May 12th, 2024

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

RE: Debit Card Interchange Fees and Routing
(Docket No. R-1818; RIN: 7100-AG67)

Dear Sir or Madam:

I write on behalf of the Dakota Credit Union Association. We represent 62 credit unions, collectively serving over 539,000 members in North Dakota and South Dakota. Our credit unions provide vital financial services across a diverse demographic spectrum, including significant segments of low- and moderate-income individuals. Our mission is to ensure that our member credit unions are empowered to offer the best possible financial support to their communities.

We are deeply concerned with the proposed revisions to Regulation II's debit interchange fee cap as announced by the Federal Reserve Board. The methodology employed in these proposals significantly underestimates the costs borne by most issuers, particularly smaller credit unions, which form a substantial part of our membership. This underestimation risks compelling credit unions to either increase fees or reduce essential services, ultimately disadvantaging our members by limiting their access to affordable banking products and services.

Given the potentially severe consequences of these proposed changes, we respectfully urge the Federal Reserve Board to reconsider these adjustments. We are committed to engaging constructively to ensure that any regulatory modifications align with the operational realities of credit unions and the financial well-being of their members.

Impact on Dakota Credit Unions

The proposed reduction in the interchange fee cap could significantly strain credit unions financially, challenging their ability to effectively serve their communities. The Federal Reserve needs to reassess its methodology and regulatory framework to ensure it more accurately reflects the unique challenges and operational models of credit unions. This careful consideration is crucial for maintaining their ability to effectively support their members.

This need for revision becomes urgent as we consider the implications of reducing the debit interchange rate cap under Regulation II. Such reductions are likely to pose serious challenges for smaller, community-oriented credit unions that inherently face higher operational costs compared to their larger counterparts. The justification for reducing the rate cap is based on broad data suggesting a general decrease in the costs associated with issuing debit transactions. However, this data does not capture the distinct economic realities of credit unions, which, due to their smaller scale, do not benefit from the economies of scale that bolster larger institutions, thus enduring higher per-transaction costs.

This oversight in the Federal Reserve's proposed rule fails to account for the unique cost burdens specific to credit unions. As a result, transaction costs for these institutions have not decreased in proportion to those of larger institutions. This discrepancy impacts credit unions disproportionately, potentially escalating their operational costs and placing them at a competitive disadvantage in the financial services market.

Additionally, the proposed rule does not adequately address the specific challenges and higher costs associated with fraud prevention for credit unions. The existing and proposed reduced caps could further strain the financial viability of credit unions, forcing them to either increase fees for their members or reduce services, which directly contradicts their community-supportive mandate.

Historical evidence underscores the potential negative impact of regulatory changes like those proposed in the amendments to Regulation II on interchange fees. Following the Durbin Amendment's implementation in 2011, which aimed to cap interchange fees, many financial institutions adjusted by decreasing the availability of free checking accounts and increasing other fees, disproportionately affecting low-income and minority communities.

The potential long-term effects on financial inclusion initiatives are significant. Services such as free checking accounts, low-cost money transfers, and accessible emergency loans might become financially unsustainable. Consumers might then turn to high-cost alternatives like payday loans, known for their exorbitant fees and interest rates, undermining the financial stability of low-income individuals and hampering broader financial inclusion efforts.

Given these points, the proposed reduction in interchange fees, if not carefully calibrated, poses a significant risk of reversing the progress made in financial inclusion, especially for the most vulnerable populations. It is imperative for regulatory bodies to consider these potential outcomes and the historical context of similar regulatory changes when assessing the impact of new rules on interchange fees. This consideration is essential to ensure that policies do not inadvertently exacerbate financial exclusion for underserved and economically vulnerable communities.

The current regulatory framework includes technical exemptions for smaller financial institutions, ostensibly protecting them from the interchange fee caps. However, the reality of market dynamics means that these exemptions do not fully insulate exempt issuers from the economic impacts of these regulations. Despite these exemptions, the proposed changes to Regulation II's interchange fees could significantly affect these smaller, exempt issuers. When fee caps are applied to larger institutions, it often results in reduced fee income for all issuers due to standardized fee structures across payment networks, causing fee compression that affects even those issuers that are nominally exempt.

The potential unintended consequences of such regulatory changes are substantial. Reduced interchange revenue could jeopardize the financial viability of services offered by smaller institutions, particularly those designed for low- and moderate-income members. Additionally, the financial pressures from reduced interchange fees could accelerate industry consolidation, reducing the diversity and number of credit unions, leading to less competition, and potentially increasing costs for consumers, especially in underserved areas where community-focused credit unions are critical.

In summary, the broader implications for the credit union sector are significant, including the risk of reduced financial service offerings and increased consumer costs, potentially weakening the foundational principles of member-focused, inclusive finance. These outcomes starkly contradict the objectives of regulations intended to ensure fair, reasonable fees aligned with transaction costs. This situation calls for a thoughtful reconsideration of the proposed regulatory changes to safeguard the interests of credit unions and their members, ensuring that they can continue to offer essential financial services to their communities without undue hardship.

Key Summary

Building on this understanding, the proposed changes to Regulation II, specifically targeting the reduction of the interchange fee cap, pose a direct threat to the progress credit unions have made in enhancing financial accessibility for vulnerable communities. These amendments could disproportionately burden credit unions that are already managing significant operational and fraud prevention costs. Without careful calibration, the proposed reduction in interchange fees may force credit unions to either scale back critical services or increase fees for their members—measures that would directly conflict with their core mission of supporting community financial needs.

It is imperative that regulatory bodies reevaluate the potential impacts of these changes and consider maintaining current fee structures to support the ongoing viability of credit unions and the communities they serve. Preserving these fee structures is crucial not only for financial inclusivity but also to prevent a shift toward more expensive financial services, which could have wider negative effects on economic equality and stability in underserved areas.

We strongly urge the Board of Governors of the Federal Reserve System to pause the implementation of these changes until a comprehensive analysis can assess the full spectrum of impacts on all debit card issuers, especially those like many credit unions under the $10 billion asset threshold. These institutions are integral in serving economically vulnerable and underserved communities.

Additionally, we encourage the Board to revisit the methodologies used in calculating interchange fees to ensure they reflect the unique cost structures and challenges faced by smaller institutions. This adjustment is crucial to prevent undue financial strain on these entities and their clientele. Credit unions in the Dakotas are indispensable in areas characterized by sparse populations and wide geographic expanses. Regulatory adjustments should consider these specific needs to safeguard the financial stability of these institutions and the economic welfare of their members.

To this end, we propose a meeting to discuss our concerns in detail and explore potential revisions to the regulation that would mitigate adverse outcomes for credit unions and their members. Such a dialogue would ensure that any regulatory changes are informed by a full understanding of their implications for financial inclusion and the stability of financial services for low-income populations.

A collaborative approach to these regulations is likely to result in more favorable outcomes for all stakeholders, particularly those relying on credit unions for accessible financial services. We look forward to your response and the opportunity to work together to achieve these goals.

Thank you for your attention to our concerns regarding the proposed amendments to Regulation II. We appreciate the opportunity to participate in this crucial discussion, which holds significant implications for credit unions and the communities they support, especially within the unique socio-economic environment of the Dakotas.

Sincerely,

Jeffrey Olson

CEO/President

John Alexander

Director of Legislative & Regulatory Affairs

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