



April 29<sup>th</sup>, 2024

The Honorable Jerome H. Powell  
Chair  
The Honorable Philp Jefferson  
Vice Chair  
The Honorable Michael Barr  
Vice Chair for Supervision  
C/O  
Anne E. Misback  
Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, N.W.  
Washington, D.C. 20551

The Honorable Michelle Bowman  
Governor  
The Honorable Lisa DeNell Cook  
Governor  
The Honorable Adriana Kugler  
Governor  
The Honorable Christopher Waller  
Governor

Re: October 25, 2023 Board Meeting Comment Letter  
Regulation II: Debit Card Interchange Fees and Routing [R-1818]

Dear Chairman Powell et al.,

I am writing to express my disappointment and concern arising from the vote at the October 25<sup>th</sup> meeting and would like to commend Governor Bowman's leadership on this issue. I am a President of a small credit union that was promised by the authors of Dodd Frank and Senator Dick Durbin's infamous handwritten amendment (aka The Durbin Amendment) that financial institutions under the \$10 Billion in assets would be exempt. This regulation made law is now in your care. It's my opinion that the Federal Reserve Board not only needs to look at how this regulation impacts covered issuers, but also exempt issuers, and more globally consumers and small businesses.

The heart of the law remains the same. 15 US § 1693o-2 - Reasonable fees and rules for payment card transactions states in section (a)(2), "The amount of any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction shall be reasonable and proportional to the cost incurred by the issuer with respect to the transaction." The law does not call for nor reference a singular interchange rate cap.

My largest concern is the Federal Reserve Bank's clear disregard for smaller card issuers both covered and exempt. How will the Federal Reserve Bank determine the impact to smaller issuers and broader impact to consumers? The law [15 US § 1693o-2] in theory *allows* my credit union as a card issuer to collect interchange fees that are reasonable and proportional to the costs incurred by my credit union with respect to the transaction. However, the *reality* is that the unintended consequences of the Federal

Reserve Bank's implementation is that our interchange fees have fallen, the fraud components are insufficient and only apply to covered issuers, and the cumulative effect of interchange fee regulation has resulted in a program that does not cover its costs. This is the case for many exempt issuers. The Federal Reserve's implementation has disproportionately squeezed small debit card programs to become unprofitable. We have no voice, no control, and no bargaining power.

#### Unintended Consequences:

- Since I represent an exempt card issuer, why did Regulation II data indicate that the average per-transaction interchange fee for **exempt** single-message transactions fall by nearly 31% in inflation-adjusted dollars from 2011 to 2021? <sup>1</sup>
- Is the data collected on large issuers reflective of the industry? I am surprised this should even be a legitimate question considered by the Federal Reserve Governors in 2023. No. It is not. The largest issuers have an economy of scale advantage and significant leverage with network participants including processors and networks due to their processing volume. The large issuer costs that you are collecting are not representative of the industry so any singular cap in fact does impact exempt issuers and disadvantages small community financial institutions that impact millions of consumers. I would urge caution, discussion, and improved data collection.
- Does Regulation II cause harm to exempt issuers and open a door for future lawsuits? I suggest that it does. Could a group of exempt issuers sue the Federal Reserve Board because it has harmed this subset of issuers and has not lived up to the law [15 US § 1693o-2 - Reasonable fees and rules for payment card transactions states in section (a)(2), "The amount of any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction shall be reasonable and ***proportional to the cost incurred by the issuer*** with respect to the transaction."]
- The Federal Reserve Board should consider, now that it is more likely that exempt issuers are not covering the costs of their programs, how that more broadly will affect consumers in the future. I have no confidence in the Board to be able to predict or measure these unintended consequences. How will this impact card rewards programs and free checking accounts tied to those debit cards? I echo Governor Bowman's concerns that "the costs for consumers—through the form of increased costs for banking products and services—will be real, while the benefits to consumers—such as lower prices at merchants— may not be realized."
- The Federal Reserve Board should consider that while Dodd Frank was designed to target regulation for "the too big to fail" banks, this Federal Reserve Board has actually given them a competitive advantage with a singular cap – based on their more efficient processing costs. A credit union President from a \$240M credit union should not have to inform any Federal Reserve Board Governor of the Efficiency Ratio disparity based on asset size. And while those "too big to fail" conglomerates have gotten even bigger and even stronger, the number of financial institutions, who are the backbone of the strongest economy in the world, and represent the fabric of US communities, continues to decline. Smaller financial institutions (exempt issuers) including community banks and credit unions are being merged out of existence at a steady pace.

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<sup>1</sup> Board of Governors of the Federal Reserve System, "2021 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions," Federal Reserve, October 2023, <https://www.federalreserve.gov/paymentsystems/2021-Interchange-Fee.htm>.

- Card Processing since 2008 has greatly consolidated since Dodd Frank was enacted. Surviving card processors have become few and enormous, making it impossible for smaller financial institutions to negotiate the best terms. Monopolies are slowly being created.

### **Federal Reserve Bank Transparency – data collection**

Thank you to the Federal Reserve Board for just releasing data it has collected from 2021. By the time this two-year old data has been released, it is completely irrelevant to me. Would I professionally or personally use data more than two years old to make any decisions about the future? No. You should not either!

### **Recommendations for the accurate and timely collection of data central to this issue:**

I would prefer that all (covered and exempt issuers) card processors on a mandatory basis report quarterly data to the Federal Reserve Bank and require all financial institutions (covered and exempt) report uniform interchange data within their quarterly call reports so it can be quickly gathered, aggregated, made publicly available, and researched. That would speed up data collection so that Regulators would have data that is within the last three months. This would allow the industry to publicly study the data. A uniform interchange data requirement would allow the Federal Reserve Board to have the timely information it needs. **It would also show the need for tiered interchange caps versus a singular cap, tiered fraud adjustments, and greater protections for exempt issuers.**

### **The Cumulative Effect**

**“It is not clear that interchange fees have kept up for many smaller issuers, and I am concerned that even if the interchange fee cap does not directly apply, smaller issuers will continue to face ongoing fee pressure in operating debit card programs.” Governor Michelle Bowman <sup>2</sup>**

### **Conclusion**

The Federal Reserve Bank’s flawed and over-simplified interchange regulation implementation since the ill-conceived Durbin Amendment have resulted in a one size fits all model applied to a complicated vital payment system comprised of merchants, financial institutions, processors, networks, and consumers. In a zero-sum game, the interchange fee regulation has disproportionately rewarded big box merchants with lower card processing fees while penalizing the nations smallest card issuers, community financial institutions, while inadvertently protecting “too big to fail” card issuers by building in a competitive advantage. Research has proven that merchants have not passed their savings to consumers. But cumulative changes in the banking system could result in permanent changes passed to consumers in the form of increased cost of financial services and reduced rewards programs. The continued shrinking of community financial institutions will means less competition for consumers’ and small businesses’ financial banking needs and the greater likelihood of empty bank buildings, banking deserts, and a larger under-banked population. The “too big to fail” targeted by the Dodd Frank Act will just continue to thrive and get bigger and stronger, while community financial institutions are collateral damage and pay the price.

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<sup>2</sup> Governor Michelle Bowman, “Statement on Proposed Revisions to Regulation II’s Interchange Fee Cap by Governor Michelle W. Bowman,” Federal Reserve, October 25, 2023, <https://www.federalreserve.gov/newsevents/pressreleases/bowman-statement-20231025.htm>.

Nowhere in the law does it require the Federal Reserve Bank to establish a formulaic approach to changes in the Interchange Rate cap. It is troubling that this bad policy will be enacted now and repeated every two years. Because the Federal Reserve prides itself on using stale data to guide it in making important decisions, how many years will pass before it realizes the actual impacts of this decision?

Interchange income related to exempt, single-message transactions has fallen due to downward market pressures of the Federal Reserve Board interchange regulations, and you have failed to protect exempt issuers which is one of many signs of unintended consequences which will have further impact to consumers and small businesses. This will likely become a perfect example of failed government price controls.

You have imposed upon me less than what I am due under the law which was expected to ***“be reasonable and proportional to the cost incurred by the issuer with respect to the transaction.”*** You have failed me, and you turn your back on both small covered and exempt issuers. By setting the proposed changes to Regulation II in motion and reducing interchange every two years you will continue to put downward pressure on the entire banking industry including exempt issuers that were supposed to be held without harm under the law.

Sincerely,



Robert McFadden  
President & Chief Executive Officer  
Finger Lakes Federal Credit Union  
FRB Regulation II ~ Collateral Damage

\$240M assets under management  
10,000 Visa Reward debit cards  
4,300 Visa Rewards credit cards  
0 Confidence in your current direction