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Congress of the United States
House of Representatives
Washington, DC 20515

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SELECT COMMITTEE ON THE STRATEGIC COMPETITION BETWEEN THE U.S. AND THE CHINESE COMMUNIST PARTY

July 10, 2024

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

Dear Ms. Misback:

The undersigned Members of Congress write in response to the above-captioned notice of proposed rulemaking ("NPRM")[1] issued by the Board of Governors of the Federal Reserve System (the "Board"). The undersigned Members do not support the NPRM because amendments to the interchange fee cap are not required or appropriate at this time, the NPRM fails to account for significant changes in the debit card landscape, and the Board has not satisfied its statutory obligation under Section 904(a)(2) of the Electronic Fund Transfer Act ("EFTA," 15 U.S.C. § 1693b(a)(2)) to conduct a fulsome economic impact analysis when promulgating the rules implementing the Durbin Amendment (15 U.S.C. § 1693o-2).

The Board has not justified the need for the NPRM at this time.

While it may be appropriate for the Board to evaluate on a periodic basis whether its current standard for assessing whether interchange transaction fees meet the statutory directive that such fees be "reasonable and proportional to the cost incurred by the issuer with respect to the transaction," there is no legal obligation that the Board amend the rule as a matter of course or at this time. In fact, the Board's own data show that the existing cap on debit interchange fees has never allowed cost recovery for 80 percent of covered issuers, which was the percentage of covered issuers the Board targeted when establishing the current rule (according to the Board's 2021 data, 77 percent of issuers would achieve cost recovery).[2] This fact indicates that the current cap continues to meet the Board's own standard for what constitutes "reasonable and proportional" interchange fees, as articulated in the preamble to the 2011 final rule.

Given the absence of data and of a reasonable basis to support the NRPM, including, as discussed further below, the absence of a cost-benefit analysis that meets the minimum requirements set out in Section 904(a)(2) of the EFTA, I are concerned that the Board felt pressured to issue the NPRM because it received a petition for rulemaking from trade associations representing large merchants

[1] 88 Fed. Reg. 78,100 (Nov. 14, 2023).

[2] *See* 88 Fed. Reg. at 78,104, 78,113. When Regulation II was adopted, the Board believed that, if the base component had been in effect in 2009, at least 80 percent of covered issuers would have fully recovered their base component costs under the current standard.

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requesting that the Board issue a proposal to lower the cap substantially. The Board is not required to propose amendments to the existing rule in response to receipt of a petition requesting such action, and the Board legally may only amend an existing rule if it supports its proposed changes with robust evidence and explains its rationale for those changes.

In addition to the Board not being required to propose a reduction in the interchange fee cap, the Board's proposal is deficient in a number of other respects, as discussed below.

The Board's economic impact analysis does not adequately consider the empirically understood effect that the NPRM would have on consumers, including low-income consumers.

The Board must satisfy its statutory obligation under Section 904(a)(2) of the EFTA to conduct an economic impact analysis when promulgating regulations to implement the Durbin Amendment. Specifically, Section 904(a)(2) requires the Board to "prepare an analysis of economic impact which considers [(1)] the costs and benefits to financial institutions, consumers, and other users of electronic fund transfers," (2) "the effects upon competition in the provision of electronic banking services among large and small financial institutions," and (3) "the availability of such services to different classes of consumers, particularly low income consumers."[3]

The NPRM states that consumers "could benefit if merchants pass on savings associated with the decrease in costs of accepting debit card transactions in the form of lower prices, forgone future price increases, or improvements in product or service quality," or consumers "could be negatively affected if covered issuers increase fees on debit cards or checking accounts, or make other adjustments that make these products less attractive to consumers."[4] The Board states that "[t]he net effect on consumers, both individually and in the aggregate," is dependent on "which of these two effects predominates," which is "difficult to predict."[5]

In its analysis, the Board has failed to adequately consider the empirical evidence that merchants' cost savings attributable to the interchange fee cap generally are not passed on to consumers and, therefore, provide no net benefit to consumers and, furthermore, that consumers experienced widespread increases in the costs of basic deposit accounts following the Board's promulgation of Regulation II in 2011, which disproportionately affects financially vulnerable and low-to-moderate income ("LMI") communities.[6]

Contrary to the Board's analysis, it is not "difficult to predict" the likely outcome of a further

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[3] 15 U.S.C. § 1693b(a)(2).

[4] 88 Fed. Reg. at 78,108.

[5] *Id.*

[6] As an example, further reducing interchange fee caps would jeopardize banks' ability to offer Bank On and similar products to LMI communities. The Cities for Financial Empowerment Fund expressed concern about the NPRM to the Board in a recent letter, stating, "At the same time the [Bank On] 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. We note to the Board that interchange fees are a relevant component of that market sustainability."

reduction in interchange fee caps, particularly for underserved and LMI communities, given the well-established effects of the original rule.[7]

The economic impact analysis in the NPRM does not adequately consider the empirically understood effect of the NPRM on debit card issuers of all sizes.

The NPRM states that "[t]he proposal could affect competition between covered and exempt issuers by reducing the average per-transaction debit card interchange fee received by covered issuers without affecting the amount received by exempt issuers," and that "the Board does not expect the proposal to have a significant impact on competitive dynamics between the two groups of issuers."[8] Again, this analysis fails to consider the empirical evidence that, between 2011 and 2021, debit card interchange revenue for exempt debit card issuers fell 13 percent in connection with single-message network transactions,[9] significantly impacting the competitive dynamic between covered and exempt issuers in this market.

The economic impact analysis in the NPRM does not consider the effect of significant changes in the debit card landscape.

For the Board's economic impact analysis to be meaningful, it must be based on data and market dynamics known to, and market developments reasonably anticipated by, the Board. In the NPRM, the Board does not consider the impact of significant market developments in its analysis. For example, the Board fails to consider, or even acknowledge, the still unknown impact of the card-not-present routing rule that went into effect on July 1, 2023.[10] Moreover, while the Board's proposal is based on 2021 data, its analysis has not addressed the data anomaly of 2021 resulting from of the Covid-19 pandemic, the impact of the Board's own payment system, FedNow, which launched in 2023, or developments in the debit card network rules regarding fraud losses, each of which affects the debit card landscape. Each of these developments was known to the Board prior to the issuance of the NPRM, and yet the Board has not discussed or acknowledged them in its economic impact analysis.

Moreover, the Board's economic impact analysis did not consider—but, indeed, should consider before the Board promulgates any final rule—the impact of recent announcements in the electronic debit market on regulated and unregulated electronic debit transactions.[11] I acknowledge that this impact will not be clear by the end of the comment period. Indeed, I believe that it will likely require at least one full year of data before the Board could conduct a proper analysis that accounts for these major changes when determining the cumulative impact that the NPRM will have on the

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[7] *See* Mukharlyamov, Vladimir and Sarin, Natasha, "The Impact of the Durbin Amendment on Banks, Merchants, and Consumers," Faculty Scholarship at Penn Carey Law, 2046 (2019), available at https://scholarship.law.upenn.edu/faculty_scholarship/2046.

[8] 88 Fed. Reg. at 78,116-17.

[9] Board of Governors of the Federal Reserve System, "Average Debit Card Interchange Fee by Payment Card Network" (2022), available at https://www.federalreserve.gov/paymentsystems/regii-average-interchange-fee.htm.

[10] *See* 87 Fed. Reg. 61,217 (Oct. 11, 2022).

[11] *See* FR Y-3 Application by Capital One, Financial Corp. to acquire Discover Financial Services, Inc., available at https://www.federalreserve.gov/foia/capital-one-discover-application-materials.htm, and the Interagency Bank Merger Act Application for Capital One, National Association to merge with Discover Bank.

market.

I urge the Board to withdraw the NPRM and issue a re-proposal only after it has data sufficient to assess the economic impact of such a proposal and only if the data lead the Board to conclude, on the basis of its own analysis, that the current standard no longer complies with the statute. Such a conclusion and any resulting proposal would, of course, be subject to independent judicial review on the issue of whether the Board is acting within its statutory authority under the Durbin Amendment. In light of all of the issues described herein, I believe that the Board simply has not justified the need to amend the debit card interchange fee caps at this time in a manner that would survive judicial review.

Sincerely,

Blaine Luetkemeyer
Member of Congress

cc Jerome H. Powell, Chair
Philip N. Jefferson, Vice Chair
Michael S. Barr, Vice Chair for Supervision
Michelle W. Bowman
Lisa D. Cook
Adriana D. Kugler
Christopher J. Waller