CrossState Credit Union Association

August 10, 2021

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

Re: Docket No. R-1748, RIN 7100-AG15; Debit Card Interchange Fees and Routing

Filed via email: regs.comments@federalreserve.gov

Dear Ms. Misback:

CrossState Credit Union Association (CrossState) appreciates this opportunity to share comments from our members on the Board of Governors of the Federal Reserve System's (Board) proposal to amend Regulation II to clarify that the requirement that each debit card transaction must be able to be processed on at least two unaffiliated payment card networks applies to card-not-present transactions, clarify the requirements that Regulation II imposes on debit card issuers to ensure that at least two unaffiliated payment card networks have been enabled for debit card transactions, and standardize and clarify the use of certain terminology. CrossState is a regional trade association that advocates for nearly 500 credit unions located in the State of New Jersey and Commonwealth of Pennsylvania.

Background

Section 920(b)(1) of the Electronic Funds Transfer Act (EFTA), added in 2010 pursuant to the Dodd-Frank Act, directed the Board to prescribe regulations that limit restrictions that card issuers and payment card networks may place on the processing of an electronic debit transaction.

Specifically, section 920(b)(1)(A) directed that the Board issue regulations to prohibit issuers and payment card networks from restricting the number of payment card networks over which an electronic debit card transaction may be processed to fewer than two unaffiliated networks.

Additionally, section 920(b)(1)(B) directed regulations be put forth to forbid issuers and payment card networks from inhibiting directly or indirectly any person that accepts debit cards from directing the routing over any network that may process it.

In July of 2011, a final rule was promulgated implementing the regulations to ensure that merchants and their acquirers could choose from at least two unaffiliated networks when routing debit card transactions.[1]

[1] Regulation II, Debit Card Interchange Fees and Routing, 12 CFR part 235

The Dodd-Frank Act exempted small issuers from the interchange fee standard set in the regulation, but not from the statute's prohibition on network exclusivity. For purposes of the rule, a small debit card issuer is an issuer that, together with its affiliates, has assets of less than $10 billion. As a result, Regulation II requires every debit card issuer, regardless of size, to have at least two unaffiliated networks for every debit card.

Current Request for Comment

Currently, the Board is proposing changes to the regulations to clarify that debit card issuers should enable, and merchants should be able to choose from, at least two unaffiliated networks for card-not-present (CNP) transactions. The proposed rule and commentary changes will clarify that debit card issuers are responsible for ensuring that two unaffiliated networks are available.

As justification for the change, the Board provides that when Regulation II was finalized, the market was not as developed for CNP transactions. With the evolution of technology over the last decade, more networks have become available to support CNP transactions. However, merchants are limited in the networks they can choose for processing. Data indicates that more consumers are doing CNP transactions as CNP transactions made up 23% of all debit card transactions in 2019.[2]

In May of 2013, the Board issued a report on the *Impact of Regulation II on Small Debit Card Issuers.*[3] The report confirmed that issuers that needed to add networks to comply with the regulation incurred increased costs due to having to reissue cards. In addition to the cost of reissuing cards, there were increased annual costs for maintaining the additional networks.

The majority of the credit unions in New Jersey and Pennsylvania are under $1 billion in assets. There is a large disparity between the resources available to a financial institution that is $8 billion in assets and one that is $500 million in assets.

Credit unions are not-for-profit cooperatives, governed by volunteer boards, that exist only to serve the needs of their members. During the COVID-19 pandemic, credit unions have assisted their members to stay in their homes and stay afloat by offering loan extensions, forbearances, fee reductions, and other forms of assistance and relief. Many of their members are beginning to return to work and still struggling with payments. The future for many consumers and businesses is still uncertain and the economy is still recovering to pre-pandemic levels.

When the original regulations were promulgated in 2011, it was contemplated that there would be a benefit to consumers. Consumers would pay less for goods and services because merchants would pass their savings along to consumers.[4] The current proposal does not indicate if consumers benefitted from having more networks available to process debit card transactions. Consumers may have incurred increased costs due to the regulation as some financial institutions may have passed on additional fees to consumers.

[2] The 2019 Federal Reserve Payments Study, https://www.federalreserve.gov/paymentsystems/2019-December-The-Federal-Reserve-Payments-Study.htm.

[3] https://www.federalreserve.gov/paymentsystems/files/debitfees_impact.pdf

[4] "Merchants, their trade groups, and some consumers supported the Board's proposal and argued that the proposal would lower the current interchange fees (the savings of which could be passed on to consumers as lower retail prices), increase transparency in the system, and increase competition by prohibiting exclusivity arrangements and enabling merchant-routing choice." 12 CFR Part 235, July 20, 2011, https://www.govinfo.gov/content/pkg/FR-2011-07-20/pdf/2011-16861.pdf.

The current rule provides an unbalanced approach to merchants, who get to choose how transactions are routed. This often entails merchants choosing the lowest-cost routing option regardless how that option benefits other parties involved in the transaction. There is concern that over time, this may undermine fraud protection measures and reduce the overall level of security in the payments system that credit unions establish for their members. In addition, there is very limited responsibility on the merchant's part if fraud would occur. The liability rests entirely on the credit union who is obligated to absorb financial losses and reverse such fraudulent transactions. A credit union's reputation is also a factor to consider when a member's personal information is compromised. The current proposal should provide credit unions the ability to choose the best network to route transactions that best serves and protects their members.

As the 2013 report indicates, there will certainly be increased costs to small asset financial institutions in the issuance of new cards and other ongoing expenses. Credit unions will need all their available resources to help their members and communities recover from the impact of the COIVD-19 pandemic. We strongly encourage the Board to withdraw the proposed rule and to conduct another study to determine the cost of the regulation to small issuers and the benefit of the regulation to consumers.

Thank you for the opportunity to provide comments on this important issue.

With best regards,

Patrick C. Conway

Patrick C. Conway
President & CEO

cc: CrossState Board
CrossState Government Relations Committee
CrossState Regulatory Review Committee