February 14, 2024

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

BY ELECTRONIC MAIL

Re: NPRM on Debit Card Interchange Fees and Routing (Regulation II), Docket No. R-1818

Dear Ms. Misback:

On behalf of the American Bankers Association and the undersigned state bankers associations, we write in strong opposition to the Federal Reserve's misguided proposal to reduce the regulated interchange cap under Regulation II, and to ask that the proposal be withdrawn pending a rigorous study of this proposal's impacts and the cumulative impacts of the tsunami of newly finalized and pending regulations from the banking agencies.

The 90-day comment period extension was welcome, but it does not change the fact that this proposal is built on a misapplication of the law and a false policy premise that the ubiquitous, frictionless, secure payments system that drives so much economic activity and customer value should somehow be costless. That is not what Congress intended when the Durbin amendment was enacted in 2011, nor is it where the Federal Reserve landed in its final implementing regulation, but that is the message this proposal sends. The consequences for banks and their customers of an immediate 30% cut in debit interchange will be tangible, and potentially severe. Regulation II is a hard cost, and its regressive formula puts the greatest strain on the smallest financial institutions, which will lead to further industry consolidation. This proposal will also have a direct impact on customers, undermining well-organized and highly effective financial inclusion efforts, and increasing the cost of checking and other basic banking services. These impacts are predictable and avoidable.

This proposal – in fact, any change to the existing regulation – is not required by Dodd Frank, despite some claims to the contrary. It is a policy decision like any other that must be justified based on statutory authority and the strictures of the regulatory process. The proposal is based on a flawed and incomplete 2021 data set, which reflects anomalous pandemic-related payment behavior and does not factor in the 2023 changes to debit routing, that is fed into a new, unproven methodology for calculating the cap that the Fed understands and acknowledges will mean hundreds of mid-size and smaller banks will not even be able to cover their debit card transaction costs. What's more, the proposal not only includes an automatic, biennial adjustment of the cap that locks in these same data and methodological flaws, but mystifyingly and inappropriately excludes these adjustments from notice and comment.

It is critical for the Federal Reserve to understand that Regulation II impacts every financial institution, even those under $10 billion in assets. In a global, two-sided market, as government regulation caps the price for the largest players, the price offered to those outside the cap is naturally dragged down. The numbers bear this out clearly. From 2011-2022, per transaction debit interchange for so-called “exempt” financial institutions fell 35%. In combination with the newly finalized routing rules that apply to every bank regardless of size, we expect to see a similar further reduction in interchange revenue for “exempt” community financial institutions due to this latest proposal. Good intentions and citations to the asset threshold will not change this fact, and further erosion of this foundational, business-to-business fee that supports core bank functions will further stress the community banking model.

Not only will this proposal constrain – on an ongoing and potentially ever-reducing basis – the revenue used to facilitate payments, secure these systems, and account for fraud, but importantly it will also deplete revenue that banks rely on to provide low- and no-cost basic banking services consistent with their values and mission as community leaders. Customers who struggle to meet minimum balance requirements or pay monthly maintenance fees on their deposit accounts are likely to feel the squeeze from this rulemaking as the direct cut in interchange revenue is offset, at least in part, by raising those requirements.

We have made significant strides in bringing unbanked households into the banking system, in part by encouraging our member banks to offer Bank On-certified accounts, which are structured to address these common barriers to bank access. In the past three years, the number of financial institutions offering these accounts has increased 100-fold, with almost 450 accounts now available nationwide. But interchange revenue plays an outsized role in making Bank On-certified accounts sustainable.

In its recent comment letter, the CFE Fund (the nonprofit organization that created and maintains Bank On standards) explains that the Bank On National Account Standards balance the needs of consumers as well as the economics of financial institutions offering low-cost accounts, observing that interchange revenue is a “relevant component of that market sustainability.” We believe the changes proposed in Reg II will jeopardize this progress and urge the Federal Reserve to collect and analyze relevant data as a precondition to proposing changes to its formula.

We remain gravely concerned that the Federal Reserve is moving forward – in response to intense pressure from the very largest retailers and an expansive misinterpretation of the statute – with an unnecessary and poorly considered rule that will have far reaching impacts. A dramatic regulatory change with clear implications for small institution competitiveness and financial inclusion following a dozen years under a carefully crafted rule begs the question, “why now?” and certainly warrants the additional time the Federal Reserve has granted stakeholders.

The extension of the comment period to May 12 only underscores the disconnect between the Federal Reserve’s timeline and the realities of policymaking on interchange. By early May, survey data from 2023 will be available to the Federal Reserve (still without a strong sample incorporating the new routing rule that took effect July 1, 2023), but this rulemaking will still be based on 2021 data. And within a few weeks of the comment period close, the U.S. Supreme Court will decide whether to allow merchants' legal challenge to the 2011 rule, further jeopardizing the legal and methodological basis of the current proposal.

Ultimately, we believe the only way forward that is consistent with the Federal Reserve's statutory obligations and prudent regulatory conduct is to withdraw the rule to allow for the data and the courts to catch up and to address the proposals' other deep-seated flaws, including its contribution to the cumulative impact of regulation on customers and the community banking model.

Sincerely,

American Bankers Association
Alabama Bankers Association
Alaska Bankers Association
Arizona Bankers Association
Arkansas Bankers Association
California Bankers Association
Colorado Bankers Association
Connecticut Bankers Association
DC Bankers Association
Delaware Bankers Association
Florida Bankers Association
Georgia Bankers Association
Hawaii Bankers Association
Idaho Bankers Association
Illinois Bankers Association
Indiana Bankers Association
Iowa Bankers Association
Kansas Bankers Association
Kentucky Bankers Association
Louisiana Bankers Association
Maine Bankers Association
Maryland Bankers Association
Massachusetts Bankers Association
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Minnesota Bankers Association
Mississippi Bankers Association
Missouri Bankers Association
Montana Bankers Association
Nebraska Bankers Association
Nevada Bankers Association
New Hampshire Bankers Association
New Jersey Bankers Association
New Mexico Bankers Association
New York Bankers Association
North Carolina Bankers Association
North Dakota Bankers Association
Ohio Bankers League
Oklahoma Bankers Association
Oregon Bankers Association
Pennsylvania Bankers Association
Puerto Rico Bankers Association
Rhode Island Bankers Association
South Carolina Bankers Association
South Dakota Bankers Association
Tennessee Bankers Association
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Utah Bankers Association
Vermont Bankers Association
Virginia Bankers Association
Washington Bankers Association
West Virginia Bankers Association
Wisconsin Bankers Association
Wyoming Bankers Association