MAY 10, 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)

Dear Secretary:

Velera Solutions, LLC, formerly PSCU/Co-op Solutions, is a payments technology company built, owned and governed by credit unions that supports over 4,000 smaller financial institutions across the U.S. Collectively, consumer customers of these financial institutions transact more than 16 billion times annually to make household purchases that keep the economy moving. On behalf of our member owners, we appreciate the opportunity to comment on the proposed rule changes to debit card interchange fees and routing.

As a 47-year-old company founded to help credit unions offer payment solutions to members, Velera strongly opposes any reduction in the debit interchange fee cap. The proposal is not necessary; the changes are punitive to smaller financial institutions, and the contemplated formulaic approach moving forward places undue risk on the financial services sector (particularly community-based financial institutions) for changes made without analysis and commentary.

Covering the costs of supporting a safe, frictionless and ubiquitous retail payment system is essential to keep innovation occurring. We believe that the new proposed methodology has clear deficiencies with the arbitrary rulemaking standard, like the automatic adjustment to the cap, and omits critical costs incurred by issuers of all sizes, including general cardholder servicing, card production and reissues due to fraud, debit overdraft losses, etc. The proposal utilizes an arbitrary cost recovery target that would have prevented a third of covered issuers from recovering their base component costs had the amendments applied in 2021. Denying credit unions recovery of these costs increases the likelihood that credit unions may need to operate their debit programs at a loss, which is both unsustainable and ultimately harmful to members in the long term.

We believe that the proposal will yield unintended negative consequences to millions of consumers, including:

- Higher fees and additional restrictions on free checking and savings accounts.
- Pass-through of revenue losses to accountholders via decreasing interest rates on savings and deposit accounts and increasing interest rates on loans.

- Retention by merchants of regulatory savings with no appreciable benefit to consumers.
- Reduced financial capability of community-based financial institutions to support low-income populations and community-oriented initiatives such as grants and scholarships.
- Reduction or elimination of debit reward programs among certain debit issuers.

This proposal represents a failure to properly consider and analyze the likelihood of negative consumer outcomes, as required by the Electronic Funds Transfer Act (EFTA).

Additionally, the Federal Reserve has supplied data with the proposed revisions showing reported costs distributed by transaction percentiles. Logic holds that larger financial institutions (with trillions of dollars in assets and dominating the checking and debit market) would have the largest transaction share and credit unions (barely over the $10B cap) the smallest. Per the data, the cost per transaction in the 99th percentile is 21.6 cents. With a reduction to 17 cents, that segment of thousands of community financial institutions would be losing nearly a nickel per transaction. Credit unions cannot sustain operations with these losses.

Concerning the proposed formulaic approach to changes, mathematicians are scrambling to design a precise formula for a very imprecise population. Using Fed data again, 70% of transactions would be weighted at 3.2 cents or less. The same credit unions above, facing the initial loss of nearly five cents per transaction, will see their 1% weighting diminished even further. Clearly, the evidence visible in the reported data illustrates how setting biennial adjustments on an arbitrary formula is harmful to these institutions. The Fed is using a skewed methodology to assess base component costs, which fails to give appropriate weight to the cost experience of a majority of covered issuers, especially credit unions.

Another concern for the smaller financial institutions is the methodology used for the proposed fraud adjustment using a median per-transaction for fraud prevention cost. Big banks win and small issuers will be penalized as big banks dominate the weighting. Using the median instead of the distribution of transactions still does not address the fundamental issue of the weighting bias toward large financial institutions. Credit unions don’t have the scale and efficiency of the large issuers.

All of this is compounded by the CFPB’s recent proposals to change the way overdrafts and NSFs are regulated and limitations on late fees for credit cards. These changes cannot be viewed lightly or in isolation, as the cumulative effect is stymying the ability of credit unions to compete in an ever-intense payments and financial services marketplace.

Our business, technology and risk environments are very, very different from when the Durbin Amendment was implemented just over a decade ago. Then, only two credit unions were subject to the debit interchange cap. Today, 21 are now subject to the cap. And the cap was and remains a flawed premise.

The Fed’s own data shows the regulatory thresholds exemption of smaller financial institutions did not protect these organizations. Since 2011, exempt debit interchange has decreased as the average fee for exempt single-message transactions has dropped by 31%.

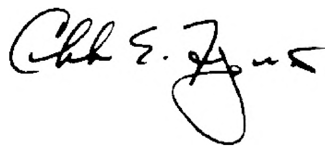
We can learn from the past and see that this proposal will have further adverse effects on consumers, who will lose access to affordable banking services. Post 2011, the share of free checking accounts fell from 60% to 20%, while monthly checking account fees rose, and minimum balances increased by 25%. Lower-income consumers are disproportionately

affected because their account balances are likely to be below the minimum needed to avoid fees.

The Board's 2011 rule fulfilled the statutory requirement to adopt standards for reasonable interchange transaction fees. Accordingly, there is no legal requirement to initiate a new rule now or at any time. 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 proposal. Furthermore, the dual routing amendments are likely to create a decline in future interchange revenue generated from card-not-present transactions, which represent the fastest-growing transaction type by volume and fraud source.

We ask that the Board 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. Moving ahead will surely cause the demise of numerous community-based financial institutions and unintended negative consequences for millions of consumers.

Sincerely,



Chuck E. Fagan
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Velera