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May 1, 2024

Ms. Ann E. Misback
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
regs.comments@federalreserve.gov

Re: Notice of Proposed Rulemaking: Debit Card Interchange Fees and Routing (Docket No. R-1818, RIN 7100-AG67; Publication Dates: 11/14/2023 and 1/29/2024)

Dear Ms. Misback:

The North Carolina Bankers Association (NCBA), the trade association for the banks operating in North Carolina and their approximately 100,000 employees, appreciates the opportunity to provide comments to the Federal Reserve. We have reviewed the proposal to update the three components of Regulation II's interchange fee cap, update the interchange fee cap every other year going forward, and implement technical revisions to the regulation. For the reasons stated below, we urge the Federal Reserve to withdraw the proposal.

Proposed Fee Caps

In 2011-2012, the Federal Reserve issued Regulation II, capping debit interchange to the sum of:

- 21 cents (the "base component");
- 5.0 basis points (multiplied by the value of the transaction; the "ad valorem component"); and
- 1.0 cent for issuers that meet certain fraud-prevention standards (the "fraud-prevention adjustment").

The Federal Reserve now proposes to adjust the price caps to:

- 14.4 cents for the base component;
- 4.0 basis points for the ad valorem component; and
- 1.3 cents for the fraud-prevention adjustment.

The Federal Reserve also proposes to automatically update the price cap every other year going forward based on data it collects from the banking industry and a formula the Federal Reserve has developed.

The Proposed Caps are Based on a Flawed Data Set

The Reg II proposal, which would sharply reduce the regulated debit interchange fee by 30%, is based on a data set from the year 2021 when the economy was dealing with the massive upheaval caused by the COVID pandemic. The data also does not factor in the changes to debit routing made by the Federal Reserve in 2023. Unfortunately, the proposal compounds these issues by using a new method for calculating the cap. The proposal impacts low-volume, covered banks the hardest because they have the highest operating costs. Some of these banks will likely not be able to cover the costs of their debit card transactions. Finally, the proposal includes an automatic, biennial adjustment of the cap without the notice and comment process that would otherwise help to reduce unintended consequences.

Changes to Regulation II Impact All Financial Institutions

Although the regulation is focused on debit card issuers with consolidated assets of $10 billion or more, it will have broader impacts. When government regulation caps the price for the largest financial institutions, market forces will also push downward the pricing at smaller financial institutions. We note an estimate from the American Bankers Association that between the years 2011 to 2022 per transaction debit interchange for "exempt" financial institutions fell 35%. And we also note that the Consumer Bankers Association has cited to separate Federal Reserve research which showed, after the Durbin Amendment, smaller issuers' interchange fees fell by at least 31% in inflation-adjusted dollars from 2011 to 2021. Erosion of the business-to-business fee that supports core bank functions will further stress the community bank model. The proposal will lead to more bank consolidation to reach economies of scale, as banks about to cross $10 billion in assets will otherwise face millions of dollars in revenue reductions.

Harm to Financial Inclusion Efforts

The proposal will make checking accounts more expensive and undo success in bringing banking services to households that were previously "unbanked." Many banks will have to increase consumer fees for checking accounts. The Government Accountability Office ("GAO") concluded in February 2022 that "debit card interchange fee regulations increased the cost of checking accounts." As the GAO noted, Federal Reserve economists in 2017 reviewed the impact of the Durbin Amendment and found that it resulted in banks "decreasing the availability of free accounts, raising monthly fees, and increasing minimum balance requirements." Federal Reserve researchers found that two-thirds of non-interest checking accounts offered by impacted banks would have otherwise been free. Furthermore, researchers found that even "exempt" banks also were forced to raise prices due to market forces putting downward pressure on their ability to generate income and recoup costs from interchange, reducing the availability of free checking accounts by over 15%.

A growing number of banks have been offering low-fee, Bank On-certified accounts. In recent years, the number of financial institutions offering these accounts has increased 100-fold. Interchange revenue helps to make Bank On-certified accounts sustainable. The Federal Reserve has not conducted sufficient analysis of how the Reg II proposed changes would impact Bank On-certified and other low-cost accounts that bring low- and moderate-income (LMI) consumers into the banking system.

No Net Benefit for Consumers

The clear beneficiaries of the changes under consideration are large merchants. There is no evidence of consumer benefits. Retailers once promised to pass on their own savings from the Durbin Amendment to consumers in the form of lower prices, but we are aware of no credible data whatsoever to show that this has occurred. The primary study that retailers reference about "savings" contains no actual debit transaction data. Instead, the author assumed a savings-pass-through-rate from transactions that occurred before the passage of the Durbin Amendment and involving a limited set of retailers and promotions.

The Federal Reserve Bank of Richmond surveyed merchants after the Durbin Amendment was enacted and only 1.2% of merchants reported reducing prices. In contrast, 21.6% of merchants reported having increased prices on their consumers.

Withdrawal of the Proposal

The Reg II proposal will severely reduce the revenue used to facilitate payments, secure payments systems and address fraud. It will also remove revenue that banks rely on to provide low- and no-cost banking services. Customers who struggle to meet minimum balance requirements or pay monthly maintenance fees on their deposit accounts will feel the impact from this rulemaking as the direct cut in interchange revenue is offset, in part, by raising those requirements. Smaller issuers, including those that are "exempt," will disproportionately feel the impact.

The interests of card-issuing banks and deposit account customers should be taken into consideration. Interchange fees are one way that banks are compensated for the value they are providing to the other side of the market, the merchants who accept cards.

We urge the Federal Reserve to withdraw the proposal, reevaluate its data to identify weaknesses in the data set, and consider the impacts on the full array of stakeholders.

Thank you for considering these comments. Please do not hesitate to contact us if you have any questions.

Sincerely,

Peter K. Gwaltney
President & CEO

Nathan R. Batts
SVP, Counsel & Director of Government Relations