey C. Gifford
Outside General Counsel to International Bancshares Corporation
Dykema Gossett PLLC