March 21, 2024

Mr. Gene Dodaro
Comptroller General of the United States
Government Accountability Office
441 G Street, NW
Washington, D.C. 20548

Dear Mr. Dodaro,

We write to request that the Government Accountability Office (GAO) study the potential impacts of the Federal Reserve Board's proposal to lower the maximum interchange fee that a large debit card issuer can receive for a debit card transaction.[1]

The "Durbin Amendment" to the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act requires the Federal Reserve Board to ensure that debit interchange fees are "reasonable and proportional" to debit issuer costs relating to debit transactions. The Federal Reserve Board subsequently issued Regulation II, establishing a fee cap that is a sum of (1) 21 cents (base component), (2) 5.0 basis points multiplied by the value of the transaction (ad valorem component), (3) and 1.0 cent, for issuers that meet certain fraud-prevention standards (fraud prevention adjustment).[2]

In November 2023, the Federal Reserve Board issued a rulemaking that would reduce the maximum amount of interchange revenue that debit card issuers with more than $10 billion of assets can earn. The new caps would be (1) 14.4 cents, (2) 4.0 basis points, and (3) 1.3 cents, respectively. This would be the first adjustment of the fee cap since it was introduced by a 2011 Fed rulemaking. The Federal Reserve Board also proposed to amend Regulation II so it would update the fee cap every other year going forward, without seeking public comment.

It is clear that the Durbin Amendment harmed consumers and financial inclusion, overall

Banks and credit unions have long relied on interchange revenue in reducing overdraft fees and expanding access to free checking. In the years since the original debit interchange fee cap was enacted, there has been substantial scholarship– including research from the GAO and Federal Reserve Board economists involved with the proposed rule– demonstrating that the by reducing interchange revenue, the Federal Reserve Board's Regulation II has caused material harm to consumers, by increasing the cost of checking account services that would otherwise benefit low-deposit consumers.

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[1] Federal Reserve Board, Debit Card Interchange Fees and Routing, 88 FR 78100 (proposed Nov. 14, 2023), available at https://www.federalregister.gov/documents/2023/11/14/2023-24034/debit-card-interchange-fees-and-routing.
[2] 12 CFR Part 235.

- In its February 2022 review of factors affecting household access to banking services, the GAO concluded that "[d]ebit card interchange fee limits imposed by the Durbin Amendment and Regulation II are associated with increases in the costs of checking accounts, according to studies we reviewed and some market participants and observers we interviewed."[3]

- In 2017, Federal Reserve Board researchers found that "banks subject to the cap raised checking account prices by decreasing the availability of free accounts, raising monthly fees, and increasing minimum balance requirements, with different adjustments across account types." The Federal Reserve Board found that even banks that were "exempt from the cap adjusted prices as a competitive response to price changes made by regulated banks."[4] As the GAO later explained, the Federal Reserve Board study also found that "after the regulation was in place, covered banks were about 35 percent less likely to offer noninterest checking accounts without monthly fees. Based on this finding, the researchers estimated that if the regulation had not been implemented, 65 percent of noninterest checking accounts offered by covered banks would have been free."

- A 2014 study by Todd Zywicki, Geofrey Manne, and Julian Morris found that the Durbin Amendment's "fee increases and loss of free checking contributed to an increase in the unbanked population of approximately 1 million people, primarily among low-income families."[5]

- Debit rewards programs and interest-bearing checking accounts have largely disappeared.

At the same time, academic literature has consistently shown that merchants have not passed on any of their savings to consumers by lowering prices, to offset these demonstrated costs to consumers:

- Merchants themselves reported to the Federal Reserve Bank of Richmond that just 1% of merchants reduced prices, and 22% actually increased prices.[6]

- In another study, a future Biden administration official concluded that there is "little evidence of across-the-board consumer savings." As the authors plainly state, "Our analysis suggests

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[3] Government Accountability Office, Regulators Have Taken Actions to Increase Access, but Measurement of Actions' Effectiveness Could Be Improved, (Feb. 2022) https://www.gao.gov/assets/gao-22-104468.pdf.

[4] Manuszak, Mark D. and Krzysztof Wozniak (2017). "The Impact of Price Controls in Twosided 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, https://doi.org/10.17016/FEDS.2017.074. Because the $10 billion exemption threshold is not adjusted for inflation, its value has diminished significantly. Today's $10 billion threshold would have been approximately $7.2 billion in 2011, so many smaller financial institutions that were intended to be exempt from the cap are now subject to it.

[5] Todd Zywicki, Geoffrey A. Manne, Julian Morris, Price Controls on Payment Card Interchange Fees: The U.S. Experience (June 2014), https://www.law.gmu.edu/pubs/papers/14_18.

[6] Renee Haltom and Zhu Wang, Federal Reserve Bank of Richmond, Did the Durbin Amendment Reduce Merchant Costs? Evidence from Survey Results (Dec. 2015), https://www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_brief/2015/pdf/eb_15-12.pdf.

that consumers are not helped by this interchange regulation."[7]

Further, when debit interchange revenue is diminished, card issuers and networks have fewer resources to dedicate to security. Indeed, Federal Reserve Board research shows that, across all debit and general-use prepaid card transactions for issuers covered by the Federal Reserve Board's interchange caps, fraud losses to all parties as a share of transaction value increased from 7.8 basis points in 2011 to 17.5 basis points in 2021.[8] That is an increase of 124%.

The Federal Reserve Board's current proposal appears to pose the same risks to consumers

If the Federal Reserve Board is successful in its current efforts to further reduce issuer interchange revenue by one-third, banks and credit unions would face material obstacles in their efforts to offset the regulatory, anti-fraud, and operating costs involved with extending banking services to low-balance consumers.

Federal Reserve Governor Michelle Bowman, for instance, has expressed concern that the Federal Reserve Board's current proposal could impact access to banking services for low-income consumers, particularly when considering the cumulative effect of other currently-proposed regulatory proposals.[9] She also highlighted that nearly one-third of bank issuers would not be able to even recover their costs, much less grow business, under the proposed rule's interpretation of a "reasonable and proportional" fee cap.

Indeed, the available evidence indicates that the Federal Reserve Board's new rule will inevitably impact the availability of low-cost banking products to consumers most in need. A recently published white paper by Nick Bourke, the former founder and director of the Pew Charitable Trust's consumer finance and housing program, reviewed prior research by Federal Reserve System and former Treasury Department economists. Bourke determined that the current Federal Reserve Board proposal would increase the cost of checking accounts to consumers by *$1.3 to 2 billion a year*.[10]

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

[8] Federal Reserve Board, 2021 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions, (Oct. 2023), https://www.federalreserve.gov/paymentsystems/files/debitfees_costs_2021.pdf.

[9] Federal Reserve Board, Statement on Proposed Revisions to Regulation II's Interchange Fee Cap by Governor Michelle W. Bowman (Oct. 25, 2023), https://www.federalreserve.gov/newsevents/pressreleases/bowman-statement-20231025.htm ("While the proposal suggests that it could result in benefits to consumers, I am concerned that the costs for consumers—through the form of increased costs for banking products and services—will be real, while the benefits to consumers—such as lower prices at merchants— may not be realized.")

[10] Nick Bourke, How Proposed Interchange Caps Will Affect Consumer Costs (Jan. 24, 2024), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4705853. Bourke also found that any corresponding merchant and consumer savings under the cap are contested or not measurable. If merchants passed savings through to consumers, as theory and some lawmakers suggest, economists concluded it is "virtually impossible" to prove or measure.

The Federal Reserve Board's proposal raises unique concerns because the agency has entered into direct competition with debit card issuers that would be impacted by the proposed rule

The Federal Reserve Board's proposed rulemaking is particularly concerning because the Federal Reserve Board actually competes with the private sector in providing payments services. In that regard, the Federal Reserve System recently entered into direct competition with bank and credit union debit cards with the launch of *FedNow*. The timing and intensity of the proposed rulemaking raises fundament questions because the Federal Reserve Board would be imposing costly operational mandates and revenue constraints against its competitors in this market.

For all of these reasons, it critically important to better understand the impact of the Federal Reserve Board's proposed debit interchange regulation on consumers.

We request that the GAO conduct an analysis of the Fed's rule to examine the extent to which implementation of the rule affects the following consumer access to checking account services.

In conducting this analysis, we request that you specifically discuss and address:

- Access to checking accounts by low- and moderate-income populations;
- The cost of checking accounts for consumers;
- Minimum balance requirements;
- Any increases in ancillary fee revenue relating to checking account services;
- Debit fraud;
- The cumulative impacts of all proposed and final rules of Federal agencies issues since January 1, 2023 that affect debit accounts.

Sincerely,

Blaine Luetkemeyer
Chairman
Subcommittee on National Security, Illicit Finance, and International Financial Institutions

Andy Barr
Chairman
Subcommittee on Financial Institutions and Monetary Policy