May 10, 2024

Via Electronic Delivery

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

Re: Docket No. R-1818, RIN 7100-AG67; Debit Card Interchange Fees and Routing

Dear Ms. Misback:

The Clearing House Association L.L.C.,[1] the Bank Policy Institute, the American Bankers Association, the Independent Community Bankers of America, America's Credit Unions, the Electronic Payments Coalition, the Mid-Size Bank Coalition of America, the National Bankers Association, and the Consumer Bankers Association respectfully submit this comment letter to the Board of Governors of the Federal Reserve System in response to the notice of proposed rulemaking regarding modifications to Regulation II and the Official Board Commentary on Regulation II related to debit card interchange fees.[2]

Representing the majority of debit card issuers, the Associations urge the Board to withdraw its proposed rule. The proposed rule would further lower the existing deficient price cap on debit card interchange fees and thereby amplify the damage already done by Regulation II as promulgated in 2011, including by driving up costs to consumers for basic deposit accounts (disproportionately harming low-income and underserved consumers) and degrading the ability of banks and credit unions (including smaller, exempt issuers) to serve their communities and to invest in payment system innovation.

We are concerned that the proposal is legally defective, is unauthorized by the Durbin Amendment, creates serious constitutional issues, and is unsupported by reasoned decisionmaking. It is not designed to ensure issuers receive a rate of return, would deny an even greater percentage of issuers the ability to recover their costs than the current rule's flawed cap, and arbitrarily omits many

[1] A description of each Association is provided in Appendix 1 of this letter.

[2] Debit Card Interchange Fees and Routing, 88 Fed. Reg. 78100 (Nov. 14, 2023).

readily-quantifiable and statutorily-permissible issuer costs the Board should consider in calculating its cost-based price cap.

Thus, for both legal and policy reasons, as described in greater detail herein, the Board should withdraw the proposal.

EXECUTIVE SUMMARY

1. Consumers, Particularly Low-Income and Minority Consumers, Will Be Harmed by the Proposal

The Durbin Amendment requires the Board to establish standards for assessing whether the amount of any interchange transaction fee [received or charged by a debit card issuer] is reasonable and proportional to the cost incurred by the issuer with respect to the transaction."[3] The Board adopted Regulation II in 2011 giving effect to this requirement by establishing a cap on interchange fees consisting of a base component and an *ad valorem* component,[4] and an interim final rule to allow for a fraud-prevention adjustment.[5] Regulation II limits permissible interchange fees to a base component of no more than 21 cents. The Board now proposes to amend Regulation II to substantially reduce the current interchange fee cap, including by adopting an entirely new methodology for determining the base component of the cap. Under the proposal, the base component of the cap would be reduced 31.4 percent, from 21 cents per transaction to 14.4 cents, the *ad valorem* issuer fraud loss component would decrease from 5.0 basis points to 4.0 basis points, and the fraud prevention adjustment would increase from 1 cent to 1.3 cents. Altogether, maximum permissible interchange recovery on a typical fifty dollar transaction would be reduced by 27.7 percent, assuming the issuer were eligible to receive a fraud-prevention adjustment.

Under Section 904 of The Electronic Fund Transfer Act, the Board is required to "prepare an analysis of economic impact which considers the costs and benefits to financial institutions, consumers, and other users of electronic fund transfers . . . and the effects upon competition in the provision of electronic banking services among large and small financial institutions and the availability of such services to different classes of consumers, particularly low income consumers."[6] This requirement must inform all aspects of the Board's proposal, including the qualitative decisions underlying the proposed reduced cap, such as the costs the Board legally should, but does not, consider; the metrics it uses to analyze industry costs (for example, considering costs on an issuer basis versus a transaction-weighted average basis); and the methodology it uses to establish an interchange fee cap.

The proposed rule fails to adequately engage in this statutorily-required analysis and runs counter to the longstanding public policy goals of the federal government and financial institutions to reduce the numbers of unbanked and underbanked consumers through the delivery of safe and affordable deposit accounts. Instead, the proposal states in cursory fashion that it is unable to determine whether any potential benefits to consumers are outweighed by the potential harms to consumers. We disagree.

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[3] 15 U.S.C. § 1693o-2(a)(3)(A).

[4] Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43394 (July 20, 2011) (12 C.F.R. pt. 235).

[5] Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43478 (July 20, 2011) (12 C.F.R. pt. 235).

[6] 15 U.S.C. § 1693b(a)(2).

Debit card networks are frequently cited as a classic example of a two-sided market, where payments to support the network from one side (i.e., merchants) encourage participation from the other side (i.e., consumers).[7] The effects of the original 2011 rule capping merchant interchange are well understood and have been subject to twelve years of econometric and academic analysis, a collection of which is cited in Appendix 2 to this letter.[8] This work has empirically demonstrated that the Durbin Amendment and Regulation II as adopted in 2011 have resulted in significant and widespread increases in the costs of basic deposit accounts to consumers.[9] As a consequence, some consumers have been priced out of the market for traditional bank accounts and have been forced to turn to riskier banking replacements, such as check-cashing and payday-lending products, which have more opaque pricing and are ultimately more expensive for consumers.[10]

In the 2017 FDIC Survey of Unbanked and Underbanked Households, nearly 30 percent of respondents who previously had access to a bank account reported that they became unbanked because of account fees. As of 2019, growth in the population of recently unbanked consumers (i.e., consumers who previously had access to deposit accounts but have closed those accounts within the last year) was at its peak in states with the highest number of financial institutions subject to the interchange fee cap, where the increase in deposit account fees was the most pronounced.[11]

Further decreasing issuers' interchange recovery from merchants by more than 30 percent will only exacerbate the real harm that consumers, especially LMI consumers, have experienced since the imposition of the interchange fee cap and will undermine the policy goal of promoting financial inclusion. Specifically, the proposal will likely result in bank account products and services that are more expensive and less attractive to LMI consumers, driving more of them out of the regulated banking industry. Even products specifically designed to be safe and affordable to LMI consumers, like the popular "Bank On" account products, will likely be affected by this proposal, as recognized by the Cities for Financial Empowerment Fund, the organization that establishes the Bank On standards.

If the proposal is finalized as proposed, it is estimated consumers would pay an extra $1.3-$2

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[7] *See, for example,* Jean-Charles Rochet and Jean Tirole, *Two-Sided Markets: A Progress Report*, 37 RAND J. of Econ. 645 (2006) (". . . payment card systems need to attract both merchants and cardholders."). https://edisciplinas.usp.br/pluginfile.php/7585351/mod_resource/content/1/Tirole.pdf.

[8] Appendix 2, "Survey of Studies Examining the Impact of the Durbin Amendment and Regulation II's Interchange Fee Cap."

[9] Mark D. Manuszak and Krzysztof Wozniak, *The Impact of Price Controls in Two-sided Markets: Evidence from US Debit Card Interchange Fee Regulation*, Finance and Economics Discussion Series 2017-074, Washington: Board of Governors of the Federal Reserve System (2017), at 5-6, https://doi.org/10.17016/FEDS.2017.074. *See also*, Hubbard, B., *The Durbin Amendment, Two-Sided Markets, and Wealth Transfers: An Examination of Unintended Consequences Three Years Later* (2013), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2285105.

[10] Natasha Sarin, *Making Consumer Finance Work*, 119 Colum. L. Rev. 1519, 1537 (2019), https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=3049&context=faculty_scholarship. *See also*, Lux, M. and Greene, R., *Regressive Trends in Credit Card Access*, (2016), page 20 https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/files/Out_of_Reach_Lux_Greene_4_7.pdf.

[11] Vladimir Mukharlyamov and Natasha Sarin, *The Impact of the Durbin Amendment on Banks, Merchants, and Consumers*, 2046 All Faculty Scholarship 1, 36 (2019), https://scholarship.law.upenn.edu/faculty_scholarship/2046.

billion annually in higher account fees.[12] Nor is it likely that this harm would be offset by lower retail prices. There is no evidence that merchants passed on cost savings from capped interchange fees to consumers after the 2011 rule was promulgated, and thus, it is unlikely that merchants would pass on any additional savings realized if the proposal is finalized. The Board should recognize the likely harm to consumers and the negative public policy consequences of the proposed rule and withdraw this proposal. This topic is discussed in greater detail in section II.A. of our letter.

2. <u>The Proposal Will Harm Financial Institutions and the Security of Payment Systems</u>

The Board also fails to appropriately consider the likely impact of the proposed rule on financial institutions and on the safety and security of debit card payment systems at a time when harmful actors and risks abound for financial institutions offering this vital payment product.

Depository institutions of all sizes support the debit card payment systems that are the most popular channel for consumers to make payments for the goods and services they purchase every day.[13] In addition to reducing a critical source of funding for <u>covered</u> financial institutions, the proposed rule similarly fails to consider the extensive evidence of its likely effect on <u>exempt</u> issuers, those with less than $10 billion in assets. For example, between 2011 and 2021, debit card interchange revenue for exempt debit card issuers fell 13 percent in connection with single-message network transactions.[14] Indeed, Board data show that single message network interchange fees for exempt issuers are nearly the same as covered issuers (27 cents versus 24 cents per transaction), while exempt issuer dual-message average interchange has been substantially higher (64 cents).[15] The proposed rule's further reduction in interchange fees, along with the effects of the 2022 dual-routing rule for card-not-present transactions, which is expected to significantly reduce total dual-message network revenue for exempt issuers, likely would lead to further declines in interchange revenue for both covered and exempt issuers.[16]

Naturally, the reduced interchange fees for exempt issuers led to a 15.5 percent decrease in the availability of free checking accounts at those issuers after Regulation II was implemented, nearly half the effect felt by covered issuers.[17] Board economists have confirmed these effects, and cautioned that failing to account for the price adjustments on checking accounts made by exempt issuers "underestimates the policy's impact on the market, for both banks subject to the cap and those exempt

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[12] Nick Bourke, *How Proposed Interchange Fee Caps Will Affect Consumer Costs* (Jan. 2024), https://ssrn.com/abstract=4705853, building on the work of Vladimir Mukharlyamov and Natasha Sarin, *Price Regulation in Two-Sided Markets: Empirical Evidence from Debit Cards* (Nov. 2022), https://scholarship.law.upenn.edu/faculty_scholarship/2885/.

[13] Board of Governors of the Federal Reserve System, *Federal Reserve Payments Study: 2022 Triennial Initial Data Release*, https://www.federalreserve.gov/paymentsystems/fr-payments-study.htm (last updated July 27, 2023).

[14] Board of Governors of the Federal Reserve System, *Average Debit Card Interchange Fee by Payment Card Network*, https://www.federalreserve.gov/paymentsystems/regii-average-interchange-fee.htm (last updated Oct. 25, 2023).

[15] *Id*.

[16] Debit Card Interchange Fees and Routing, 87 Fed. Reg. 61217 (Oct. 11, 2022).

[17] Manuszak and Wozniak, *supra* note 9, noting that 35.2% of covered issuers reduced the availability of free deposit accounts.

from it."[18] Further decreases in the availability of low- and no-cost deposit accounts at exempt issuers will further amplify harms to consumers and make it harder for exempt issuers to serve their customers, including those served by low-income designated credit unions,[19] which compose approximately half of all federally-insured credit unions, and community banks in rural and historically underserved areas.[20]

As card issuers for consumers, depositories rely on interchange revenue to support their investments to improve the security and fraud-prevention innovations of the debit networks. Fraud incidence has more than tripled from 2011 to 2021, and issuer fraud losses have also increased. As fraud schemes continue to grow in frequency and sophistication, issuers should be encouraged to innovate, increase investment, and devote substantial resources in fraud detection and prevention. Removing or reducing interchange revenue, particularly to levels below even reasonable cost recovery, will disincentivize the investments in innovations which are vital to protecting consumers and merchants alike. This topic is discussed further in sections II.B-D of this letter.

3. <u>The Proposed Rule Violates the Durbin Amendment and Creates Serious Constitutional Issues</u>

The proposed rule would not only harm consumers, particularly LMI and underserved consumers, financial institutions, and payment systems, but the proposal is legally deficient in multiple respects. The text of the Durbin Amendment requires interchange fees to be "reasonable and proportional" to a covered issuer's costs – not merely "equal to" and certainly not "less than" those costs. Any contrary interpretation of the Durbin Amendment would not only violate the statute on its face, but would raise serious concerns as to its constitutionality, as it likely would be considered confiscatory, and thereby violative of the Takings Clause. Courts have repeatedly held that price-control regulations that fail to allow a reasonable return are unconstitutional.[21]

The proposal not only would deny cost recovery to 34 percent of covered issuers, but, like the existing rule, the proposal is not designed to allow for a reasonable return for any issuer.[22] The proposal fails to provide for sufficient cost recovery for at least two statutorily impermissible reasons. First, as the Associations have previously advised the Board in connection with the existing rule, the proposed rule fails to consider the totality of issuer costs necessary to effectuate debit card transactions by excluding significant and statutorily-permissible issuer costs the Board should consider when calculating the cap. Second, the proposal would use a new methodology to calculate the cap, which would overweight the costs of the highest-volume issuers, that, because of scale, have the lowest costs, and

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[18] *Id*.

[19] Fifty-four percent of all federally insured credit unions possessed a low-income designation at the end of 2023. National Credit Union Administration, Quarterly Credit Union Data Summary 2023 Q4, https://ncua.gov/files/publications/analysis/quarterly-data-summary-2023-Q4.pdf.

[20] *See,* National Credit Union Administration, Low Income Designation, https://ncua.gov/support-services/credit-union-resources-expansion/field-membership-expansion/low-income-designation. *See also*, Consumer Financial Protection Bureau, *Rural and Underserved Counties*, https://www.consumerfinance.gov/compliance/compliance-resources/mortgage-resources/rural-and-underserved-counties-list/.

[21] *See, e.g.*, *Michigan Bell Tel. Co.* v. *Engler*, 257 F.3d 587, 595-96 (6th Cir. 2001); *Guaranty Nat'l Ins. Co.* v. *Gates*, 916 F.2d 508, 515 (9th Cir. 1990); *Calfarm Ins. Co.* v. *Deukmejian*, 771 P.2d 1247, 1255-56 (Cal. 1989); *Aetna Cas. & Sur. Co.* v. *Commissioner*, 263 N.E.2d 698, 703 (Mass. 1970).

[22] 88 Fed. Reg. 78100, 78113 (noting that only 66 percent of covered issuers would have fully recovered their base component costs in 2021 had the relevant base component been in effect in 2021).

thereby essentially ignores the cost experience of a substantial majority of covered issuers. We discuss these deficiencies in greater detail herein.

Additional Issuer Costs Should Be Included in the Cap

The Board currently surveys issuers on two important costs which it has excluded from the calculation of the cap in the proposal: costs related to cardholder inquiries from debit card transactions and the costs of handling non-sufficient funds matters related to debit card transactions. The Board has previously acknowledged it could legally include these when calculating the cap and has been reliably collecting this cost data from issuers since 2011. These categories represent significant, ongoing, and inescapable costs to issuers from effectuating debit transactions, with the costs of cardholder inquires alone being nearly as large as the current authorization, clearing, and settlement costs (3 cents versus 3.9 cents under the proposal's transaction-weighted average metric).[23] At the same time, the Board has shown that it can collect data on these cost categories in a consistent, manageable way, thereby allowing them to be reliably considered by the Board in setting any cap. Excluding them is inconsistent with issuers' right to recover interchange fees that are "reasonable and proportional to their costs" – not equal to or less than – and a reasonable return. Having failed to provide a reasoned explanation for excluding these costs, their continued exclusion is necessarily arbitrary and capricious.

In addition, there are other categories of costs, such as non-sufficient funds losses and compliance costs related to debit transactions, which the Board does not currently include in its issuer survey. These are material issuer costs that are "incurred in the course of effecting" debit card transactions, which should be included when calculating the cap and which should be included in future surveys. Through a supplemental survey of our members, the Associations believe non-sufficient funds losses and transaction-related compliance costs are each nearly a quarter as large as the current authorization, clearing, and settlement costs (1 cent each versus 3.9 under the proposal's transaction-weighted average metric). This cost data also can be reliably provided to the Board by issuers and are readily quantifiable, particularly the costs of non-sufficient funds losses. This topic is discussed further in section III of this letter.

The Proposed Methodology to Set the Cap Ignores the Costs of the Majority of Issuers

The existing rule was based on the Board's prior determination that the statute required the Board to set a cap that was reasonable and proportional "to the overall cost experience of the substantial majority of covered issuers," given the statute's reference to costs that are reasonable and proportional to an issuer's costs.[24] In practice, it did this by surveying the average transaction cost of each covered issuer and setting the cap at a level designed to allow 80 percent of issuers to recover their average transaction costs. While the existing rule has flaws that the Associations have highlighted previously, the current rule was at least based on consideration of the cost experience of all issuers, as contemplated by the statute.

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[23] Board of Governors of the Federal Reserve System, *Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions, data tables* (revised as of April 3, 2023), at sheet 14, https://www.federalreserve.gov/paymentsystems/files/regiireportsdata.xls (noting "Cardholder inquiry costs exclude fraud-related cardholder inquiry costs, which are counted as part of fraud-prevention costs."); 88 Fed. Reg. 78100, 78105.

[24] 76 Fed. Reg. 43394, 43433.

The proposal abandons the existing issuer-focused methodology in favor of a transaction-weighted average methodology to calculate the base component of the cap. In doing so, the proposal no longer considers the cost experience of a "substantial majority of issuers" and instead focuses on the costs of all transactions, viewed in the aggregate. In practice, this methodology grossly over-weights the cost experience of the largest debit card issuers, which constitute only one third of all issuers, but effectuate 94.3 percent of all transactions. In contrast, the cost experience of the remaining two-thirds, or 110, mid- and low-volume issuers are weighted in the aggregate at less than 6 percent – effectively disregarding their cost experience, contrary to the statutory text.

The Board asserts that the proposal is reasonable because it would cover a significant majority of "transactions."[25] The Board therefore arbitrarily proposes to depart from the statutory text and the Board's prior determination that the statute requires it to focus on the cost experience of covered issuers. Moreover, the proposal does not provide a sufficient explanation for why the Board proposes to abandon the existing methodology. The proposal states that the Board originally set the cap to target issuer cost recovery at the 80th percentile because that was the point above which reported cost data for covered issuers showed a "clear discontinuity" from one covered issuer to the next, but that the proposed change in methodology and reduction of the cap is justified because in subsequent survey years, the data has contained either "no clear discontinuity" or "multiple apparent discontinuities."[26] That is a description, not a rationale. The assertion does not explain or justify why the Board would abandon a methodology designed to consider the costs of all issuers in favor of a methodology that essentially ignores the cost experience of 2/3 of issuers in the marketplace. Nor does the Board provide any data or evidence to allow the public to confirm its description of the change it cites in abandoning the existing methodology. The APA requires the Board to disclose the "most critical factual material" on which it relied and provide "further opportunity to comment."[27] The Board, however, chose not to do so. In this regard, it is notable that the proposal largely mirrors the methodology championed by merchant trade associations in their petition for rulemaking submitted to the Board in 2022.[28] This topic is discussed in greater detail in section IV of our letter.

4. <u>The Board's Choice of the 98.5 Percent Cost Recovery Target is not Based on Reasoned Decision Making</u>

The Board proposes to use a transaction-weighted average methodology <u>combined</u> with a cost recovery target of 98.5 percent of covered transactions in setting the base component of the cap. To calculate the base component of the cap, the proposal uses the transaction-weighted average costs that would allow for 98.5 percent of transactions to achieve cost recovery. Although the 2011 rule did not target a particular transaction-based cost recovery percentile, it has historically provided for 99.5 percent of transactions to achieve cost recovery over the twelve years since it was adopted. The proposal thus not only arbitrarily abandons an issuer-focused methodology for a transaction-weighted methodology, but also arbitrarily lowers the effective "cost-recovery target" from 99.5 percent to 98.5 percent with no factual justification for choosing this particular target or explanation of how that target

[25] 88 Fed. Reg. 78100, 78107.

[26] 88 Fed. Reg. 78100, 78106.

[27] *Chamber of Commerce v. S.E.C.*, 443 F.3d 890, 900-01 (D.C. Cir. 2006).

[28] *See* The Food Industry Association and NACS, *Petition for Rulemaking Pursuant to Section 920 of the Electronic Fund Transfer Act* (Dec. 22, 2022), https://www.federalreserve.gov/regreform/rr-commpublic/trade-association-letter-20221222.pdf.

achieves recovery that is "reasonable and proportional" to issuers' costs under the statute.

In addition, further compounding the Board's arbitrary design of the proposed rule, rather than targeting cost recovery for 98.5 percent of transactions based on data the Board ***actually collects and possesses***, the Board inexplicably proposes to use a "Weibull distribution" model to estimate the base component costs that would achieve its targeted cost recovery of 98.5 percent of transactions. In fact, the model is a poor fit for such actual cost data and thus inappropriate to be used to determine the costs at a given recovery target, which the Board does not acknowledge or address. Importantly, the Board's published data do not permit an analysis of the goodness-of-fit of the Weibull distribution to the proposed cost-recovery target of 98.5 percent based on actual data, as this point is aggregated within the larger cohort of the 95th to 99th percentile data the Board provides. We can assess the fit of the historical cost recovery target of 99.5 as the Board has released the aggregate fit of the 99th to 100th percentile group, where the model consistently underestimates the actual costs by 33.1 percent (or more than 6 cents) over the 2013 to 2021 surveys. Withholding the 98.5 percentile fit denies the public the "most critical factual material" on which the Board relies and denies the public "further opportunity to comment," contrary to the APA.[29] Furthermore, the use of the Weibull distribution is wholly unnecessary in the first instance, as the Board possesses the actual cost data of issuers and thus knows the actual base component cost for any given percentile target in a survey year. This topic is discussed in greater detail in section IV of our letter.

5. <u>The Board's Justification for Issuing the Proposed Rule is Misleading and Not Grounded in Fact</u>

The Board asserts that "transaction-processing costs of the average debit card transaction declined by nearly 50 percent between 2009 and 2021, and therefore, the current interchange fee standards may no longer be effective for assessing whether any interchange fee is reasonable and proportional to the cost incurred by the issuer." This assertion is misleading.

First, it is based on only one metric, the transaction-weighted average, which grossly over-weights the costs of the largest 53 debit card issuers. As noted, because of scale, the very largest issuers have consistently reported the lowest costs, and because those issuers process 94.3 percent of transactions in the market, a transaction-weighted average fails to give due consideration to the costs of two thirds of covered issuers. To the extent that the transaction-weighted average processing cost has declined, it is not because all issuers' costs have decreased, it is because of the decreasing percentage of low-volume issuers in the market and the efficiency gains of the largest issuers that benefit from scale.[30] Based on other data from the Board's surveys, such as the average cost of the 80th percentile issuer (which is greater than 21 cents) or the average costs of all issuers (reported by the Board as 2.15 dollars per transaction), the cap should be *increased* from the current 21 cents.

Second, the 2009 Board survey was voluntary and thus undersubscribed as compared to subsequent survey years and has been shown to have underassessed issuer costs compared to all subsequent surveys. For calendar year 2009, only 66 issuers reported purchase transaction volumes and

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[29] *Chamber of Commerce*, 443 F.3d at 900-01.

[30] In 2011 the covered issuer market was composed of 28% low-volume issuers, 48% mid-volume issuers, and 24% high-volume issuers. By 2021 it was comprised of 15% low-volume issuers, 53% mid-volume issuers, and 33% high volume issuers. Board of Governors of the Federal Reserve System, *supra* note 23, sheet 12.

values, representing only 57 percent of total debit volume and 60 percent of total debit value,[31] in comparison to the 131 issuers that completed the mandatory survey in 2011 and similar numbers of respondents in every survey year thereafter.[32] While the 2009 survey estimated that the 2011 rule would allow 80 percent of issuers to recover their average costs, the mandatory survey from 2011 showed that only 61 percent of issuers had average costs below the 21 cent base component.[33] Thus, the original cap has been shown to have been set unjustifiably low, measured against the Board's own rationale in issuing and defending the rule, to the extent that 80 percent of issuers have ***never recovered*** their allowable costs under the current rule.[34] Any statistical comparisons of survey results should start with the 2011 survey to ensure comparability, yet the Board inappropriately cites as justification for the proposed reduction in the cap a reduction in transaction-weighted average between 2009 and 2021.

Third, we are not able to meaningfully assess the Board's statement regarding the decrease in transaction-weighted average costs between 2009 and 2021, because the Board only provides aggregate numbers and not the underlying data the Board used to calculate those reported numbers. Nor has the Board explained or demonstrated how the survey instrument provides the Board with an accurate picture of the cost experience of the entire ecosystem of issuers. For example, the Board has not provided information about the number of blank or "NR" ("not reported") responses it receives. Low-and-middle volume issuers have reported difficulty in completing all fields of the survey, particularly those that rely on the core processors. Thus, we have reason to believe that low and middle-volume issuers may disproportionately provide NR responses, but the Board has not provided the public with sufficient information to enable us to determine whether that is indeed the case. The Board does not explain whether it includes any NR responses as a "zero" cost, which would skew the data to be underinclusive of costs. Nor has the Board explained whether it excludes outlier responses in the data, which also could skew costs downward, or any other data manipulation the Board may do in calculating issuer costs. Nor has the Board explained whether it has consistently applied any such data manipulation in the same manner since 2011 when evaluating the survey data, which would be required in order to compare values across reporting years. These failures run afoul of the APA, which requires agencies "to explain the assumptions and methodology" they use.[35] Thus, we are unable to evaluate the veracity of the Board's reported values regarding the data it collects. To the extent that a future final rule may adjust the interchange fee cap based on results of future biennial surveys, ensuring complete survey responses by all issuers and providing the public with the ability to confirm the Board's assertions regarding conclusions the Board draws from the data is of critical importance.

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[31] Board of Governors of the Federal Reserve System, *2009 Interchange Revenue, Covered Issuer Cost, and Covered Issuer and Merchant Fraud Loss Related to Debit Card Transactions*, (June 2011), https://www.federalreserve.gov/paymentsystems/files/debitfees_costs.pdf.

[32] The number of respondents that replied to the Board's Debit Card Issuer Survey from the years 2011 to 2021 were as follows: 2011 (131), 2013 (131), 2015 (129), 2017 (115), 2019 (152), and 2021 (163). Board of Governors of the Federal Reserve System, *supra* note 23, sheet 12.

[33] Board of Governors of the Federal Reserve System, *supra* note 23, sheet 15.

[34] The percentage of covered issuers with average costs below the level permitted by the "interchange fee standard": 2011 (61.1%), 2013 (59.1%), 2015 (64.5%), 2017 (76.0%), 2019 (77.6%), 2021 (77.4%). *Id*., sheet 15. (*See* footnote 4 defining the interchange fee standard as "Average ACS costs, including issuer fraud losses, per transaction of 21 cents plus 5 basis points of the issuer's average transaction value or less." The Board does not publish the percentage of issuers with average costs less than the allowable ACS cost, excluding fraud losses.)

[35] *Small Refiner Lead Phase-Down Task Force v. EPA*, 705 F.2d 506, 535 (D.C. Cir. 1983) (citation omitted).

Finally, the proposed rule is based on 2021 data which is skewed by the once-in-a-lifetime occurrence of a global pandemic, calling into question both the suitability of that data as a basis for the Board's price regulation and the Board's prediction that data in future years will support the conclusion underlying the proposed rule. The 2021 survey showed a sustained increase in card-not-present transaction activity during and after the pandemic, a substantial shift of fraudsters' attention away from ordinary debit card transactions and toward government Covid-19 benefits and programs, and other relevant factors that likely render the 2021 data unrepresentative of a typical two-year reporting period. Furthermore, the Board already possesses the 2023 data and thus, there is no justification for the Board's reliance on skewed, stale data to promulgate a rule with significant implications for consumers, issuers, and the payments system. This topic is discussed in greater detail in section IV of our letter.

6. <u>Numerous Other Aspects of the Proposal are Unsupported by Reasoned Decisionmaking</u>

Various additional aspects of the proposal are unsupported by reasoned decisionmaking and thus arbitrary. For example, the Board fails to adequately explain its proposal to retain the existing methodology for calculating the *ad valorem* and fraud prevention adjustment components of the interchange fee cap. While the Board proposes to abandon the existing methodology for calculating the *base* component, the proposal would continue to use the median (or 50th percentile) issuer costs for the *ad valorem* and fraud prevention adjustment components of the cap, which would unjustifiably – and without explanation – deny half of all covered issuers full recovery for both their efforts to prevent fraud and the losses they experience.[36]

Had the Board consistently adopted a transaction-weighted-average approach for the *ad valorem* component, it would <u>increase</u>, not decrease. Indeed, dividing the transaction-weighted average issuer fraud losses by the average transaction value would result in an *ad valorem* of 4.7 bps for 2011[37] and an *ad valorem* of 6.0 bps based on 2021 data.[38] We believe the Board should use the issuer-weighted average issuer fraud loss figures, which would result in an 11.4 bps *ad valorem* for both 2011 and 2021, consistent with our concerns that a transaction-weighted average is not representative of all issuers.[39] Instead, the proposed rule relies on the cost experience of the 50th percentile issuer, which

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[36] We note that Appendix B to Part 235(d) describing the Board's method to calculate the *ad valorem* component is unclear as to whether the Board uses the median ratio of "issuer fraud losses to transaction value" on an issuer-by-issuer and then selects the 50th percentile ratio or uses the 50th percentile issuer fraud loss cost (as disclosed on table 14) divided by the average debit card purchase transaction value (as disclosed on table 1). Board of Governors of the Federal Reserve System, *supra* note 23. As the Board does not publish the ratios of issuer fraud losses to transaction value on an issuer-by-issuer basis, we use the 50th percentile issuer cost as disclosed table 14 and the average debit card purchase transaction value as disclosed on table 1.

[37] Board of Governors of the Federal Reserve System, *supra* note 23, sheets 1 and 14 (transaction-weighted average issuer fraud losses for 2011 were $0.018, average transaction size for 2011 was $39.02).

[38] Board of Governors of the Federal Reserve System, *supra* note 23, sheets 1 and 14 (transaction-weighted average issuer fraud losses for 2021 were $0.028, average transaction size for 2021 was $46.26).

[39] Board of Governors of the Federal Reserve System, *supra* note 23, sheets 1 and 14 (Issuer-weighted average issuer fraud losses for 2011 were $0.044, average transaction size for 2011 was $39.02, resulting in 11.398 bps. Issuer-weighted average issuer fraud losses for 2021 were $0.053, average transaction size in 2021 was $46.26, resulting in 11.446 bps.)

declined from 5 bps in 2011 to 4.4 bps in 2021.[40] Given the importance of this multiplier, the Board should in all cases use an *ad valorem* defined to one tenth of a basis point.[41]

Similarly, the proposed rule would maintain the median-issuer approach for calculating the fraud-prevention adjustment, but raise it from 1 cent to 1.3 cents.[42] However, the transaction-weighted average fraud prevention costs have increased from 1.9 cents in 2011 to 2.2 cents per transaction in 2021, while the issuer-weighted average fraud prevention costs, while declining since 2011 still come in at 8.2 cents in 2021, both of which are substantially larger than the proposed 1.3 cents.[43]

The Board has failed to justify with any rationale why the base component methodology should change but the *ad valorem* and fraud prevention adjustments should remain the same. If the Board believes it must revisit Regulation II, then it should use a consistent methodology for all components of the cap, or provide a reasoned explanation for any distinction, and not arbitrarily select methodologies for different components in a manner that suggests a predetermined goal of lowering the interchange fee cap.

In addition, the proposed rule's automatic, biennial recalculation of the cap on interchange fees is both substantively and procedurally deficient. This aspect of the proposal is substantively deficient, as the Board fails to adequately explain its presumption that the data will remain consistent enough to justify adopting the proposed flawed methodology that would then be used every other year to automatically revise the interchange fee cap. As a procedural matter, the Board attempts, but fails to justify the proposed rule's qualification for the "good cause exception" from notice and comment rulemaking under the APA. Recalculating the interchange fee cap has significant implications for the payments industry, merchants, and consumers; an automatic recalculation of it does not fit within the narrow circumstances for which this exception to providing notice and comment is meant to apply.

These topics, and numerous other aspects of the proposal that are unsupported by reasoned decisionmaking, are discussed in greater detail in section IV of our letter.

7. <u>The Board is Not Legally Compelled to Issue the Proposal</u>

Finally, and critically, there is no legal requirement in either the Durbin Amendment or the Regulation that the Board revisit the existing rule. The Board has the authority to avoid inflicting the harm the proposal would cause and withdraw the proposal. When the Board finalized Regulation II in 2011, the Board stated that it "anticipates that it will periodically conduct surveys of covered issuers in order to reexamine and potentially reset the fee standard," but that statement was only an explanation of the final rule and in no way creates a legal obligation for the Board to revisit the fee standard now.

While a group of retail merchant trade associations filed a petition for rulemaking with the Board in December 2022 requesting that the Board revise the rule to lower the cap, this on its own does

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[40] We use the 50th percentile issuer cost as disclosed table 14 and the average debit card purchase transaction value as disclosed on table 1. *See, supra* note 23.

[41] Appendix B to Part 235(d) describing the Board's method to calculate the *ad valorem* component proposes to round this value "to the nearest quarter of one basis point."

[42] 88 Fed. Reg. 78100 (Nov. 14, 2023).

[43] Board of Governors of the Federal Reserve System, *supra* note 23, sheet 14.

not create a legal obligation for the Board to do so. The APA gives interested persons the right to petition an agency to amend a rule, but nothing requires an agency to take the action specifically requested in a petition. Indeed, the APA contemplates that a petition may be denied, requiring that a notice of denial of a petition must be accompanied by a brief statement of the grounds for denial.[44] This topic is discussed in greater detail in section V of our letter.

8. <u>The Proposed Transition Period</u>

To the extent that the proposal would create an interim interchange cap prior to the first biennial recalculation of the cap beginning July 1, 2025, the Board should use calendar year 2023 issuer cost data, which it recently collected, not the calendar year 2021 data as it has proposed. This topic is discussed in greater detail in section VI of our letter.

We expand upon each of the aforementioned points in the Detailed Commentary, below.

[44] Section 553(e) of the Administrative Procedure Act provides that "[e]ach agency shall give an interested person the right to petition for the issuance, amendment, or repeal of a rule," but nothing requires an agency to take the action requested in the petition. Indeed, the APA contemplates that a petition may be denied, and that any such denial must be justified by a statement of reasons pursuant to section 555(e) and can be appealed to the courts under sections 702 and 706 of the APA. *See* 5 U.S.C. §§ 553(e), 555(e), 702, and 706; *see also Auer v. Robbins*, 519 U.S.C 452, 459 (1997).

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I. Background

A. Overview of Debit Cards

Debit card transactions continue to be a highly popular, non-cash means of purchasing goods and services in the United States. In 2021, 106 billion debit card transactions were performed in the United States, amounting to $4.55 trillion in total transaction value.[45] These numbers represent a significant increase in debit card usage over the past several years. From 2018 to 2021, the number of debit card transactions performed in the U.S. rose by 18.6 billion, representing close to $1 trillion in total transaction value.[46] In 2021 alone, the number of non-prepaid debit card transactions increased more than any other type of card transaction, reaching 87.8 billion, or approximately 56 percent of all card transactions in 2021.[47] According to the 2022 Federal Reserve Payments Study, since 2001, non-prepaid debit card transactions have increased more than any other non-cash payment type.[48]

Indeed, debit cards have become a primary payment method for millions of American consumers, and financial institutions have invested large sums of money to develop an effective and efficient infrastructure that permits American consumers to pay with, and merchants to accept, debit cards. The remarkable growth of the use of debit cards is due in large part to the fact that they represent one of the most effective and innovative consumer banking products of the twentieth century, bringing substantial benefits to merchants, consumers, and financial institutions by:

- providing an inexpensive and effective electronic payment mechanism for consumers, especially to LMI consumers;
- allowing consumers to purchase goods and services beyond the amount of cash they are carrying, thereby freeing consumers from the risks and inconvenience of carrying cash;
- affording consumers the convenience of widespread acceptance at retailers across the United States;
- enabling consumer access to deposit accounts (including their account records) easily and electronically;
- facilitating customer service in connection with payments and account inquiries;
- facilitating internet transactions and quicker transactions at a physical check-out;
- serving as a global currency conversion payment vehicle to support trade and commerce worldwide;
- providing fraud protection to both consumers and merchants;
- providing merchants with assured, immediate payments (in contrast to checks);

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[45] Federal Reserve Payments Study: 2022 Triennial Initial Data Release, *supra* note 13.

[46] *Id*.

[47] *Id*.

[48] *Id*.

- lowering merchants' security costs by making them less of a target for theft, and avoiding "shrinkage" at the till when customers pay in cash;
- reducing costs for merchants by eliminating checks deposited daily, as well as cash services necessary to conduct hard currency purchases; and
- reducing merchant costs by reducing the need for employee hours spent handling cash and check payments for certain goods and services (e.g., pay at the pump).

Each participant in the debit card payments system, including every merchant that wishes to accept debit cards, enters into the system voluntarily. If any merchant disapproves of any aspect of the debit card payments system, then the merchant has the option to refrain from joining the system in the first place, to leave the system altogether, or to remain in the system but discourage consumers from using debit cards by offering discounts for other payment methods. When presented with these options, however, most merchants have elected to join the debit card system, as they understand the benefits the system provides to them, and few merchants elect to discourage consumers from using their debit cards. The proposed rule disregards these facts and, if adopted, would further disrupt the payments system in which the participants understand the value proposition the debit card system provides as a result of massive investments by financial institutions, as further discussed in this comment letter. For the reasons discussed herein, the Board should withdraw the proposal.

B. Summary of the Existing Interchange Fee Cap

Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 amended the Electronic Fund Transfer Act ("EFTA")[49] to add new Section 920 to the EFTA. The Durbin Amendment directed the Board to "establish standards for assessing whether the amount of any interchange transaction fee [received or charged by a debit card issuer] is reasonable and proportional to the cost incurred by the issuer with respect to the transaction."[50] The Durbin Amendment also authorized the Board to provide for a fraud-prevention adjustment to the amount of any interchange transaction fee, subject to the issuer's compliance with fraud-prevention standards established by the Board.[51]

In 2011, the Board adopted a final rule that imposed a cap on interchange fees consisting of a base component and an *ad valorem* component,[52] and an interim final rule to allow for a fraud-prevention adjustment.[53] Specifically, Sections 235.3 and 235.4 of Regulation II limited permissible interchange fees to a base component of no more than 21 cents, plus an *ad valorem* component of 5 basis points, multiplied by the value of the transaction, plus a fraud-prevention adjustment of no more than 1 cent. The base component, *ad valorem* component, and fraud-prevention adjustment compose the "interchange fee cap."

In determining the interchange fee cap, the Board relied on data provided by covered issuers in

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[49] 15 U.S.C. §§ 1693 et seq.

[50] 15 U.S.C. § 1693o-2(a)(3)(A).

[51] 15 U.S.C. § 1693o-2(a)(5)(A).

[52] *See* 76 Fed. Reg. 43394.

[53] *See* 76 Fed. Reg. 43478.

a 2009 survey.[54]

C. Summary of the Board's Proposed Modifications to the Interchange Fee Cap

The Board proposes to amend Regulation II and the Commentary to substantially reduce the interchange fee cap, including by adopting an entirely new methodology for determining the base component of the interchange fee cap. The Board also proposes to provide for automatic adjustments to the interchange fee cap on a biennial basis, and to make certain other changes to Regulation II.

The proposed rule would amend Section 235.3(b) of Regulation II to provide that the interchange transaction fee received or charged by a covered issuer for any debit transaction performed from the effective date of the final rule to June 30, 2025, must not exceed the sum of (A) a base component of 14.4 cents, and (B) an *ad valorem* component of 4.0 basis points, multiplied by the value of the applicable debit transaction. In addition to the reduction to the interchange fee cap, the proposed rule would add a new section, Section 235.3(c), to establish a mechanism for automatic updates to the base component and the *ad valorem* component on a biennial basis without the Board engaging in further rulemaking.

The proposed rule also would amend Section 235.4(a) of Regulation II to provide for a fraud-prevention adjustment of no more than 1.3 cents for any debit transaction performed from the effective date of the final rule to June 30, 2025. As with the base component and the *ad valorem* component, the proposed rule would add a new section, Section 235.3(b), to establish a mechanism to automatically update the fraud-prevention adjustment on a biennial basis.

The proposed rule would also add a new appendix, Appendix B, to set forth and codify the new mechanism for automatically updating the interchange fee cap. The automatic updates would be based on data from the biennial debit card issuer surveys. Under Appendix B, the Board would determine the base component, the *ad valorem* component, and the fraud-prevention adjustment for every two-year period beginning with the period from July 1, 2025, to June 30, 2027 (each, an "Applicable Period") using the data reported by covered issuers in the relevant biennial debit card issuer surveys for debit card transactions performed during the calendar year that is two years prior to the year in which the Applicable Period begins.

Under the new methodologies for determining the interchange fee cap, the base component would be the product of (i) the transaction-weighted average of per-transaction allowable costs (excluding fraud losses) across covered issuers; and (ii) 3.7, rounded to the nearest tenth of one cent.[55] The proposed rule states that the 3.7 multiplier targets full cost recovery for 98.5 percent of covered issuer transactions over time based on the cumulative data reported to the Board since the initial biennial debit card issuer surveys were submitted.[56] The Board asserts that this cost-recovery target "is reasonable because it would allow covered issuers to fully recover their base component costs over time for a significant majority of covered issuer transactions."[57] At the same time, the Board observes that "this target acknowledges that full cost recovery for the highest-cost covered issuer transactions would

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[54] 76 Fed. Reg. 43394, 43397.

[55] 88 Fed. Reg. 78100, 78108.

[56] *Id.* at 78101.

[57] *Id.* at 78107.

not be reasonable."[58] The Board elsewhere acknowledges that under this target, approximately one-third of covered issuers would *not* be able to recover their base component costs.[59]

Under the proposed rule, the "allowable costs" are limited to (i) costs of authorization, clearance, and settlement; and (ii) transaction-monitoring costs tied to authorization as reported in the applicable biennial survey. The Board would determine the transaction-weighted average of per-transaction allowable costs by (i) summing these allowable costs across all covered issuers; (ii) dividing this sum by the total number of electronic debit card transactions across all such covered issuers; and (iii) rounding this result to the nearest tenth of one cent.

The *ad valorem* component would be calculated in an entirely different way. This calculation would continue to be based on the median ratio of issuer fraud losses to transaction value among all covered issuers, rounded to the nearest quarter of one basis point, multiplied by the value of the applicable electronic debit transaction. The ratio of issuer fraud losses to transaction value for each covered issuer would be issuer fraud losses of the applicable covered issuer, divided by the total value of electronic debit card transactions of the covered issuer. The Board would determine the median ratio of issuer fraud losses to transaction value by (i) determining the ratio of issuer fraud losses to transaction value for each covered issuer; (ii) sorting these ratios in ascending order; and (iii) selecting the median ratio of the sorted array. As such, in contrast with the methodology used to calculate the base component, the methodology used to calculate the *ad valorem* component—and specifically its use of a median point among covered issuers—is designed to allow even fewer covered issuers (approximately half) to fully recover these actually-incurred fraud costs. While the Board opines that a transaction-weighted average is preferable for calculating the base component, the Board asserts that this median ratio of issuer fraud losses to transaction value remains the representative and appropriate metric for the *ad valorem* component.[60]

Finally, the fraud-prevention adjustment would also utilize a median—setting the adjustment at the median per-transaction fraud-prevention costs among all covered issuers, rounded to the nearest tenth of one cent. In the proposed rule, the Board states that its objective in 2011 was to calculate the fraud-prevention adjustment based on the median per-transaction fraud-prevention costs among covered issuers, and asserts that this methodology remains an appropriate methodology for the same reasons set forth in the final rule in 2012.[61] Under the Board's proposed calculation, the fraud-prevention costs of each covered issuer would be (i) the total fraud-prevention and data-security costs, minus (ii) transaction-monitoring costs tied to authorization, as reported in the applicable biennial survey. Per-transaction fraud-prevention costs would be fraud-prevention costs incurred by the covered issuer, divided by the covered issuer's total number of electronic debit card transactions. The Board would determine the median per-transaction fraud-prevention costs by (i) determining per-transaction fraud-prevention costs for each covered issuer; (ii) sorting those values in ascending order; and (iii) selecting the median value of the sorted array.

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[58] *Id*.

[59] *Id.* at 78113.

[60] *Id.* at 78108.

[61] *Id.* at 78111.

II. The Proposed Rule Will Harm Consumers, Financial Institutions, and Payment Systems

The Proposed Rule should not be adopted because of the significant harm it will cause, most of which is already apparent from the Board's first imposition of a price cap on debit interchange. The imposition of this harm is both bad as a policy matter as well as a legal deficiency with the Board's rulemaking. As to the latter, Section 904 of EFTA requires the Board to: (a) consider the "costs and benefits to financial institutions, consumers, and other users of electronic fund transfers" of the regulation prior to issuing the regulation;[62] (b) consider the ways that the proposed regulation affects "competition in the provision of electronic banking services among non-exempt and exempt financial institutions and the availability of such services to different classes of consumers, particularly low-income consumers";[63] and (c) to the extent practicable, "demonstrate that the consumer protections of the proposed regulations outweigh the compliance costs imposed upon consumers and financial institutions."[64] The Proposed Rule fails to adequately engage in this statutorily required analysis. The Board arbitrarily departs from the existing methodology and selects a cost recovery target with no consideration of these statutorily mandated factors. Below, we highlight these issues, both as a matter of policy and as a failure to comply with Section 904.

A. The Board Ignores Significant Evidence that the Proposed Rule Will Harm Consumers, Particularly LMI Consumers

The proposed rule takes the position that consumers are likely to face one of two outcomes from the proposed rule. Consumers "could benefit if merchants pass on savings associated with the decrease in costs of accepting debit card transactions in the form of lower prices, forgone future price increases, or improvements in product or service quality," or consumers "could be negatively affected if covered issuers increase fees on debit cards or deposit accounts, or make other adjustments that make these products less attractive to consumers."[65] In the Board's estimation, "[t]he net effect on consumers, both individually and in the aggregate," depends only on "which of these two effects predominates," which the Board finds "difficult to predict."[66]

But this conclusion is disingenuous, as the Board inexplicably disregards robust evidence of the consumer harm that resulted from the original promulgation of the below-cost cap in Regulation II. The uncertainties that existed in 2011, regarding whether consumers would be harmed by the interchange fee cap, and whether increases in fees for consumer banking services would be offset by lower retail prices, no longer exist. Empirical data collected and analyzed over the past 12 years demonstrates that the interchange fee cap has resulted in significant and widespread increases in the costs of basic deposit accounts, while there is no evidence demonstrating that there have been reductions in retail prices for consumers. The same is likely to occur now. First, issuers were forced to charge more to cover their costs to maintain the viability of their deposit accounts and debit card payment products. At the same time, merchants failed to pass on cost savings resulting from capped interchange fees, reaping an economic windfall of $6.5 billion annually while paying less than what the market would otherwise

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[62] 15 U.S.C. § 1693b(a)(2).

[63] *Id*.

[64] 15 U.S.C. § 1693b(a)(3).

[65] 88 Fed. Reg. 78100, 78108.

[66] *Id*.

dictate for the services from which those merchants so greatly benefit.[67]

As a result, some consumers have been priced out of the market for traditional bank accounts and have been forced to turn to riskier banking replacements, such as check-cashing and payday-lending products, which have more opaque pricing and are ultimately more expensive for consumers.[68] In the 2017 FDIC Survey of Unbanked and Underbanked Households, nearly 30 percent of respondents who previously had access to a bank account reported that they became unbanked because of account fees.[69] As of 2019, growth in the population of recently unbanked consumers (i.e., consumers who previously had access to deposit accounts but have closed those accounts within the last year) was at its peak in states with the highest number of financial institutions subject to the interchange fee cap, where the increase in deposit account fees was the most pronounced.[70]

Further decreasing interchange recovery from merchants by more than 30 percent will only exacerbate the real harm that consumers, especially LMI consumers, have experienced following the imposition of the interchange fee cap and will undermine the significant policy priority of both the banking industry and federal banking regulators of promoting financial inclusion. Specifically, the proposed rule will likely result in bank account products and services that are more expensive and less attractive to LMI consumers, driving more of them out of the regulated banking industry. Even products specifically designed to be safe and affordable to LMI consumers, like the popular "Bank On" account products, will likely be adversely affected by this proposal.

The language of the Durbin Amendment does not mandate any periodic adjustment of the Board's interchange rule, yet the Board has proposed one; conversely, Section 904 of the Electronic Fund Transfer Act does require the Board to consider the "costs and benefits to financial institutions, consumers, and other users of electronic fund transfers" of its regulations prior to issuing them, which the Board has essentially ignored. The Board should recognize the likely harm to consumers and the negative public policy consequences of the proposed rule and withdraw the proposal.

1. **<u>Further Reducing Interchange Recovery Will Likely Increase the Cost to Consumers of Deposit Accounts and Other Debit Card-Related Products</u>**

The current interchange fee cap has substantially harmed U.S. consumers due to (i) the substantial reduction in the availability of free and low-cost deposit accounts to consumers, and (ii) increases in the frequency and amounts of deposit account-related fees and decreased opportunities for consumers to avoid those fees. These adverse effects have been most pronounced for financially vulnerable and LMI consumers for whom deposit account fees are most burdensome and who tend to be least able to avoid such fees.[71] These harms will be amplified if the Board reduces the total

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[67] Sarin, *supra* note 10, at 1539.

[68] *Id*. at 1537, *citing* Federal Deposit Insurance Corporation, *2017 FDIC National Survey of Unbanked and Underbanked Households*, at 23 https://www.fdic.gov/householdsurvey/2017/2017report.pdf.

[69] *Id*. at 1537-38. The 2017 study is the last time the FDIC reported numbers related to recently unbanked respondents responding to high and unpredictable fees.

[70] Mukharlyamov and Sarin, *supra* note 11, at 36.

[71] *See* Vladimir Mukharlyamov and Natasha Sarin, *Price Regulation in Two-Sided Markets: Empirical Evidence from Debit Cards* (Nov. 2022), page 3, https://scholarship.law.upenn.edu/faculty_scholarship/2885/. (noting "These

interchange recovery by another 30.2 percent on an average fifty dollar transaction, as currently proposed.[72]

When the cost of payment services is appropriately shared by merchants, financial institutions can provide free and low-cost deposit accounts to consumers. However, when interchange is capped at a rate that allows issuers to recover only a subset of costs related to debit card payments and is not designed to allow for a reasonable return, financial institutions have to make difficult business decisions in order to still be able to support the products and services they offer. Prior to the Board's imposition of the interchange fee cap in 2011, nearly 60 percent of large financial institutions offered free deposit account options to consumers.[73] As financial institutions have continued to lose interchange fee revenue as a result of Regulation II, free deposit accounts have become increasingly unavailable to consumers.[74] Data from the first few years following the 2011 imposition of the interchange fee cap reveals that the number of large financial institutions offering free deposit accounts to consumers fell to below 20 percent.[75] Further, free, non-interest bearing checking accounts declined 15.5 percent even at exempt institutions, nearly half the effect felt by covered issuers.[76]

Consumers also experienced substantial increases in the amounts of fees on fee-based deposit accounts. Within the first few years after 2011, average deposit account fees for consumers nearly doubled, from roughly $4 per month to more than $7 per month.[77] In the year following the imposition of the interchange fee cap, the average monthly fee associated with non-interest-bearing deposit accounts at covered financial institutions rose by 25 percent,[78] and the average monthly fees on interest-bearing deposit accounts at covered financial institutions increased by nearly 13 percent.[79]

Consumers have also become less able to avoid fee-based accounts. The average minimum balance requirement to avoid deposit account fees at covered financial institutions for non-interest-

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higher fees are disproportionately borne by low-income consumers whose account balances do not meet the monthly minimum required for fee waiver.") *See also*, Lux, M. and Greene, R., *Regressive Trends in Credit Card Access*, (2016), page 20, https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/files/Out_of_Reach_Lux_Greene_4_7.pdf. (noting "an increasing number of Americans – particularly low-income Americans – [are being priced] out of the traditional banking system.")

[72] The proposal states that on fifty dollar transaction total interchange recovery would decrease from 23.5 cents to 16.4 cents, or 30.2 percent. If a fraud prevention adjustment were allowed on the transaction, total interchange recovery would decrease from 24.5 cents to 17.7 cents, or 27.8 percent. 88 Fed. Reg. 78100, 78127.

[73] Sarin, *supra* note 10, at 1537.

[74] Manuszak and Wozniak, *supra* note 9.

[75] Sarin, *supra* note 10, at 1537.

[76] Manuszak and Wozniak, *supra* note 9, noting that 35.2% of covered issuers reduced the availability of free deposit accounts.

[77] Mukharlyamov and Sarin, *supra* note 11, at 4; Manuszak and Wozniak, *supra* note 9.

[78] Zhu Wang, *Price Cap Regulation in a Two-sided Market: Intended and Unintended Consequences* (The Federal Reserve Bank of Richmond, Working Paper No. 13-06R, 2013), https://www.richmondfed.org/-/media/RichmondFedOrg/publications/research/working_papers/2013/pdf/wp13-06r.pdf.

[79] Mukharlyamov and Sarin, *supra* note 11, at 4.

bearing deposit accounts increased by $400, or 50 percent, in the wake of Regulation II.[80] For interest-bearing deposit accounts, the consequences were more pronounced, as minimum balance requirements at covered financial institutions rose by $1,700, which reflects a 55 percent increase.[81] Unfortunately, financially vulnerable consumers—for whom it is more difficult to meet minimum balance requirements—have disproportionately borne the brunt of increased fees associated with debit card related payment products.[82]

Financial institutions' decreased ability to offer free and low-cost deposit accounts and other financial products to consumers includes, for example, "Bank On"[83] and similar financial-inclusion products targeted at unbanked and underbanked consumers. The proposed rule is at odds with the goals of Bank On which has been supported by policymakers, consumer groups, trade associations, and financial institutions alike.[84]

The Cities for Financial Empowerment Fund leads the national Bank On initiative, which partners with financial institutions, community organizations, government leaders, and regulators to create pathways for unbanked and underbanked individuals to enter or re-enter the financial mainstream with safe and appropriate accounts. The goal of Bank On is to ensure that everyone has access to a safe and affordable bank or credit union account. The Bank On National Account Standards (the "Bank On Standards") allow for limited monthly fees and opening deposit amounts in recognition of the costs of account maintenance but prohibit overdraft or insufficient fund fees. For example, the Bank On Standards include a minimum opening deposit of $25 or less, and no or low ($5 or less) monthly maintenance fees.[85] The Bank On Standards do not permit penalty fees for low balances or account dormancy.[86] Additionally, Bank On accounts allow for negative balances without charge to consumers.[87]

According to the most recent data about Bank On, there are now over 375 nationally certified Bank On accounts offered by banks and credit unions representing over 60 percent of the domestic deposit market, and more than half of all U.S. branches of banks offer Bank On certified accounts.[88] As

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[80] Manuszak and Wozniak, *supra* note 9, at 5.

[81] Manuszak and Wozniak, *supra* note 9, at 5.

[82] *See* Mukharlyamov and Sarin, *supra* note 11. *See also*, Lux and Greene, *supra* note 10.

[83] The aim of "Bank On" products (i.e., low-cost, basic accounts) is to help reduce the number of unbanked people in the country. *See* American Bankers Association, *Bank On: ABA encourages banks of all sizes to take part in this industry-wide financial inclusion initiative*, https://www.aba.com/banking-topics/consumer-banking/inclusive-banking/bank-on (last visited Apr. 2024).

[84] *See, e.g.*, Financial Services and General Government Appropriations Act of 2023, H.R. 8254, 117th Cong. (2022). The bill directed Treasury to develop a national strategy to improve financial inclusion. The Department of the Treasury recently issued a Request for Information to inform its development of this strategy. *See* Request for Information on Financial Inclusion, 88 Fed. Reg. 88702 (Dec. 22, 2023).

[85] *See* Bank On, Bank On National Account Standards (2023-2024), https://joinbankon.org/wp-content/uploads/2020/10/Bank-On-National-Account-Standards-2021-2022.pdf.

[86] *See id.*

[87] *See id.*

[88] Press Release, Bank On and CFE Fund, Country's Top Banking Regulators Celebrate Growth of National Safe Banking Partnership (May 23, 2023), https://bankon.wpenginepowered.com/wp-content/uploads/2023/05/CFE-

of 2021, more than 14 million Bank On certified accounts had been opened across 28 reporting institutions, a 67 percent increase from the previous reporting year, and of those, over 5.8 million accounts were open and active as of 2021.[89] Further, as of 2021, Bank On accounts had been opened in more than 35,000 ZIP codes, or 85 percent of all U.S. ZIP codes.[90] Based on 2021 data, neighborhoods with over 50 percent minority representation, which make up 13 percent of all neighborhoods, accounted for 32 percent of ever-opened accounts, underscoring the positive effect of Bank On accounts on minority communities.[91] Similarly, the 2021 data shows that neighborhoods with over 50 percent low-to-moderate-income households, which make up 20 percent of all neighborhoods, represented 40 percent of ever-opened accounts.[92]

The designated features, guardrails, and fee limitations of the Bank On Standards are designed to meet critical consumer needs and to be economically sustainable for partner financial institutions, rather than to depend solely on ephemeral charitable motivations. Further reducing the interchange fee cap would endanger this successful trend for Bank On in particular and for making banking more accessible to low-income individuals in general. The Cities for Financial Empowerment Fund has expressed concern over the proposed rule to the Board, stating:

> "At the same time the [Bank On] Standards' designated features, guardrails, and fee limitations are designed to meet those critical consumer needs, we also designed them to be economically sustainable for partner financial institutions, if not even somewhat profitable, rather than dependent upon more ephemeral charitable motivations. We note to the Board that interchange fees are a relevant component of that market sustainability."[93]

As in 2011, the proposed rule is likely to result in more frequent and higher consumer costs for deposit accounts and other financial products to offset resulting interchange recovery losses from merchants. These increased fees have already priced some consumers out of the market and have resulted in higher costs for consumers who face limited alternative options—including more expensive and riskier banking replacements such as check-cashing and payday-lending facilities.[94] Bank On accounts have been carefully crafted by participating financial institutions to succeed, notwithstanding the current interchange fee cap. However, the viability of Bank On certified accounts, and mainstream financial services accessed by financially vulnerable consumers, will be threatened should interchange revenue be slashed again. These concerns have also been raised with the Board by 38 Members of

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Fund_Bank-On-Conference-Press-Release-2023.pdf.

[89] *Id*.

[90] The Federal Reserve Bank of St. Louis, *The Bank On National Data Hub: Findings from 2021* (Dec. 13, 2022), https://www.stlouisfed.org/community-development/bank-on-national-data-hub/bank-on-report-2021.

[91] Paul Calem and Yasmeen Abdul-Razeq, *"Bank On" Transaction Accounts and Financial Inclusion: New Data Shows Continuing Success* (July 25, 2023), https://bpi.com/wp-content/uploads/2023/07/Bank-On-Transaction-Accounts-and-Financial-Inclusion-New-Data-Shows-Continuing-Success.pdf.

[92] *Id*.

[93] Letter from Cities for Financial Empowerment Fund to the Board of Governors of the Federal Reserve System (2024), https://cfefund.org/wp-content/uploads/2024/01/FRB-Reg-II-Comment-Letter-final.pdf.

[94] Sarin, *supra* note 10, at 1537.

Congress who wrote:

> "Banks and credit unions offering Bank On-certified accounts, in partnership with trusted community-based organizations and local governments, provide consumers with an essential onramp to mainstream financial markets. These accounts have a demonstrated track record of reaching unbanked and underbanked communities – and are the starting point for the ongoing work of true financial inclusion and aid in a wider mission of closing the racial wealth gap. We . . . urge you to ensure that the final rule does not unintentionally impact LMI consumers negatively."[95]

Based on the robust evidence collected since the passage of the 2011 final rule, it is clear that further lowering the interchange fee cap will result in bank account products and services that are more expensive and less attractive to LMI consumers, driving more people out of the regulated banking industry. The proposed rule will only exacerbate the real harm that consumers, especially low-income consumers, experienced after the original rule became effective.

2. Further Reducing the Interchange Fee Cap is Unlikely to Result in Merchants Passing on Their Savings to Consumers

The investments that card network operators and financial institution participants have made to develop, operate, and maintain the two-sided debit card market have dramatically enhanced the value proposition for consumers and merchants, including by making it significantly easier and more efficient for consumers to transact with merchants. This two-sided market provides meaningful operational benefits for merchants, such as no longer having to handle cash,[96] or worry about checks clearing, as well as meaningful commercial benefits such as engaging more consumers, making more sales, and improving the overall consumer experience. A recent study found that average transaction sizes increase by 10 to 15 percent compared to cash when merchants accept card payments.[97] These benefits are the direct result of the decades – and billions of dollars – of investments that operators of the card networks have poured into their networks and that financial institutions have poured into innovative payments products and services that operate on those networks. During the Covid-19 pandemic, for example, financial institutions made huge investments in new technologies, allowing contactless payments to become a mainstay in the payments ecosystem. Financial institutions also regularly invest in fraud detection and prevention efforts, which, according to studies conducted biannually by Visa, are needed now more than ever.[98]

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[95] Letter from Nikema Williams, Blaine Luetkemeyer, et al to the Board of Governors of the Federal Reserve System (2024), https://nikemawilliams.house.gov/posts/congresswoman-nikema-williams-leads-protection-for-underbanked-americans-to-federal-reserve-chairman-jay-powell.

[96] This helps merchants reduce their expenses from handling of cash, which could equal up to 15 percent of total sales. *See* IHL Group, Cash Multipliers – How reducing the costs of cash handling can enable retail sales and profit growth (Jan. 2018).

[97] Mastercard, Measuring the Value of Electronic Payments to Merchants (2017), at 2, C:\Users\pparidon\Downloads\MCUS_16188_Merchant_Value.pdf.

[98] Visa, Visa Research Highlights Emerging Fraud Schemes in Retail and eCommerce (Sept. 7, 2023), https://investor.visa.com/news/news-details/2023/Visa-Research-Highlights-Emerging-Fraud-Schemes-in-Retail-and-eCommerce/default.aspx. According to Visa's latest biannual study, the presence of fraud, including through

When merchants help cover the cost of these payment products through interchange fees, it benefits all involved: the issuers, the merchants, and the consumers. As voluntary participants in the debit card ecosystem, merchants should be expected to pay their fair share for the countless benefits they receive through their participation in the card networks. The Board's proposal would reduce merchants' contributions well below their fair share.

Congress's stated goals in enacting the Durbin Amendment included consumers' benefiting through lower retail prices and helping small, struggling businesses.[99] Advocates of the Durbin Amendment were adamant that the new law would "enable small businesses and merchants to lower their costs and provide discounts for [consumers]."[100] Although it was widely predicted that the interchange fee cap would raise deposit account prices, merchants indicated that any resulting increase in consumer fees for banking services would be offset by merchants passing through to consumers, in the form of lower pricing, their interchange fee savings.

In the proposed rule, the Board suggests that a further reduction of merchant interchange payments might lead to merchants passing on their savings to consumers in the form of lower prices for goods and services, citing two studies in support. However, contrary to the Board's claims, the two cited studies do not provide compelling evidence of lower costs being passed on to consumers as a result of the 2011 rule.

The first study cited by the Board as evidence of a pass-through effect is a 2022 paper written by Vladimir Mukharlyamov and Natasha Sarin entitled "Price Regulation in Two-Sided Markets: Empirical Evidence from Debit Cards."[101] The paper studies the impact of price regulation in two-sided markets, including whether lower debit interchange fees brought about by the Durbin amendment led to price reductions in the retail gasoline industry. They find that gasoline merchant savings amounted to 0.07 percent of total sales such that "estimating with statistical significance the extent of merchant's pass-through is virtually impossible."[102] Contrary to the Board's assertion that this study supports the notion

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ransomware attacks, enumeration attacks that impact merchants and consumers alike, and general fraud committed at card-not-present merchants, has reached all-time highs.

[99] *See* Press Release, Senator Richard J. Durbin, Durbin Statement on His Debit Card Swipe Fee Amendment (May 13, 2010), https://www.durbin.senate.gov/newsroom/press-releases/durbin-statement-on-his-debit-card-swipe-fee-amendment; *see also* Press Release, Senator Richard J. Durbin, Statement by Richard J. Durbin on Swipe Fee Reform (Mar. 16, 2011), https://www.durbin.senate.gov/newsroom/press-releases/2011/03/16/swipe-fee-reform

[100] Press Release, Senator Dick Durbin, Assistant Senate Majority Leader, U.S. Senate, Durbin Sends Letter to Wall Street Reform Conferees on Interchange Amendment (May 25, 2010) (quoting Letter from Senator Dick Durbin, Assistant Senate Majority Leader, U.S. Senate, to Senator Chris Dodd, Chairman of U.S. Senate Comm. on Banking, Housing, & Urban Affairs & Senator Barney Frank, Chairman of the House Fin. Servs. Comm. (May 25, 2010)), https://www.durbin.senate.gov/newsroom/press-releases/durbin-sends-letter-to-wall-street-reform-conferees-on-interchange-amendment; *see also* Press Release, Senator Richard J. Durbin, Durbin Statement on His Debit Card Swipe Fee Amendment (May 13, 2010), https://www.durbin.senate.gov/newsroom/press-releases/durbin-statement-on-his-debit-card-swipe-fee-amendment; *see also* Press Release, Senator Richard J. Durbin, Statement by Richard J. Durbin on Swipe Fee Reform (Mar. 16, 2011), https://www.durbin.senate.gov/newsroom/press-releases/2011/03/16/swipe-fee-reform.

[101] Mukharlyamov, V. and Sarin, N., "Price Regulation in Two-Sided Markets: Empirical Evidence from Debit Cards" (November 24, 2022), http://dx.doi.org/10.2139/ssrn.3328579.

[102] *Id*. at 4- 5.

that merchants may pass on cost savings from reduced interchange fees to consumers, the study in fact concludes that "this article . . . provides empirical evidence in support of the theoretical conjecture that cost-based regulation in these markets is unlikely to benefit consumers."[103]

The second study the Board cites as evidence of a pass-through effect is a 2022 paper authored by Efraim Berkovich and Zheli He entitled "Rewarding the Rich: Cross Subsidization from Interchange Fees."[104] The study, commissioned and published by the Hispanic Leadership Fund (HPL), focuses on credit card pricing, only briefly touching on the topic of debit interchange fees.[105] HPL is an active member in the "Lower Credit Card Fees Coalition," and the group's President penned an introduction to the paper that clearly demonstrates their pro-merchant and anti-bank agenda in commissioning the study.[106] The study uses merchant profitability as a proxy for the retailer's ability to pass through credit card interchange costs to consumers in the form of higher retail prices.[107] Despite the study's defects, it finds that merchants with over $5.2 million in annual sales "appear to be fully passing through interchange costs while the smaller stores absorb much of these costs."[108] Thus, the only other study the Board cites as evidence that merchants may pass on savings to consumers has significant defects and does not provide evidence that larger merchants will pass on any interchange savings to consumers.

Both of these studies are consistent with the merchant survey conducted by the Federal Reserve Bank of Richmond and Javelin Strategy & Research in 2014, finding 75 percent of merchants reported that they did not change prices following the implementation of Regulation II, 23 percent reported that they *increased* prices, and only 2 percent reported that they decreased prices,[109] even though interchange fees as a proportion of total merchant costs have declined every year, as the interchange fee cap is not adjusted for inflation. These results are also consistent with other surveys that have reported that, in the sectors that have experienced the greatest cost reduction following imposition of the interchange fee cap, a corresponding decrease in prices to consumers is clearly absent.[110]

As a result of the 2011 rule, merchant interchange fees have decreased by $6.5 billion annually.[111] Further, some estimates suggest that around 75 percent of the $6.5 billion in annual

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[103] *Id*. at 5.

[104] *See* 88 Fed. Reg. 78100, 78115 n.91 (*citing* Efraim Berkovich and Zheli He, Hispanic Leadership Fund, *Rewarding the Rich: Cross Subsidies from Interchange Fees* (May 3, 2022), https://hispanicleadershipfund.org/wp-content/uploads/2022/05/HLF_Report_RewardingTheRich-InterchangeFees_03May22.pdf).

[105] *See* Efraim Berkovich and Zheli He, Hispanic Leadership Fund, *Rewarding the Rich: Cross Subsidies from Interchange Fees* (May 3, 2022), https://hispanicleadershipfund.org/wp-content/uploads/2022/05/HLF_Report_RewardingTheRich-InterchangeFees_03May22.pdf.

[106] See *id.*

[107] See *id.*

[108] See *id.*

[109] Zhu Wang, Scarlett Schwartz, and Neil Mitchell, *The Impact of the Durbin Amendment on Merchants: A Survey Study*, 100 Economic Quarterly 183, 190 (2014), https://www.richmondfed.org/-/media/RichmondFedOrg/publications/research/economic_quarterly/2014/q3/pdf/wang.pdf.

[110] *Id*. at 183, 202, 207.

[111] Sarin, *supra* note 10, at 1539.

savings has gone straight to merchants' bottom line.[112] In a 2010 Q4 Home Depot Inc. Earnings Conference, Home Depot's then-CFO Carol Tomé stated that, "[o]n the Durbin side . . . [b]ased on the Fed's draft regulations, we think the benefit to The Home Depot could be $35 million a year."[113] It is apparent that the effective result of the interchange fee cap has been to boost merchants' profits rather than passing on their savings to consumers.[114] And while the evidence is clear that merchants have *not* passed on their <u>savings</u> from reduced interchange fees to consumers, the evidence also suggests that the very largest merchants have been able to pass on all of their interchange <u>costs</u> to consumers.[115] Experts in the banking and payments industries estimated that consumers lost, on net, about $22 billion to $25 billion more from higher bank fees and reduced banking services than from lower merchant prices and better merchant services due to the enactment of the Durbin Amendment (estimated as present discounted values calculated over the lifetime of the interchange fee reductions).[116]

Since Regulation II originally took effect, the largest retail merchants have experienced windfall expense savings and record financial performance, while low income consumers saw the cost of basic deposit accounts increase.[117] Or, as two researchers put it in 2019, "we can conclusively show that consumers experience immediate Durbin losses through higher bank fees, and we find limited evidence [] for across-the-board consumer gains through significantly lower merchant prices. This merchant behavior is consistent with contemporaneous anecdotal evidence (Electronic Payments Coalition 2011, Wang et al. 2014) and industry reports documenting higher retail margins post-Durbin (Home Depot Earnings Call 2011)."[118]

That the interchange fee cap has amounted to a transfer of wealth from consumers to merchants should come as no surprise. None of the countries in the world that have imposed price controls on interchange fees have experienced any documented pass through of savings to consumers in the service of lower retail prices.[119] In Australia, for example, interchange fees have been regulated for

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[112] *Id*. at 1542.

[113] Carol Tomé, Exec. Vice President of Corp. Servs. & Chief Fin. Officer, The Home Depot, Inc., Remarks at the Q4 2010 The Home Depot, Inc. Earnings Conference Call (Feb. 22, 2011), http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9ODMwMTB8Q2hpbGRJRD0tMX xUeXBlPTM=&t=1 (on file with the *Columbia Law Review*).

[114] Jeff Horwitz and Harry Terris, *A Year On, Debate About the Durbin Effect Continues*, Am. Banker (Oct. 1, 2012) (quoting Gil Luria, an analyst at Wedbush Morgan Securities).

[115] *See* Berkovich and He, *supra* note 105 and Mukharlyamov and Sarin, *supra* note 11.

[116] David S. Evans, Howard H. Chang, and Steven Joyce, *The Impact of the U.S. Debit Card Interchange Fee Regulation on Consumer Welfare: An Event Study Analysis* 1-56 (Univ. of Chi. Law Sch. Coase-Sandor Inst. for Law & Econ, Working Paper No. 658, 2013) at 6, https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=1651&context=law_and_economics.

[117] According to National Retail Federation Data, retail sales grew by more than 63 percent, an increase of more than $1.6 trillion, from 2013 through 2022, with the greatest increases occurring since the global pandemic began. National Retail Federation, State of Retail, https://nrf.com/research-insights/state-retail.

[118] Mukharlyamov and Sarin, *supra* note 11, at 30.

[119] Ian Lee et al., Macdonald-Laurier Institute, *Credit Where It's Due: How Payment Cards Benefit Canadian Merchants and Consumers, and How Regulation Can Harm Them* (Oct. 29, 2013) at 2, 14-19, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2346311. *See also*, Juan Iranzo, et al., The Effects of the

almost a decade, yet there has not been any documented evidence that the benefiting retailers have passed-through any of their savings to retail consumers.[120]

Congress's other stated goal of the Durbin Amendment, helping small, struggling businesses, has also failed to materialize.[121] This is due in large part to an aspect of the payments industry that the Board fails to address or even consider in its rulemaking: the difference in payment acceptance costs between large merchants and smaller merchants. The interchange fee cap has primarily benefited larger retailers without helping smaller merchants. Larger merchants tend to pay for payments acceptance on a "cost-pass-through" basis, which means reductions in interchange fees correlate to a direct reduction in those merchants' costs incurred to reap the significant benefits provided by the payment card system.[122] Smaller merchants, by contrast, tend to pay a flat-rate blended fee for payments acceptance services, which does not vary with cost inputs, such as interchange fees.[123] Consequently, the benefit of lowering the interchange fee cap accrues most clearly and directly to large retail chains, while small businesses are much less likely to experience any real cost reductions.

In sum, empirical data collected and analyzed over the past 12 years reflects that the interchange fee cap has resulted in significant and widespread increases in the costs of basic deposit accounts, while reductions in retail prices for consumers have not appeared. Consumers are accordingly already squeezed from both sides—from financial institutions who have no option but to recover costs from consumers rather than merchants and from merchants that do not pass on the windfall of the reduced interchange fees. As researchers have noted, as a result of the Durbin Amendments, "[c]onsumers got the short end [of] the stick . . . [m]erchant [sic] are not giving enough of their gains back to consumers to compensate for the higher fees and reduced services that consumers are getting from banks as a result of the interchange price caps, nor, as we have shown, are merchants expected to do so."[124] Further decreasing merchant interchange fees by more than 30 percent will only exacerbate the real harm that consumers, especially LMI consumers, have experienced following the imposition of the interchange fee cap. If merchants did not pass on their debit interchange savings over the past 12 years, it is exceedingly unlikely that they will elect to do so now. The Board provides no basis in its rulemaking for believing the results of the proposed rule will be any different.

Mandatory Decrease of Interchange Fees in Spain, MUNICH PERSONAL REPEC ARCHIVE, MPRA Paper No. 43097, (October 2012), https://mpra.ub.unimuenchen.de/43097/1/MPRA_%20paper_43097.pdf. (noting "There is no evidence that consumers have benefitted from lower prices following the reduction of interchange fees.")

[120] *Id*. at 2, 3-4; *see* Howard H. Chang et al., *The Effect of Regulatory Intervention in Two-Sided Markets: An Assessment of Interchange-Fee Capping in Australia,* Review of Network Economics (forthcoming Oct. 2005), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=820044.

[121] *See* Press Release, Senator Richard J. Durbin, Durbin Statement on His Debit Card Swipe Fee Amendment (May 13, 2010), https://www.durbin.senate.gov/newsroom/press-releases/durbin-statement-on-his-debit-card-swipe-fee-amendment; *see also* Press Release, Senator Richard J. Durbin, Statement by Richard J. Durbin on Swipe Fee Reform (Mar. 16, 2011), https://www.durbin.senate.gov/newsroom/press-releases/2011/03/16/swipe-fee-reform.

[122] Fumiko Hayashi, *The New Debit Card Regulations: Effects on Merchants, Consumers, and Payments System Efficiency*, Economic Review of the Federal Reserve Bank of Kansas City 89, 97 (2013), https://www.kansascityfed.org/documents/1625/The_New_Debit_Card_Regulations_Effects_on_Merchants_Consumers_and_Payments_System_Effi.pdf.

[123] *Id*. at 97-98.

[124] Evans, Chang, and Joyce, *supra* note 116, at 49.

3. The Board Fails to Adequately Consider Consumer Protection and Compliance Costs

With respect to consumer protection and compliance costs, the Board provides a brief statement that it "cannot, at this time, determine whether the potential benefits of the proposal to consumers exceed the possible costs imposed on consumers and financial institutions."[125] The Board does not explain why it is unable to determine whether the potential benefits of the proposed rule to consumers outweigh the possible costs imposed on consumers and financial institutions. There is plenty of evidence to consider, as cited in this comment letter and Appendix 2, showing that consumers have received no benefit from the current interchange fee cap in the form of lower retail prices and that the direct harm to financial institutions in the reduction in annual interchange fee revenue has directly contributed to more frequent and higher consumer fees for deposit accounts and related services, to the particular detriment of financially vulnerable consumers.

The Board offers that "the proposal *may* [emphasis added] yield benefits for consumers," but then asserts that "the magnitude of these benefits will depend on the behavior of various participants in the debit card industry."[126] In making this statement, the Board avoids its obligation to confront these issues. The Board makes no attempt to elaborate on the potential behaviors of various industry participants in the debit card industry or the ways in which those behaviors may influence the magnitude of the benefits. Further, the statement conveniently ignores evidence of the effects of interchange price caps over the past decade – a convenience Section 904(a) does not afford the Board.

Empirical data derived from experience of the past decade reveals that consumers and financial institutions have been significantly harmed by the interchange fee cap with all benefits accruing to large retailers. There is no quantitative or qualitative reason to believe that further lowering of the interchange fee cap, as the Board has proposed, would have any effect but magnification of these outcomes. The Board's decision to ignore this evidence in its perfunctory Section 904(a) analysis renders its proposed rule unlawful.

The Board Is not required by statute to lower the interchange fee cap, as discussed in section V of this letter below, and the proposed rule fails to recognize the likely harm to consumers and negative public policy consequences of the Board's proposal, in direct contravention of section 904 of EFTA. The Board should use its broad discretion regarding whether, when, and how to amend Regulation II, and withdraw the proposal.

B. The Board Fails to Adequately Consider the Effect on Competition Between Covered and Exempt Issuers

While the Board acknowledges that "[t]he proposal could affect competition between covered and exempt issuers by reducing the average per-transaction debit card interchange fee received by covered issuers without affecting the amount received by exempt issuers," the Board contends that this depends on "the degree of substitution between exempt and covered issuers" and that "the Board does not expect the proposal to have a significant impact on competitive dynamics between the two groups

[125] 88 Fed. Reg. 78100, 78117.

[126] 88 Fed. Reg. 78100, 78117.

of issuers."[127] The data does not support the Board's suppositions.

The exemption for debit card issuers with less than $10 billion in assets from the interchange fee cap does not protect smaller debit card issuers from market-driven declines in interchange fees. As covered issuers have been forced to reduce interchange fees, exempt issuers have similarly faced reduced interchange fees due to downward market pressure and the need to remain competitive. Between 2011 and 2021, debit card interchange revenue for exempt debit card issuers fell 13 percent in connection with single-message network transactions.[128] In 2014, 73.3 percent of surveyed exempt debit card issuers indicated that "debit card interchange fees policy" generally had a negative impact (either "significant" (29.1 percent) or "slight" (44.2 percent)) on their earnings.[129] These figures reflect what industry participants and government officials, including Governor Michelle W. Bowman, predict will continue to be the case with respect to exempt issuers – that market pricing pressures will increase for exempt debit card issuers as a result of the Board's proposal to further reduce the interchange fee cap as proposed.[130]

Decreased interchange fee revenues have in turn forced exempt issuers to pass on costs to consumers in the form of higher-priced payment products. The availability of free, non-interest-bearing deposit accounts offered by exempt financial institutions declined by 15.5 percent following imposition of the interchange fee cap.[131] Similarly, a Federal Reserve Bank of Richmond study has found that both large and small debit card issuers have substantially reduced free deposit account products and services in the aftermath of Regulation II's interchange fee cap.[132]

Community banks and credit unions understand that a reduced interchange fee cap will necessitate curtailment of services for consumers, which will greatly impact unbanked and underbanked populations and the neighborhoods where they reside.[133] Community Depository Institutions Advisory Council ("CDIAC") members have "voiced concerns about pending restrictions on their fee income," which these financial institutions rely on to support the cost of services like free accounts, and to cover

[127] 88 Fed. Reg. 78100, 78116-117.

[128] Board of Governors of the Federal Reserve, *Average Debit Card Interchange Fee by Payment Card Network*, *supra* note 14.

[129] Hester Peirce, Ian Robinson, and Thomas Stratmann, *How Are Small Banks Faring Under Dodd-Frank?* 1-105 (Mercatus Center, Working Paper No. 14-05, 2014), at 56, https://www.mercatus.org/students/research/working-papers/how-are-small-banks-faring-under-dodd-frank.

[130] Press Release, Board of Governors of the Federal Reserve System, Statement on Proposed Revisions to Regulation II's Interchange Fee Cap by Michelle W. Bowman (Oct. 6, 2023) (noting that "[b]y contrast, smaller issuers subject to the cap—those with smaller transaction volumes, less negotiating power, and fewer efficiencies in scale—may be at a significant competitive disadvantage. Because retail banking is such a core function for many smaller issuers, this pricing dynamic may not ultimately force smaller issuers to abandon their debit card programs. But it is possible that banks will be forced to either pass costs through to customers or operate their debit card programs as a loss leader, which many banks do today."), https://www.federalreserve.gov/newsevents/pressreleases/bowman-statement-20231025.htm.

[131] Manuszak and Wozniak, *supra* note 9, at 5-6.

[132] *See* Zhu Wang, *supra* note 78.

[133] Community Depository Institutions Advisory Council, FedRecord of Meeting (Nov. 16, 2023), https://www.federalreserve.gov/aboutthefed/files/CDIAC-meeting-20231116.pdf.

increases in operating expenses to implement fraud prevention and mitigation measures.[134] And, at the November meeting of the CDIAC, a request was made to the Board to withdraw the proposed rule. Specifically, "Council members noted the opaque nature of these [merchant] practices [(i.e., surcharges)], and generally believe that the Regulation II proposal is picking winners (merchants) and losers (banks) with no evidence of customer benefit. Council members suggested that the Federal Reserve withdraw the proposal and re-introduce it once an appropriate cost-benefit analysis has been conducted."[135]

The Board misses the point when it concludes that "the continued growth in debit card popularity since the adoption of Regulation II, and the lack of pronounced shift by consumers from debit card programs of covered issuers to exempt issuers, suggests that such fee increases and other adjustments to deposit accounts and debit card programs offered by covered issuers did not make them substantially less attractive to consumers."[136] Far from proving that payment products with higher fees were equally attractive to consumers, these observations are further evidence that the Board's price capping of covered issuers also drags down the ability of exempt issuers to offer more desirable debit card programs or accounts, as they experience downward pressure on their ability to recover their costs. And the evidence shows that these increased account fees are not offset for consumers on the merchant side, given the lack of any material evidence that merchants have passed on savings from reduced interchange fees to consumers.[137]

C. <u>The Board Fails to Consider the Proposed Rule's Potential to Undermine the Safety and Soundness of Payment Systems by Further Restricting a Key Revenue Source, Particularly Given Overlapping Regulatory Limitations on Fee-Based Revenue</u>

Large financial institutions currently face a litany of revenue limitations and cost increases at a time of great market instability and risk, including:

- Increasing capital requirements;
- New debt-funding requirements;
- Regulatory restrictions on fee revenue, including deposit account fee revenue (i.e., overdraft fees, insufficient funds fees), credit card revenue (limit on credit card late fee safe harbor), and service-related fee revenue (e.g., fees for responding to specific information requests from consumers);
- High interest rates increasing costs of deposits;
- Threats from un-regulated and under-regulated financial technology companies that face significantly lower costs;
- The effects of the Board's 2022 routing amendments to Regulation II, which are just now being realized and have not been reflected in any of the Board's data collection

[134] *Id*.

[135] *Id*.

[136] 88 Fed. Reg. 78100, 78115-16.

[137] *See supra* Section III.A.

or other marketplace studies;

- The CFPB's recently proposed rule regarding Section 1033 of the Consumer Financial Protection Act, which proposes to require financial institutions to develop and make available to third parties, such as data aggregators, access to and use of technology and data in order for those third parties to enhance their monetized products and services for consumers, while at the same time prohibiting financial institutions from charging any fee to such third parties to defray the costs incurred by financial institutions in developing and maintaining these offerings on an ongoing basis;[138]
- The CFPB's recently proposed rule regarding Regulations E and Z to alter the treatment of overdraft credit provided by large financial institutions;[139] and
- The threat of lower interchange revenue on credit card transactions as the result of the proposed Credit Card Competition Act of 2023.

In light of these ever-increasing costs and revenue limitations, the proposed rule will create yet another challenge for financial institutions and will discourage issuers from investing in the improvement, maintenance, and security of the debit card interchange payments system, because those issuers are unlikely to recoup the costs of such investments, let alone make any return on capital. Accordingly, the natural result of the proposed rule will be the degradation of the safety and soundness of the payments system (including system failures and security breaches) at a time when harmful actors and risks abound. The cumulative effect of concurrently prohibiting or dramatically limiting various streams of revenue for financial institutions will therefore further constrain financial institutions' ability to operate and serve their communities in a safe and sound manner.

D. <u>The Board Fails to Consider How the Proposed Rule Will Stifle Innovation in the Debit Card Market</u>

Advancements in the debit card industry that benefit all participants (consumers, merchants, and financial institutions) are driven in substantial part by investments by larger debit card issuers. The Board's proposal to materially lower the interchange fee cap will further erode a revenue stream that supports covered issuer debit-card-industry investment, which may result in additional harm to consumers and the banking and payments systems.

Covered issuers use interchange fee revenue to develop new products and technologies, which benefits all participants in the payments system. During the Covid-19 pandemic, for example, financial institutions made huge investments in new technologies, allowing contactless payments to become a mainstay in the payments ecosystem. Undoubtedly, covered issuers need interchange fee revenue to continue to adapt to new challenges and enhance the customer experience overall.

If the Board further lowers the interchange fee cap as proposed, the Board will stifle innovation and investment in the payments system by covered issuers, including in the fraud detection and prevention sector. As fraud schemes continue to grow in frequency and sophistication, covered issuers should be encouraged to increase investment in fraud detection and prevention. According to studies conducted biannually by Visa, the presence of fraud, including through ransomware attacks,

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[138] *See* Required Rulemaking on Personal Financial Data Rights, 88 Fed. Reg. 74796 (Oct. 31, 2023).

[139] *See* Overdraft Lending: Very Large Financial Institutions, 89 Fed. Reg. 13852 (Feb. 23, 2024).

enumeration attacks that impact merchants and consumers alike, and general fraud committed at card-not-present merchants, has reached all-time highs.[140] Fraudsters will continue to innovate and become more efficient and effective in perpetrating their crimes, and covered issuers should be encouraged to continue to devote substantial resources and innovate to keep pace.

III. The Proposed Rule Violates The Durbin Amendment and Creates Serious Constitutional Issues

A. The Proposed Rule Violates the Durbin Amendment by Denying Issuers an Opportunity to Recover Costs Plus a Reasonable Rate of Return for the Payment Services They Provide

The Board's proposed interchange fee cap is not designed to allow issuers to recover a reasonable rate of return on the innovative payment services they provide, instead setting a cap so low that a significant percentage of covered issuers (34 percent) would not fully recover even the limited universe of costs the Board currently includes in the calculation of the cap. As discussed further herein, the proposed rule, if adopted, would thus require many issuers – indeed, a greater percentage than the current rule – to provide their payment products at a substantial loss or to exit certain business lines or markets. Indeed, denying a significant percentage of covered issuers the ability to recover even the limited costs the Board allows to be considered, could threaten the vibrant and diverse banking industry that the Federal Reserve and other banking regulators consistently promote as a critically important aspect of the United States' banking system.[141] The Durbin Amendment neither requires nor supports this result. Interpreting it otherwise, as the Proposed Rule does, raises serious constitutional concerns. Moreover, as discussed in greater detail below, this constitutional problem cannot be legally or practically dismissed with the assertion that issuers can offset losses resulting from the reduced interchange fee cap from other lines of their business.[142] As described further herein, the proposal fails to provide for sufficient cost recovery for two statutorily impermissible reasons. First, as the Associations have previously advised the Board in connection with the existing rule, the proposed rule fails to consider the totality of issuer costs necessary to effectuate debit card transactions by excluding significant and readily identifiable categories of issuer costs when calculating the cap. Second, the

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[140] Visa, *Visa Research Highlights Emerging Fraud Schemes in Retail and eCommerce* (Sept. 7, 2023), https://investor.visa.com/news/news-details/2023/Visa-Research-Highlights-Emerging-Fraud-Schemes-in-Retail-and-eCommerce/default.aspx.

[141] *See*, e.g., Joint Press Release re: Proposed Rules to strengthen capital requirements for large banks, Statement by Vice Chair for Supervision Michael S. Barr re: (July 27, 2023) ("[W]e want to ensure that the capital rules support a vibrant, diverse banking system with banks of all sizes by applying capital requirements appropriate to the size and risks of institutions."), https://www.federalreserve.gov/newsevents/pressreleases/barr-statement-20230727.htm; OCC Annual Report, 2023 at 17 "(The OCC is committed to promoting a vibrant and diverse banking system. This diversity helps the system remain healthy, meet our nation's financial services needs, and be capable of adapting to change and withstanding adversity. A vibrant and diverse system comprises a broad spectrum of institutions, including community banks and minority depository institutions, community development financial institution banks, mutual savings associations, and FSAs. Supporting them is critical to our mission and vision"), https://www.occ.gov/publications-and-resources/publications/annual-report/files/2023-annual-report.pdf.

[142] The Associations previously raised these concerns with respect to the 2011 proposed rule, but the Board's 2011 final rule also was not designed to allow all issuers to achieve cost recovery and also did not contemplate providing issuers a reasonable rate of return. *See* Letter to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, from The American Bankers Association et. al. (Feb. 22, 2011), https://media.theclearinghouse.org/-/media/Files/Association-Documents/20110222_Interchange_Fees-Too-Low.pdf?rev=8fc34c4c2609417698c35272ba4aaee3.

proposal would use a new methodology to calculate the cap, which would overweight the costs of the highest-volume issuers, that, because of scale, have the lowest costs, and essentially ignore the cost experience of a substantial majority of covered issuers.

Congress mandated that the amount of interchange fees be "reasonable and proportional" to the costs incurred by the issuer with respect to particular debit card transactions. It did *not* use terms like "limited to" or "equal to" an issuer's costs, as one would expect if Congress's intent was to establish a ceiling on interchange fees equal to (let alone below) an issuer's costs.[143] Instead, the phrase "reasonable and proportional" is more akin to Congress's use of the phrase "just and reasonable" in federal ratemaking statutes.[144] Courts have consistently interpreted these statutes to require that the rates in question "yield[] sufficient revenue to cover all proper costs … plus a specified return on invested capital."[145] The statute here does not authorize an interchange fee cap that would foreclose recovery even of an issuer's *costs*, let alone anything approaching a reasonable return on its investment in payment services.

To the extent there is any ambiguity about what the "reasonable and proportional" language requires, principles of constitutional avoidance confirm that issuers must be allowed to recover their costs plus a reasonable rate of return. Indeed, if the Durbin Amendment authorized the Proposed Rule's approach to the interchange fee cap—which it does not—it would "raise[] 'a serious doubt' as to its constitutionality."[146] And wherever possible, statutes must be construed to avoid such doubts. Specifically, the Constitution prohibits "confiscatory" price controls, *i.e.*, those setting rates so low as to be "inadequate to compensate current equity holders for the risk associated with their investments."[147] Although the government may place some limits on returns, it is "plain that the 'power to regulate is not a power to destroy.'"[148] In other words, where the government acts to regulate prices, it must at least "enable [a] company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed."[149] Courts have repeatedly held that price-control regulations that fail to allow a reasonable rate of return are unconstitutional.[150]

The Proposed Rule "clearly" does not guarantee "the constitutionally-required fair and reasonable rate of return."[151] The Board expressly refuses to allow issuers *any* return, having rejected a "level of profit" or "rate of return" as recoverable categories in 2011, which decision the Board has not

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[143] *See, e.g.*, 7 U.S.C. § 940f(c)(2) ("The amount of the fee paid shall be equal to the modification cost[.]" (emphasis added)).

[144] *See, e.g.*, *id* at § 211(a); 15 U.S.C. § 717c(a).

[145] *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945, 951 (D.C. Cir. 2007) (per curiam); *see also, e.g.*, *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 770 (1968).

[146] *See Zadvydas v. Davis*, 533 U.S. 678, 689 (2001).

[147] *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 307, 312 (1989).

[148] *Permian Basin*, 390 U.S. at 769.

[149] *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 605 (1944).

[150] *See, e.g.*, *Michigan Bell Tel. Co.*, 257 F.3d at 595-596; *Guaranty Nat'l Ins. Co.*, 916 F.2d at 515; *Calfarm Ins. Co.*, 771 P.2d at 1255-1256; *Aetna Cas. & Sur. Co.*, 263 N.E.2d at 703.

[151] *Michigan Bell Tel. Co.*, 257 F.3d at 595.

revisited in the proposal.[152] Indeed, the Board acknowledges that even the *existing* Regulation II cap covers the base component costs of only 77 percent of covered issuers based on 2021 debit card issuer survey data.[153] Low-volume covered issuers, who tend to have higher per-transaction costs, are particularly impacted by the current cap, as 84 percent in 2021 did not recover their costs under the total maximum interchange fee.[154] This is lower even than the initial 80 percent of covered issuers that the Board expected to be able to recover allowable costs under Regulation II as promulgated in 2011. Far from allowing a reasonable return, the Proposed Rule would do even worse, allowing even fewer issuers—only 66 percent—to recover even their allowable, base component costs.[155] Neither the statute nor the Constitution authorizes such an action.

The Board's responses in its 2011 Rulemaking to similar objections cannot save the Proposed Rule here. In 2011, the Board reasoned that, because the Durbin Amendment uses the phrase "reasonable and proportional" rather than the phrase "just and reasonable" commonly used by ratemaking statutes applicable to public utilities, Congress did not "intend[] the Board to consider other ratemaking jurisprudence."[156] But that reasoning fails for two reasons. First, it is well-established, and the Board cannot dispute, that the term "reasonable" has a well-understood meaning in the ratemaking and price-setting context, ensuring that prices are set at levels to ensure a reasonable return. That Congress paired that term with "proportional" in the Durbin Amendment only confirms that meaning, demonstrating that Congress meant for debit card issuers to be able to receive interchange fees above and proportionally related to their costs. Second, the Board's 2011 response also ignores *constitutional* prohibitions against confiscatory price caps that are not confined to the operation of any particular statutory language. While the confiscatory-rate doctrine originally developed in cases concerning public utilities, the Supreme Court has made clear that the doctrine is not limited to the public-utility context. Indeed, in *In re Permian Basin Area Rate Cases*, the Supreme Court applied the confiscatory-rate doctrine to resolve a constitutional challenge brought by non-public utility natural gas producers against allegedly confiscatory rates for gas produced in the Permian Basin.[157] The Supreme Court expressly noted that "[p]roducers of natural gas cannot usefully be classified as public utilities," as they could abandon the natural gas production business, unlike public utilities,[158] but the Supreme Court nonetheless applied the confiscatory-rate doctrine to determine whether the government gas rates were constitutional.[159] Numerous courts have applied the confiscatory rate doctrine in contexts not involving public utilities to strike down government price caps that would require companies to offer products only at a loss.[160]

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[152] Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43394, 43427 n.119 (July 20, 2011).

[153] 88 Fed. Reg. 78100, 78113.

[154] *See* Board of Governors of the Federal Reserve System, *supra* note 23, sheet 15.

[155] *Id*.

[156] 76 Fed. Reg. 43394, 43434.

[157] *Permian Basin*, 390 U.S. at 770.

[158] *Id.* at 756-57.

[159] *Id.* at 770.

[160] *See Giles Lowery Stockyards, Inc. v. Department of Agriculture*, 565 F.2d 321 (5th Cir. 1977) (applying confiscatory rate analysis to government mandated price caps applicable to cattle auction market); *Central*

As the Supreme Court explained in *Permian Basin*, although the Constitution permits regulation of maximum prices "in appropriate circumstances," "[i]t is … plain that the 'power to regulate is not a power to destroy.'"[161] Far from agreeing with the Board's determination that only utility-related ratemaking statutes are subject to these foundational constitutional protections, the Supreme Court has held that such ratemaking statutes "coincide[] with the applicable constitutional standards" applicable to any government-imposed price cap.[162] And while the Supreme Court has recognized regulators' ability to "limit stringently the return recovered on investment," it is clear that the Constitution protects the ability to obtain *some* return on investment.[163]

Nor is it an answer to this constitutional infirmity—as the Board similarly asserted in 2011[164]—to speculate that covered issuers might be able to offset their losses resulting from the reduced interchange fee cap from other lines or parts of their business. This legal principle is also well established. In 1920, for example, the Supreme Court invalidated as unconstitutionally confiscatory a Railroad Commission order requiring a railroad company to operate its railroad between two particular towns.[165] Although the company could have offset its losses incurred from the ordered operation, the Court held that the company "cannot be compelled to carry on even a branch of business at a loss, much less the whole business of carriage."[166] This precedent is still relied on by courts. In *Michigan Bell Telephone*, for example, the Sixth Circuit invalidated as facially unconstitutional a statute abolishing a fee charged to consumers by two telephone companies and freezing the rates charged by the same companies.[167] The court found that the statute failed to allow the companies to recover a reasonable rate of return, noting that companies are "not required to subsidize their regulated services . . . with revenues generated from unregulated services."[168]

Even if the possibility of recouping losses from a price-fixing regulation could save that regulation from constitutional infirmity—again, it cannot—the nature of the debit card industry as a two-sided market means any "other sources" within the debit card line of business are unlikely, and at a minimum uncertain, to be sufficient to allow recoupment of actual costs and a constitutionally guaranteed reasonable rate of return. The key feature of a two-sided market "is that it facilitates transactions among two . . . distinct groups . . . that would otherwise not take place, or not take place as

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Arkansas Auction Sales, Inc. v. Bergland, 570 F.2d 724 (8th Cir. 1978) (same); *Keystone Ins. Co. v. Foster*, 732 F. Supp. 36 (E.D. Pa. 1990) (applying doctrine to confiscatory rate rollback applicable to insurers); *Yellow Cab Co. v. City of Chicago*, 919 F. Supp. 1133 (N.D. Ill. 1996) (government-imposed cap on rates at which tax companies could lease cabs to drivers); *Medical Malpractice Joint Underwriting Ass'n of R.I v. Paradis*, 756 F. Supp. 669 (D.R.I. 1991) (one-year rate freeze on medical malpractice insurance premiums); *Aetna Cas. & Surety Cor. v. Comm'r of Ins.*, 263 N.E.2d 698 (Mass. 1970) (reduction in rates that auto insurance providers could charge).

[161] *Permian Basin*, 390 U.S. at 769.

[162] *Id.* at 770.

[163] *Id.* at 769.

[164] 76 Fed. Reg. 43394, 43434.

[165] *See Brooks-Scanlon Co v. R.R. Comm'n of La.*, 251 U.S. 396 (1920).

[166] *Id.* at 399.

[167] *See Michigan Bell Tel. Co.*, 257 F.3d at 590-91.

[168] *Id.* at 594-595 (citing *Brooks-Scanlon Co.*, 251 U.S. at 396).

efficiently, absent the intermediating platform bringing the parties together."[169] In such a market, there are significant practical limits on the theoretical ability to increase charges on the more price-sensitive side of the market (fees to consumers) in response to confiscatory price caps on the less price-sensitive side of the market (fees to merchants). The Board offers no basis—either here or in the 2011 Rulemaking—supporting a conclusion that it would be at all feasible for issuers to recoup a reasonable return for debit card services by shifting costs from merchants to consumers; while issuers have shifted some costs, as described throughout this letter, the Board has not shown or even attempted to demonstrate through economic study that the market could survive if, given the even lower caps the Board now proposes to set, debit card consumers were charged fees in the amount needed to allow issuers to recoup their costs plus a reasonable return. Indeed, if the proposal is finalized as proposed, it is estimated consumers would pay an extra $1.3-$2 billion annually in higher account fees.[170]

In short, the proposed rule is at odds with the plain language of the Durbin Amendment and with constitutional restraints on price-fixing regulations. It proposes to establish a price cap that would allow only 66 percent of covered issuers to recover—and 34 percent of covered issuers to recover *less than*—just a subset of the costs they incur by providing debit card payment services; moreover, the proposal is not designed to allow issuers to obtain a rate of return, raising constitutional infirmities. The proposed rule should be withdrawn for these fundamental defects alone, even setting aside the methodological problems with the Board's proposed approach discussed in greater detail below.

B. The Board Proposes to Establish an Interchange Fee Cap Without Considering Numerous Costs that Should Be Considered Under the Durbin Amendment, and Fails to Offer any Explanation for that Decision

Although the Durbin Amendment requires the Board to distinguish between (i) the incremental costs incurred by a covered issuer for authorization, clearance, or settlement of a transaction, which costs must be considered, and (ii) other costs incurred by the issuer that are not specific to the transaction and therefore cannot be considered,[171] it is clear that the Board may consider any costs that are not expressly prohibited under the Durbin Amendment. In other words, the Board may consider any costs that are specific to a particular electronic debit transaction, whether or not those costs are for authorization, clearance or settlement.[172] The Board acknowledges this to be the case.[173]

Nonetheless, the proposed rule excludes specific costs incurred by issuers that are recoverable under the Durbin Amendment and that clearly meet the Board's own Regulation II test for inclusion as

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[169] Prager et al., *Interchange Fees and Payment Card Networks: Economics, Industry Developments, and Policy Issues* 1-85, (Finance and Economics Discussion Series, Working Paper, 2009), at 14-15, http://www.federalreserve.gov/pubs/feds/2009/200923/200923pap.pdf (describing debit-card market as a two-sided market—i.e., "a market for the provision of a product whose value is realized only if a member of each of two distinct and complementary sets of users simultaneously agrees to its use") (citing Rochet and Tirole, *Two-Sided Markets: A Progress Report*, 37 RAND J. of Econ. 645 (2006)).

[170] Bourke, *supra* note 12.

[171] 15 U.S.C. § 1693o-2(a)(4)(B).

[172] *See NACS v. Bd. of Governors of the Fed. Reserve Sys.*, 746 F.3d 474 (D.C. Cir. 2014).

[173] 88 Fed. Reg. 78100, 78104 n.23.

costs "incurred in the course of effecting" debit card transactions.[174] Moreover, excluding them is inconsistent with issuers' right to recover interchange fees that are "reasonable and proportional to their costs" – not equal to or less than – and a reasonable return. Yet, without meaningful discussion or other indication of serious consideration, the Board curtly states that it "believes that [its] prior analysis [regarding what costs may be included in calculating the cap] remains sound."[175] This refusal to consider additional costs, especially in the face of facts that have developed since the earlier rulemaking, ignores multiple petitions by the industry to do so, as well as the Board's own prior acknowledgment that certain currently-excluded costs are within its authority to consider and, indeed, may be considered once the Board had collected relevant data, which it has now done for over a decade.[176] The Board's exclusion of these costs, as well as the Board's failure to justify that exclusion, is therefore arbitrary and capricious.

1. Costs of Non-Fraud-Related Cardholder Inquiries

Costs issuers incur in receiving, responding to, and resolving cardholder inquiries regarding debit card transactions are costs specific to those debit card transactions. Responding to customer inquiries about debit card transactions is not only a necessary customer service by covered issuers but also a compliance obligation, as many of these "inquiries" are related to disputes governed by the EFTA and its implementing regulation, Regulation E, or payment card network rules. Additionally, debit card issuers are prohibited under the EFTA from charging customers for responding to these inquiries, making it all the more important that such costs be allowed under Regulation II. The Board acknowledged when it issued Regulation II in 2011 that costs of cardholder inquiries related to debit card transactions meet the Board's own test for inclusion in determining the interchange fee cap, but were excluded at that time in large part because "cost data obtained by the Board in response to its issuer survey does not allow for the separation of the costs of cardholder inquiries related to specific transactions from the costs of inquiries that do not relate[] to particular transactions."[177] Regardless of whether that was the case in 2011, it is certainly not the case now, and therefore by its own interpretation of the law and the 2011 rationale, the Board should be including this cost.[178] Further, costs from cardholder inquiries for fraud

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[174] 76 Fed. Reg. 43394, 43426.

[175] 88 Fed. Reg. 78100, 78104.

[176] *See* Letter from American Bankers Association et. al. to Board of Governors of the Federal Reserve System (Feb. 22, 2011), https://media.theclearinghouse.org/-/media/Files/Association-Documents/20110222_Interchange_Fees-Too-Low.pdf?rev=8fc34c4c2609417698c35272ba4aaee3; *see also* Letter from American Bankers Association et. al (Dec. 17, 2013), https://www.federalreserve.gov/SECRS/2014/March/20140328/ICP-201322/ICP-201322_121713_111726_604783895384_1.pdf; *see also* Letter from American Bankers Association et. al to Board of Governors of the Federal Reserve System to (Oct. 2016), https://www.federalreserve.gov/SECRS/2016/November/20161125/ICP-201624/ICP-201624_101116_130983_452926149258_1.pdf.

[177] 76 Fed. Reg. 43394, 43429.

[178] The Board also noted in 2011 that "Payor's banks bear the costs associated with customer inquiries for check transactions and do not receive reimbursement for these costs from the payee's bank" as another reason why the Board did not include cardholder inquiries in allowable costs at that time. 76 Fed. Reg. 43394, 43429. First of all, the statute provides that in issuing regulations, the Board shall ***consider*** the functional similarity between (i) electronic debit transactions; and (ii)checking transactions that are required within the Federal Reserve bank system to clear at par. However, it is appropriate to consider cardholder inquiries even if check-related inquiries

are currently included in the calculation of the fraud prevention adjustment, in recognition that cardholder inquiry costs are costs that issuers bear in the course of effectuating debit card transactions.

The Board began collecting cardholder inquiry costs through issuer surveys in 2011 and so now has a long history of tailored issuer cost data. Section 4b. of the 2021 issuer survey directs issuers to report "costs of cardholder inquiries associated with particular debit card transactions . . . not related to possible fraudulent debit card transactions." Based on 2021 survey data, using the Board's proposed new transaction-weighted average cost method of evaluating recoverable issuer costs, the cost of non-fraud-related, transaction-specific cardholder inquiries was 3 cents.

2. <u>NSF Handling Costs</u>

The proposed rule unjustifiably excludes the cost of handling non-sufficient funds matters. Whether or not the debit card issuer incurs a related loss, handling non-sufficient funds issues, including pursuing collection from customers, are costs specific to debit card transactions when incurred in connection with those transactions. The Board excluded these costs in 2011 because it believed that "[t]he issuer incurs [these costs] as a service to its cardholders, and generally imposes fees to recover the associated risk."[179] That premise is currently false: neither we nor the CFPB are aware of any issuer that charges NSF fees for declined debit card transactions. Additionally, nearly two-thirds of financial institutions with over $10 billion in assets have eliminated non-sufficient funds fees for all kinds of transactions,[180] including check and ACH payments. In addition, like cardholder inquiry costs, the Board collects this data through issuer surveys but does not include it as an issuer cost in determining the interchange fee cap. Indeed, based on 2021 survey data, the transaction-weighted average cost of NSF handling costs was 0.5 cents.

The costs of cardholder inquiries and non-sufficient funds handling are readily available in current issuer survey data. Including issuer transaction-weighted average costs under the Board's new proposed methodology for calculating the interchange fee cap, the pre-multiplier base component costs would increase from 3.9 cents to 7.4 cents per transaction (resulting in base component cost recovery of 27.4 cents per transaction after applying the Board's proposed multiplier of 3.7).

3. <u>Costs of NSF Losses</u>

The Board currently does not collect data from issuers on several additional categories of costs that are "incurred in the course of effecting" debit card transactions but that issuers are able to capture and report to the Board as discrete costs incurred in connection with debit card transaction processing. The Associations have collected these costs from their members in separate data collections, and these

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are not recoverable by a payor's bank, because many card transaction inquiries likely relate to the types of features unique to cards that checks do not possess, such as extended chargeback windows, more complex dispute procedures, and authorization, for example. Therefore, card inquiries are generally unique to the debit card product and should thus not be excluded for the reason the Board cited in 2011. Moreover, check usage has declined significantly since 2011 and thus inquiry costs have shifted significantly to those related to debit cards. Thus, the comparison to check-related inquiries is not sufficient justification to exclude cardholder inquiry costs.

[179] 76 Fed. Reg. 43394, 43429.

[180] Consumer Financial Protection Bureau, *Vast majority of NSF fees have been eliminated, saving consumers nearly $2 billion annually* (Oct. 11, 2023), https://www.consumerfinance.gov/data-research/research-reports/vast-majority-of-nsf-fees-have-been-eliminated-saving-consumers-nearly-2-billion-annually/.

should be included in calculating the interchange fee cap.

Losses debit card issuers incur for charged-off or otherwise uncollected amounts in connection with debit card transactions are costs inherently specific to debit card transactions and incurred in the course of effecting those debit card transactions. The Board's conclusion in 2011 that non-sufficient funds losses "are incurred when an issuer authorized a transaction that overdraws the cardholder's account" and therefore "are largely within the issuer's control" is simply not accurate in today's debit card marketplace for large issuers. As noted above with respect to non-sufficient funds handling costs, non-sufficient funds losses related to debit card transactions generally are incurred by issuers today in situations where the issuers did not knowingly authorize a debit card transaction into a negative balance. Rather, these losses typically (and increasingly) arise when provisional credits required under the error resolution requirements of the EFTA are reversed resulting in a negative balance in the underlying account and when issuers are required under payment card network rules to accept force-post transactions (i.e., transactions that the issuers must settle without a valid, antecedent authorization from the issuer). Data reported by Association members on the cost of non-sufficient funds losses estimate that these are 1.05 cents per transaction.

4. Transaction Specific Compliance Costs

Costs of issuer compliance functions specifically related to debit card transactions are also costs "incurred in the course of effecting" debit card transactions. Absent the debit card transactions, debit card issuers would not incur these specific compliance costs. Debit card transactions are required to comply with applicable laws, such as Regulation E, and with the rules of the payment card networks over which they are processed, and debit card issuers incur costs to evaluate, develop, maintain and update controls and compliance functions, and audit associated compliance. The Board addressed account-related compliance costs in 2011 but summarily dismissed these costs as not recoverable under the statute because they are "not incurred in the course of effecting an electronic debit transaction."[181] However, the Associations request inclusion only of those compliance costs incurred in connection with debit card transactions – not compliance costs related to the broader account relationship between the issuer and the customer. Data reported by Association members on debit card transaction compliance costs indicate that these costs are 1.15 cents per transaction, which issuers are required to absorb without opportunity for recovery under the current and proposed new interchange fee cap.

As illustrated in Figure A below, inclusion of these permissible and material costs would significantly increase the transaction-weighted average costs from 3.9 cents to 9.58 cents. Using the proposed multiplier of 3.7, the resultant base component of the interchange cap would increase from the proposed 14.4 cents to 35.446 cents. This further illustrates that the current 21 cent cap has arbitrarily denied issuers "reasonable and proportional" interchange recovery since it was introduced in 2011, even when calculated using the proposal's flawed methodology.

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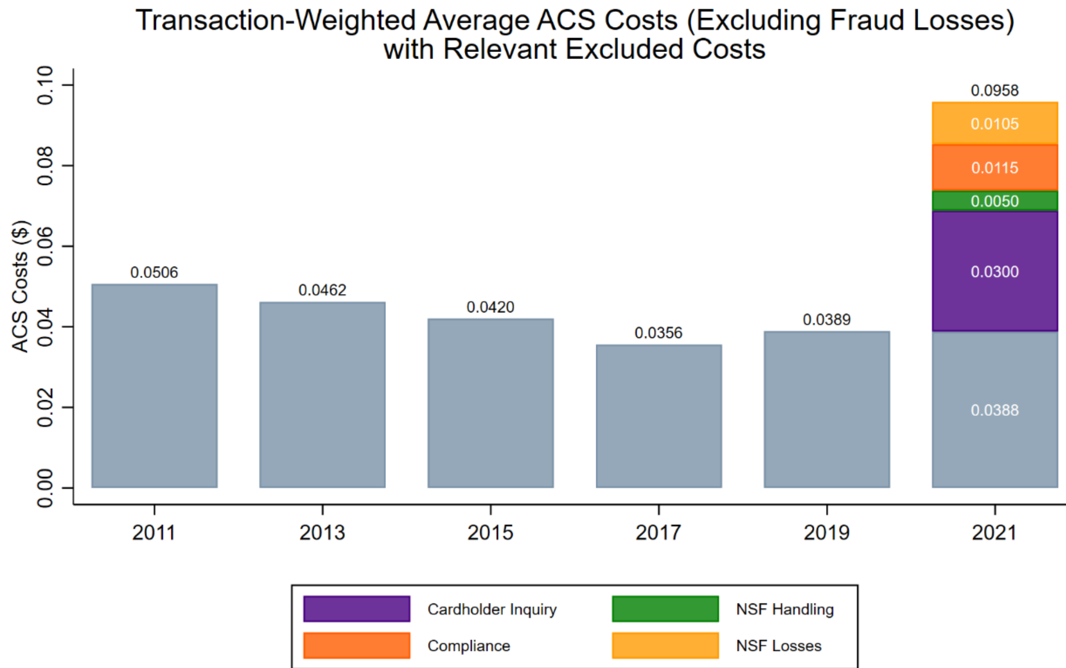
[181] 76 Fed. Reg. 43394, 43428.

Figure A: Impact of Additional Cost Categories on the Interchange Cap



5. Card Production Costs

Debit card transactions cannot occur absent the issuance of physical or virtual debit cards by issuers. The Board excluded these costs in 2011 because it believed that they were not incurred to process specific transactions.[182] However, these costs are incurred in the course of effecting debit card transactions, which cannot be conducted without the predicate issuance of a debit card. Acknowledging this, the Board concluded in 2011 that while debit card production and delivery costs "are related to debit card programs and transactions,"[183] the Board elected to exclude them from the interchange fee cap determination because an issuer may produce and deliver debit cards that are never used.[184] That some debit cards may not be used is not a valid reason to categorically exclude card production and delivery costs from recovery; issuers can easily ascertain what percentage of debit cards produced and delivered are used to effect debit card transactions and can report only those costs associated with that proportion of debit cards that are used to effect transactions. Therefore, the costs of card production and delivery should be recoverable, at least with respect to the proportion of debit cards that are used to conduct debit card transactions. Data reported by Association members on the percentage of cards issued that are used for debit card transactions demonstrates that such data can be identified, collected and reported by issuers. Further, as the Board reported in 2011, issuer costs for card production and delivery are significant – 2 cents per transaction in 2011 before the advent of more expensive materials and card-embedded technologies that the Associations believe have resulted in significant increases in

[182] 76 Fed. Reg. 43394, 43427-29.

[183] *Id.* at 43427.

[184] *Id.* at 43428.

card production costs since 2011.

6. International Fraud Costs

Costs incurred by debit card issuers in connection with international debit card transaction fraud, including transaction monitoring, error resolution, customer inquiries, and fraud losses, are costs "incurred in the course of effecting" debit card transactions. Although costs associated with legitimate debit card transactions at non-U.S. merchants are out of scope of the Durbin Amendment and Regulation II, many U.S.-issued debit cards are compromised as a result of transactions at merchants in the U.S. and then are fraudulently used for transactions outside of the U.S. In these scenarios, the critical data-compromise event leading to the fraudulent debit card activity occurs in the U.S. in connection with transactions that are subject to the Durbin Amendment; only the related fraudulent activity occurs outside the U.S. This results in significant costs and losses for covered issuers that are specific to U.S. debit card transactions – the transactions that resulted in the data compromise event resulting in international fraud —that issuers must absorb but are prevented to recover. The Board's current practice denies debit card issuers recovery of these costs simply because the fraudsters who compromised covered debit card credentials in connection with covered transactions chose to perpetrate compromised credential fraud outside the U.S.; indeed, these costs would be recoverable by issuers if the fraudsters chose to conduct their fraud at U.S. merchants.

The Board has appropriately limited applicability of Regulation II to accounts and debit card transactions in the United States.[185] However, limiting the geographic reach of Regulation II's requirements does not mean that the source of costs issuers may recover pursuant to the interchange fee standards must arise solely from U.S. sources. Indeed, the Board's own discussion in releasing Regulation II in 2011 confirms that the Board's geographic considerations were focused on the scope of the Board's authority to regulate and not on the geographic source of the costs the Board could collect and consider in establishing the regulation.[186] That the Board cannot regulate debit card transactions outside the U.S. does not mean that the Board cannot or should not consider costs related to U.S. debit cards or U.S. debit card transactions that originate from non-U.S. sources in establishing the interchange fee cap. Indeed, the methodology the Board established under Regulation II for determining whether a debit card issuer's assets qualify the issuer for the small issuer exemption calls for consideration of the issuer's non-U.S. assets.[187] The Board can and should allow debit card issuers to report and recover fraud costs associated with international fraud perpetrated following a U.S. compromise event.

The Board's failure to include any of the aforementioned costs in connection with the interchange fee cap under the proposed rule—and its failure to give any explanation for its refusal to consider them in light of developments since 2011—violates the Board's obligation to support its regulations with reasoned decisionmaking. Given the Board's apparent decision to overhaul the methodology used to set the interchange fee cap, its failure to give due consideration to including additional costs without explanation — including costs it has previously contemplated including once it had relevant issuer data – which it now has – is inconsistent with its legal obligations. Moreover, the

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[185] 12 C.F.R. § 235.2(a) and (h).

[186] 76 Fed. Reg. 43394, 43406 (reflecting the Board's concern that Regulation II not be perceived as having territorial application outside the U.S. or create related conflicts of laws).

[187] *Id*. at 43420 (reflecting the Board's conclusion that the assets of a debit card issuer's foreign affiliates should be considered in determining whether it is a small issuer).

Board's efforts to dissuade commenters from providing comments on the costs the Board considered in proposing amendments to the interchange fee cap are contrary to the APA, which requires agencies to subject proposed rules or changes to rules to public comment.[188] Given that the Board has asserted, albeit curtly, that it considered but ultimately rejected including additional costs in the calculation of the interchange fee cap, the public is entitled to comment on that decision, despite the Board's admonition against doing so. A refusal to consider additional costs also provides further evidence that the Board may not have engaged in its own robust and independent analysis in proposing the amendments to the rule, but rather simply promulgated in significant part the position advanced by merchant and retailer advocates.

IV. The Proposed Rule is Unsupported by Reasoned Decisionmaking

Beyond its clear violations of the Durbin Amendment's statutory mandates, the Board fails to support key components of its Proposed Rule with reasoned decisionmaking, as required by the Administrative Procedure Act.

The Board attempts to justify lowering the cap by arguing that "allowable costs incurred by covered issuers have fallen significantly since the original Regulation II rulemaking" as measured by the transaction-weighted average of per-transaction base component costs across covered issuers."[189] The Board asserts that "transaction-processing costs of the average debit card transaction declined by nearly 50 percent between 2009 and 2021, and therefore, the current interchange fee standards may no longer be effective for assessing whether any interchange fee is reasonable and proportional to the cost incurred by the issuer." This justification is misleading and not well-grounded in fact.

First, the 2009 voluntary survey of issuer costs relied on a different survey instrument than subsequent years, and the 2009 voluntary survey results are not in line with the mandatory survey results from 2011 onward. It is now obvious that the original 2009 survey used to set the 21 cent base component had significant inaccuracies, as the expected 80 percent of issuers have never recovered their average costs since the creation of the 21 cent cap. In fact, the 21 cent cap only covered 61 percent of issuers in 2011, 58 percent in 2013, and 62 percent in 2015. Even for 2021, the Board acknowledges that the existing base component level of 21 cents covered only 77 percent of covered issuers.[190] Thus, the 2009 survey resulted in an inappropriately low cap in the first instance. Moreover, for calendar year 2009, only 66 issuers reported purchase transaction volumes and values, representing only 57 percent of total debit volume and 60 percent of total debit value, in comparison to the 131 issuers that completed the mandatory survey in 2011 and 162 issuers that completed the mandatory survey in 2021. Any statistical comparisons of survey results should start with the 2011 survey to ensure comparability and accuracy.

Second, the Board's statements in the rulemaking are based on only one metric that the Board has chosen to highlight to justify lowering the interchange fee cap: the transaction-weighted average, which grossly over-weights the costs of the high-volume issuers, as discussed more fully below. Because

[188] 88 Fed. Reg. 78100, 78113 n.82.

[189] *Id.* at 78105.

[190] Somewhat inexplicably, the Board does not publish ACH cost data at the 80th percentile in its issuer survey results, so we cannot evaluate "apples to apples" based on the most recently published data. Board of Governors of the Federal Reserve, *supra* note 23, sheet 14.

those high-volume issuers compose 33 percent of issuers but account for **94.3 percent of transactions** in the market, a transaction-weighted average fails to give due consideration to the costs of 66 percent of covered issuers. To the extent that the transaction-weighted average has declined, it is in substantial part because of the decreasing percentage of low-volume issuers in the market and the efficiency gains of the largest issuers, not because the costs of all issuers declined correspondingly. If the Board insists on voluntarily re-opening Regulation II, including to adjust the existing interchange fee cap, other data points from the Board's surveys, such as the average cost of the 80th percentile issuer (which is greater than 21 cents) or the average costs of all issuers (reported by the Board as 2.15 dollars per transaction), support *increasing* the current 21 cent interchange fee cap.

Moreover, in light of the additional costs that the Board should consider in calculating the cap and the constitutional guarantee that issuers receive a rate of return, the transaction weighted issuer costs should be substantially greater than 3.9 cents as a base component starting point, should the Board adopt the proposed new methodology.

Finally, the Board has not explained how it calculates costs using the data it receives, which is necessary to ensure the public has a meaningful opportunity to comment on the Board's representations regarding issuer costs. For example, the Board has not explained whether it discards extreme outliers from the survey sample, which would affect the results, or how pervasive blank or "NR" (not reportable) responses are among issuers or whether low-and-mid-volume issuers disproportionately report "NR" responses. Nor does the Board explain whether it includes blank or "NR" responses as a "zero" cost, which would skew the data to be underinclusive of costs, or whether it engages in any other data adjustments in calculating issuer costs. The Board has not indicated whether it has calculated issuer costs using the same methodology since 2011. These failures are contrary to the Administrative Procedure Act, which requires agencies "to explain the assumptions and methodology" they used.[191]

A. The Board Arbitrarily, and Without Reasoned Explanation, Proposes to Adopt a Transaction-Weighted Methodology for Calculating the Base Component, Ignoring the Costs of Two-Thirds of Covered Issuers

The Board abandons the methodology adopted in the 2011 Final Rule for calculating the base component of the interchange fee cap, opting instead to establish the base component as the product of (i) "the transaction-weighted average of per-transaction allowable costs" across all covered issuers' electronic debit transactions and (ii) a fixed multiplier.[192] However, the Board's biennial Issuer Cost Survey does not contain actual transaction-level cost data. Instead, this transaction-weighted average attempts to capture "the average base component costs of a debit card transaction for covered issuers as a whole"[193] by (i) summing the base component costs across covered issuers that reported these costs and (ii) dividing this sum by the sum of the total number of debit card transactions across covered issuers that reported base component costs.

Focusing on the costs incurred from all such transactions, viewed in the aggregate, obscures variation in costs across issuers, and particularly variation resulting from comparative transaction

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[191] *Small Refiner Lead Phase-Down Task Force*, 705 F.2d at 535.

[192] 88 Fed. Reg. 78100, 78108.

[193] *Id.* at 78105 n. 36.

volumes across issuers. Far from adhering to a methodology which takes account of the costs of all issuers as required by the Durbin Amendment,[194] the Board's proposed methodology dilutes the cost information of low-volume – and even mid-volume – covered issuers. As the Board's 2021 survey data shows, the 53 high-volume issuers that reported survey data, or 32.5 percent of the 163 total reporting issuers, account for 94.32 percent of transactions.[195] The other 110 reporting covered issuers would need their base component costs to change by many orders of magnitude before those costs would have any effect on the transaction-weighted average cost.

In other words, the Board's methodology effectively disregards the costs of two-thirds of all covered issuers—issuers Congress intended to be covered by rules promulgated under the Durbin Amendment and whose costs must be duly considered—in favor of transaction data that corresponds overwhelmingly to only the costs of high-volume, low-cost issuers. It does so by setting standards based on the transaction-weighted average that gives undue weight to one third of issuers instead of using a methodology that gives appropriate consideration to the costs of all issuers.

The Board also fails to adequately explain its abandonment of the methodology adopted in 2011. For all its shortcomings, the existing Regulation II at least established its base component by considering each and every issuer's per-transaction base component costs, rather than considering the costs of all transactions. Specifically, in 2011, the Board set the base component of the interchange fee cap ($0.21) at the average per-transaction cost of the covered issuer at the 80th percentile based on 2009 survey data. The Board did so, in part, because the 80th percentile was the point above which reported cost data for covered issuers showed a "clear discontinuity" from one covered issuer to the next.[196] In addition to the "clear discontinuity" the 2011 Board identified, it noted that "[b]elow the 80th percentile, the difference between the per-transaction allowable costs of adjacently ranked issuers is small" while "[a]bove the 80th percentile, . . . the distribution shows a marked discontinuity, with per-transaction allowable costs varying more significantly across issuers of similar rank."[197] Thus, the 2011 rule was at least established by considering the costs *among all issuers* when deciding the amount of the base component cap.

The Board offers three reasons for abandoning this approach, all of which are contradicted by its own reasoning in the proposed rule. *First*, the Board claims that in subsequent survey years, the data has contained either "no clear discontinuity" or "multiple apparent discontinuities."[198] As noted, the Board has not released the data or analyses on which it bases this assertion and therefore, we have no way of evaluating the Board's claim, contrary to what the APA requires. Moreover, just two paragraphs later, the Board claims that "the shape of the distribution of per-transaction costs across covered issuer transactions has *not changed markedly* between the data collections."[199] Furthermore, the Board's

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[194] The Durbin Amendment requires the Board to establish standards for assessing whether an interchange fee is "reasonable and proportional to the cost incurred by the issuer with respect to the transaction." 15 U.S.C. § 1693o-2(a)(3) (emphasis added).

[195] Board of Governors of the Federal Reserve System, 2021 Survey Data, https://www.federalreserve.gov/consumerscommunities/shed_data.htm.

[196] 76 Fed. Reg. 43394, 43433.

[197] *Id*.

[198] 88 Fed. Reg. 78100, 78106.

[199] *Id*.

newly-proposed methodology entirely relies on a consistent shape of the distribution of average covered issuer costs when it asserts that in every survey year the distribution resembles a Weibull distribution, "including the existence of a small number of high-cost transactions associated with relatively low-volume, high-cost covered issuers."[200] The Board's claim of no clear or consistent discontinuity is inconsistent with these subsequent claims, and it is inconsistent with reasoned decisionmaking to claim that both are true.

Moreover, the Board's focus on whether there exists a "clear discontinuity" in the data obscures the fundamental rationale underlying the 2011 adoption of a metric – cost recovery of the issuer at the 80th percentile. This metric was selected to secure the costs for all but a small subset of the issuers that appeared "to be organizations whose commercial banking operations (and associated debit card programs) are small relative to their overall operations" such that the Board "does not believe that setting interchange fee standards to accommodate these higher-cost issuers would be reasonable or proportional *to* ***the overall cost experience of the substantial majority of covered issuers*** [emphasis added]."[201] The Board now asserts that the proposed cost-recovery target "is reasonable because it would allow covered issuers to fully recover their base component costs over time for a significant majority of covered issuer ***transactions***."[202] The Board therefore has redefined, contrary to the statutory language, what is meant by "reasonable and proportional to the cost incurred by the issuer" without sufficient explanation. In this regard, it is notable that the proposal largely mirrors the methodology championed by merchant trade associations in a petition for rulemaking to the Board in 2022. Nor has the Board explained whether the proposed new cap would only exclude those organizations whose debit card operations are "small relative to their overall operations," as the original rule intended, and if not, why a different definition of reasonable and proportional is permissible under the statute.

Second, the Board justifies its revised methodology for calculating the base component by claiming that "going forward" its previous methodology "would not facilitate the regular and predictable updates to the interchange fee standards that the Board proposes."[203] That statement is demonstrably false. The Board regularly publishes aggregate results by issuer percentile from its biennial Debit Card Issuer Survey. The Board has chosen not to disclose the 80th percentile but has published the 25th, 50th, and 75th issuer percentiles of issuer ACS costs, excluding fraud losses from 2011 through 2021. This is the same survey from which the Board computes the aggregate transaction-weighted average of these costs. To the same extent that the biennial Debit Card Issuer Survey would facilitate "regular and predictable updates" to the transaction-weighted average every two years, it can do so for the 80th percentile issuer.

Third, the Board claims that "this methodology will ensure that the maximum interchange fee that a covered issuer may receive will be proportional to the base component costs incurred by covered issuers in the aggregate with respect to the average covered issuer transaction."[204] This is simply a description, though, not a justification. Moreover, it is a straightforward admission that the Board is

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[200] *Id.* at 78107 n. 42.

[201] 76 Fed. Reg. 43394, 43433.

[202] 88 Fed. Reg 78100, 78107.

[203] 88 Fed. Reg. 78100, 78106.

[204] *Id*.

proposing an interchange fee cap that departs from both the statute and its original conclusion that the rule should allow for a cap that is reasonable and proportional "to the overall cost experience of the substantial majority of covered issuers"[205] and instead is based on costs in the aggregate, rather than on a critical consideration of *issuers'* actual costs and ability to recover those costs. That approach fails for the reasons described above.[206] In short, the Board's new base component methodology is not adequately supported by the purported justifications the Board offers in the proposed rule.

B. <u>The Board Arbitrarily, and Without Reasoned Explanation, Sets a "Cost-Recovery Target" that Guarantees a Third of Covered Issuers Will Not Recover Their Costs</u>

The second half of the proposed methodology to establish the base component relies on a fixed multiplier derived from a Weibull distribution (the use of which is also arbitrary, as described further below). To determine the value of the fixed multiplier the Board relies on a corresponding "cost-recovery target" selected by the Board. However, as noted above, because the Board does not have transaction-level data, the Board creates an issuer-by-issuer average transaction cost to perform a distribution analysis of average costs across issuers. To do so, the Board first determines the average "per-transaction base component costs of the covered issuer by (i) summing the base component costs reported by the covered issuer and (ii) dividing this sum by the total number of debit card transactions reported by the covered issuer." The Board then assigns this average cost result to each of the covered issuer's transactions. [207] Finally, the Board arranges all covered issuer transactions in ascending order from lowest to highest by their assigned costs.[208] A covered issuer is considered to have "fully recovered" its allowable costs if the covered issuer's average costs in a particular year were less than or equal to the base component interchange fee in the particular year.[209]

The Board describes the "cost-recovery target" as the "percentage of covered issuer transactions for which covered issuers should fully recover their base component costs over time."[210] This too is misleading. It is more accurate to say that the Board's cost-recovery target is the percentage of transactions performed by issuers with average costs below the cap. Notably, the Board does not actually know the interchange recovery of each debit card transaction and thus does not know whether the proposed cap would in fact cover 98.5 percent of all transactions in the marketplace. The distribution analysis performed by the "cost-recovery target" describes the ratio of the number of transactions performed by issuers who have average base component costs that are lower than the cap relative to the number of transactions performed by issuers who have higher average base component costs than the cap.

According to Board survey data from 2011 to 2021, issuers who had lower average base component costs than the current cap were responsible for between 99.4 and 99.7 percent of all transactions in the market, meaning the 2011 rule has had an effective average "cost-recovery target" of

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[205] *Id.* at 78104.

[206] *See supra* Section III.A.

[207] 88 Fed. Reg. 78100, 78106 n. 41.

[208] *Id*.

[209] *Id.* at 78105 n. 37.

[210] *Id.* at 78106.

99.5 percent.[211] The Board now proposes to set the new "cost-recovery target" at 98.5 percent, nearly a percentage point lower than it has ever been (see Table A).[212] As such, the Board is not only proposing a fundamental change in the methodology it has used for the last decade to set the base component, but it is also choosing to ratchet down the cost recovery target from an *implicit* 99.4 – 99.7 percent of covered transactions to an *explicit* 98.5 percent of transactions.

Table A: Percent of transactions covered by the interchange fee standard, 2011 – 2021.

Year	Share of Covered Transactions with Costs Below the Base Component	Share of Covered Issuers with Costs Below the Base Component	Total Covered Issuers	Estimated Number of Covered Issuers with Costs Above the Base Component
2011	99.5%	61.1%	131	51
2013	99.4%	59.1%	131	54
2015	99.5%	64.5%	129	46
2017	99.7%	76.0%	115	28
2019	99.4%	77.6%	152	34
2021	99.5%	77.4%	163	37
2023 *(proposed)*	**98.5%**	66%	163 *(est.)*	55 *(est.)*

Source: Federal Reserve Board, 2021 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions, Tables 12 and 15; 88 Fed. Reg. 78100, 78113; ABA analysis.

This change would significantly harm issuers. Notwithstanding the failure of the 21 cent cap to ever achieve the cost-recovery metric set out in 2011, the Board now seeks to further reduce the base component cap. Based on the Board's published data, targeting the 98.5 percentile would result in a cap that allows just 66 percent of covered issuers to receive full cost recovery, as opposed to 76 percent if the cap were established at the historical average 99.5 percentile.[213] In practice, this difference

[211] Percent of transactions below the interchange fee standard: 2011 (99.5%), 2013 (99.4%), 2015 (99.5%), 2017 (99.7%), 2019 (99.4%), 2021 (99.5%). The Board does not publish the percentage of transactions with average costs less than the allowable ACS cost, excluding fraud losses. Board of Governors of the Federal Reserve, *supra* note 23, sheet 15, footnote 4 ("Average ACS costs, including issuer fraud losses, per transaction of 21 cents plus 5 basis points of the issuer's average transaction value or less.")

[212] *Id.*

[213] 88 Fed. Reg. 78100, 78113 (based on 2021 debit card issuer survey data).

represents roughly 17 small and mid-size issuers that currently receive enough debit interchange revenue to cover their transactions costs but would generate losses on each debit transaction under the Board's proposal. Meanwhile, an additional 23 percent of covered issuers (equivalent to nearly three dozen issuers) who are *already* losing money on every debit card transaction would experience even greater per-transaction losses, further incentivizing them to discontinue offering debit cards to consumers.

The Board offers no justification for its choice of an interchange fee cap at a level so low that it prevents recovery for a greater percentage of covered issuers of even the limited universe of costs it considered here, contrary to the Durbin Amendment, let alone a constitutionally guaranteed rate of return. While the Board states that targeting "98.5 percent of covered issuers transactions is reasonable,"[214] the Board offers no facts, evidence, or policy rationale to support that conclusion. For example, the Board does not explain how it determined that 98.5 percent cost recovery is reasonable, either within the meaning of the statute or compared to other threshold levels for covered issuer transactions, such as the 99.5 percent of covered issuer transactions for which cost recovery is achieved today (and which was achieved in 2011).[215]

Instead, the Board attempts to justify its arbitrary selection of the 98.5 percent target by noting that it would correspond to an efficiency gap ratio of 5.2, but the Board similarly offers no justification for referencing an efficiency gap ratio or its preference for a 5.2 efficiency gap ratio. The Board states that it calculated the efficiency gap ratio "for a range of potential cost-recovery targets using each set of data collected from covered issuers since 2009"; that, based on its calculation and analysis, "the average value of [the efficiency gap ratio for its proposed cost recovery target of 98.5 percent of covered issuer transactions] is approximately 5.2"[216]; and that the efficiency gap ratio of 5.2 "[means] that covered issuers whose transactions are above the 98.5 percentile are, on average, more than five times less efficient than covered issuers whose transactions are below the 98.5 percentile."[217] But these statements are purely descriptive.

The Board provides no explanation of why the Board has chosen to reference an efficiency gap ratio or why an efficiency gap ratio of 5.2 results in an interchange fee cap that is consistent with the statute or sound policy, except to state in conclusory fashion that "the Board believes full cost recovery would be unreasonable."[218] A cost-recovery target of 99.5 percent of transactions, such as the current 21 cent base component achieves, would also not allow for full cost recovery by all issuers. The Board does not even attempt to anticipate and answer fundamental questions raised by its proposed approach, including why the efficiency gap ratio is an appropriate metric to be used by the Board and why an efficiency gap ratio of 5.2 is reasonable, but other efficiency gap ratios identified by the Board are not, such as the efficiency gap ratio of 7.7 that is associated with the 99.5 percent of covered issuer transactions for which cost recovery is achieved today. In short, the Board appears to seize on its approach simply because it is *possible* but offers little to no explanation for why it is a permissible or desirable approach in light of the statutory objectives. Indeed, given that a group of merchant trade

[214] *Id*. at 78108.

[215] *Id.* at 78105.

[216] *Id.* at 78107.

[217] *Id.* at 78107-08.

[218] *Id.* at 78107.

associations requested that the Board adopt essentially the same approach that the Board now proposes, it seems plausible that the Board has based the proposal on the merchants' preferred methodology and proposed a cap that would result in a substantial revenue increase for the largest corporate retailers consistent with the merchants' petition.

Despite the lack of attention paid to it in the proposal, the decisions by the Board to use a new transaction weighted methodology and to target 98.5 percent cost recovery of covered issuer transactions drive a substantial reduction in the interchange fee cap. In 2021, interchange fee recovery across all debit and general-use prepaid card transactions totaled $31.59 billion. Had the Board proposed the average historic cost recovery target of 99.5 percent of covered issuers, the base component would be 17.6 cents, a 16 percent reduction from the current base component cap of 21 cents.[219] By choosing the 98.5 percent target, the base component is reduced an additional 18 percent to 14.4 cents.[220] The Board is obligated to better support and justify a rulemaking decision which would permanently deny issuers the ability to recover such a significant amount of their costs.

The selection of a "cost-recovery target" of 98.5 percent compounds the Board's arbitrary abandonment of its original methodology in which it sought to allow for a cap that is reasonable and proportional "to the overall cost experience of the substantial majority of covered issuers." The Board should abandon both aspects of its proposed approach—the transaction-weighted average methodology and the new cost-recovery target—in favor of an approach that gives appropriate weight to the experience of <u>all covered issuers</u>, as is the case with the existing regulation and as required by the statute. The Board does not justify, and likely cannot justify, why the Durbin Amendment now requires—let alone permits—even more covered issuers—34 percent—to be prohibited from recovering even the narrow subset of costs the Board has determined are allowable, in addition to not being designed to allow for any issuer to receive a reasonable return.

C. <u>The Proposal's Use of an Inaccurate Model is Arbitrary and Lacks a Reasoned Explanation</u>

As noted previously, under the Board's proposed methodology, the base component would be determined by multiplying the transaction-weighted average of base component costs (per-transaction) across covered issuers by a fixed multiplier. The Board proposes to base the fixed multiplier on the ratio between the average cost in a Weibull distribution and the cost of a target percentile of transactions in a Weibull distribution. The new cap for the base component costs would be the product of this fixed multiplier and the transaction-weighted average of per-transaction base component costs. Thus, as described further herein, the Board further compounds its arbitrary design of the proposed rule, because, rather than targeting cost recovery for 98.5 percent of transactions based on data the Board ***actually collects and possesses***, the Board inexplicably proposes to use a "Weibull distribution" model to estimate the base component costs that would achieve its targeted cost recovery of 98.5 percent of transactions. In fact, the model is a poor fit for such costs and thus inappropriate to be used to determine the costs at a given recovery target, which the Board does not acknowledge or address. Furthermore, the use of this distribution is wholly unnecessary, as the Board possesses the actual data and thus knows the cost recovery at any given cost recovery target.

The Board asserts that the shape of the distribution of the per-transaction base component

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[219] *Id.* at 78113.

[220] *I*d.

costs across covered issuers has not changed markedly between data collections and can be approximated using a Weibull distribution. After publishing the proposed rule, the Board released additional data related to its use of the Weibull distribution to set the base component of the interchange fee, including the historical accuracy with which the Weibull distribution has approximated covered issuers' per-transaction base component costs, which is recreated in Table B.

Table B: Average per-transaction base component costs of covered issuer transactions, in cents, by transaction percentile range and year (actual vs. fitted).

Data Collection Year	Distribution	Transaction Percentile Range					
		0-40	40-70	70-90	90-95	95-99	99-100
2009	actual	3.7	7.5	10.7	14.4	17.2	41.9
	fitted	2.2	6.7	12.5	18.7	24.6	37
2011	actual	2.9	4.2	7.2	10.1	12.3	22.5
	fitted	1.4	4.4	8.2	12.4	16.3	24.2
2013	actual	2.8	3.6	5.8	8.6	12.5	31.7
	fitted	1.3	4.1	7.5	11.1	14.7	21.4
2015	actual	2.6	3.5	5	7.8	11.9	26.4
	fitted	1.2	3.7	6.9	10.1	13.3	19.2
2017	actual	2.2	3.1	4	6.6	9.8	21.6
	fitted	1	3.1	5.8	8.6	11.5	16.8
2019	actual	2.2	3.3	4.6	8	11.2	24.2
	fitted	1.1	3.5	6.3	9.3	12.3	18.6
2021	actual	2.3	3.2	4.4	8	12.1	21.6
	fitted	1.1	3.4	6.3	9.6	12.6	17.8

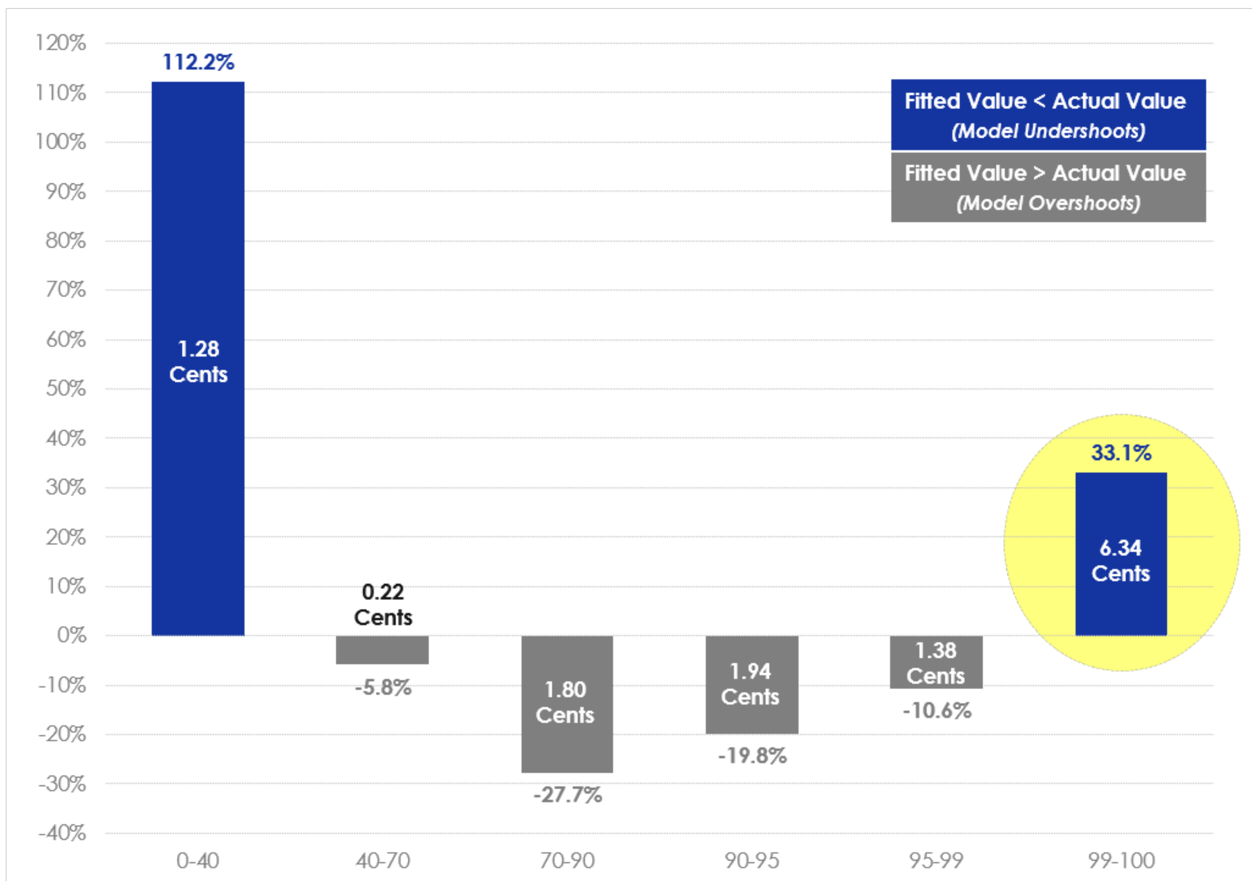
Source: Federal Reserve, Regulation II (Debit Card Interchange Fees and Routing): *Additional Data Concerning the Proposed Methodology for Determining the Base Component of the Interchange Fee Cap,* Table 2.

The first row for every year represents the average per-transaction base component costs of covered issuer transactions that fall within the specified percentile range. The second row for each year represents the average per-transaction base component costs of covered issuer transactions for the same percentile ranges using the "fitted" Weibull distribution. Comparing the fitted data of a Weibull distribution to the actual data demonstrates the relative fit of the Weibull distribution to the actual cost data over time.

However, as seen in Figure A below, over the last five collection periods the Weibull distribution does not approximate issuers' actual cost data particularly well. Importantly, the Board's published data do not permit an analysis of the goodness-of-fit of the Weibull distribution to the proposed cost-recovery target of 98.5 percent based on actual data, as this point is aggregated within the larger cohort of 95 to 99 percentiles. Withholding the 98.5 percentile fit denies the public the "most critical factual material" on which the Board relies and denies the public "further opportunity to comment," contrary

to the APA.[221] As illustrated, for data in the 90–95, 95–99, and 99–100 percentile groups, the fitted data misses the actual data by a sizeable amount. Of particular concern, the average difference between the fitted and actual values in the final percentile leads to an "undershoot" of 33.1 percent, or more than six cents per transaction.

Figure B: Average difference between fitted values (Weibull) and actual values across percentile ranges, 2013 – 2021. (Source: Federal Reserve, Regulation II (Debit Card Interchange Fees and Routing): Additional Data Concerning the Proposed Methodology for Determining the Base Component of the Interchange Fee Cap; Authors' analysis.)



[221] *Chamber of Commerce*, 443 F.3d at 900-01.

Moreover, the Board's data also reveals that the Weibull distribution has *consistently* undershot actual costs at this point in the distribution, with a magnitude ranging from 21–48 percent of actual costs over the last five years (see Table C).

Table C: Average Per-Transaction ACS Costs of Covered Issuer Transactions, 99 – 100 Percentile, 2013 – 2021 — Actual Costs vs. Estimated Costs Using Weibull Distribution (Source: Regulation II (Debit Card Interchange Fees and Routing) — Additional Data Concerning the Proposed Methodology for Determining the Base Component of the Interchange Fee Cap; Authors' analysis.)

Year	Estimated Costs (Weibull Distribution	Actual Costs (Issuer Survey)	Undershoot of Cost Estimate	
			%	¢
2013	$0.214	$0.317	48.1%	10.3¢
2015	$0.192	$0.264	37.5%	7.2¢
2017	$0.168	$0.216	28.6%	4.8¢
2019	$0.186	$0.242	30.1%	5.6¢
2021	$0.17.8	$0.216	21.3%	3.8¢
Average	-	-	**33.1%**	**6.3¢**

In this way, the Weibull distribution suffers from a significant and consistent downward bias compared to observed cost data at the tail end of the cost distribution. Indeed, in both percentage and dollar terms, the Weibull distribution's performance is weakest in the part of the cost distribution that is most relevant to setting the base component of the cap. This lack-of-fit is significant in percentage terms and is even more problematic in dollar terms, as costs rise sharply in this part of the distribution and the importance of a well-fitting model is magnified. Moreover, while any model could result in some degree of error, well-fitting models will result in both positive and negative error terms rather than only missing on the low side or high side. The proposed Weibull distribution, however, has consistently underestimated costs between the 99 – 100 percentile, including a 21.3 percent underestimate in 2021.

Given the model's consistent downward bias in the most important segment of the distribution, it is unreasonable that the Board did not incorporate an adjustment factor to offset this bias and improve fit. There are several ways the Board could have chosen to make this adjustment. For example, it could have proposed adjusting the model upward (or downward) by the same average percentage as the model has undershot (or overshot) actual costs over the most recent five issuer surveys. Alternatively, it could have adjusted the model upward (or downward) by the same average number of cents as the model has undershot (or overshot) actual costs over the most recent five issuer surveys. Each of these methods would calculate the adjustment factor using a moving average of

previously collected data (i.e., the adjustment would occur automatically). While the Board did not publicly publish the actual and fitted values at the 99.5 percentile, based on data that is available for the 99 – 100 percentile, the baseline component based on 2021 data would rise to 23.7 cents under the first method and 24.1 cents using the second method. However, the Board proposes no adjustment factor, instead proposing to adopt a poorly fitted model which will arbitrarily deny issuers interchange recovery otherwise called for by the Board's own data. Given the fact that actual per-transaction base component costs are clearly higher than the Board's poorly-fitted Weibull model would predict, the Board should at a minimum include an adjustment factor.

Importantly, the Board provides a circular explanation as to why using a Weibull-based model is necessary at all. The Board collects the actual cost data from issuers every two years. Instead of using a model to approximate the base component cost that corresponds to a particular cost-recovery target, the Board can simply use the actual average per-transaction base component costs of covered issuers and identify the value that meets a particular cost-recovery target by performing the Board's current distribution analysis. Doing so would eliminate the need for both a fitted model and a multiplier. This figure could be published biennially by the Board just as easily as it proposes to calculate and publish the actual transaction-weighted average cost or any of the actual transaction percentile ranges that appear in Table A above. Furthermore, the Board could consider using a moving average of this actual value if it was concerned about excessive volatility.

The Board notes simply that it "considered determining the base component by reference to a target percentile in (i) the distribution of per-transaction base component costs, arranged from lowest- to highest-cost covered issuer, or (ii) the distribution of per-transaction base component costs across covered issuer transactions" but in both cases, "the Board determined that these methodologies could result in a base component that does not reflect changes over time in the transaction-weighted average of per-transaction base component costs across covered issuers due to the sensitivity of these alternative methodologies to low-volume, high-cost covered issuers."[222] This curt statement fails to explain why it is consistent with the statute, the APA, or sound policy to use the Weibull model and a corresponding multiplier rather than to rely on the actual issuer data reported in its mandatory issuer cost survey. The proposed use of the Weibull model fails to meet the Board's obligations under the statute to set the cap in relation to actual issuer costs and is unnecessarily inaccurate. Additionally, the fixed multiplier, which is determined by the cost recovery target in the proposal, would not be subject to biennial adjustment, unlike other variables in the proposal, meaning that the model would not be adjusted even if the actual cost data consistently skews even further away from the Board's model. For these reasons, should the Board proceed with amending Regulation II, the reliance on a Weibull distribution should be abandoned. If, despite all of the statutory and practical deficiencies with using a Weibull distribution, the Board nevertheless chooses to use that model, it should target the historical cost recovery of 99.5 percent and incorporate an adjustment factor to offset the model's consistent underestimation of costs at that target.

D. The Proposed Biennial Recalculation of the Interchange Fee Cap is Both Substantively and Procedurally Deficient

The proposed rule would allow the Board to reset, automatically and on a biennial basis, the base component, *ad valorem* component, and fraud-prevention adjustment of the interchange fee cap without providing the public an opportunity to participate in the changes through the notice-and-

[222] 88 Fed. Reg. 78100, 78108.

comment process.[223] The Board's proposal to automatically update the interchange fee cap is flawed for several reasons.

First, the Board's basis for establishing an auto-renewing interchange cap is inconsistent with its own reasoning elsewhere in the proposed rule. The Board claims to have abandoned its prior methodology for calculating the base component of the interchange fee cap because the data it examined changed in the more than a decade since it promulgated the 2011 rule. If, under the Board's reasoning, changes in the data over the last few years required a revised methodology in its new proposed rule, there is good reason to expect that future years will similarly yield changed data indicating that the methodology should be revisited. That deficiency is amplified by the unreliability of the data considered by the Board in support of the proposed rule, as described throughout this letter.[224] The Board fails to adequately explain its presumption that the data will remain consistent enough to justify adopting the proposed flawed methodology that would automatically be used every other year to revise the interchange fee cap and allow the Board to not exercise any discretion in setting the cap, as the Board asserts would be the case with the automatic adjustment.

Second, the proposed rule's biennial recalculation of the interchange fee cap violates the Administrative Procedure Act's requirement that the Board provide notice and an opportunity to comment on the rules it establishes and proposed amendments thereto.[225] The Board acknowledges as much, but argues that the Proposed rule "should qualify for the good cause exemption from notice and comment rulemaking because such determinations would involve the ministerial application of the approach described" by the proposed rule, and because "the Board would not be exercising any discretion in connection with such determinations."[226] The Board is incorrect that the good cause exception allows it to skirt Congressionally mandated notice-and-comment procedures—the exception is not meant to "provid[e] agencies with an 'escape clause' from the requirements Congress prescribed."[227]

The good cause exception to notice-and-comment rulemaking applies only where notice and comment would be "impracticable, unnecessary, or contrary to the public interest."[228] "The good cause exception is to be narrowly construed and only reluctantly countenanced."[229] The exception is "typically applied … to 'excuse[] notice and comment in emergency situations, where delay could result in serious harm, or when the very announcement of a proposed rule itself could be expected to precipitate activity by affected parties that would harm the public welfare."[230] "[R]egulations which respond … to much more than the exigencies of the moment must be promulgated through public procedures before they

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[223] *See* 88 Fed. Reg. 78100.

[224] *See infra* Section III.A.

[225] 5 U.S.C. § 553(b)-(c).

[226] 88 Fed. Reg. 78100, 78109 n.58.

[227] *United States v. Garner*, 767 F.2d 104, 120 (5th Cir. 1985).

[228] 5 U.S.C. § 553(b)(3)(B).

[229] *Amer. Public Gas Ass'n v. United States Dep't of Energy*, 72 F.4th 1324, 1339 (D.C. Cir. 2023) (citation omitted).

[230] *Amer. Public Gas Ass'n*, 72 F.4th at 1339-1340 (quoting *Chamber of Commerce*, 443 F.3d at 908).

are chiseled into bureaucratic stone."[231]

Here, the Board points to no emergency, no impracticability, and no harm to the public interest that would result from allowing notice and comment on future revisions to the interchange fee cap. Instead, its stated rationale—that future changes to the interchange fee cap will be "ministerial" and nondiscretionary—must rest solely on the Board's determination that providing notice and comment would be "unnecessary."

The "unnecessary" prong of the good cause exception is "confined" "to those situations in which the administrative rule is a routine determination, *insignificant in nature and impact, and inconsequential to the industry and to the public.*"[232] Even if the Board were correct that the biennial recalculation it establishes would be "routine," it cannot establish—and has not even attempted to establish—that future changes to the interchange fee cap would be "insignificant" or "inconsequential." First, because the Board cannot predict the future, it cannot determine whether the data underlying its methodology for calculating the interchange fee cap will be significant or not—significant changes in the data would, under the automated recalculation the Board proposes, result in significant changes to the interchange fee cap. More importantly, this issue is one with massive implications for consumers, financial institutions, and merchants, as discussed in greater detail throughout this letter.[233] The Board's appeal to the purportedly ministerial nature of the automatic recalculation it proposes does not address the significance or consequence of a changed interchange fee cap on these stakeholders, and accordingly, does not and cannot satisfy the good cause exception to Congressionally mandated notice-and-comment procedures.

E. <u>The Board's Conclusions are Based on Unreliable Data</u>

The Board has not demonstrated whether the reporting of the survey data differs across issuers. For example, the majority of card issuers rely on core services providers to report the data requested and they have reported experiencing extraordinary difficulty in obtaining data necessary to complete the survey. In full transparency, the Board should disclose the percentage of institutions that report blank or "NR" for each data field. If small and medium sized issuers are overly represented as non-reporting certain data fields, the aggregate data that is reported will skew in an unrepresentative way toward the largest issuers. In addition, as noted, the Board has not explained how it addresses outliers in the survey responses or how it treats blank responses or any other ways in which it may construct the data in calculating issuer costs or whether it has engaged in any such manipulation on a consistent basis since the survey was first issued in 2011. All of these elements are of critical importance in ensuring that the data are reported comprehensively and consistently and that the Board's calculations of issuer costs are consistent across time and reflect the cost experience of issuers across the ecosystem. It is essential that the Board's methodologies are understood by the public so that the public can meaningfully comment on whether the Board's methodologies are defensible and its calculations are accurate.

If the Board intends to rely on the debit card issuer survey to re-visit Regulation II's interchange fee standard and to automatically adjust its hard price cap based on such surveys, the Board should first devote significant effort to ensuring that it is collecting complete and accurate data across all covered

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[231] *Am. Fed'n of Gov't Emp., AFL-CIO v. Block*, 655 F.2d 1153, 1157 (D.C. Cir. 1981).

[232] *Mack Trucks, Inc. v. EPA*, 682 F.3d 87, 94 (D.C. Cir. 2012).

[233] *See infra* Section III.A.

issuers, including by engaging directly with covered issuers.

Even if the Board had ensured that the data is consistently reported across all issuers and had explained how it addresses outliers and other data anomalies, the data collected from 2021 were likely skewed in light of the global pandemic and the changes in behavior during that period, including a sustained increase in card-not-present transaction activity during and after the pandemic, a substantial shift of fraudsters' attention away from ordinary debit card transactions and toward government Covid-19 benefits and programs, and other relevant factors that are likely to cause the 2021 data to be unrepresentative of a typical two-year reporting period. According to the Board's 2021 interchange fee cost report, debit transaction volume grew 14.6 percent from 2020 to 2021, which is double the average transaction volume growth rate from 2009 to 2019 (i.e., 7.7 percent) and fourteen times the transaction volume growth rate from 2019 to 2020 (i.e., 1.4 percent). This data shows that 2021 was an anomalous year that should not be used as a benchmark for reducing the interchange fee cap. As such, revising the interchange fee standard based on 2021 survey data is arbitrary and capricious.

Issuer responses to the Debit Card Issuer Survey for calendar year 2023 have already been submitted to the Board, and the 2023 debit card issuer survey will at least provide the Board with more current data that should largely be free from skewing effects of the pandemic that made 2021 an anomalous year. Moreover, unlike the 2021 debit card issuer survey, the 2023 survey data may provide some insight into the impact of certain material intervening events and changes that have occurred in the debit card market since 2021, including the initial effects of the Board's card-not-present routing amendments to Regulation II, which took effect on July 1, 2023, changes to card network rules designed to shift fraud losses from merchants to card issuers, [234] and rapid growth in contactless and mobile wallet usage. Accordingly, the Board should, at a minimum, wait until it has evaluated the 2023 issuer survey data before proceeding with proposing any changes to Regulation II.

However, because the 2023 data likely will not reveal the full effect of either the routing requirements or the changes in network rules given that they were not effective until partway through 2023, the Board should wait to consider proposing revisions to the rule until it collects the 2025 data. In addition, ideally, the Board would wait to proceed with any possible rulemaking until it can ensure – and demonstrate to the public – that all covered issuers are able to report all data fields consistently and accurately, which it could do prior to the 2025 data collection.

The Board must take a cautious and analytical approach to revisiting Regulation II, particularly before making the type of foundational, sweeping, and proposed-to-be automatically-enduring changes in the proposed rule.

F. The Board's Proposal Regarding the *Ad Valorem* Component and Fraud-Prevention Adjustment is Unsupported by Reasoned Decisionmaking

While the Board has proposed to upend the methodology for calculating the base component of the interchange fee cap, the Board has elected to maintain the median ratio for the *ad valorem*

[234] For example, Visa updated its rules in April 2023 to make it easier for merchants to return chargebacks for allegedly fraudulent transactions to issuers, a change that will reduce merchant fraud losses and increase issuer fraud losses. https://usa.visa.com/content/dam/VCOM/regional/na/us/support-legal/documents/evolution-of-compelling-evidence-merchant-faqs-mar2023.pdf (visited May 3, 2024).

component. In 2011, the Board asserted in the final rule for Regulation II that "[u]sing the median figure [for the *ad valorem* component] recognizes that . . . fraud losses can result from the action[] or inaction of merchants as well as issuers, and will provide incentives for both issuers and merchants to take appropriate steps to reduce fraud losses, since each group will incur some costs for these losses."[235] The Board points to this reasoning in the proposed rule as justification for maintaining the methodology for calculating the *ad valorem* component.[236] But that proffered justification appears to hinge on the fact that issuers should be required to split fraud losses with merchants, a concept that finds no foothold in the text of the Durbin Amendment or sound policy. To make matters worse, the Board's flawed methodology denies 50 percent of covered issuers full cost recovery for fraud losses, and the Board provides no justification or explanation for this result.

Had the Board shifted away from the median ratio approach to a transaction-weighted-average approach for the *ad valorem* component, as it has proposed to do with the base component, the *ad valorem* component would <u>increase</u>, not decrease.[237] Indeed, dividing the transaction-weighted average issuer fraud losses by the average transaction value would result in an *ad valorem* of 4.7 bps for 2011[238] and an *ad valorem* of 6.0 bps based on 2021 data.[239] We believe the Board should use the issuer-weighted average issuer fraud loss figures, which would result in an 11.4 bps *ad valorem* for both 2011 and 2021, consistent with our concerns that a transaction-weighted average is not representative of all issuers.[240] Instead, the proposed rule relies on the cost experience of the 50th percentile issuer, which declined from 5 bps in 2011 to 4.4 bps in 2021.[241] Given the importance of this multiplier, the Board should in all cases use an *ad valorem* defined to one tenth of a basis point.[242]

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[235] 76 Fed. Reg. 43394, 43434.

[236] 88 Fed. Reg. 78100, 78108 ("The median ratio of issuer fraud losses to transaction value among covered issuers remains a representative metric of the cost of fraud incurred by covered issuers. Therefore, for the reasons explained in the preamble accompanying the 2011 final rule, the Board believes that the original methodology continues to be appropriate for determining the ad valorem component.")

[237] We note that Appendix B to Part 235(d) describing the Board's method to calculate the *ad valorem* component is unclear as to whether the Board uses the median ratio of "issuer fraud losses to transaction value" on an issuer-by-issuer and then selects the 50th percentile ratio or uses the 50th percentile issuer fraud loss cost (as disclosed on table 14) divided by the average debit card purchase transaction value (as disclosed on table 1). Board of Governors of the Federal Reserve System, *supra* note 23. As the Board does not publish the ratios of issuer fraud losses to transaction value on an issuer-by-issuer basis, we use the 50th percentile issuer cost as disclosed table 14 and the average debit card purchase transaction value as disclosed on table 1.

[238] Board of Governors of the Federal Reserve System, *supra* note 23, sheets 1 and 14 (transaction-weighted average issuer fraud losses for 2011 were $0.018, average transaction size for 2011 was $39.02).

[239] Board of Governors of the Federal Reserve System, *supra* note 23, sheets 1 and 14 (transaction-weighted average issuer fraud losses for 2021 were $0.028, average transaction size for 2021 was $46.26).

[240] Board of Governors of the Federal Reserve System, *supra* note 23, sheets 1 and 14 (Issuer-weighted average issuer fraud losses for 2011 were $0.044, average transaction size for 2011 was $39.02, resulting in 11.398 bps. Issuer-weighted average issuer fraud losses for 2021 were $0.053, average transaction size in 2021 was $46.26, resulting in 11.446 bps.)

[241] We use the 50th percentile issuer cost as disclosed table 14 and the average debit card purchase transaction value as disclosed on table 1. *See, supra* note 23.

[242] Appendix B to Part 235(d) describing the Board's method to calculate the *ad valorem* component proposes to

Given the absence of any rationale in support of this decision, the industry is left to conclude that the re-affirmed 2011 approach is intended to support lowering the interchange fee cap. In short, the Board has failed to offer any legal or policy rationale to justify its decision to adopt a transaction-based methodology for setting one component of the cap (i.e., the base component), while adopting an issuer-based methodology for another (i.e., the *ad valorem* component).

Similarly, the proposed rule would maintain the median-issuer approach for calculating the fraud-prevention adjustment.[243] In the 2011 final rule, the Board explained that this approach "is intended, in part, to reduce the adjustment as a way to recognize the fraud-prevention and data-security costs of merchants and parallels the *ad valorem* component, which was set at the median issuer's per-transaction fraud losses."[244] However, the transaction-weighted average fraud prevention cost has increased from 1.9 cents in 2011 to 2.2 cents per transaction in 2021, while the issuer-weighted average fraud prevention cost has declined from 27.0 cents in 2011 to 8.2 cents in 2021.[245] Both 2.2 and 8.2 cents are substantially larger than the proposed 1.3 cents.

Again, while the proposed rule would upend the methodology for calculating the base component of the interchange fee cap, the Board elects to maintain the existing methodology for calculating the fraud-prevention adjustment without providing justification as to why the base component should change but the fraud-prevention adjustment should remain the same. And here again, as to an indisputably important part of debit card services—fraud prevention—the Board proposes to deprive 50 percent of covered issuers cost recovery for their fraud prevention costs.

The decision to establish an *ad valorem* component and fraud prevention adjustment that ensures *half* of covered issuers will be unable to recoup their costs contributes significantly to the proposed rule's violation of the Durbin Amendment itself and the requirement that rules establishing price caps must allow a reasonable rate of return.[246] The use of a median calculation for these two components of the interchange fee cap accordingly violates the Durbin Amendment and compounds the "serious doubt" as to the constitutionality of the proposed rule.[247]

This defect is especially important because issuer fraud costs and losses are expected to rise with recent material changes in the debit card market, including:

- Effects of the card-not-present routing amendments to Regulation II;
- New network rules which shift liability for card-not-present transactions from merchants to issuers if merchants adopt certain anti-fraud technologies; and
- The rapid growth in contactless and mobile wallet usage, and PIN-less card-not-present

round this value "to the nearest quarter of one basis point."

[243] 77 Fed. Reg. 46258, 46265.

[244] *Id*.

[245] Board of Governors of the Federal Reserve System, *supra* note 23, sheet 14.

[246] *See supra* Section III.A.

[247] *See Zadvydas*, 533 U.S. at 689; *supra* Section III.A.

transactions.

As the Board acknowledges in the proposal, "in 2021, the most commonly reported and highest-value fraud types for covered issuer transactions were card-not-present fraud," which "accounted for almost half of overall fraud on covered issuer transactions in 2021." The Board also observed that in 2021, single-message transactions had on average lower fraud losses than dual-message transactions, which the Board attributes in part to "differences in the use of single- and dual-message networks for card-not-present transactions" because single message networks continue to be used relatively rarely for card-not-present transactions."[248] The reason those transactions were generally not routed over single-message networks is because some of those networks did not have sufficiently robust security systems to combat fraud for card-not-present transactions, in contrast to dual-message networks.

In July of 2023, the Board's amendments to Regulation II requiring that (i) each card-not-present debit card transaction can be processed on at least two unaffiliated payment card networks, and (ii) debit card issuers ensure that at least two unaffiliated networks have been enabled to process a debit card transaction became effective.[249] As a result, many more card-not-present transactions will likely be shifted to single-message networks, which may not have sufficiently robust fraud detection and prevention technology, likely increasing fraud and investment in fraud prevention measures to address the weaknesses with certain networks' fraud controls. The Board should, at a minimum, not proceed with proposing or finalizing any amendments to Regulation II until the full impact of the Board's recent amendments to the Regulation's network routing provisions can be discerned from survey data.

In addition, changes to card network rules have recently taken effect that will shift fraud losses from merchants to card issuers, the impact of which the Board should consider before proposing any amendments to the existing rule. The Board should, thus, at a minimum, wait until it can assess the full impact of the new routing requirements and the changes in network rules that will shift fraud losses from merchants to card issuers. This means that the Board should postpone any adjustments to the interchange cap until after the calendar year 2025 data collection, rather than use the inferior and outmoded 2021 data. In addition, the Board should wait to proceed with any possible rulemaking until it can ensure – and demonstrate to the public – that all covered issuers are able to report all data fields consistently and accurately, which it could do prior to the 2025 data collection.[250]

V. <u>The Board is Not Legally Compelled to Issue the Proposal</u>

Finally, there is no legal requirement in either the Durbin Amendment or the current regulation that the Board revisit the existing rule. The Durbin Amendment authorizes the Board to collect information from issuers and payment networks and provides that "in issuing rules" under the statute

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[248] 88 Fed. Reg. 78100, 78118 (Nov. 14, 2023).

[249] 87 Fed. Reg. 61217 (Oct. 11, 2022).

[250] *See Paypal, Inc. v. Consumer Fin. Prot. Bureau*, 2024 U.S. Dist. LEXIS 58976, at 31. "All told, in imposing a prescriptive and burdensome disclosure regime on a nascent and fast-evolving product, the CFPB was required to offer-at a minimum-'a rational connection between the facts found and the choice made,' and some quantitative or qualitative assessment of the 'costs' of regulation for digital wallets as well as its 'benefits.' The CFPB did neither, and instead tried to solve an imaginary problem with no real evaluation of what the 'solution' would cost digital wallet providers or consumers. These missteps render the Prepaid Rule's short-form disclosure requirement arbitrary and capricious and contrary to law. Administrative arrogance of this magnitude is hardly deserving of judicial imprimatur!" (citations omitted).

"and on at least a bi-annual basis thereafter . . . the Board shall disclose such aggregate or summary information concerning the costs incurred, and interchange transaction fees charged or received, by issuers or payment card networks . . . "[251] But the statute does not require the Board to review, revisit, or amend the rule the Board promulgates as required by the statute. The only reference in the statute to adjusting interchange fees is in the provision permitting, but not requiring, the Board to make adjustments for fraud prevention costs.[252] However, that authority contemplates an "adjustment" to the interchange fee standard that the Board is required to adopt under the statute at the time of such adoption and in no way refers to a periodic revisiting or adjustment of the interchange fee standard more generally. Furthermore, although the Board stated in 2011 when finalizing Regulation II that it "anticipates that it will periodically conduct surveys of covered issuers in order to reexamine and potentially reset the fee standard," that statement was only an explanation of the final rule and in no way creates a legal obligation for the Board to revisit the fee standard. Indeed, that statement does not even represent a commitment to revisit or revise the standard.

Finally, as noted previously, while a group of retail merchant trade associations filed a petition for rulemaking with the Board in December 2022, this on its own does not create a legal obligation for the Board to lower the cap. The APA gives interested persons the right to petition an agency to amend a rule, but nothing requires an agency to take the action specifically requested in a petition. Indeed, the APA contemplates that a petition may be denied, requiring that a notice of denial of a petition must be accompanied by a brief statement of the grounds for denial.[253] Therefore, the Board is under no legal obligation to propose changes to the rule.

VI. The Proposed Transition Period

The proposal calls for an effective date of the final regulation which would begin on the first day of the next calendar quarter that begins at least 60 days after the final rule is published in the Federal Register. Proposed section 235.3(b) would create a stub period, beginning from the effective date through June 30, 2025, during which the interchange cap would be set based on the calendar year 2021 issuer survey data. Even if the Board were to finalize the rule largely as proposed by the end of 2024, an inappropriately short period of time for the Board to address our significant concerns, this stub period would likely be only one calendar quarter long before the standard biennial periodic update would take effect on July 1, 2025.

The costs of accommodating a temporary three month rate cap only to then reset the cap in accordance with calendar year 2023 data by July 1, 2025, are in no way outweighed by the benefits of this provision. The change management required, the cost to industry, and contractual accommodations between acquirers and merchants would be both material and unnecessary. As a practical matter, issuers, networks, and merchants would be working to implement both the stub period

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[251] 15 U.S.C. § 1693o–2(a)(3)(B).

[252] 15 U.S.C. § 1693o–2(a)(5)(A).

[253] Section 553(e) of the Administrative Procedure Act provides that "[e]ach agency shall give an interested person the right to petition for the issuance, amendment, or repeal of a rule," but nothing requires an agency to take the action requested in the petition. Indeed, the APA contemplates that a petition may be denied, and that any such denial must be justified by a statement of reasons pursuant to section 555(e) and can be appealed to the courts under sections 702 and 706 of the APA. *See* 5 U.S.C. §§ 553(e), 555(e), 702, and 706; *see also Auer v. Robbins*, 519 U.S.C 452, 459 (1997).

rate cap and the rate cap effective on July 1, 2025, at the same time. As the Board already has issuer cost data from 2023, these unnecessary costs can be avoided by the Board reasonably applying the 2023 cost data to any stub period before the proposed biennial updates begin on July 1, 2027.

* * * * * *

In closing, the Associations encourage the Board to withdraw the proposed rule for the legal and policy reasons explained in this letter.

Thank you for your consideration and review of these comments. If you have any questions or wish to discuss this letter, please do not hesitate to contact Paige Pidano Paridon at (703) 887-5229 or paige.paridon@bpi.com or Rodney Abele at (347) 703-1839 or rodney.abele@theclearinghouse.org.

Respectfully,

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/s/
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/s/
Paige Pidano Paridon
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/s/
David Pommerehn
SVP, General Counsel, Head of Regulatory Affairs
Consumer Bankers Association

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Jeffrey Tassey
Chairman of the Board
Electronic Payments Coalition

/s/
Anne Balcer
Senior Executive Vice President
Chief of Government Relations and Public Policy
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/s/
Brent Tjarks
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Mid-size Bank Coalition of America

/s/
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President and CEO
National Bankers Association

/s/
Rodney Abele
Director of Regulatory & Legislative Affairs
The Clearing House Association

Appendix 1

American Bankers Association

The American Bankers Association is the voice of the nation's $23.7 trillion banking industry, which is composed of small, regional and large banks that together employ approximately 2.1 million people, safeguard $18.8 trillion in deposits and extend $12.5 trillion in loans.

America's Credit Unions

America's Credit Unions is the voice of consumers' best option for financial services. We represent our nation's nearly 5,000 federally and state chartered credit unions that collectively serve nearly 140 million consumers with personal and small business financial service products. America's Credit Unions delivers strong advocacy, resources, and services to protect, empower and advance credit unions and the people they serve. We advocate for responsible legislative policies and regulations so credit unions can efficiently meet the needs of their members and communities.

Bank Policy Institute

The Bank Policy Institute is a nonpartisan public policy, research and advocacy group that represents universal banks, regional banks, and the major foreign banks doing business in the United States. The Institute produces academic research and analysis on regulatory and monetary policy topics, analyzes and comments on proposed regulations, and represents the financial services industry with respect to cybersecurity, fraud, and other information security issues.

Consumer Bankers Association

The Consumer Bankers Association is the only national trade association focused exclusively on retail banking. Established in 1919, the association is a leading voice in the banking industry and Washington, representing members who employ nearly two million Americans, extend roughly $3 trillion in consumer loans, and provide $270 billion in small business loans. See the Consumer Bankers Association's web page at consumerbankers.com

Electronic Payments Coalition

The Electronic Payments Coalition is the credit unions, community banks, payment card networks and institutions who support the electronic payments system, the backbone of our economic system."

Independent Community Bankers of America

The Independent Community Bankers of America® has one mission: to create and promote an environment where community banks flourish. We power the potential of the nation's community banks through effective advocacy, education, and innovation.

As local and trusted sources of credit, America's community banks leverage their relationship-based business model and innovative offerings to channel deposits into the neighborhoods they serve, creating jobs, fostering economic prosperity, and fueling their customers' financial goals and dreams. For more information, visit ICBA's website at icba.org.

Mid-size Bank Coalition of America

Across the country mid-size banks are providing financial solutions to entrepreneurs, professionals, their businesses and their families. Mid-size banks fuel their growth and build stronger connections to the communities in which they operate. The MBCA is proud to be their voice and their self-help network. The MBCA's-member banks average less than $20 billion in size and serve customers and communities through more than 10,000 branches in all 50 states, the District of Columbia, and three U.S. territories."

National Bankers Association

The National Bankers Association is the leading trade association for the country's minority depository institutions (MDIs). Our members include Black, Hispanic, Asian, Pacific Islander, Native American, and women owned and operated banks across the country who are on the front lines of closing the racial wealth gap by providing access to financial services, mortgages, and small business loans to low- and moderate-income (LMI), minority, and underserved communities. Many of our member institutions have become banks of last resort for consumers and businesses underserved by mainstream financial institutions.

The Clearing House Association L.L.C.

The Clearing House Association L.L.C., the country's oldest banking trade association, is a nonpartisan organization that provides informed advocacy and thought leadership on critical payments-related issues. Its sister company, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the U.S., clearing and settling more than $2 trillion each day. *See* The Clearing House's web page at www.theclearinghouse.org.

Appendix 2

Survey of Studies Examining the Impact of the Durbin Amendment and Regulation II's Interchange Fee Cap

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