

## FED Proposes New Rule Reducing Interchange Fees

With the recent announcement that the Federal Reserve Board (Fed) will be initiating rulemaking on interchange fees in the coming months, we feel it's critically important to provide you with an overview and deeper background.

As mentioned during the six-state GAC meeting at the recent GoWest MAXX convention, the Supreme Court has agreed to hear a case filed by a merchant naming the Federal Reserve as a defendant. The case challenges the Federal Reserve's rulemaking on interchange, alleging the fees are not "reasonable and proportional," nor are they regularly reviewed to ensure they are meeting those standards. The Supreme Court is expected to rule specifically on whether a retailer has the standing to file a lawsuit outside of the statute of limitations. In this case, the retailer, Corner Post, has not been in business for six years, which is the time standard to initiate a lawsuit in this type of matter. Corner Post is arguing that they have standing to sue because the interchange rule has been in place for longer than six years.

If the Supreme Court rules that Corner Post has standing, then the retailer's case challenging the Fed on whether the interchange rule was "reasonable and proportional" could move forward. While the case is being adjudicated, the Federal Reserve took a rare but not unprecedented step by issuing a proposed Interchange rule revision, on October 26, that will reduce interchange substantially for covered financial institutions -- those over \$10 Billion in assets. The proposed rule change in Regulation II would reduce the average interchange income on a \$50 transaction from 24.5 cents to 17.7 cents.

If adopted as proposed, it would mean a 28% decrease on the average interchange transaction for covered issuers. The fees will be adjusted every two years based on the mandatory interchange cost reports that covered issuers submit. The fee structure would be released no later than March 31 every two years and would take effect three months after publication on July 1.

The proposed rule change issued Oct. 26 will have a 90-day comment period. The Fed is hoping to finalize the rule by mid-2024. In addition, the Fed separately proposed to publish the data on which the information is determined every two years. Fed Board Governor Michelle Bowman was the lone dissenter on issuing the proposed rule and she also was the lone dissenter on publishing the actual data that shows the costs incurred by covered issuers.

As presented by the Federal Reserve staff, here are the components of the interchange fees as well as the outlined changes in the proposed rule.

- The base which is designed to cover processing costs is being reduced from 21 cents to 14.4 cents. This portion of the interchange fee was designed to cover the processing costs which have gone down substantially since 2009 when the initial rule was proposed.

- The ad valorem component goes down from 5 basis points to 4 basis points. This is the fraud component which is being reduced based on information showing that fraud costs associated with debit transactions have dropped for covered issuers as a percentage of the transaction.
- The third component, the fraud prevention adjustment, rises from 1 cent to 1.3 cents. This is the adjustment for having a chip that reduces fraud but increases the card costs, which have risen since 2009.

The Federal Reserve Board also released its [2021 Interchange Fee Revenue Report](#) on which the new proposed rulemaking is based.

The Fed is seeking comments on a number of specific provisions. They have asked commenters whether setting the adjustment every two years is the appropriate cadence, whether there might be unintended consequences, and if so, what those unintended consequences would be.

Go West is prepared to advocate on this important issue and will be working with credit unions across our region, as well as with our national partners, to ensure a robust response. While the current judicial view of agency authority to liberally interpret statutes may hinder our argument that the Fed can and should consider raising the current \$10 Billion exemption threshold, we still intend to make that argument in our comment letter and in advocacy outreach to the Fed.

The Fed's proposed rulemaking has the potential to go one of two ways on Capitol Hill. Lawmakers could see the actions being taken by the Fed as the financial services industry policing itself and remedying perceived unfairness in the marketplace, which could reduce the likelihood that Senator Durbin and his partners would gain any additional momentum with the Credit Card Competition Act. On the other hand, it could put the spotlight on this issue and provide credence to a very complicated issue with misinformation being outlined by the retailers, merchants, and grocers, potentially softening the resolve of members on the Hill to fight off this issue.

We continue to strategize with CUNA and other relevant partners on messaging, tactics, research, and data on interchange issues as a whole, including Durbin 1.0, the Credit Card Competition Act, and this new Fed proposal. A strong review and push to increase the \$10 Billion exemption threshold for debit interchange must and will be a key component of additional advocacy strategy in this area. Please do not hesitate to reach out to me directly to share your questions or concerns.

Link: [Proposed Interchange Rule](#)