May 12, 2024

*Via Electronic Mail*

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

Re: Proposed Amendment to Regulation II – Debit Card Interchange Fees and Routing; Docket No. R-1818, RIN 7100-AG67

Dear Ms. Misback:

NBT Bank, N.A. ("NBT Bank") appreciates the opportunity to comment on the Federal Reserve Board's ("FRB") proposed rulemaking to substantially decrease the debit card interchange fee cap imposed by Regulation II (Docket No. R-1818, RIN 7100- AG67) (the "NPRM"). For the reasons set forth below, NBT Bank respectfully suggests that the NPRM should not proceed without more complete studies of its effects on all affected parties and consideration of alternative approaches. We further urge the FRB, if it determines that it must implement changes to Regulation II's interchange fee cap, to establish a tiered maximum interchange fee structure to reflect the vast difference in size and efficiency between smaller affected banks and their trillion-dollar competitors.

**About NBT Bank**

NBT Bank, founded in 1856, is a community-oriented financial institution headquartered in Norwich, New York. NBT Bank provides a broad array of banking services and financial products to retail, commercial and municipal customers through its 150 branch offices located in upstate New York, northeastern Pennsylvania, southern New Hampshire, western Massachusetts, Vermont, southern Maine and central and northwestern Connecticut.

As a bank with total assets of $13.2 billion as of March 31, 2024, NBT Bank is a "covered issuer" under Regulation II. Like many of the other smaller covered issuers, it will not be able to recover the vast bulk of its interchange costs under the proposed fee caps, and it will consequently suffer material financial harm but, most importantly, as with so many other covered banks NBT Bank will be constrained in its ability to continue offering this requisite service to its customer base vis-a-vis the larger competitors in the marketplace.

**The NPRM is a discretionary rulemaking.**

The FRB's revision of the interchange fee caps established in its original promulgation of Regulation II is not mandated by the Durbin Amendment – and, given the likelihood that the proposed rule will increase fees and/or lessen services for bank customers while not providing any material benefits to consumers (as discussed below), it is certainly not required by

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considerations of federal regulatory policy. Given the discretionary nature of the rulemaking, and the real economic harm that would result if the FRB issues a final rule in the same form as proposed in the NPRM, the FRB should not proceed with an amendment to the interchange fee cap without both considering alternative courses of action and more thoroughly studying the costs to banking institutions and their customers of changes to the current regulation.

**NBT Bank's Comments on the NPRM**

The NPRM proposes major changes to the interchange fee caps imposed by Regulation II. The NPRM would substantially reduce the interchange fee cap and provide for the FRB to amend the fee cap every two years without engaging in a notice and comment rulemaking process. The proposed fee cap, like that in the current Regulation II, would apply equally to all covered issuers – whether their total assets are \$10 billion or \$4 trillion.

NBT Bank's principal concerns with the NPRM are the FRB's lack of consideration of a tiered approach to interchange fee caps and the inadequacy of the background studies and analyses supporting the FRB's action – particularly its completely insufficient cost/benefit analysis. We concur with Governor Michelle Bowman's dissenting statement to the FRB's issuance of the NPRM in which she summarizes the factors that should be considered by the FRB in implementing any proposed changes to the Durbin interchange fee caps:

> [The FRB] must take into account the broader context: the wide range of business models and sizes for issuers subject to the interchange fee cap; the effect of the rule on bank capital and earnings; the potential benefits and costs to consumers; the cumulative effect of regulatory changes and rules; and other unintended consequences.[1]

This comment will address the FRB's failure in the NPRM to provide any reasoned analysis or discussion of the first three of the factors cited by Governor Bowman: (i) the absence of any consideration of a tiered fee cap approach for different sizes of covered issuers: (ii) the FRB's indifference to the financial effects of the proposed fees caps on covered issuers, especially smaller or lower-volume issuers; and (iii) the NPRM's incomplete and misleading cost/benefit analysis regarding the proposal's potential effects on consumers.

1. **The NPRM does not address the appropriateness of its one-size-fits-all approach for covered issuers and does not adequately consider the possibility of a tiered interchange fee cap structure.**

The NPRM proposes a single interchange fee cap that would apply to all debit card issuing banking companies with total assets of over \$10 billion ("covered issuers"), despite the fact that

[1] Statement on Proposed Revisions to Regulation II's Interchange Fee Cap by Governor Michelle W. Bowman, October 25, 2023 (available at https://www.federalreserve.gov/newsevents/pressreleases/bowman-statement-20231025.htm)

such institutions vary in asset size from the minimum threshold to almost $4 trillion. While the Durbin Amendment, as enacted, required the FRB to establish a cap on debit interchange fees for card issuing banks of over $10 billion in assets, it does not require that all covered issuers must be subject to the same limits on interchange fees.

The FRB justifies its decision to impose further limits on interchange fees as follows:

> The data collected by the FRB from large debit card issuers since the original Regulation II rulemaking show that the costs incurred by large debit card issuers in connection with debit card transactions have changed significantly over time. In particular, the costs on which the FRB based the base component have nearly halved, the issuer fraud losses on which the FRB based the *ad valorem* component have fallen, and the fraud-prevention costs on which the FRB based the fraud-prevention adjustment have risen, according to key metrics of those costs.

The NPRM, however, at no point addresses the obvious difference in the cost improvements experienced by smaller covered issuers on the one hand and multi-trillion-dollar banks on the other. While the NPRM acknowledges that low-volume, high-cost covered users would not be able to recover their base component costs under the proposed fee caps, it disregards the unreasonable penalty for smaller and less efficient covered users in its use of a single standard and does not give serious consideration to a tiered approach. The NPRM only gives lip service to the possibility of establishing different fee cap base components for high-volume, low-cost covered users and low-volume, high-cost covered users:

> [T]he FRB determined that such an approach would create numerous practical challenges for both the FRB and debit card industry participants and could disincentivize covered issuers in the tier with the higher base component from growing their debit card programs.

The "practical challenges" noted by the FRB, which are summarized in a short footnote to the NPRM, are not quantified – nor is the unknown cost of implementing a tiered approach weighed against the obvious significant costs of the proposed rule to be incurred by low-volume, high-cost covered users. Furthermore, the argument that the tiered approach would "disincentivize" such covered issuers from growing their debit card programs is negligible, as the net effect of the NPRM's increased costs to these issuers is far more likely to cause such a disincentive.

2. **The NPRM does not model or otherwise analyze the effects of the reduced interchange cap on different sizes of covered issuers.**

The FRB has historic cost data for <u>all</u> covered issuers, and it could easily have provided details regarding the average costs experienced by covered issuers of different size ranges (e.g., $10-50 billion, $50-$100 billion, $100-$500 billion, and $500 billion+) as well as modeling the effects of its proposed rule on the different sizes of covered issuer. However – for whatever reason – it either did not complete such an analysis or chose not to include the results in the NPRM.

The Durbin Amendment requires the FRB to ensure that debit interchange fees are "reasonable and proportional" to debit card issuer costs. As noted in Governor Bowman's dissenting statement, approximately one-third of bank issuers would not be able to even recover their costs, much less grow business, under the proposed rule. If the NPRM's interchange fee cap would require such issuers to operate their debit card program at a loss, it clearly is not "reasonable and proportional" to the costs incurred by a large percentage of covered issuers.

It is very likely that the great majority of the low-volume, high-cost issuers experiencing a material negative effect from the NPRM would be covered issuers with assets under $50 billion. As recognized by Governor Bowman, such banks will be at a "significant competitive disadvantage" and may well be forced to pass costs through to consumers or to discontinue certain low-cost or free banking products or services to their customers.

NBT Bank – which is a "large issuer" under the Durbin Amendment despite being a mid-sized community bank with total assets of $13.2 billion – is one of such small, covered issuers. NBT Bank would not be able to cover the majority of its debit card transaction costs under the lower interchange fee caps proposed in the NPRM, and it may be forced to make difficult choices in response to the reduced interchange fee revenue.

3. **The NPRM disregards the clear evidence that the 2012 interchange fee caps resulted in material negative effects on consumers and provides no analysis regarding the potential adverse effects of the reduced fee cap**.

The "Cost/Benefit Analysis" included in the NPRM is incomplete and one-sided. The NPRM essentially dismisses, with effectively no analysis, the various studies that have established the negative effects of the original fee cap rule on consumers, while relying on the possibility of benefits to consumers that have not resulted from the current regulation and are speculative at best.

Senator Durbin and the large retailer lobby claimed that merchants would pass the savings resulting from the Durbin Amendment's interchange fee cap through to consumers. However, as a number of studies, including that by the Federal Reserve Bank of Richmond, make plain[2], the great majority of retailers passed on little or no savings to consumers while increasing their revenue by hundreds of billions of dollars.

[2] Zhu Wang, Scarlett Schwartz & Neil Mitchell, The Impact of the Durbin Amendment on Merchants: A Survey Study. Economic Quarterly, Federal Reserve Bank of Richmond, Volume 100, Number 3, 183-208 (2014). *See also* Todd J. Zywicki, Geoffrey Manne & Julian Morris, Price Controls on Payment Card Interchange Fees: The U.S. Experience, George Mason Law & Economics Research Paper No. 14-18 (2014).

The NPRM cites two recent studies suggesting the possibility that large merchants may pass on to consumers some savings from Durbin Amendment fee cap – although one of such studies[3] indicates that merchant pass-through of Durbin Amendment savings has been minor, while confirming the negative effects experienced by banking institutions and their customers. Apparently on the basis of the studies, the FRB claims that merchants benefiting from the further decrease in interchange fees "may" pass on "some or all" of their savings to consumers." This is, in effect, the sum total of the "benefit" side of the NPRM's cost/benefit analysis.

By contrast, the significant costs of the original Durbin Amendment fee cap – both to banks and to bank customers – have been well-documented by numerous studies (including each of those cited above) and are acknowledged in the NPRM. There is every reason to think that an additional 31.4% decrease in the interchange fee cap will have a similar, if not greater, negative effect. The consequent major reduction in debit card revenue will compel issuing banks, particularly smaller covered issuers like NBT Bank, to consider raising fees or eliminating services, at the likely detriment of consumers. Certainly, the loss of revenue caused by the reduced fee caps will cause many if not most of the one-third of bank issuers that are unable to recover their costs under the proposal to restrict current or future banking services to a broad range of debit card customers.

In light of the fact that not only have consumers not benefited from the 2012 interchange fee cap but that they have, in many cases, had to bear the increased bank fees or decreased bank services that resulted from the original fee cap, it is incomprehensible that the FRB could decide to proceed with this rulemaking without both completing a comprehensive study of the effects on consumers and analyzing possible alternative approaches so as to minimize unforeseen effects both on consumers and on the smaller size range of covered issuers. We submit that the FRB, before taking any further action on the NPRM, should – and indeed is compelled by the Administrative Procedure Act to – undertake a comprehensive review of the costs and benefits of a lowered interchange fee cap.

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In conclusion, NBT Bank questions whether any new regulation is necessary, as the proposed amendment to Regulation II is not required by statute or public policy considerations. If, however, the FRB determines to proceed with rulemaking, it should return to the beginning of the process and complete robust studies and analyses of (i) the differing interchange fee cost structures of different sizes of covered issuers, (ii) the likely effects of its rulemaking on covered issuers of different sizes; and (iii) the effects on consumers that are likely to result from a greater than 30% decrease in the interchange fee cap. Finally, if following the conclusion of a more comprehensive rulemaking process the FRB decides to amend Regulation II, it should implement a tiered fee cap structure to ensure that new interchange fee caps are equitable for smaller

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[3] Vladimir Mukharlyamov & Natasha Sarin, Price Regulation in Two-Sided Markets: Empirical Evidence from Debit Cards (Nov. 28, 2022) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3328579).

covered issuers as well as "reasonable and proportionate" to the costs incurred by all covered issuers.

Thank you for your consideration of our comments.

Very truly yours,

M. Randolph Sparks
Executive Vice President
General Counsel and Chief Ethics Officer