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August 9, 2021

Ann Misback
Secretary
Regs.comments@federalreserve.gov

Re: Proposed Changes to Regulation II – Debit Card Interchange Fees and Routing (Docket No. R-1748, RIN 7100-AG15OP-1747)

Dear Ms. Misback:

NBH Bank strongly disagrees with the Federal Reserve's proposed rule to make changes to Regulation II, as it will have significant impact on small community banks like ours. Community banks have been greatly impacted by proposed regulatory changes that increase compliance costs for the institution but also reduce fairly-earned revenue the bank can receive. The expansion of the routing requirement to all card-not-present transactions and the accompanying mandate that banks accept PINless transactions effectively creates a price cap on the revenue community banks receive to participate in these transactions. It also results in extensive and recurring costs to comply with these rules, while reducing operational latitude to mitigate the higher fraud costs that are associated with these newly-covered transactions.

Any expanded requirements only create new challenges for small banks trying to provide the best financial products for consumers in our communities. Debit revenue is particularly vital to offering affordable core deposit accounts, but the proposed rule does not acknowledge the harms that this intervention will cause to consumers in the two-sided debit card market. While the Bank cares deeply for merchants in its community, this rule largely benefits the largest and most profitable national merchants who ship their products to customers. Merchants indicated that savings from cheaper interchange fees would be passed onto consumers when the Durbin Amendment was implemented a decade ago but there is no indication that has been the case. As such, there is no indication that the financial benefits afforded under this proposal would benefit consumers either.

Fundamentally, the rule shifts the compliance paradigm for Durbin by placing the burden on banks to ensure merchants can enforce certain new rights across all geographies and transactions. Yet the proposed rule does not explain how an issuer can ensure these conditions are met, in a card system where all the bank controls is its own cards and the bank has no knowledge of or control over merchants' transaction choices. In a nation this large, most merchants are located far from any given bank, making the all-geographies requirement particularly challenging and complex. NBH has complied with the Durbin Amendment for a decade by issuing cards with two networks and the merchant had to do their part by supporting cards that came across the checkout counter. It is beyond any reasonable technical expectation that the bank can issue a card that is guaranteed to support every merchant across the country who insists on an unsupported transaction configuration. The information to prevent such a violation would be literally unknowable since the bank does not have a business relationship with them. Industry experts believe this would require elaborate technical builds and potentially still fall short. The Federal Reserve asserts that there is no solution available today, yet then goes on to explain that these transactions are not used frequently enough for merchants' liking. There are legitimate operational reasons for these trends, which unfortunately, the proposed rule does not explore. Working through these myriad of issues, on a timeline set by third-party providers, could crowd out and deprioritize discretionary investments in other solutions such as adapting faster payment systems.

Perhaps most importantly is the need to address how this proposed rule could expose the payments ecosystem to more fraud and potentially reduce the overall level of security in the system, creating real consumer impact. Different networks and transaction types offer different protections against fraud, including the ability of issuing institutions to charge back fraud to the merchant. Banks manage the transactions they support with these differences in mind and work to offer customers the most secure experience, minimizing fraud events. This proposal makes it even more difficult, if not impossible, for fraud-conscious financial institutions and consumers to manage how debit transactions are processed. Under the current rule (and if it were applied to card-not-present transactions) retailers, not consumers, choose how transactions are routed. Often the merchant may choose the lowest-cost routing option, regardless of the value that option provides to other parties in the transaction. Over time, this may undermine fraud protection benefits like zero liability protection and text alerts on potentially fraudulent debit transactions. At a time when the industry is working so closely with the Federal Reserve to improve payments security, the proposed rule takes away key latitude and tools for financial institutions to do everything possible.

Additionally, if a retailer chooses a debit network and transaction type that lacks security and necessary fraud mitigation benefits and fraud occurs, they bear limited responsibility. This is particularly true of "PINless" transactions, which consumers assume to be signature transactions, but are entirely different. For instance, the world's leading online retailer says that refunds to consumers can take 2x to 3x longer via PINless transactions, leaving banks to pick up the slack and resolve the customer service problems that can result. PINless transactions are often difficult or impossible to decline when necessary and can be harder or impossible to reverse in the event of fraud or consumer error. By forcing financial institutions to take these less protected transactions, the proposed rule goes beyond the constrained routing rights merchants acquired in the Durbin Amendment. These transactions are often pushed on banks by core providers who own the very networks that benefit from them, which is hardly a competitive or fair scenario for banks. It is banks like NBH that cover the losses and reverse fraudulent transactions. We have the most incentive to ensure consumers are protected yet this proposal limits the banks ability to choose the best debit networks to route transactions and best serve and protect consumers.

The provisions of Regulation II have significant negative effects on consumers and banks and should not be expanded in any way. NBH would rather spend resources offering customers new options like faster payments systems that are becoming available now than the distraction of revisiting the impacts of the Durbin Amendment. To enable a truly competitive marketplace, NBH strongly encourages the Federal Reserve to withdraw the proposed rule to expand routing controls to card-not-present debit transactions and the requirement to have two debit networks for routing.

Thank you for the opportunity to submit comments on this matter.

Kindest regards,

Nancy Taylor

Nancy Taylor
Chief Compliance Officer