Indiana Credit Union League
The association of Indiana credit unions

May 12, 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)

To Whom It May Concern:

The Indiana Credit Union League (League) appreciates the opportunity to submit comments to the Board of Governors of the Federal Reserve System (Board) on its proposed rule to amend Regulation II related to debit card interchange fees and routing. The ICUL member credit unions represent 99% of assets and members of Indiana's credit unions, with those memberships totaling more than 2.8 million consumers.

The League opposes any reductions in the debit interchange fee cap, and we strongly urge the Board to withdraw the proposed rule. The Board faces no statutory or regulatory requirement to change the existing rule and we believe that much more study should be completed on the potential impact of the changes being proposed, especially the unintended but inevitable impact it will have on exempt institutions. We continue to believe that there are tremendous flaws in the original development and implementation of Regulation II and the changes currently being proposed will only make it worse, not just for card issuers, but for the consumers that they serve.

Although the Durbin Amendment and Regulation II's interchange fee cap formally apply only to card issuers $10 billion in assets and above, evidence and experience indicate that the impact of the cap extend well beyond. After the fee cap went into place in 2011, research shows that card issuers overall lost nearly $106 billion in interchange revenue. Because of the enormous market pressure created by the large card issuers covered by the cap, there was downward pressure on interchange revenue on exempt institutions, too, and when interchange revenue falls, other costs have to rise. Research on the impact of the current debit card interchange fee cap has shown that a decrease in interchange revenue leads to reduced access to free checking accounts, higher fees, and an increase in the number of unbanked consumers. A study conducted by Federal Reserve economists in 2017 showed that free checking accounts offered by exempt institutions decreased by 15.5 percent after the cap was introduced and research published by the Federal Reserve Bank of Richmond in 2015 found that large and small debit card issuers significantly reduced free deposit account products and services. Further lowering the debit card interchange fee cap through the current proposed rule would only accelerate the loss of free checking and other low-cost services being provided by credit unions.

Unfortunately, the increased costs to consumers for financial services when interchange fees are forced down are not offset by the benefit of lower retail merchant costs being passed along through lower retail prices. Another study conducted by the Federal Reserve Bank of Richmond concluded that a staggering 99 percent of merchants either kept prices the same or raised them following the implementation of the debit card interchange fee cap. It is no more likely now that retail merchants would pass along the windfall generated by the significant additional drop in the debit card interchange fee cap being proposed than it was when the first cap was put into place and consumers would continue to lose. Unfortunately, the worst of the impact is felt by low-income households. When deposit account fees and required minimum balances for accounts have to rise to offset the loss of interchange revenue, research finds that the impact falls disproportionately on low- and moderate-income communities. The Board should conduct further study on the wider-range impact of this proposed rule before proceeding.

Beyond the inevitable negative impact of this proposed rule on exempt institutions and consumers, we strongly believe that the methodology being proposed to determine the cap is deeply flawed. When it initially developed the method for determining the base component of the interchange cap, the Board attempted to set a cap that was "reasonable and proportional" to an issuer's costs by factoring in the surveyed average transaction cost of each covered issuer and setting the cap at a level that would allow 80 percent of issuers to recover their average transaction costs. This was certainly not a perfect approach, but it did at least attempt to measure the costs of all issuers. Now, with this proposed rule, the Board is proposing to move away from an issuer-based methodology to one that is transaction-based. This approach would have the effect of forcing the whole marketplace to be determined by the transaction costs of the very largest card issuers. Because nearly 95 percent of all debit card transactions occur through accounts held by the top third of all issuers (with the top three processing nearly 50 percent of the transactions) a methodology that focuses on the costs of all transactions viewed in aggregate heavily skews the results toward the costs experienced by those issuers. Because of the efficiencies and cost reductions generated by these institutions' economies of scale, their per-transaction costs are considerably lower than those of other covered institutions (to say nothing of the costs experienced by exempt institutions that will be impacted) and it is not reasonable to tie the base component for all institutions so closely with the costs experienced by the top third of issuers. In fact, we would argue that the proposed methodology does not comply with the Board's previous understanding that the statute requires the Board to establish a cap that is reasonable and proportional "to the overall cost experience of a substantial majority of covered issuers." The League believes that the Board should comprehensively review its proposed method for determining the cap's base component and stick to a methodology that more closely considers the costs experienced by the full array of card issuers.

We note that the Board's staff memo includes a comment that "the Federal Register notice would not invite public comment on the allowable costs that the Board considered in establishing the interchange fee standard" and that the Board believes its original analysis regarding allowable costs remains sound. We strongly disagree with this conclusion and approach. We believe that the Board continues to exclude costs that could and should be considered when calculating the debit card interchange fee cap. Some of these costs include the costs of non-fraud-related cardholder inquiries, NSF losses and handling costs, card production costs, and certain types of fraud losses. Not including these costs in the calculation of the interchange fee cap continues to significantly underrepresent the true costs that credit unions experience in offering and maintaining competitive, secure debit card programs. We believe that the Board should more fully study these costs and be more open to incorporating them in any rulemaking/determination of the debit card interchange cap.

The League also opposes the proposed rules intent to begin automatically indexing issuer costs every other year. In our view, this would circumvent the process for providing advance notice and the appropriate rulemaking process and requisite comment period. The ongoing impact of Regulation II and the interchange fee cap is much too significant to be left to an automated process that does not allow input from those who are impacted. Additionally, the Electronic Funds Transfer Act requires the Board to consider the impact of its rules on consumers, which would not take place if this process were to be implemented. The Board should reconsider this proposed approach.

The League appreciates the opportunity to comment on the Board's Regulation II proposed rule and its potentially harmful effects on Indiana credit unions and the communities they serve. We do not believe this rulemaking is required or necessary and we strongly urge the Board to withdraw the proposed rule and more deeply study its potential impact and, more broadly, the components it uses to determine the debit card interchange fee cap. If you have any questions about our letter, please do not hesitate to give me a call at (317) 594-5320.

Sincerely,

John McKenzie

John McKenzie, President
Indiana Credit Union League