Proposal: 1818(AG67) Debit Card Interchange Fees and Routing

Description:

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From: Wellby Financial, Dwayne D. Busby

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Comments:

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Proposal: Regulation II: Debit Card Interchange Fees and Routing [R-1818]
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Your comment:
RE: Debit Card Interchange Fees and Routing
(Docket No. R-1818; RIN: 7100-AG67)
To whom it may concern,
On behalf of Wellby Financial, I am writing in response to the proposed amendments to Regulation II issued by the Board of Governors of the Federal Reserve System (Board). We along with credit unions across the nation, partner with America's Credit Unions to voice that consumers' best option for financial services are credit unions. We advocate for policies that allow the credit union industry to effectively meet the needs of nearly 140 million members nationwide. We greatly appreciate the Board's willingness to hold discussions with America's Credit Unions, credit unions, and other associations during the open comment period. We thank each of the individual Board Governors who listened to our concerns. We thank you, Ann, for lending us your ear to hear our case.

Wellby Financial strongly opposes the debit interchange fee cap reduction. The proposed rule is based on a flawed methodology that disregards the cost experience of most issuers, especially smaller credit unions. Moreover, the ultimate effect of reducing interchange revenue will be felt most by consumers, the member-owners of credit unions, who will lose access to affordable banking products and services. The Durbin Amendment's "exemption" of smaller financial institutions has proven to be largely misleading, as the Federal Reserve's data shows that regulatory thresholds in the interchange market do not protect smaller issuers from harm. We ask the Board to halt this rulemaking so that a baseline of timely, accurate, and comprehensive data about the effect of existing regulations can be developed and analyzed before further action is taken on new rules related to debit card interchange.

A further reduction in the interchange fee cap, as proposed, would amplify Regulation II's known negative effects.

The Board's 2011 rule fulfilled the statutory requirement to adopt standards for reasonable interchange transaction fees. Accordingly, there is no legal requirement to pursue a new rule now or in the future. Even assuming there was a need to reconsider whether interchange fees are "reasonable and proportional," it would be premature to do so before interested parties have had time to consider the impact of the Board's 2022 amendments to Regulation II. Those amendments only took effect in July 2023 and are not reflected in the 2021 Debit Card Issuer survey data relied upon by the Board in the current proposal. Furthermore, the dual routing amendments are likely to correspond with a decline in future interchange revenue generated from card-not-present (CNP) transactions, which represent the fastest-growing transaction type by volume and fraud source.

Credit unions are less able to absorb reductions in interchange revenue due to their unique, not-for-profit structure. Unlike banks, credit unions are unable to issue shares to outside investors as a means of raising capital. Instead, credit unions must build capital primarily through retained earnings, a process that is slow and, in the case of federal credit unions, further constrained by a statutory interest rate ceiling. The introduction of the Durbin Amendment, coupled with new laws and regulations targeting sources of non-interest income in the Dodd-Frank era, has had a profound effect on the credit union industry's ability to maintain competitive viability. Further reduction in interchange revenue could also threaten credit unions' ability to return savings and benefits to their members. Based on an analysis of credit union data by America's Credit Unions, over 3,500 credit unions offer free checking accounts. Those credit unions serve 130 million members, or 93 percent of total credit union members.

The Proposal Will Negatively Impact Consumers

The proposed reduction in the fee cap is likely to harm consumers by reducing the availability of free or low-cost banking products and services. 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.

A study conducted by the Richmond Federal Reserve in conjunction with Javelin Strategy and Research concluded that current Regulation II has had limited positive effects on consumers. According to the study's authors:
77% of merchants did not change prices following the implementation of debit card price caps
22 % of merchants chose to increase prices
1% passed on savings to customers

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. Despite this evidence, the Board briefly concludes that merchants are likely to pass on a larger portion of their cost savings a finding that is not supported by any kind of empirical analysis.

Covered credit unions will likely adjust to reduced interchange by passing on a greater share of costs to consumers. Covered credit union issuers surveyed by America's Credit Unions have indicated which actions are likely to follow from the proposed reduction in the fee cap (Figure 1). None of these outcomes are positive for credit union members, and none have been considered by the Board.

Credit unions, as non-profit entities based on communal ties with limited fields of membership, reinvest in the communities they serve. The revenue generated from interchange fees often supports community-oriented projects, grants, and programs. For example, Wellby located primarily in the Houston Galveston metro area has been able to reinvest the revenue generated back to the community it is embedded. Wellby established a scholarship, the largest of its kind, at a local university. In partnership with Habitat for Humanity, Wellby made a donation enabling a family to build their first house in the city they call home. Without access to these funds, Wellby would not be able to benefit its members as explained.

Alarmingly, over 50 percent of covered credit union respondents indicated a likelihood of reducing community grants, scholarships, and support, representing a tangible loss for communities and credit union members, as shown in Figure 2. As mission-driven institutions, credit unions may nonetheless attempt to absorb reductions in interchange revenue to avoid passing on higher costs to members. However, credit unions with limited capacity to operate debit programs as loss leaders may face pressure to merge, especially in an environment where there is a regulatory agenda to limit fee income.

Figure 2

The Proposal Fails to Adequately Consider the Full Costs of Fraud

The size of financial institutions plays a significant role in terms of preventing fraud and mitigating 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 (Figure 3) shows that the ratio of fraud losses to total transactions is increasing for covered credit unions. When the magnitude of fraud is greater on a per-transaction basis, issuers with lower debit transaction volume are likely to experience greater volatility on a year-to-year basis in terms of their ability to fully recover fraud costs. Such volatility is compounded by the Board's decision to target full recovery for only half of the covered issuer market.

Conclusion

Should interchange revenue decline, as proposed, negative consumer outcomes will follow. Exempt credit unions, like Wellby (with assets less than $10B), report that a proposed reduction in the debit interchange cap would prompt most to consider various mechanisms for replacing lost revenue. The most likely courses of action would be to increase fees on share draft/checking accounts, higher debit card fees, and increase other fees. Nearly all actions intended to compensate for lost interchange revenue involve passing those costs onto members; members who are typically at low to moderate income levels.

As previously mentioned, exempt credit unions rely on interchange revenue to support community-focused programs and services (i.e. grants, scholarships, and other ways to support the community). This would be lost if interchange revenue is reduced.

Exempt credit unions cannot afford to see interchange revenue decline by even a small margin. Based on survey data collected by America's Credit Unions, exempt credit unions are seeing accelerating fraud losses. In 2023 alone, total fraud losses grew by 28 percent for exempt respondents. Like covered credit unions, exempt credit unions are simultaneously making larger investments to prevent fraud. Fraud prevention costs have increased across the board in just the last five years. These costs include things like data security (41 percent increase), transaction monitoring (34 percent increase), (20 percent increase), and tokenization (70 percent increase). At Wellby, our Shared Risk Services team, which includes our Fraud team, has increased from a team of 8 to a team of 25 in less than 24 months.

Thank you for the opportunity to provide comments in response to the proposed rule. As stated, Wellby strongly opposes the debit interchange fee cap reduction proposal. We respectfully ask that you consider our commentary when evaluating the said proposal. If you have any questions, please do not hesitate to contact me at (832)621-7325 or dbusby@wellbyfinancial .com.

Respectfully,

Dwayne D. Busby
Vice President of Government Affairs