

July 2024

ICBA Regulatory Update: Reg II – Proposed Rule to Reduce Debit Interchange

Topic/Issue: Debit Interchange and Routing

Agency: Federal Reserve Board

Overview: On Nov 14, 2023, the Federal Reserve Board proposed updates to Regulation II, which implements the Durbin Amendment's requirements on debit card interchange fees and routing for covered issuers, those with at least \$10 Billion in assets (Covered Issuer). The comment period closed May 12, 2024. Covered Issuers owe their 2023 debit data to the Federal Reserve on May 1, 2024.

Current Debit Interchange: $(\$0.21 + .05\% (\text{Purchase Price}) + \$0.01 = \text{covered issuer interchange})$

Proposal: $(\$0.144 + .04\% (\text{Purchase Price}) + \$0.013 = \text{covered issuer interchange})$, review and adjusted every two years.

ICBA Position:

ICBA has deep concerns about the impact of the Federal Reserve proposed rule to reduce interchange rates at banks with at least \$10 billion in assets. The Durbin amendment, as codified in Reg II, is a highly unsuccessful policy, amounting to government price controls that choose winners and losers among businesses. Government price controls on debit card interchange have caused significant economic harm to community banks and the communities they serve, and further expanding these policies would only compound that harm.

Reps. Blaine Luetkemeyer (R-Mo.) and Andy Barr (R-Ky.) recently [asked](#) the Government Accountability Office to study the potential impact of the Fed's proposal on the availability of low-cost banking products and banking services for low-income consumers.

Rep. Luetkemeyer and Sen. Budd (R-N.C.) have separately [introduced](#) ICBA-supported legislation, the Secure Payments Act of 2024, directing the Fed to stop and study its proposed changes before finalizing the rule.

Talking Points: The Fed's proposal should be withdrawn and repropose for three key reasons:

Data

- The methodology the Board uses is biased against community banks.
- The Board's formula for calculating costs is transaction cost, is an average of fixed and variable costs, which leads to higher per-transaction costs for small banks.
- The Board's segmentation of issuers by high volume, mid volume, and low volume does not adequately reflect the distribution of debit transaction value and volume.

- ICBA member banks are considered High volume banks in many situations, banks under \$50 B are grouped with TBTF banks.
- The data the Board relies on is out of date and incomplete.
 - The Board uses data from 2021, a year of unusual spending patterns.
 - Data does not incorporate the impact from the July 2023 Reg II clarification for online transactions.
 - The Board's overly complicated data requests results in incomplete survey data from financial institutions, especially community banks.

Law

- The Board could be including costs that they are collecting, but not including such as NFS costs.
- The Board should include compliance costs, debit card compliance such as Reg E claim processing on debit card transactions.
- The Board is not legally required to act now, can legally take the time to preform unbiased data collection and academic research.

Policy

- Bad data leads to bad policy
- The current proposal will leave 1/3 of covered issuers not covering costs.
- Federal Reserve Bank of Richmond data shows merchants have pocketed \$12 billion per year in interchange fees without passing the savings along to customers.
- As Fed Governor Michelle Bowman said in voting against the proposal, the agency's cap on debit card interchange puts smaller issuers at a disadvantage, which could cut off access to low-cost and no-cost banking services in local communities — even those served by the community banks that are intended to be exempt from the proposal.
- The Board should update its Payment Card Network and Debit Card Issuer survey
- The Board should study the impact of new developments in the card market, including the evolving role of debit card transactions, the role of Reg II in financial institution consolidation, and the roles of payment facilitators in merchant card acceptance
 - Small businesses process cards are via Payment Facilitators such as Square and Paypal, a major change from 2009. Square and PayPa charge nearly 3% for debit cards. A reduction in debit interchange is just an increase in FinTech profits with no increase in consumer fraud protections or reduction in small business card acceptance costs.