TAXPAYERS PROTECTION ALLIANCE

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Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

The Taxpayers Protection Alliance Comments on Proposed Regulatory Changes Governing Debit Card Interchange Fees

The Taxpayers Protection Alliance (TPA) is a rapid-response, nonpartisan organization dedicated to educating the public through the research, analysis, and dissemination of information on the government's effects on the economy.

On behalf of the millions of taxpayers and consumers it represents, TPA is pleased to respond to the Board of Governors of the Federal Reserve System's Notice of Proposed Rulemaking on *Debit Card Interchange Fees and Routing*.[1] According to data from 2021, debit cards are the most popular noncash payment type in America; how they are regulated has enormous import for American consumers.[2] TPA worries that the updated interchange fee caps, although well-intentioned, will in practice make affordable financial services available to fewer Americans and produce little – if any – consumer savings.

Background

Under the so-called "Durbin Amendment," a provision of the Dodd-Frank Act, the Federal Reserve in 2011–2012 imposed rate caps on debit card interchange fees. Specifically, these regulations limited rates to a base component of 21 cents, a 5-basis-point *ad valorem* component (multiplied by the transaction value), and a 1-cent fraud-prevention adjustment for qualifying issuers. On October 25, 2023, after nearly a decade of inaction, the Federal Reserve proposed to adjust the base component to 14.4 cents, the *ad valorem* component to 4 basis points, and the fraud-prevention adjustment to 1.3 cents. It should be noted that the proposed changes would reduce the base component rate by nearly one third, and the *ad valorem* component by one fifth.

Price Controls Harm Consumers

To be clear, capping interchange rates – which are the price that financial institutions charge for providing the services that correspond to debit cards – constitute a price control. When a regulator orders a company to charge less for its services, it reduces the revenues that company earns. This forces companies to find some other way to recoup the loss. Whatever its methods of doing so, the results are often unforeseen and unintended by regulators but nonetheless very harmful to consumers. In other words, forcing businesses to offer services for less in one area will often lead to higher prices, or fewer benefits or services offered, elsewhere.

[1] https://www.federalregister.gov/documents/2023/11/14/2023-24034/debit-card-interchange-fees-and-routing
[2] https://www.federalreserve.gov/newsevents/pressreleases/bowman-statement-20231025.htm

The financial institutions that the proposal would cover would struggle mightily under the proposed rate caps. The Federal Reserve itself has conceded that, as put by Governor Michelle W. Bowman, "a lower interchange fee cap will result in an ongoing, permanent decrease in gross revenue from interchange fees."[3] The revenues generated by interchange fees cover critical business expenses, including cybersecurity, anti-fraud measures, overhead and human capital, and much more. Debit card issuers do not hoard interchange-fee revenues like a dragon hoarding gold in its lair; they put the capital to work, benefitting their customers.

In a statement responding to the proposed rate caps, Governor Bowman noted further that "nearly one-third of bank issuers would not be able to recover even the subset of costs that factor into the interchange fee cap, let alone those debit card program costs that are disregarded in the cap."[4]

Although the proposed rule would only apply to institutions with more than $10 billion in assets, it would likely affect even those below this threshold. As markets pivot to comply with new rate caps, putatively unaffected institutions would likely face new fallout and price pressures.

Moreover, ultra-low rate caps could also incentivize growing institutions to remain below the threshold to avoid *directly* being covered by the regulation – regardless of what otherwise would be best for their business or their customers. This underscores an important economic reality: ill-conceived regulation of markets invariably spins off a host of unintended consequences as businesses and people adjust their behavior to new regulatory incentives.

The Durbin Amendment Harmed Consumers

If history is a guide – if what is past is prologue – the proposed rates would harm consumers greatly. The Durbin Amendment was supposed to help the average American. Savings were supposed to have been passed on to consumers. The opposite occurred.

The Durbin Amendment prompted banks to make up their losses by raising account-related fees or by raising the minimum account balance necessary to open an account without fees. From 2009 to 2013, the percentage of banks offering free accounts was cut in half, dropping to 38 percent from 76 percent.[5] In that same time, the average monthly fee for fee-based accounts doubled, all the way to more than $12. "[A] typical lower income bank customer who previously qualified for a free current account but, after Durbin, no longer meets the minimum monthly balance requirement, is likely paying around $12 in monthly fees, as well as an additional $1 or more in ATM fees," write researchers from George Mason University, the International Center for Law and Economics, and the Reason Foundation.[6] "That's an annual cost of around $160."

[3] Ibid
[4] Ibid
[5] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2446080
[6] Ibid

The Durbin Amendment also transferred to large retailers an estimated "$1 billion to $3 billion annually from low-income households," the researchers write. The Richmond Federal Reserve reported that while only 1.2 percent of retailers lowered prices, 21.6 percent raised prices.[7] More than three quarters saw no change.

Moreover, the Durbin Amendment caused many debit card issuers to end customer-rewards programs. As reported by the Richmond Fed, analysis found that "50 percent of regulated debit card issuers with a reward program ended their programs in 2011, and another 18 percent planned to do so in 2012."[8] This provides yet another example of price controls' inevitable – albeit unintended – anti-consumer consequences.

There is little reason to think the future would be any different if the proposed rate caps are imposed. One commentor on this proceeding, Matthew Steilberg of Citizens and Farmers Bank, stated that "Debit Card interchange income is the only other way we are able to offset…expenses."[9] Citizens and Farmers Banks offers accounts to customers with problematic financial histories, Steilberg wrote, and "[c]hanges to debit card interchange regulations will likely mean we are losing money with each of these accounts and that may impact our decision to offer them." This, along with the researchers' work cited above, demonstrate how price controls can have a disproportionate impact on the lower-income Americans.

Regulators Need To Update These Regulations Carefully

TPA is also concerned that the proposed means of updating these rates would be insufficient to the changing conditions of the market and will cause further harm to consumers. Under this scheme, the Federal Reserve would update rate caps biennially by feeding industry data into a formula.

Two elements of this plan raise red flags. First off, even the best-constructed formula may be rendered flawed due to changing market conditions. New market entries, changing technology and consumer habits, and other factors can change how well the presuppositions upon which a formula is built reflect market conditions. As Governor Bowman wrote, "[o]nce 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."[10] Markets are complex and dynamic ecosystems, and regulators should bear in mind both the importance of flexibility and the inescapability of human fallibility.

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[7] https://www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_brief/2015/pdf/eb_15-12.pdf

[8] https://www.richmondfed.org/~/media/richmondfedorg/publications/research/economic_quarterly/2012/q3/pdf/wang.pdf

[9] https://www.federalreserve.gov/SECRS/2024/January/20240118/R-1818/R-1818_011324_157194_404280591526_1.pdf

[10] https://www.federalreserve.gov/newsevents/pressreleases/bowman-statement-20231025.htm

Second, the formula-determined rate caps would be published without undergoing public comment. For all the reasons stated, regulating financial markets is an incredibly difficult task. To ensure they are not overlooking some key consideration, regulators ought to seek input from stakeholders on important questions such as these.

Conclusion

Responsibly overseeing financial markets is of utmost importance. The prosperity of America and of her citizens is inextricably linked to functioning markets and convenient, widely available payment systems. For these reasons, TPA urges the Federal Reserve to look long and hard at its proposed rate caps, which, when examined carefully, seem unlikely to accomplish their stated goals.

Moreover, regulators should reconsider the proposed rate caps because they seem likely to harm consumers. This is evident from Economics 101 as well as the recent and all-too-painful history of the Durbin Amendment.

TPA appreciates the opportunity to provide input on behalf of the American taxpayer and consumer on this incredibly important issue. It urges the Federal Reserve to reconsider the proposed rate caps and to find better policies that will promote prosperity for all.

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