June 7, 2019

Ms. Anne E. Misback
Secretary
Board of Governors of the Federal Reserve System
Washington, DC 20551

Re: Proposal to extend for three years, without revision, the Recordkeeping and Disclosure Requirements Associated with Regulation II (Debit Card Interchange Fees and Routing) (FR II; OMB No. 7100-0349)

Dear Ms. Misback:

The undersigned trade associations appreciate the opportunity to provide comments on the Federal Reserve Board of Governors' proposal to extend for three years, without revision, the Recordkeeping and Disclosure Requirements Associated with Regulation II (Debit Card Interchange Fees and Routing).

In addition to supporting the Board's proposal to maintain certain current administrative (recordkeeping) processes, we also urge the Board to resist requests to reopen Regulation II for purposes of imposing further regulatory burden associated with the Durbin Amendment to the Dodd-Frank Act.

To the extent that the Board, upon receipt of other comments relative to this Proposal, may choose to explore revisions to recordkeeping and disclosure requirements associated with Regulation II, the following comments should be incorporated into consideration of such action.

* * *

American leadership in the payments arena depends on the ability and willingness of all stakeholders to invest in continuous innovation. More so than anywhere else in the world, regulated financial institutions here have led the way in continuously providing consumers and merchants with new, faster, and more secure payment options that support economic growth and inclusion and protect merchants and consumers alike from fraud.

Bank and credit union-issued debit cards provide convenient access to deposits and serve as an alternative to cash, checks, and credit cards. Unfortunately, the Durbin Amendment has distorted the debit card and consumer checking markets, much to the detriment of consumers.

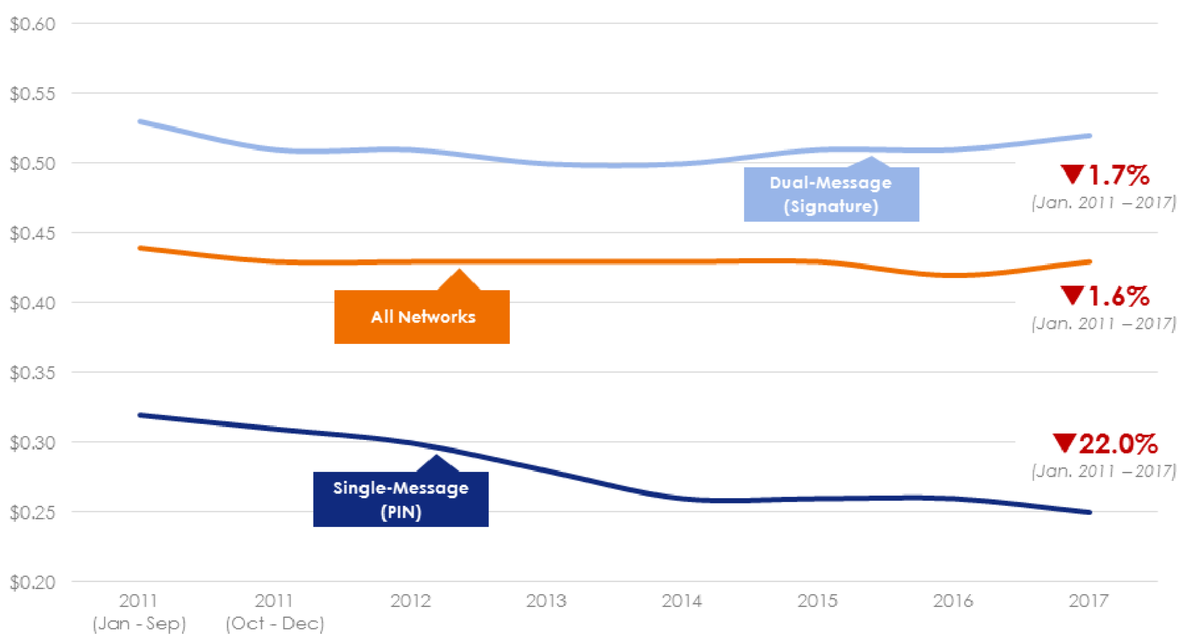
The law has made it more difficult for financial institutions to provide consumers with access to robust core banking services like free checking and feature-rich debit cards, and hindered their ability to invest in needed payments infrastructure.

Durbin Amendment's Cost to Community Financial Institutions

The negative impacts of the Durbin Amendment are well-documented, both by academic and Federal Reserve staff researchers. Most recently, the Federal Reserve's Debit Card Issuer Cost Study[1] found that community financial institutions (less than $10b in assets) have experienced a 22% decrease in per-transaction debit card revenue (PIN) since 2011. Though these smaller institutions were excluded from one prong of the law, this "exemption" has not shielded them from its distortive effects.

On a per-transaction basis, nominally "exempt issuers," such as **community banks and credit unions**, have seen interchange fees decline, particularly for single-message (i.e., PIN) transactions.

Debit Interchange Fees for "Exempt Issuers" – Durbin Amendment
Average Fee per Transaction, by Type



Source: Federal Reserve.

Durbin Amendment's Effect on the Cost and Availability of Core Financial Services

Ten years after the passage of the Durbin Amendment, the evidence is clear: the large merchants which advocated for the law's passage have reaped the vast majority of its benefits in the marketplace, while consumers and small businesses have suffered.

Contrary to merchant promises to Congress that average Americans would benefit from the Durbin Amendment, there exists no evidence that consumers and small businesses benefited from the law. Instead, large merchants appear to have absorbed roughly $54 billion (and counting) in interchange-related savings. Small businesses have also been disserved by the Durbin Amendment, as interchange fees have actually increased for small-ticket transactions: According to research from the Federal Reserve Bank of Richmond, interchange fees increased for almost one-third of all merchants after the Durbin Amendment was implemented, and merchants who specialize in small-ticket items are nine times more likely to have encountered an increase in interchange cost than a decline[2] The basic economic principle still holds that price ceilings become price floors.

As with any price control, and in line with widely accepted market theory, the Durbin Amendment has reduced supply of the service being regulated. Fewer financial institutions now offer free checking accounts: A recent study by the Federal Reserve Board found that as a result of capping debit interchange fees, banks are 35% less likely to offer consumers free checking. Based on this finding, researchers estimated that if the Durbin Amendment had not been passed, twice as many consumers would enjoy free checking as do today — translating to tens of millions of consumers who now face checking account fees as a direct result of the Durbin Amendment.[3]

Consumers have also experienced increased costs of maintaining a checking account, including higher minimum balance requirements and fees. For example, the aforementioned Federal Reserve Board study found that banks covered by Regulation II increased the average minimum balance requirement for noninterest checking accounts by $400, or 50%. For interest-bearing checking accounts, minimum balance requirements rose even more, by $1,700, or 55%.[4]

Debit card rewards, which were ubiquitous prior to the enactment of the law, have now largely disappeared. These changes have occurred without the promised offsetting reduction in prices at merchants' point of sale. According to the Federal Reserve Bank of Richmond, only 1% of merchants reduced prices in the wake of lower debit fee acceptance costs. Most (77%) did not adjust prices at all, and 22% actually raised them.[5] In fact, some merchants admit their windfall.

These are entirely predictable[6] effects of a law premised on arbitrarily and simplistically setting static prices for services in what the United States Supreme Court recognized in late 2018 to be a highly complex and dynamic two-sided market. Flexible interchange rates make it possible for networks to deliver maximum value for both merchants and consumers. By accepting debit payments, merchants enjoy higher average sales and can better meet consumer demand by quickly processing transactions and reducing checkout times, all while reducing the risk of theft and fraud. For consumers, debit payments are a convenient, secure, and easy way to pay for items, whether in-store or online.

However, due to this two-sided nature, restraint of one side of the market results not in lower overall costs, but in shifting costs onto another group, in this case checking account customers. The rigidity of the Durbin Amendment's approach has created the artificial shortages referenced above and placed the Federal Reserve in the peculiar role of enforcing one sector's financial interests at the expense of all other stakeholders, including consumers.

We are especially dismayed that the law's impacts have been most pronounced for those consumers in need of feature-rich, low-cost basic banking services. When access to a bank or credit union service like checking is hindered, a consumer faces a cascade of impacts, including loss of access to other basic financial tools such as direct deposit and ACH bill pay. According to FDIC data, the Durbin amendment led to higher minimum balance requirements and checking fees. In 2013, 38% of previously banked households cited account fees as a reason for closing their account (up from 12% in 2009). Similarly, 61% reported closing their accounts because they did not have enough money to keep in an account or meet a minimum balance requirement, whereas 34–45% cited these factors in 2009.[7]

Pushed out of the banking system but still needing access to financial services, many consumers turn to check cashers and bill pay stores. Not only are these services often more expensive than those offered by a traditional bank, they also make it difficult to build a credit history needed to access lower-cost payment methods and loans.[8] In depriving financial institutions of needed revenue to serve underbanked populations, the Durbin Amendment is at odds with public policy that values increasing inclusion in mainstream banking services.

Community Financial Institutions and Investment in Evolving, Faster Payments

For smaller financial institutions that lack the economies of scale of larger competitors, the Durbin Amendment's adverse impact on debit card revenue is especially important and compounds challenges they face in the marketplace.

Compared to large issuers, smaller institutions have fewer customers across which to spread payment system costs and are often debit-only card issuers. They pay third party "core" providers for service upgrades that allow them to remain competitive but must finance these investments with existing revenue. By reducing the revenue available to make these investments, the Durbin Amendment impairs the ability of smaller institutions to modernize their payments infrastructure and offer new options that may come to market. This is particularly egregious since, as the Federal Reserve is aware from its Faster Payments Task Force, we are entering an era where financial institutions will need to ramp up their readiness for new payment options.

Regulation II's Divisive History

The Durbin Amendment was premised on the flawed logic that debit cards, which act a method of transmitting funds from underlying accounts, could be isolated from the rest of the customer's interactions with a bank or credit union. In reality, a debit card is the revenue-contributing component of a deposit relationship bundle that includes a checking account, technology, and customer service.

In implementing the Durbin Amendment, the Federal Reserve faced the unenviable task of interpreting a flawed and hastily-passed law. This amendment was drafted at the last possible moment for peripheral inclusion in the Dodd-Frank Act and did not face the rigorous scrutiny of legislative hearings or regular legislative order. Nor was there opportunity for assessment, amendment, or improvement. Its mandates, particularly the use of price controls, represented a departure from norms of modern commercial regulation and a return to discredited central planning of business relationships. Given these circumstances, it was not surprising that protracted litigation ensued in connection with Regulation II.

Secure Payments Require Constant Investment

Lobby groups for the nation's largest merchants have advocated[9] for the Federal Reserve to repeat the rule writing process, but this is neither justified by the facts nor good public policy. These groups assert that the reduction in fraud resulting from highly effective security systems such as chip cards constitutes a reduction in cost burden borne by banks and credit unions, and insist that these "reduced" costs should be reflected by a corresponding reduction in interchange.

This is an intentionally narrow misreading of the current state of fraud. If pursued, these calls would punish card issuers for their anti-fraud investments and prematurely presume a long term step change in overall fraud levels. While banks and credit unions are actively battling against payments fraud and have achieved notable progress against specific threats over certain time periods, the payments threat landscape is constantly evolving and a posture of unrelenting adaption is essential. Though some merchant groups may believe that now is the time for a victory lap (and a reduction in interchange), our members recognize the need to continue developing and investing in advanced fraud detection, prevention, and mitigation technologies.

As the Federal Reserve knows from its Secure Payments Task Force, highly sophisticated criminal organizations attacking our payment infrastructure will incessantly seek opportunities to defraud, shifting to tactics which only become apparent with time. The observed reductions in counterfeit card fraud thanks to the widespread adoption of chip cards is an industry-led success story, but combatting other emerging forms of fraud requires the constant innovation of new technologies to keep merchants and consumers safe.

For example, while counterfeit fraud has been falling, card issuers are facing new kinds of direct and indirect fraud costs related to social engineering and collusive merchants. Issuers and their customers continue to endure the fallout of almost-daily data breaches at merchants who fail to comply with industry security standards or any national data safeguarding rules. Regulation II was drafted at the very dawn of what has become the age of routine merchant megabreaches. To claim that financial institutions are materially less impacted by fraud or need be operationally less focused on it in today's world of multiplying threats is not credible.

Simply put, the early data on the chip card transition showing its effectiveness in combating counterfeit fraud is not a sufficient or reliable signal to predict future fraud trends, nor a compelling reason to reevaluate assumptions made in Regulation II.

Conclusion

Our members remain committed to serving the American economy — consumers and merchants alike. Merchants value the benefits of accepting cards, as proven by their increasingly demonstrated preference for electronic payments. Only a handful view them as a battleground.

We continue to believe that the Durbin Amendment was a transparent attempt to reallocate wealth to a small tranche of large merchants. In doing so, much harm has been done to the once-vibrant debit card ecosystem and its actors, including consumers, small businesses, and community banks and credit unions[10]. Almost a decade later, it remains controversial and as evidence mounts, legislative attempts to repeal it emerge periodically.

It had never been the role of the central bank to attempt to replace, through regulation, the price discovery mechanisms of a complex two-sided marketplace. Further adjustments, ostensibly to refine the implementation of Durbin's mandates, are likely to have additional and unpredictable distortionary market effects and exacerbate the damage done by existing rules.

We urge you to recognize that demands to reopen Regulation II are premature and motivated by short-term and parochial economic interests, and to exercise appropriate restraint by declining to entertain those demands. Further, we reiterate the request[11] made during the 2016 Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) process that the Federal Reserve report to Congress a conclusion that the Durbin Amendment has failed to achieve its stated goals, and that the Board recommend its speedy repeal.

Sincerely,

AMERICAN BANKERS ASSOCIATION

CREDIT UNION NATIONAL ASSOCIATION

NATIONAL ASSOCIATION OF FEDERALLY-INSURED CREDIT UNIONS

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(CITATIONS ON FOLLOWING PAGE)

[1] Federal Reserve Board (2019). Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions.

[2] Wang, Z., Schwartz, S., and Mitchell, N. (2014). The Impact of the Durbin Amendment on Merchants: A Survey Study. Federal Reserve Bank of Richmond and Javelin Strategy & Research, 194.

[3] Manuszak, M. and Wozniak, K. (2017). The Impact of Price Controls in Two-sided Markets: Evidence from US Debit Card Interchange Fee Regulation. Federal Reserve Board, Washington, D.C., 5-6.

[4] ibid.

[5] Wang, Z., Schwartz, S., and Mitchell, N. (2014).

[6] Katz, D. (2011). Blame Dick Durbin for Bank Fees. The Heritage Foundation, Washington, DC.

[7] FDIC (2014). 2013 FDIC National Survey of Unbanked and Underbanked Households, FDIC, 6; FDIC (2009). National Survey of Unbanked and Underbanked Households, FDIC, 27. Note that both the FDIC's 2009 and 2013 National Survey of Unbanked and Underbanked Households instructed previously banked survey participants to mark all that applied from a list of potential reasons for closing their banks accounts. However, whereas the 2013 survey listed "do not have enough money to keep in an account or meet a minimum balance requirement" as a single reason for closing an account, the 2009 survey broke this into two options: "minimum balance requirement is too high," and "do not have enough money to need an account," respectively selected by 11% and 34% of previously banked survey participants. Taking into consideration that was possible for survey participants to check multiple options, this indicates that at least 34%, but no more than 45% of respondents closed their accounts due to these factors.

[8] Hayashi, F. and Cuddy, E. (2014). General Purpose Reloadable Prepaid Cards: Penetration, Use, Fees, and Fraud Risks. The Federal Reserve Bank of Kansas City, 32-36; Hayashi, F. (2014). General Purpose Reloadable Prepaid Cards. Federal Reserve Bank of Boston; Bennet, J. (2015). From Coins to Big Bucks: The Evolution of General-Purpose Reloadable Prepaid Cards. Page One Economics, The Federal Reserve Bank of St. Louis.

[9] RILA (2019). Retailers React to Federal Reserve Report on Debit Swipe Fees. Retail Industry Leaders Assn. Washington, DC.

[10] Electronic Payments Coalition (2018). Out of Balance: How the Durbin Amendment Has Failed to Meet Its Promise. http://www.electronicpaymentscoalition.org/wp-content/uploads/2018/12/EPC.DurbinStudiesPaper.pdf

[11] [11] Kern, S. (2016). Re: Fourth Published Request for Comments Under the Economic Growth and Regulatory Paperwork Reduction Act of 1996. Amer. Bankers Assn., Washington, DC https://www.aba.com/Advocacy/commentletters/Documents/ABACommentLettertoJointAgenciesonFourthEGRPRAReview.pdf