Proposal: 1818(AG67) Debit Card Interchange Fees and Routing

Description:

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From: Jesse Busby

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Comments:

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Proposal: Regulation II: Debit Card Interchange Fees and Routing [R-1818]
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Your comment: The proposed amendments to the debit interchange fee cap will harm credit union issuers and their members. The proposed rule will impact covered issuers and their members by demonstrating a likelihood of Increased fees and greater restrictions on free checking and savings accounts among credit unions; Pass-through of revenue losses to account holders by decreasing interest rates and savings rates; Retention by merchants of regulatory savings to the detriment of consumers; Reduced financial capability to support low-income populations and community-oriented initiatives such as grants and scholarships; and, Reduction or elimination of debit reward programs among certain covered credit union issuers. The Board's proposal also suffers from several critical flaws: A skewed methodology for assessing base component costs that fails to give appropriate weight to the cost experience of a majority of covered issuers, especially credit unions; An arbitrary cost recovery target that would have prevented a third of covered issuers from recovering their base component costs had the amendments applied in 2021; A failure to properly consider and analyze the likelihood of negative consumer outcomes, as required by the Electronic Funds Transfer Act (EFTA); An unreasonable exclusion of certain allowable costs in the fraud prevention adjustment component; and, A failure to account for the full cost of fraud incurred by covered issuers. Research examining the initial effects of the current fee cap introduced by the Board in 2011 shows that the resulting decline in debit interchange revenue translated into reduced access to free accounts, higher fees, and a rise in the number of unbanked consumers. During this period, the loss of affordable banking services was compounded by a failure on the part of merchants to pass their savings on to consumers. A further reduction in the interchange fee cap, as proposed, would amplify Regulation II's known negative effects, yet the Board vastly understates the proposed rule's future impact and fails to offer meaningful analysis of likely consumer harm. Instead, the Board proposes a new rulemaking when none is required and adopts a methodology so skewed it practically invites future challenges. While it may seem expedient to quell the saber-rattling of the largest merchants by adopting their preferred (but severely flawed) mechanism for indexing costs automatically, this approach corresponds with numerous risks, not only to the Board's reputation as an apolitical entity, but also to the millions of credit union member-owners who are poised to bear the burden of a poorly calibrated fee cap. The Board's 2011 rule fulfilled the statutory requirement to adopt standards for reasonable interchange transaction fees. Accordingly, there is no legal requirement to pursue a new rule now or in the future. Even assuming there was a need to reconsider whether interchange fees are "reasonable and proportional," it would be premature to do so before interested parties have had time to consider the impact of the Board's 2022 amendments to Regulation II. Those amendments only took effect in July 2023 and are not reflected in the 2021 Debit Card Issuer survey data relied upon by the Board in the current proposal. Furthermore, the dual routing amendments are likely to correspond with a decline in future interchange revenue generated from card not present (CNP) transactions, which represent the fastest growing transaction type by volume and fraud source. The Federal Reserve has also improperly excluded certain categories of allowable costs when calculating the fee cap, and maintains this exclusion in the proposal without reasonable justification. Denying credit unions recovery of these costs increases the likelihood that credit unions may need to operate their debit programs at a loss, which is both unsustainable and ultimately harmful to members in the long term. Credit unions are less able to absorb reductions in interchange revenue due to their unique, not-for-profit structure. Unlike banks, credit unions are unable to issue shares to outside investors as a means of raising capital. Instead, credit unions must build capital primarily through retained earnings, a process which is slow and, in the case of federal credit unions, further constrained by a statutory interest rate ceiling. The introduction of the Durbin Amendment, coupled with new laws and regulations targeting sources of non-interest income in the D0dd-Frank era, has had a profound effect on the credit union industry's ability to maintain competitive viability. Further reduction in interchange revenue could also threaten credit unions' ability to return savings and benefits to their members. Based on analysis of credit union data by America's Credit Unions, over 3,500 credit unions offer free checking accounts. Those credit unions serve 130 million members, or 93 percent of total credit union members. A Government Accountability Office (GAO) study ranked the Durbin Amendment among the top five laws and regulations most cited as having significantly affected the cost and availability of basic banking services. The study further concluded that the regulation was associated with increases in the costs of checking accounts and a decrease in the availability of noninterest checking accounts without monthly fees. Section 904(a)(2) of the EFTA requires the Board, in prescribing regulations to carry out the purposes of EFTA section 920, to prepare an economic analysis that considers the costs and benefits to financial institutions, consumers, and other users of electronic fund transfers. The proposed reduction in the fee cap is likely to harm consumers by reducing the availability of free or low-cost banking products and services. Based on historical precedent, a higher cost of basic banking services resulting from downward adjustments to the interchange fee cap will not be offset by lower costs of goods. Research shows that merchants sharing their savings is unlikely, yet the proposal offers a more equivocal assessment: "[m] easuring the extent to which merchants pass on cost savings to consumers, including any decrease in the costs of accepting certain forms of payment, is generally difficult." The Board catalogues a few studies that actually reveal lack of consumer savings, but offers little analysis regarding the extent to which different empirical approaches might correspond with different consumer outcomes. Furthermore, the single study presented as counterargument to evidence that most merchants pocketed their Durbin-related savings does not actually challenge that finding; instead, it examines the extent to which merchants passed on the cost of interchange to consumers; a consideration that might be relevant under EFTA if the Board were proposing to raise the cap rather than lower it. With all of this and so much more, we implore you to not pursue this new rule.