May 12, 2024

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

Re: NASCUS Comments on Board of Governors of the Federal Reserve System Notice of Proposed Rulemaking: Debit Card Interchange Fees and Routing (Docket No. R–1818, RIN 7100–AG67).

Dear Secretary Misback:

The National Association of State Credit Union Supervisors (NASCUS)[1] provides the following comments on the Federal Reserve System Board of Governor's (Board) Notice of Proposed Rulemaking (Proposal or Proposed Rule) entitled "Debit Card Interchange Fees and Routing."[2] NASCUS appreciates the opportunity to share its views and those of state credit union system stakeholders on this important matter.

Our comments raise potential safety and soundness concerns unique to credit unions, specifically the potential impact of the Proposed Rule on credit union regulatory capital and consumer access to financial services. Experience with the previous implementation of limitations on interchange fees confirms that the benefits to consumers are uncertain, at best, and realistically unlikely. Accordingly, the Board must counterbalance the speculative benefits of the Proposed Rule with the potential harm to consumers that would follow the downward pressure on the regulatory capital positions of credit unions that have historically provided an affordable alternative for retail financial services to consumers, particularly those of more modest means. NASCUS recognizes that the Proposed Rule, as currently designed, would only apply to large issuers, but in practice the changes will likely affect issuers at all levels, including credit unions of all sizes, dampening other value-added services provided as part of card issuance and limiting the potential for future innovations.

[1] NASCUS is the professional association of the nation's forty-six state credit union regulatory agencies that charter and supervise over 1800 state credit unions. NASCUS membership includes state regulatory agencies, state chartered and federally chartered credit unions, and other important stakeholders in the state system. State-chartered credit unions hold over half of the $2.25 trillion assets in the credit union system and are proud to represent nearly half of the 140 million members. The remaining 5 states lack state-chartered credit unions.
[2] Federal Register 88 FR 78100 (November 14, 2023),

Potential Impact of the Proposal on Consumers

The Board is required to consider significant harms to consumers, financial institutions and the payment systems resulting from its proposed rulemakings. Analysis[3] of the impact on the initial establishment of interchange caps indicates that the percentage of regulated banks offering free checking declined from 60 percent to less than 20 percent within the first few years of implementation, significantly limiting consumer inclusion in the financial systems through low-cost accounts. Further, checking account fees more than doubled during this period, and nearly 30 percent of respondents who previously reported being banked became unbanked because account fees became too high and unpredictable[4]. Further declines in the cap can only be assumed to accentuate these trends.

With these reported negative implications on affordable access to the financial system, the Proposed Rule will have to result in significant savings to consumers through the lowered cap to offset the previously documented detrimental impact to consumers. Unfortunately, the data is clear that since the implementation of Regulation II in 2011, cost caps have not resulted in lower consumer prices. A New York Federal Reserve study[5] published in 2014 found that 75 percent of respondents surveyed reported no change in prices due to Regulation II, and 23 percent reported raising their prices. Additionally, estimates[6] from the Electronic Payments Coalition indicate the addition of $42 million of income attributable to merchants as of 2016 as a result of the initial fee cap. Further, a study by Nick Bourke[7] estimated consumers face $1 to $2 billion per year in higher costs as a result, and that retailers' estimates for cost savings have been unproven and "likely unmeasurable."

Potential Impact on Credit Union Industry

Credit unions are different from banks; they operate as member-owned and controlled cooperative financial institutions. Credit unions serve restricted membership classes defined by geographic, associational, or employment-based common bonds, and they have different capital requirements than banks. In 1998, Congress enacted the Credit Union Membership Access Act (CUMAA), which imposed Prompt Corrective Action (PCA) requirements on federally insured credit unions. Similar to capital-based standards for banks, this law established capital requirements for credit unions and associated supervisory actions in the event the credit union becomes less than well-capitalized. However, unlike other depository institutions, credit unions are not able to raise capital by issuing stock or other means. By statute,[8] retained earnings provide the only mechanism for credit unions to raise their net worth positions. This definition greatly limits the ability for credit unions to manage their net worth ratios.

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[3] https://bpi.com/regulation-ii-the-big-box-boondoggle-paid-for-by-american-consumers/
[4] 2017 FDIC Survey of Unbanked and Underbanked Households.
[5] The Impact of the Durbin Amendment on Merchants: A Survey Study, Economic Quarterly Volume 100, Number 3 Third Quarter 2014 Pages 183 208
[6] https://www.nafcu.org/newsroom/epc-nafcu-continue-push-durbin-repeal
[7] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4705853
[8] https://uscode.house.gov/view.xhtml?path=/prelim@title12/chapter14&edition=prelim

Because credit unions are limited by the consumer base they are able to serve and are required to maintain significantly higher capital levels than other debit issuers, the negative impacts of the Proposed Rule is much more significant, as it exerts negative pressure on a credit union's retained earnings. Absent the ability to increase earnings and raise capital by other means, a credit union's only choice in this situation would be to discourage deposit growth in order to stem the erosion of its regulatory net worth ratio. Such a move would harm consumers in multiple ways, including denying the benefit of affordable access to retail banking services as depositors, as well as limiting the funds available to make loans and providing other critical member services to the communities they serve.

Notwithstanding the Board's intention to limit the scope of the Proposed Rule as applying to only large issuers, experience confirms that once implemented, the new rules will exert a downstream affect on institutions of all sizes, including credit unions. For example, NASCUS recognizes the importance of compliance with applicable Bank Secrecy, Anti-Money Laundering and Know Your Customer requirements, but is also cognizant of the reality that ever-increasing compliance standards continue to exert increased financial pressure on small- and mid-sized financial institutions. In addition, Regulation E and Consumer Financial Protection guidance place the burden of losses from fraudulent debit card use on financial institutions, even in the case of negligence by the consumer. The increase in third-party and customer fraud has resulted in significant increases in fraud losses for credit unions. Further limiting the diversity of earnings via debit interchange fee limitations while increasing compliance costs may only exacerbate the pressure on these smaller institutions, and inappropriately limit financial systems access within disadvantaged communities that need access the most.

Moreover, from a public policy standpoint, state regulatory agencies are concerned that the Proposed Rule may inadvertently constrict access to financial services if credit unions or other financial institutions can no longer economically provide affordable access to retail banking services.

Reconciliation of the Proposal's Positive and Negative Benefit Impact

As outlined above, state regulatory agencies question whether there are any consumer benefits of the Proposal. Consumers have not previously been the beneficiary of the implementation of these cost limitations and remain unlikely to see any benefit from these proposed changes. Card issuers will continue to be responsible for increasing costs of securing and monitoring the systems to help combat fraudulent or criminal related activities or maintain statutorily required[9] monitoring or compliance standards. The Proposed Rule would artificially limit the ability to recoup those costs at levels related to the most competitive participants, and without recognizing any other value provided as part of the delivery of the product.

[9] https://uscode.house.gov/view.xhtml?path=/prelim@title12/chapter14&edition=prelim

While this is concerning across the industries, it is most pertinent to the credit union industry, where capital is held to a higher standard and is primarily limited to that which can be earned. Implementation of this Proposal under this paradigm will likely require credit unions to limit membership access to financial services based on economic analysis of a member's "profitability" to ensure their own safety, soundness and future viability. Such a reaction would not only represent a public policy consumer-oriented concern with respect to accessibility to legitimate, regulated financial services, but also significantly impact the ability of the industry to maintain an adequate membership base to compete with other financial service providers.

Sincerely,

- signature redacted for electronic publication -

John J. Kolhoff
Senior Vice President,
Policy and Supervision,
NASCUS