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May 12, 2024

The Honorable Jerome Powell
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave, N.W.
Washington, DC 20551

RE: Notice of Proposed Rulemaking on Debit Card Interchange Fees and Routing, Request for Public Comment; Regulation II; Docket No. R-1818

Dear Chair Powell,

On behalf of Randolph-Brooks Federal Credit Union ("RBFCU"), this letter is being submitted in response to the Board of Governors of the Federal Reserve System's ("Board") notice of proposed rulemaking for Debit Card Interchange Fees and Routing (Regulation II). RBFCU is committed to serving our community's financial needs and protecting our members' access to affordable products and services, therefore, we greatly appreciate the opportunity to comment.

Background

A section of the Dodd-Frank Wall Street Reform and Consumer Protection Act known as the Durbin Amendment requires the 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 debit card transaction. The Board is now proposing to update three components of the interchange fee cap based on the latest data reported to the Board by large debit card issuers concerning transactions performed in 2021. Under the proposal, the base component would decrease from 21.0 cents to 14.4 cents, the ad valorem component would decrease from 5.0 basis points (multiplied by the value of the transaction) to 4.0 basis points (multiplied by the value of the transaction), and the fraud-prevention adjustment would increase from 1.0 cents to 1.3 cents.[1] The Board is also proposing to automatically update the interchange rate cap every two years, an update that will be implemented without notice and comment.

Insight

[1] Board of Governors of the Federal Reserve System, "Debit Card Interchange Fees and Routing," (October 25, 2023), https://www.federalreserve.gov/aboutthefed/boardmeetings/frn-reg-ii-20231025.pdf

A Texas Credit Union
1-800-580-3300
P.O. Box 2097, Universal City, TX 78148-2097

As written, the Board's proposal could have effects on financial institutions that will be quite harmful. As with all proposed rules, implementing changes across the board for all financial institutions should be prefaced with careful and thorough research, especially when it comes to credit unions. What may seem like minimal costs and adjustments to operating a debit card program to a large bank will not accurately reflect the impact on a credit union. With this in mind, implications such as unavoidable consumer harm, financial and operational burdens caused by implementing the proposed changes, and the lack of notice and comment before updates to the interchange rate cap every other year are substantial concerns that RBFCU shares with other impacted credit unions and our advocates at America's Credit Unions.

I. Consumer harm

RBFCU is committed to serving our members' financial needs and our mission, which is to improve our members' economic well-being and quality of life. To achieve this, our credit union offers a wide variety of products and services that benefit our members, including Really Free Checking accounts, low-rate tiers offered on our Premier Rate Mastercard credit card, 2% cash back rewards on every purchase with our World Cash Back Mastercard credit card, and no annual fees for either of our credit cards. While our credit cards would not be directly affected by an interchange adjustment, our flexibility in charging fees on these programs could certainly be impacted.

While our credit union commends the Board's attempt to act in the best interest of consumers, the reality is that some of the first negative repercussions of the proposed changes will be felt by our membership. With the interchange being potentially cut by 30%, credit unions will be forced to either pass costs through to customers which can result in the loss of products and services, increase in fees, or reduced access to credit. In a time of economic uncertainty, a sharp reduction in the interchange fee would be regressive in nature for credit unions, especially those that don't have the ability to recoup losses like larger banks, as well as their members. One must only search as far back as 13 years ago to observe the consequences of capped debit card interchange fees from 44 cents to 21 cents under the Durbin Amendment. The last time the Federal Reserve placed a cap on debit transaction costs, two things happened: the availability of free checking accounts declined, and merchants pocketed the difference in cost.[2] For example, RBFCU reached a significant milestone in its cash-back rewards program before it was discontinued in 2019 because of the

[2] Ballard Spahr, "Fed's New Swipe at Debit Fees Stirs Up Dilemma for Banks," (December 19, 2023), https://www.ballardspahr.com/-/jssmedia/Files/Articles/Law360--Feds-New-Swipe-At-Debit-Fees-Stirs-Up-Dilemma-For-Banks.pdf?rev=b7f5bc375ee34a72a9b3a53259294dd0&hash=E568B1EEE3379B180EC3DF3C778DCE78

arduous regulatory and economic conditions that were created as a result of the Durbin Amendment. Our credit union gave members more than $14 million in cash-back debit card rewards in 2018, for a total of more than $100 million over the 11 years of the program's existence.[3] Opportunities for beneficial products and services for our membership will continue to be at stake if the fee cap reduction is finalized as is.

While there is little evidence of merchants passing on savings to their consumers, financial services providers and card issuers have asserted that the proposed rule is based on stale and faulty data in reports to the board, ignores their increased digital security costs, and can be expected to only benefit merchants, not consumers.[2]

II. Financial and operational burden on financial institutions

There is concern that the proposed interchange fee cap is not reasonable or proportional to the actual cost of implementing the change. The debit card program is vital for our membership as this form of noncash payment is the most convenient and immediate way to pay merchants. The interchange fees are the cost for this convenience and if the cap is lowered as proposed, it would be difficult for credit unions to reconcile the financial and operational burdens that would follow, such as implementing stronger cybersecurity and fraud protections, mitigating risk tied to laws such as Regulation E which becomes more burdensome as the compliance landscape evolves, and the overhead required to manage disputes. It is important to consider overall program costs, not just per transaction cost, to obtain a clearer picture of how this proposal would impact financial institutions and consumers alike.

The Board has also admitted that it is unable to determine the compliance costs for these changes. Per the Notice of Proposed Rulemaking, the Board cannot, at this time, determine whether the potential benefits of the proposal to consumers exceed the possible costs imposed on consumers and financial institutions.[4] Yet, the Board is proposing a substantial change and is relying heavily on outdated information. In its proposal, the Board admits the current data is largely in line with the market when Reg II was originally implemented in 2011. For example, the 21-cent base amount was intended to "correspond to the per-transaction allowable cost, excluding fraud losses, of the issuer at the 80th percentile." The 2011 data reveal the base amount now covers 77.4% of issuers. This minor difference does not necessitate a 30% decline in debit interchange.[5]

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[3] RBFCU, "RBFCU Debit Cardholders Reach $100 Million in Total Cash-Back Rewards", (February 8, 2019), https://www.rbfcu.org/news/rbfcu-debit-cardholders-reach-$100-million-in-total-cash-back-rewards
[4] Federal Register, "Debit Card Interchange Fees and Routing," (November 14, 2023), https://www.federalregister.gov/documents/2023/11/14/2023-24034/debit-card-interchange-fees-and-routing
[5] Mastercard, "Federal Reserve's proposed Regulation II debit rate reduction," (December 2023)

III. Updates to the fee cap will happen every 2 years without requesting public comment

Further effort must be made to ensure that any changes are proportional across the board for all financial institutions and one way to do so is to implement a notice and comment period before each proposed update to the interchange rate cap every other year. This will allow for all financial institutions, including credit unions that rely on their ability to serve their communities and provide affordable products to their membership to remain competitive, to submit important data to the Board and help inform on any changes before they are enforced.

Finally, it would not be sustainable for financial institutions to adjust to an automatic update to the rate cap every other year. Such an undertaking will create additional regulatory and operational burdens and could perhaps be assuaged by considering a 3–5-year period to review the cap instead of every other year. Doing so would assist in showing a more consistent trend in data and reduce the unintended impacts in the market.

Conclusion

While the Board insists that the overall effects of this proposal depend on a variety of factors, financial institutions, especially credit unions, foresee more harm than good in implementing the above changes as proposed. It is respectfully that we urge the Board to reconsider the drastic reduction to the interchange fee cap or to leave the cap unchanged in order to protect consumers and financial institutions of all sizes. If the changes are to be implemented, then we urge the Board to rely on more recent and further-reaching data to help inform on changes before they are made, update the proposal to allow for a notice and comment period before additional cap changes are made in the future, and to push out the effective date for these changes to allow for financial institutions of all sizes to prepare for impact, as budget is prepared in the previous year and potential changes in interchange fees will impact the projected financials.

It is our hope that providing our insight to the Board about the potential and significant challenges that will accompany any update to the interchange fee cap will help to inform on any future rulemaking. Thank you for your consideration.

Sincerely,

Sonya McDonald (Apr 26, 2024 09:30 CDT)

Sonya McDonald
EVP, Chief Operating Officer
Randolph-Brooks Federal Credit Union