Transcript of Open Board Meeting
October 25, 2023

CHAIR POWELL. Great. Welcome everyone and good afternoon. I want to welcome our guests both here at the Federal Reserve and also online. Today we will consider a proposal to revise the Board's rule that implements the Dodd-Frank Act requirements to cap debit cards interchange fees. Consistent with the statute and the Board's current rule, the proposal would apply only to debit card issuers with at least $10 billion in consolidated assets. We will also consider the issuance of our regular report on debit card transaction costs. Vice Chair Barr leads the Board's Committee on Payments, Clearing, and Settlement and will offer introductory remarks before we hear the staff presentation on the proposals. I want to thank staff for all of your work. I look forward to hearing your presentations and I now turn it over to Vice Chair Barr.

VICE CHAIR FOR SUPERVISION BARR. Thank you, Mr. Chair. I would like to thank the staff for their hard work in developing this proposal to update the debit card interchange fee cap of Regulation II and further related report. The proposal represents the culmination of extensive staff analysis and consultation with the Board's Committee on Payments, Clearing, and Settlement. Debit cards continue to be the most popular method of making everyday purchases by a wide margin. Data collected by the Federal Reserve has shown significant and consistent growth in the use of debit cards over the last two decades, such that by 2021, debit cards accounted for over half of all non-cash payments performed by consumers and businesses in the United States. This growth and the popularity of debit cards more broadly speaks to the attractiveness of debit cards as a means of payment, with consumers and merchants viewing debit cards as a safe and convenient way to make payments using funds and bank accounts. Interchange fees are an important element of debit card transactions. These fees are paid by a merchant's bank to a consumer's bank for each debit card transaction. As such, interchange fees are a cost of card transactions to merchants and a source of revenue from card transactions for card issuing banks. In a provision of the Dodd-Frank Act, Congress directed the Board to establish standards for assessing whether the amount of any interchange fee that an issuer may receive with respect to a debit card transaction is reasonable and proportional to the cost incurred by the issuer with respect to the transaction. The Board implemented this statutory requirement in 2011 through Regulation II. At the time, the Board stated that it would adjust the interchange fee cap in the future as appropriate based on debit card-related cost data the statute requires us to collect. The proposal would amend the regulation applicable to the interchange fees that large banks can receive for debit card transactions and is intended to fulfill the statutory requirement that these fees be reasonable and proportional to cost. As staff will explain in more detail, key debit card-related costs incurred by large debit card issuers have changed significantly since the interchange fee cap was established. The proposed rule would update the interchange fee cap for the first time since it was adopted to reflect the changes in debit card-related costs so that the cap remains reasonable and proportional to these costs. The proposal also would establish a process for updating the interchange fee cap going forward on a transparent, predictable basis. Staff has developed a proposal in close consultation with the Board's Committee on Payments, Clearing, and Settlement, and I believe that the proposal is ready for the Board's consideration. The proposal provides for a 90-day comment period. Public input is a critical part of our rulemaking process, and I look forward to reviewing the comments we will receive. I am pleased to turn things over to Kriss Wozniak for the staff presentation.

KRISS WOZNIAK. Thank you, Vice Chair. I will be discussing the two matters that the Board is being asked to vote on today. I will first discuss the proposed revisions to Regulation

II's interchange fee cap. My remarks on the proposed revisions will provide background on the statute and the current interchange fee cap, the reasons for revising the cap, and an overview of the proposed revisions. I will then conclude by briefly discussing the report on the debit card industry. Regulation II implements Section 1075 of the Dodd-Frank Act. Among other things, this statute requires the Board to establish standards for assessing whether the amount of any interchange fee received by a debit card issuer for a debit card transaction is reasonable and proportional to the cost incurred by the issuer with respect to the transaction. The statute also sets for certain types of costs that the Board must consider in establishing the standards, as well as certain types of costs that the Board may not consider. Furthermore, the statute authorizes the Board to allow for an adjustment to such interchange fee standards to account for fraud prevention costs incurred by an issuer, provided the issuer meets certain fraud-related standards established by the Board. By statute, the interchange fee standards do not apply to certain government-administered debit cards, certain other prepaid cards, or debit card issuers that, together with affiliates, have assets less than $10 billion. I will refer to large debit card issuers to which the interchange fee standards generally apply, that is, those with consolidated assets of at least $10 billion, as covered issuers. The Board fulfilled its statutory obligations in 2011 by establishing a cap, or in other words an upper limit, on the amount of any interchange fee that a covered issuer can generally receive for a debit card transaction. In developing the cap, the Board identified the allowable costs that it was required or permitted to consider under the statute. The Board further conducted a voluntary survey of covered issuers to collect information on their debit card activities in 2009, including their transaction volumes and values. Based on the allowable costs identified by the Board and the corresponding data collected from the survey, the Board established an interchange fee cap consisting of three components. First, a base component. Second, an ad valorem component. And third, for eligible issuers, a fraud prevention adjustment. I will now provide additional details about each component of the interchange fee cap in current Regulation II. The first and largest component of the interchange fee cap, the base component, is based on transaction processing costs reported by covered issuers for 2009. The Board set the value of the base component at 21 cents based on a notable inflection point in the distribution of transaction processing costs across covered issuers as observed in the 2009 data. The second component of the interchange fee cap, the ad valorem component, is based on covered issuer fraud losses. In establishing this component, the Board recognized that, unlike other allowable costs, issuer fraud losses vary with the size of the transaction. The Board therefore adopted an ad valorem component of five basis points multiplied by the value of the transaction. The Board selected five basis points based on median covered issuer fraud losses in the 2009 data. This ad valorem component contributes 2.5 cents to the interchange fee cap for the average $50 debit card transaction. The third and final component of the interchange fee cap, the fraud prevention adjustment, is based on costs covered issuers incur to prevent fraud. The Board adopted a fraud prevention adjustment of one cent, which approximated the fraud prevention costs for the median covered issuer in the 2009 data. As instructed by the statute, the Board also established a set of fraud prevention standards an issuer must meet to qualify for the adjustment. Taken together, these three components mean that the maximum interchange fee that a covered issuer may currently receive for a $50 debit card transaction subject to the cap is 24.5 cents. I will now turn to why staff recommend that the Board propose revisions to the interchange fee cap. When the Board established the interchange fee cap in 2011, it acknowledged that, to fulfill its statutory obligations, the Board may need to update the values of the interchange fee cap as the costs incurred by debit card issuers change over time. The Board further noted that lower costs should result in a lower interchange fee cap as issuers become more efficient. Since the initial voluntary survey, covered issuers have reported data to the Board on a mandatory basis every two years, as required by the statute. These data show that the covered issuer costs that are relevant for each component of the interchange fee cap have changed significantly over time. First, related to the base component, the cost of processing the average transaction across covered issuers, which is a key metric for measuring the transaction processing costs on which the Board based that component, has declined by nearly 50 percent, from 7.7 cents in 2009 to 3.9 cents in 2021. Second, related to the ad valorem component, the median covered issuer fraud losses on which the Board based that component have declined from five basis points in 2009 to four basis points in 2021. Third, related to the fraud prevention adjustment, the median covered issuer fraud prevention costs on which the Board based adjustment have increased from approximately one cent in 2009 to 1.3 cents in 2021. In light of these significant changes in issuer costs, the current interchange fee cap may no longer be effective for assessing whether the amount of an interchange fee received by an issuer is reasonable and proportional to the cost incurred by the issuer, as required by the statute. Therefore, staff recommend that the Board request public comment on proposed revisions to Regulation II's interchange fee cap. I will now summarize staff's recommended proposed revisions. The proposed revisions would update all three components of the interchange fee cap based on the latest data reported to the Board by covered issuers for 2021. The proposed revisions would also codify an approach for updating these components every two years going forward based on the latest data reported to the Board by covered issuers in the future. Updating the interchange fee caps components both now and in the future requires robust, repeatable methodologies for calculating the value of each component that appropriately capture covered issuer costs. I will describe the methodology that the proposal presents for each component in turn along with the implications for each component value. Beginning with the base component, the proposal would set the component using a new methodology that is informed by consistent patterns in the cumulative data that issuers have reported to the Board since 2021. A new methodology is needed because the approach used by the Board in 2011 to establish the current base component value has not proven to be robust over time. The new methodology would specifically determine the base component as the product of a fixed multiplier and the transaction processing cost of the average covered issuer transaction. Under this methodology, the base component would therefore be proportional to the cost of processing the average transaction across covered issuers. The new methodology for the base component further recognizes that covered issuers should fully recover their transaction processing costs for a significant majority of transactions, but that allowing the outlying highest cost issuers to fully recover such costs would not be reasonable. Therefore, the proposed revisions would target full cost recovery for 98.5 percent of transactions across covered issuers, corresponding to a fixed multiplier of 3.7. Due to consistent patterns in the data reported by covered issuers to the Board since 2011, staff expects that, going forward, this methodology should achieve the target cost recovery of 98.5 percent of transactions over time. This new methodology for setting the base component would thus ensure that, to the extent practicable, the base component will be reasonable and proportional to the transaction processing covered issuer costs consistent with the statute, reflecting the proposed multiplier of 3.7 and the transaction processing cost of the average transaction of 3.9 cents in the 2021 data, the proposed base component would be 14.4 cents, down from the current value of 21 cents. Turning to the other two components of the cap, the data reported by covered issuers to the Board since Regulation II was adopted shows that the methodologies that the Board used to determine these components in

2011 remain representative of the relevant covered issuer costs. Therefore, for the ad valorem component, the proposal would base the component on the median covered issuer fraud losses. When applied to the 2021 data, this methodology would yield a proposed value for the ad valorem component of 4 basis points multiplied by the value of the transaction, down from the current value of 5 basis points multiplied by the value of the transaction. Finally, for the fraud prevention adjustment, the proposal would base the component on the median covered issuer fraud prevention costs. When applied to the 2021 data, this methodology would yield a proposed value of the fraud prevention adjustment of 1.3 cents, up from the current value of 1 cent. Taken together, the proposed updates to the three components mean that the maximum interchange fee that the covered issuer may generally receive for a $50 debit card transaction would be 17.7 cents, down from the current value of 24.5 cents for the same transaction. Under the proposal, these updated interchange fee components would apply to a debit card transaction performed from the effective date of the final revisions to the regulation through June 30, 2025. In addition to updating the interchange fee cap for the first time since it was established in 2011, the proposed revisions would codify in Regulation II, an approach for updating the interchange fee cap every two years going forward. Under this approach, future interchange fee cap values would be calculated using the proposed methodologies applied to the latest data reported to the Board by covered issuers. The Board would then publish by March 31st of odd-numbered years, without notice and comment, updated interchange fee cap values computed based on the data reported by covered issuers the prior year. These updated values would go into effect on July 1, and would remain in effect for two years, at which time new interchange fee cap values would go into effect. By directly linking the interchange fee cap to data from the Board's biannual survey of covered issuers, this approach should ensure going forward that, to the extent practicable, any interchange fee subject to the cap will remain reasonable and proportional to the cost incurred by the issuer with respect to the transaction. The Federal Register notice accompanying the proposed rule provides for a 90-day public comment period and requests comment on all aspects of the proposal. Among other things, the proposal would request feedback on the cost recovery target of 98.5 percent of transactions by cross-covered issuers for the base component, the approach for regularly updating the interchange fee cap, and the impact on various participants in the debit card market. Finally, as noted at the beginning of my remarks, staff is also requesting that the Board approve publication of the latest edition of a routine report on the debit card industry. As required by the statute, the Board has published this report on a biannual basis since 2011. The report presents summary information on debit card transaction volumes and values, interchange fees for debit card transactions, covered issuer transaction processing and fraud prevention costs, and fraud losses associated with debit card transactions. The proposed revisions to Regulation II incorporate information from this year's report, and we recommend that the Board also approve publication of the report. My colleagues and I would be happy to answer any questions you may have.

CHAIR POWELL. Thank you. So we're going to have two rounds here. One will be an opportunity for governors to ask questions, and then we'll have another round after that for governors to state their positions, and then we'll have a vote. So let's begin with potential questions, and I'll turn first to Vice Chair Jefferson.

VICE CHAIR JEFFERSON. Thank you, Chair Powell, and thank you very much for that excellent presentation. My question is as follows. What would staff expect the effect of the revised cap as envisioned in the proposal to be on community banks and other small depository institutions?

MARK MANUSZAK. So I'll take that question. So thank you very much for that question, Vice Chair Jefferson. The potential implications of the cap and revisions to the cap for community banks and other small depository institutions is an important issue. As Kriss said in his remarks, the statute explicitly exempts depository institutions with less than $10 billion in consolidated assets from the interchange fee standards that the Board is instructed to develop, and Regulation II correspondingly does not apply to those issuers. So the cap does not apply to issuers with less than $10 billion in consolidated assets, and any revisions to the cap also would not apply to those issuers. The experience since the current cap was established in 2011 provides some evidence about whether that exemption for small issuers has been effective. In particular, all networks have established interchange fee schedules that distinguish between banks that are subject to the cap and banks that are not. So that despite concerns when the current cap was implemented in 2011 that networks would simply apply the same regulated fee to all issuers, that has not actually been the case. And moreover, the interchange fees on average for community banks and their small depository institutions did not decline following the implementation of the current cap, and in fact have risen somewhat in recent years. So there's really remained a consistent and persistent and large gap between the interchange fees that small issuers receive and those that apply to issuers subject to the cap. All of this suggests to us that the small issuer exemption has in fact been effective in practice, and we see no reason why that would change under the proposed revisions. That having been said, we recognize that this is a complex market with a lot of potential complicated effects on the different parties in the market. And so the proposal does seek comment on the effects that the revisions might have, including on smaller depository institutions.

CHAIR POWELL. Thanks. Vice Chair for Supervision, Barr, please.

VICE CHAIR FOR SUPERVISION BARR. Thank you. And this is a question I think you're probably positioned to answer. A key element of the proposal is the approach to regularly update the interchange fee cap as new data are collected. Could you elaborate on why staff recommends establishing this process for regular updates?

EVAN WINERMAN. Thank you, Vice Chair Barr. The Dodd-Frank Act requires, as my colleagues have noted, that the Board establish standards for assessing whether the amount of any interchange fee is reasonable and proportional to the costs incurred by the issuer with respect to the transaction. To ensure that the Board's standards remain effective over time, staff believes that the interchange fee cap should be updated to account for changes in issuer costs. In addition, a process to regularly update the cap would create predictability for the debit card industry about when and how such changes would occur. The proposal requests comment on whether the Board should adopt such a process.

CHAIR POWELL. Governor Bowman, please.

GOVERNOR BOWMAN. Thank you, Mr. Chair. I have several questions, so I'll start with my first question, which is that today's proposal contemplates codifying an approach for updating the components of the interchange fee every other year going forward based on the latest data reported to the Board by covered issuers. With any formula, it's important to consider whether the data that's collected over time is accurate and appropriate. So the question is, does the data that we collect, show the aggregate cost of operating a debit card program and the impact of proposed changes to the interchange fee cap? Or have we limited the data collection to the subset of costs that are reflected in the cap? And then does the limited data collection give us enough context to understand the impacts on financial institutions of the proposed revisions to the cap?

EVAN WINERMAN. Thank you, Governor Bowman. I can take that. The Dodd-Frank Act provides that when the Board establishes interchange fee standards, it must consider certain issuer costs and it must not consider certain other costs. In addition, when the Board initially adopted the interchange fee cap in 2011, the Board identified a third category of costs that it was permitted but not required to consider. Consistent with the statute, the Board determined in 2011 the transaction processing costs, and issuer fraud costs were the relevant allowable costs. The data that the Board collects today reflect those allowable costs. Staff has reviewed the Board's construction of the statute and the Board's prior analysis of allowable costs from the 2011 final rule. Staff believes that the Board's analysis remains sound and therefore does not recommend that the Board propose changes to the costs considered for purposes of the interchange fee cap. However, the proposal solicits comments on the economic impact of the proposal and we look forward to reviewing comments on that issue from debit card issuers, particularly regarding the impact of the proposal on their debit card programs.

GOVENOR BOWMAN. So the answer to the first question was that the impact, do we feel like we have collected data that shows the aggregate cost? That answer is no, because we've limited artificially the information that we're collecting in the survey, correct?

EVAN WINERMAN. We've limited it as we believe required by the statute.

GOVENOR BOWMAN. Great, thank you very much. So the second question I have is that the materials presented today contemplate that there may be unintended consequences arising from changes to the debit interchange fee cap. This could include banks passing on higher costs for basic banking services and banks discontinuing certain products or services. What sorts of unintended consequences might occur, since you've included that in the proposal but not identified them, and what is the potential impact on consumers, including low- and moderate-income consumers?

KRISS WOZNIAK. I can take the question. Thank you, Governor, for the question. So I think we recognize that this is a complicated market and there may be many different effects of the proposed revisions on different participants. I think the data that we've collected since 2011 gives us a good idea of what the effect of the proposed revisions would be on various participants in the market. Nonetheless, we recognize that this may not capture everything, and we are also looking forward to the feedback we receive in public comment in response to the notice. And for the final rule, we would look to incorporate the feedback while keeping in mind the statutory guidance.

GOVENOR BOWMAN. I appreciate that, and I look forward to the public comment on that as well. So my last question is, the materials suggest that the benefits of this proposal will come from merchants passing on reduced fees to consumers in the form of lower prices, fewer price increases over time, or improved service quality. Is there any evidence to base that assertion on, that the effects of the final rule, whether they will benefit or harm consumers?

KRISS WOZNIAK. I can also, I think, speak to that. Thank you again for the question. I think the first thing I think to note, maybe take a step back, is to recognize that retailing is a very competitive industry. And this economic theory will predict that merchants should have -- the competition should ensure that merchants have low profit margins and thus pass on costs and savings onto consumers. Empirically, I think the question of merchant cost pass through is one of those that is well recognized to be very difficult. Partly because prices are well known to be sticky, especially when the underlying cost changes are relatively small. And there's a lot of other confounding factors that may make statistical analysis difficult. So studies that have actually successfully investigated the issue take another approach, and what they do instead is they look at how the variation, the cost of accepting card payments, affects merchants' profit margins. One such study in particular, for example, which was conducted, which uses data collected in the 2010s following the introduction of the original energy cap, finds clear evidence that merchants pass on the cost of accepting card payments onto consumers, and in particular large merchants.

GOVENOR BOWMAN. That study that you're referring to is from 2009?

KRISS WOZNIAK. No, the study, sorry, just to clarify, the study uses data from, I want to say, 2011 to 2021. So, the study is relatively recent.

GOVENOR BOWMAN. Have we published that along with the materials for the Board package today? Is that what we're basing the assertion on, that we think -- or should the Fed be making an assertion that this will be the outcome?

KRISS WOZNIAK. So I think to answer your first question, we do reference the study in the notice directly, but also we recognize in the notice and try to capture in our remark that it is the question of the effect on consumers through merchant cost pass-through is, I think, empirically, there's a good question, and it's difficult to determine ahead of time the exact extent to which this will happen.

GOVERNOR BOWMAN. Thanks, Kriss. I appreciate it.

CHAIR POWELL. Great. Thank you, Governor Waller, please.

GOVERNOR WALLER. I have no questions.

CHAIR POWELL. Great. Governor Cook.

GOVERNOR COOK. Thank you, Kriss, for that clear presentation. Could you speak a bit more about the changes in fraud figures that have been observed in the data collected by the Board? What effect would staff expect the revised cap to have on debit card fraud?

ELENA FALCETTONI. I'll take this. Thank you very much, Governor Cook, for this question. Fraud is absolutely a key factor for all stakeholders in this industry, and it's therefore an important consideration in this regulation as well. Now, as we heard in Kriss's remarks earlier, there are actually two components of the interchange fee cap that refer to fraud. There's the ad valorem component that refers to fraud losses, and the fraud prevention adjustment that is based on fraud prevention costs. So starting from the first of these two that I mentioned, the proposal updates the ad valorem component downward, reflecting the fact that issuer fraud losses as a share of transaction value have declined since 2011. Now, what we have is that covered issuers report data to the Board, as Kriss mentioned, every two years. And what we see from that data is that while fraud overall has been increasing pretty steadily since 2009, the fraud losses of the median covered issuer actually declined since then. Now, secondly, we have the fraud prevention adjustment, and the proposal updates that upward, and that reflects the fact that in the data, the same data that covered issuers report to the Board, we see that those costs went up from 2009 to 2011 and stayed relatively stable since, likely reflecting the fact that fraud is ever-evolving, and issuers have to continuously invest in fraud prevention to combat fraud. Now, because fraud is ever-evolving, issuers have incentives to combat fraud, both for themselves and their own consumers. And this regulation and the proposed revisions ultimately do not change this fact. And because of this, we do not believe that the proposed revisions would reduce the incentives the issuers face to combat fraud and mitigate the upward trend that we've seen in the data.

CHAIR POWELL. Thank you. Governor Kugler?

GOVENOR KUGLER. Thank you, Chair. The materials you provided indicate that the formula used should achieve target cost recovery of 98.5 percent of transactions over time. Could you indicate how you determined that this target was appropriate?

KRISS WOZNIAK. I think I can speak to that. Thank you for the question, Governor. So the proposed target in the notice and the proposal reflects one potential way to balance varying sort of factors. On the one hand, it looks to that the cost recovery is reasonable across covered issuers on the recoverable amount of their transaction processing costs. On the other hand, for example, we want to make sure that the cost recovery isn't so high that even issuers that have unreasonably high transaction processing costs can also fully recover those costs. I will note also that in the proposal, in the notice, we ask for feedback, for public comment, on whether the proposed methodology should use an alternative target for cost recovery.

GOVERNOR KUGLER. Thank you.

CHAIR POWELL. Great, thanks. If there are no further questions, then we'll move to stating our individual positions on the proposals, and I'll begin again with Vice Chair Jefferson, please.

VICE CHAIR JEFFERSON. Thank you, Chair Powell. I am thankful for the staff's work on the proposal before us today, which would update the interchange fee cap. I believe it is important for our approach to rulemaking to be both transparent and driven by data. For that reason, I support the publication of the biannual data report, which presents the data on which the proposed adjustment to the interchange fee cap is based, and which is being presented to the Board along with the proposed rule. The adjustments to the interchange fee cap in the proposed rule seeks to fulfill the statutory requirement from the Dodd-Frank Act, and I support issuance of the proposal for public comment. I look forward to reviewing the feedback submitted by commentators, including on whether the proposed methodology for updating the interchange fee cap is appropriately calibrated. Thank you.

CHAIR POWELL. Thank you. Vice Chair for Supervision Barr, please.

VICE CHAIR FOR SUPERVISION BARR. I'd like to thank the staff for the excellent presentation and for all the work involved in the proposed rule, given the extensive analysis and careful proposal presented. This proposal fulfills our statutory duty to help ensure that debit card interchange fees are reasonable and proportional to costs. The comment process is an important part of the rulemaking, and I look forward to hearing views on the proposal. The final rule will be the better for it. I support the proposal.

CHAIR POWELL. Thank you. Governor Bowman, please.

GOVERNOR BOWMAN. Thank you, Mr. Chair. I'd like to begin also, as my colleagues have, by recognizing our staff and their work in preparing today's proposal and, of course, for the accompanying presentation for today's Board meeting. I know this has been a long time in the drafting and in presenting it to the Board for consideration. As I noted in yesterday's open Board meeting, I am very encouraged by the Board's renewed commitment to consider important regulatory matters through open Board meetings. Addressing these policy issues in this open forum promotes public transparency about the Board's work, and I appreciate that we are reverting back to that practice. Today, the Board is considering a proposal to amend the regulatory cap on debit interchange fees. The Dodd-Frank Act mandates that the Federal Reserve establish a cap on debit interchange fees that's reasonable and proportional to the cost incurred by the issuer with respect to debit transactions. In my view, before engaging in significant regulatory proposals, it's critical to reflect the broader context and to understand the potential consequences of the revisions. While the proposal suggests that it could result in benefits to consumers, I'm concerned that the cost for consumers, through the form of increased costs for banking products and services, will be real, while the benefits to consumers, such as lower prices at merchants, may not be realized. The debit card payments ecosystem is vitally important, and it's a vital, important part of the overall payment infrastructure in the United States. And as staff has noted, according to the Fed's most recent industry data collection, which is from 2021, at a very different economic time than we are facing today, debit cards remained the most popular form of non-cash payment. When we're considering proposed changes to the fees that support this important form of payment, we must take into account the broader context. The wide range of business models and sizes for issuers that are subject to the interchange fee cap, the effect of the rule on bank capital and earnings, and the potential benefits and costs to consumers. The cumulative effect of regulatory changes and rules, and other unintended consequences. While today's rule acknowledges the varied size, business model, and product offerings of banks subject to the interchange fee cap, the fee cap aims to achieve rough justice by establishing a single cap that applies to all covered issuers. The fee cap is the product of a limited set of aggregated data reported by issuers. Both setting a single cap for all issuers and basing that cap on data reported by a wide range of issuers is regressive in several ways. Larger issuers, those with the highest transaction volumes, greater negotiating power, and the most efficiencies that come from scale will continue to have significant competitive advantage under this rule. Even the lower interchange fee may allow them to continue profitably operating their debit card programs. In contrast, smaller issuers subject to the cap, those with smaller transactions volumes, less negotiating power, and fewer efficiencies in scale may be at a significant competitive disadvantage. Because retail banking is such a core function for smaller issuers, this pricing dynamic may not ultimately force smaller issuers to abandon their debit card programs. But it is possible that banks will be forced to either pass costs through to customers or operate their debit card programs as a loss leader, which many banks do today. Under the proposed rule, nearly one-third of the bank issuers would not be able to recover even the narrow subset of costs that factor into the interchange fee cap, let alone those debit card program costs that are disregarded in our cap calculation. Because debit card programs are important to the functioning of the payment system, any increase in price or reduction in availability of debit cards could be harmful for bank customers, particularly low-income customers who may not qualify for credit products or other alternatives. The proposal also acknowledges that a lower interchange fee cap will result in an ongoing permanent decrease in gross revenue from interchange fees. This consequence will be felt at banks of all sizes. While the banking system remains strong and resilient, I'm concerned that the cumulative effect of regulatory changes, including the lower interchange fee cap, higher capital requirements, new debt funding requirements, increasing data collection requirements, and many others, could pose ongoing risks to the health of certain financial institutions and the overall banking system. While banks charging fees for services has been criticized by some regulators, in many instances, these fees support a bank's ability to offer low-cost or no-cost banking products or services to customers. It's difficult to predict the impact of this rule on bank product offerings, but one consequence may be that banks discontinue their lowest margin products, including products and options designed to increase financial inclusion and access for low- and moderate-income individuals and families. I sincerely hope that this is not the case, but it is a real and important risk. While the newly revised CRA rules create incentives for banks to offer responsive deposit products, other rules should not impede ongoing progress to improve broader financial product access and availability. Before finalizing any rule, it's incumbent upon policymakers to understand the intended and the unintended consequences of our revisions. This is particularly important when we're talking about vital payment tools like debit cards. Today's proposal also includes a formula that would periodically adjust the interchange fee cap based on data collected by the Board over time. Once a formulaic approach is adopted, it will be hard to overcome inertia to revisit and reopen that approach, even if there are good reasons to do so. There is merit in the Board periodically reconsidering whether the data we collect as the foundation for this cap is appropriate and accurate. There is also merit in revisiting from time to time the policy decisions embedded in the formulaic approach to setting the interchange cap. And there is merit in responding to changing conditions as the payment system evolves, given new market entrants and the increase and evolution of fraudulent activity in the payment system. One such evolution relates to the recent significant revisions adopted by the Board related to debit card transaction routing rules. We do not yet know the effects of those revisions. And I would have preferred that the Board pause to collect data on evolving conditions before proposing this rule change and follow a more deliberative approach for future updates to the interchange fee cap. While today's rule only applies directly to a subset of issuers, those with more than $10 billion in assets, I'm concerned that the impact of the fee cap has and will likely continue to affect a broader range of issuers, including community banks. Virtually all retail banks offer checking accounts and debit cards to their customers, and many of these retail banks are community banks, banks that are intended to be exempt from the interchange fee cap. But these smaller debit card issuers do not exist in a vacuum. Issuers of all sizes use the same payment rails, and smaller issuers inevitably face some degree of pricing pressure, at least indirectly, from the interchange fee cap. And while the interchange fees many smaller issuers have collected since the introduction of the interchange fee cap may have remained largely stable, it's difficult to determine how this compares to the aggregate costs of processing, fraud, and fraud prevention, and the many other inputs for running a debit card program. It's not clear that interchange fees have kept up for many small issuers, and I'm concerned that even if the interchange fee cap does not directly apply, smaller issuers will continue to face ongoing fee pressure in operating their debit card programs. So today's proposal also suggests that any final rule would become effective at least 60 days after the final rule is published in the *Federal Register*. I look forward to public comment on whether such a brief transition period is reasonable for issuers to make any changes to systems, products, or terms and conditions that may be necessary to adjust to an amended debit card interchange fee cap. I suspect that this short transition period will put undue burden on banks, requiring them to make changes under a 60-day timetable could significantly increase their short-term operational risk. And while I look forward to reviewing feedback from the public on all of these issues and everything else included in the proposed rule, for the reasons I just noted, I cannot support the proposed revisions to Reg II's interchange fee cap and the plan for periodic updates. Thank you.

CHAIR POWELL. Thank you. Governor Waller, please.

GOVERNOR WALLER. Thank you, Chair Powell. I want to thank the staff, as others have done, for all their work on this. We have a responsibility to remain in compliance with Reg

II, which requires interchange fees charged by card issuers to be proportional to the cost of the transaction incurred by the issuer. I know this proposal is going to affect a wide range of stakeholders, and I'm looking forward to reading the comments.

CHAIR POWELL. Thank you. Governor Cook, please.

GOVERNOR COOK. First, I would like to recognize and thank staff for their hard work on this rulemaking proposal. This proposal thoughtfully uses the most recent available data to fulfill one of the Board's statutory responsibilities under the Dodd-Frank Wall Street Reform and Consumer Protection Act. I look forward to receiving and reviewing feedback on all aspects of this proposal and taking the feedback into account when considering any final rule. I believe our work is improved when we hear feedback from a broad range of sources and consider the most recent and robust data. I encourage all members of the public with a stake to offer their insights. I appreciate the time, consideration, and careful attention that has gone into this proposal, and I support its issuance. Thank you, Chair Powell.

CHAIR POWELL. Thank you. Governor Kugler, please.

GOVERNOR KUGLER. Thank you, Chair. As several have noted, Congress has charged the Board with the responsibility of assessing whether debit card interchange fees are reasonable and proportional to card issuers' costs. In light of the data collected by the Board indicating that issuers' costs have changed in the 12 years since the Board first issued its regulation, the Board must reexamine whether its current rules appropriately implement instructions from Congress. In addition, the Board must consider whether the rules strike the right balance for consumers, merchants, and issuers. For that reason, I support releasing this proposal for public comment. In particular, I support the proposed approach of setting out a predictable process to enable regular adjustments to the cap every two years. This would provide a method to ensure the continued alignment of issuers' costs and the interchange fee. I want to thank the staff for their efforts in assembling this great proposal, and I look forward to hearing from a wide range of stakeholders during the comment period.

CHAIR POWELL. Thank you. I'll just say a couple of things. First, again, thanks for everyone's great work. I will support these proposals. I'll just point out, as others have, that we are fulfilling here a statutory responsibility that Congress has given us, and I think have done it as well as it can be done. I thank you for that. And the last thing I'll say is that I look forward to seeing, understanding, and thoughtfully reacting to the comments that we no doubt will receive. And with that, we will move to voting on the proposed rule. I need a motion to approve a notice of proposed rulemaking seeking comments on revisions to the interchange fee cap in the Board's Regulation II, and authorize staff to make any minor or non-substantive changes to prepare the documents for publication in the *Federal Register*.

VICE CHAIR JEFFERSON. So moved.

CHAIR POWELL. I need a second.

VICE CHAIR FOR SUPERVISION BARR. Second.

CHAIR POWELL. I will now ask for individual votes, beginning with Vice Chair Jefferson.

VICE CHAIR JEFFERSON. Yes.

CHAIR POWELL. Vice Chair Barr.

VICE CHAIR FOR SUPERVISION BARR. Yes.

CHAIR POWELL. Governor Bowman.

GOVERNOR BOWMAN. No.

CHAIR POWELL. Governor Waller.

GOVERNOR WALLER. Yes.

CHAIR POWELL. Governor Cook.

GOVERNOR COOK. Yes.

CHAIR POWELL. Governor Kugler.

GOVERNOR KUGLER. Yes.

CHAIR POWELL. And I vote yes. We will now proceed to vote on the biennial report. I need a motion to approve publication of the *Biennial Report on 2021 Interchange Fee Revenue, Covered Issuer Costs and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions* and authorize staff to make any minor or non-substantive changes to prepare the document for publication on the Board's website.

VICE CHAIR JEFFERSON. So moved.

CHAIR POWELL. I need a second.

VICE CHAIR FOR SUPERVISION BARR. Second. For votes, please, Vice Chair Jefferson.

VICE CHAIR JEFFERSON. Yes.

CHAIR POWELL. Vice Chair for Supervision Barr.

VICE CHAIR FOR SUPERVISION BARR. Yes.

CHAIR POWELL. Governor Bowman.

GOVERNOR BOWMAN. No.

CHAIR POWELL. Governor Waller.

GOVERNOR WALLER. Yes.

CHAIR POWELL. Governor Cook.

GOVERNOR COOK. Yes.

CHAIR POWELL. Governor Kugler.

GOVERNOR KUGLER. Yes.

CHAIR POWELL. And I vote yes as well. The motion has carried and the report is approved. Again, thanks to everyone for your hard work over so many years on this proposal and the report, and all of us look forward to receiving the comments, and we encourage all stakeholders to share their views with us during this comment period. Our meeting is now adjourned. Thank you very much.