Independent Bankers Association of Texas

February 12, 2024

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

Via Email: regs.comments@federalreserve.gov

Re: Notice of Proposed Rulemaking; Debit Card Interchange Fees and Routing; 12 CFR Part 235; Docket No. R–1818, RIN 7100–AG67; 88 FR 78100 (October 25, 2023)

Ladies and Gentlemen,

The following comments are provided on behalf of the Independent Bankers Association of Texas ("IBAT"), a trade association that represents the independent community banks of Texas, to the above-referenced Notice of Proposed Rulemaking relating to Debit Card Interchange Fees and Routing (the "Proposed Role"). IBAT member banks range in size from $27 million to $50 billion in assets, serving Texans in communities of every size.

Regulation II implements a provision of the Dodd-Frank Act that requires the Board of Governors of the Federal Reserve System ("Board") to establish standards for assessing whether the amount of any interchange fee received by a debit card issuer is reasonable and proportional to the cost incurred by the issuer with respect to the transaction. Under the current rule, for a debit card transaction that does not qualify for a statutory exemption, the interchange fee can be no more than the sum of a base component of 21 cents, an ad valorem component of 5 basis points multiplied by the value of the transaction, and a fraud-prevention adjustment of 1 cent if the issuer meets certain fraud-prevention- standards.

The Board developed the current interchange fee cap in 2011 using data voluntarily reported to the Board by large debit card issuers concerning transactions performed in 2009. Since that time, data collected by the Board every other year on a mandatory basis from large debit card issuers show that certain costs incurred by these issuers have declined significantly; however, the interchange fee cap has remained the same. For this reason, the Board is seeking comments on this proposal to update all three components of the interchange fee cap based on the latest data reported to the Board by large debit card issuers.

Consumers Not Reaping Benefits

What we know for certain is that the Durbin Amendment imposed artificial price controls on the interchange fees merchants pay to use debit card networks, under the misguided assumption that merchants would pass their savings on to customers. That simply did not happen.

That conclusion was based upon research conducted by the University of Chicago[i] that examined whether merchants passed savings to consumers in the form of lower prices and better services. Their conclusion was that consumers ended up worse than before. Merchants have retained most of their savings for themselves with the lion's share accruing to the nation's largest retailers.

Meanwhile, community banks saw a significant decline in interchange income. Community banks were forced to offset the interchange revenue losses by raising other fees for consumers (monthly service fees, minimum balance fees, etc.), which affects not only the wallets of their accountholders but also the success of the overall banking system.

As we previously noted, the facts are that merchants did not reduce prices for consumers in any significant way and, in fact, the merchants retained more than $100 billion in savings.

Reduced Availability of Banking Services

According to the Government Accounting Office ("GAO")[ii], unbanked individuals cite lack of funds, minimum balance requirements, and unpredictable or costly fees as the primary reasons for not having a bank account. As such, additional restrictions on account fees and requirements – like those associated with interchange regulation – exacerbate the problem of unbanked and underbanked households. How much has the Durbin Amendment harmed the American people? The answer, unfortunately, is a tremendous amount. As a result, since the amendment's passage in 2010, America's underbanked population has increased by 1 million people.

"The bottom line: the Durbin Amendment takes critical resources away from smaller banking institutions, like credit unions and community banks, and gifts them to big-box retailers who are already making massive profits.

Price controls are nothing new, and unfortunately, neither are their effects on consumers. Time and again, price controls have harmed citizens, businesses and financial institutions. As retailers continue to advocate for strict price controls on payment cards, it is more important than ever to remember what happens when the government decides to set prices. When President Nixon imposed price controls on oil and gas, it led to the oil crisis, with gas stations across the country running out of gas. In Venezuela, price controls on basic goods led to empty supermarket shelves. In the case of the Durbin Amendment, the GAO reports that price controls on interchange fees have led to reduced free checking accounts, minimum balance requirement increases and the loss of rewards on debit cards."

Increased Competitive Disadvantage for Community Banks

While this rule does not target smaller issuers like community banks, those banks don't operate in a competitive vacuum. Larger issuers have the advantage of economies of scale and greater negotiating power. If this rule is adopted, it will result in those larger issuers having an even greater competitive advantage.

In her Statement on the Proposed Revisions to Regulation II's Interchange Fee Cap (Bowman, 2023)[iii], Governor Michelle W. Bowman stated the following in her opposition:

"By contrast, smaller issuers subject to the cap—those with smaller transaction 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 many 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 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. Because debit card programs are important to the functioning of the payments 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 card 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 am concerned that the cumulative effect of regulatory changes—including a 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 U.S. banking system."

The initial rule had the unintended consequences of actually increasing cost to consumers in the form of increased costs for banking products, reducing access those to banking products and services and exacerbating the competitive disadvantage for small community banks.

There is no reason to think this further attempt at price controls will be any different.

Thank you for your consideration of our comments.

Sincerely,

Christopher L. Williston, CAE
President and CEO

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[i] David S. Evans, Howard H. Chang & Steven Joyce, "The Impact of the U.S. Debit Card Interchange Fee Caps on Consumer Welfare: An Event Study Analysis" (Coase-Sandor Institute for Law & Economics Working Paper No. 658, 2013).

[ii] Government Accounting Office, BANKING SERVICES Regulators Have Taken Actions to Increase Access, but Measurement of Actions' Effectiveness Could Be Improved (February 2022).

[iii] Board of Governors of Federal Reserve System, Statement on Proposed Revisions to Regulation II's Interchange Fee Cap by Governor Michelle W. Bowman (October 25, 2023)