MERCHANTS PAYMENTS COALITION

Proposal and Comment Information

Title: Regulation II: Debit Card Interchange Fees and Routing , R-1818

Comment ID: FR-0000-0095-01-C580

Submitter Information

Organization Name: Merchants Payments Coalition

Organization Type: Organization

Submitted Date: 12/23/2024

December 23, 2024

The Honorable Jerome H. Powell
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Dear Chair Powell:

We write in response to correspondence that the American Bankers Association ("ABA") sent to you on December 12 reiterating the ABA's opposition to the Board's proposed revision to Regulation II ("Reg. II"). The ABA's December 12 correspondence is both procedurally irregular and substantively deficient, and we urge the Board to reject the ABA's request for further delay in the finalization of the Board's necessary and long-overdue Reg. II updates.

At the outset, we note that the ABA sent you this correspondence a full seven months after the close of the formal public comment period for Board's proposed Reg. II revision—a comment period that the ABA acknowledges was already extended for three additional months "after numerous requests from the industry."[1] While the ABA is not prohibited from sending letters after the comment period, there is little in the ABA's December correspondence that is new. The ABA's cover letter admits that it is being sent simply "to reiterate" the ABA's opposition. And the accompanying report the ABA transmitted, which highlights certain comments that were submitted during the formal comment period, provides no information that the Board has not already had in its possession since May (though, as discussed below, it does strategically omit important information).

While the ABA's seven-months-late correspondence does not offer any new illumination on the substance of the Board's proposal, it is perhaps revealing that the ABA sent this correspondence several weeks after the CEO of the ABA's largest member spoke at the ABA annual convention, told the ABA that it is "time to fight back" against bank regulators, and said about Reg. II "this one really pisses me off."[2] If the ABA's December correspondence was indeed prompted by this CEO's widely-reported call to fight back against industry regulators, it should prompt renewed focus on how the ABA's advocacy prioritizes the interests of its largest members over the

[1] ABA Report, "Regulation II Debit Card Proposal." Dec. 2024, at p. 3.
[2] ABA 2024 Annual Convention session, "The Road Ahead for America's Banks: JPMorgan Chase Chairman and CEO Jamie Dimon" Oct. 28, 2024.

interests of smaller ABA members who are exempted from Reg. II fee regulation and who under Reg. II have gained debit market share from their giant competitors.[3]

In addition to its problematic context and procedural posture, the substantive claims in the ABA's December correspondence should raise eyebrows. While the ABA's report and letter purport to summarize what other commenters said during the formal comment period, the ABA proves an unreliable narrator. For example, the ABA claims that "commenters reinforced that the proposed amendments to Reg. II threaten the economic viability of offering Bank On accounts for low- and moderate-income households"[4] and that "[e]very comment addressing Bank On was submitted in opposition to the Proposed Rule."[5] But the ABA's report ignores the comment submitted in support of the proposed rule by the consumer advocacy organization U.S. PIRG, which states as follows:

> We understand that some commenters have cautioned the Board against reductions to the regulated rate out of concern that such reductions would impact the Bank On Program which seeks to make bank accounts available to unbanked Americans. It is important to note in response that accounts through the Bank On Program are currently made available by hundreds of financial institutions across the country, most of which are not covered by Regulation II because their assets fall below the $10 billion covered issuer threshold. The Board's proposed update to Regulation II will not affect those financial institutions' operations or their ability to continue offering accounts through the Bank On Program. Additionally, with respect to Bank On accounts that are offered by the nation's largest financial institutions (those that are considered covered issuers under Regulation II), the Proposed Rule, even with our suggested modification, will enable those issuers to continue enjoying a highly profitable rate of return on their debit transaction costs. While giant financial institutions and their advocates frequently claim that any diminution of their revenue will force them to cut off services or raise other fees on consumers, the economics of interchange reform do not compel them to do so, and if they do so there are many smaller financial institutions that would be well-positioned to pick up that consumer business and serve those consumers profitably.[6]

U.S. PIRG's comment is both relevant and persuasive with respect to the ABA's Bank On analysis, and the fact that the ABA's report excludes the comment from its analysis calls into question both the accuracy and the utility of the report. We would urge the Board to rely on its own independent judgment in evaluating submitted comments, and not the ABA's characterization of those comments.

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[3] See Board of Governors of the Federal Reserve System report, "2021 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions," Oct. 2023, at p. 12 (noting that the total debit transaction volume market share for exempt issuers increased 3.5 percentage points from 2011 to 2021.)

[4] ABA Letter at p. 2.

[5] ABA Report at p. 13.

[6] Comment of Edmund Mierzwinski, Senior Director, U.S. Public Interest Research Group, May 10, 2024.at p. 2 (internal citations and formatting omitted).

The ABA's arguments with respect to Bank On, as well as its related contentions that reductions in debit interchange fees for covered issuers would reduce bank services for low- and moderate-income consumers, deserve additional scrutiny because they are based upon the myth that high interchange fees cause banks to offer more or cheaper services to those consumers. This simply is not the case. The findings of the joint study conducted by the European Commission's Directorates for Competition and Financial Services provide one example refuting the ABA's underlying assumption. In that study, the Commission found no evidence to support the card systems' arguments that the high fee levels associated with the interchange system benefit consumers. In particular, the Commission rejected arguments that lower interchange fees to merchants would result in higher fees to consumers, stating the following:

> There is no economic evidence for such a claim. Firstly, the inquiry's data suggests that in most cases card issuers would remain profitable with very low levels of interchange fees or even without any interchange fees at all. Secondly, the international card networks have failed to substantiate the argument that lower interchange fee[s] would have to be compensated with higher cardholder fees. The evidence gathered during the inquiry rather suggests that the pass-through of higher interchange fees to lower cardholder fees is small. Consumers already pay the cost of the interchange fee without knowing it. This cost is now hidden in the final retail price and is therefore non-transparent.[7]

Other economists have made similar findings. For example, Sumit Agarwal, Andrea Presbitero, Andre Silva, and Carlo Wix found that in fact banks collect higher interest and fee payments from people who use cards with higher swipe fee rates.[8] The opposite would be true if there was merit to the banking industry's claims. And University of Utah economist Hal Singer has examined and rebutted the myth put forth by the banking industry that "[w]henever there is a proposal to deal with an aspect of bank activity that seems unfair, or deceptive, bankers…will raise a fee, charge someone else more money, or take away some benefit."[9] Singer points out that "As banks have hit consumers with higher interest payments, late fees, overdraft fees, and more, they have also hit businesses with higher swipe fees. In other words, excessive and often unfair pricing by banks in one area hasn't slowed excessive and often unfair pricing in other areas. Instead, all of these revenues have increased alongside each other for years."[10] Singer warns that it is important "to stay vigilant against the idea that any firm in the economy is automatically entitled to the same profits that it could achieve using anticompetitive or deceptive measures," as that idea "is a license for everyone to keep getting ripped off."[11]

[7] European Commission, Directorates on Competition and Financial Services, "Competition: Final report on retail banking inquiry – frequently asked questions," Jan. 31, 2007.
[8] Sumit Agarwal, Andrea Presbitero, Andre Silva, and Carlo Wix, "Who Pays For Your Rewards? Redistribution in the Credit Card Market," Federal Reserve Board, Finance and Economics Discussion Series, Dec. 2022, at 11, 16-17.
[9] Hal Singer, "The Lie Banks Use To Protect Their Late-Fee Profits," The Lever, March 20, 2024.
[10] Id.
[11] Id.

The ABA appears to base much of its position on the underlying view that accepting money from consumers in the form of deposits is a something of a charitable exercise. It is not. Banks try to attract deposits. Doing that is central to their business and provides funds that they can use to lend and generate revenue. It is clear that this business strategy is profitable, as money center and regional banks maintain net profit margins of around 30 percent, exceeding the margins of any other industry sector in the nation.[12] Debit cards are simply a device to provide accountholders access to their own deposited money. Banks must provide such access if they expect to attract any deposits at all, and debit cards allow banks to give that access at a lower cost to banks than the methods that preceded debit cards, such as checks or tellers.[13] That is just one of the reasons why many debit systems around the world function efficiently with minimal interchange fees or no interchange fees at all. Accepting deposits and maintaining accounts is a profit-making activity for banks and they do not need interchange revenue for allowing consumers access to their deposits in order for it to be so.

The Federal Reserve should see through the ABA's myths, just as European regulators saw the falsity of similar arguments made to them. Higher debit fees do not lead to better or increased bank services for low- and moderate-income consumers and lower debit fees do not lead to reduced bank services for low- and moderate-income consumers. There is not credible evidence of causation between those factors, no matter how much effort the ABA expends to try to make people believe the opposite.

We also note that the ABA letter seeks to recycle several of its own flawed arguments by relaying that commenters (many of whom were ABA members) cited those arguments in their comments. Such repetition does not cure the ABA's defective reasoning. For example, the ABA letter claims that Reg. II's asset-based exemption "has proven ineffective," even though the Board itself confirmed in its notice of proposed rulemaking that "data collected by the Board demonstrate that average per-transaction interchange fees for exempt issuers across all payment card networks did not decline after the current interchange fee cap was introduced in 2011 and have not declined since then."[14] The ABA also maligns the Board's proposal as having an "ill-conceived methodology that fails to account for allowable costs," even though the Board's proposal covers not only the costs allowed by the statute but also other costs that are not mentioned in the statute but that the Board exercised discretion to include. The ABA further claims that the Board's proposal fails to "maximize cost recovery for covered issuers" even though neither the statute nor Reg. II provide such a mandate, and indeed such a concept directly contradicts the language of the statute.

The ABA also renews its hypocritical claim that more data must be gathered about the Board's card-not-present routing clarification before Reg. II can be updated. As one of our members, FMI: The Food Industry Association, noted in its comment letter, "The Board should not be swayed by arguments that it cannot act because of the October 2022 card-not-present routing clarification to Regulation II, as this clarification was made necessary by covered issuers' circumvention of the Durbin Amendment's text and intent. These covered issuers should not be

[12] See New York University, "Margins by Sector (US)," at Net Margins).
[13] Doug Kantor, "The Backward Reasoning Behind Debit Card Fees," DC Journal, Oct. 4, 2024.
[14] 88 Fed. Reg. 78116.

rewarded for that misbehavior by being allowed to continue receiving interchange fees that the data clearly show are unreasonable and not proportional to cost."[15]

Further, we reject the ABA's contention that those who submitted comments in support of the Board's proposal "raised fundamental issues" which "demonstrate[s] that the proposal is fundamentally and critically flawed." Comments that suggest modifications to a regulatory proposal are not proof that the proposal is critically flawed. The point of the notice-and-comment rulemaking process is for commentors to have the opportunity to suggest such modifications and for the agency to consider and weigh those suggestions.

Ultimately, the ABA's correspondence requests that the Board "review this report" and "take the time to understand" the ABA's position. But these requests should be viewed for what they are: a transparent effort by the banking industry to further delay revisions that are necessary to bring Reg. II into compliance with the governing statutory standard. The banking industry wants to extend, for as long as possible, the status quo in which covered debit card issuers are able to have Visa and Mastercard fix interchange rates on their behalf at lucrative levels that exceed the reasonable and proportional standard Congress established. Each day of delay means another day of excessively high fees that accrue to the ABA's larger members and that are borne by Main Street merchants and their customers. It is long past time for the Board to take action to rein in these inflationary fees by updating Reg. II.

We urge the Board to finalize its proposed revisions to Reg. II without further delay. Thank you for your consideration.

Sincerely,

Merchants Payments Coalition

[15] Comment of FMI: The Food Industry Association, May 10, 2024, at p. 32.