

Proposal: 1748 (AG15) Regulation II - Debit Card Interchange Fees and Routing

Description:

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From: Clifton Carney

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Subject: R-1748; Regulation II - Debit Card Interchange Fees and Routing

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Comments:

NONCONFIDENTIAL // EXTERNAL

Dear Secretary Misback,

I strongly disagree with the Federal Reserve's proposed rule to make changes to Regulation II, as it will have a significant impact on credit unions like mine. My credit union is particularly vulnerable to regulatory changes which combine new compliance costs with reductions in fairly-earned revenue. This expansion of the routing requirement to all card-not-present transactions and accompanying mandate that we accept PINless transactions effectively creates a price cap on the revenue credit unions receive from these transactions. The proposed changes also result in extensive and recurring costs to comply with these new rules, while reducing my operational latitude to mitigate the higher fraud costs that are associated with these newly-covered transactions. For these reasons the Federal Reserve should withdraw the proposed rule.

Any expanded requirements will only create new significant challenges for credit unions trying to provide financial services to those that need them most. Credit unions offer debit cards as a vital service so that members can access their funds and purchase items from merchants and retailers. Revenue from debit transactions is used to offset the costs associated with providing debit cards to credit union members and operating the accounts that the debit cards are linked to. While we care deeply for merchants in our community, this rule will largely benefit the most profitable national merchants who ship their products to customers and who are not vital members of the community.

The Proposal Would Increase Compliance Costs for Credit Unions

While presented as a clarification, my credit union will experience the proposed rule as a material change in how we handle debit card transactions. Fundamentally, the rule shifts the compliance paradigm for the Durbin Amendment by placing the burden on my credit union 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 my credit union only controls our own cards and we have no knowledge of or control over merchants' transaction choices. In a nation this large, most merchants are located far from any given credit union, making the all-geographies requirement particularly challenging. My credit union 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 I 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 I do not have a business relationship with merchants. Industry experts believe this would require elaborate technical builds and potentially still fall short.

The Federal Reserve asserts that there are solutions available today, yet it then states 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 issues, on a timeline set by my third-party providers, could crowd out and deprioritize

discretionary investments I would like to make, including adopting faster payments systems.

#### The Proposal Would Increase Fraud Costs

The 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. Credit unions 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 to be 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. Consumers expect all these benefits as part of my credit union's brand promise, but when another party is given nearly-total control of how my credit unions' debit cards operate, they may not be sustainable. At a time when the industry has worked 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 to protect consumers.

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 states that refunds to consumers can take 2x to 3x longer via PINless transactions, leaving credit unions 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. These novel transactions did not exist in common usage when the Durbin Amendment was passed, so I am uncertain how they can be mandated upon card issuers now despite our reasonable reservations. By forcing us 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 credit unions by core providers who own the very networks that benefit from them, which is hardly a competitive or fair scenario for us. It is credit unions like mine that cover the losses and reverse fraudulent transactions. We have the most incentive to ensure consumers are protected, yet this proposal limits our ability to choose the best debit networks to route transactions and best serve and protect consumers.

#### The Proposal Would Decrease Competition Among Debit Networks

Lastly, I am concerned the proposed rule would further suppress competition among debit networks and the required competition analyses were not completed by the Federal Reserve. The proposed rule could drive further consolidation among the debit networks, reducing choices for issuers and small businesses. There has already been significant vertical consolidation between credit union technology vendors and payment networks. As proposed, the rule would benefit a handful of large merchants, potentially increasing their competitive advantage over Main Street stores. The proposed rule lacks a fulsome competition analysis and does not mention that the U.S. Supreme Court found in 2017 that the card market is two-sided, where policymakers must balance the commercial interests of issuers and merchants. The proposed rule still follows the one-sided market model where network dynamics will be tilted towards merchants who will not directly bear consequences if the cardholder experience offered by my credit union is diminished. We should be encouraging an environment where debit networks compete on the quality of their network and whether they provide the best service for routing debit transactions, not by arbitrarily imposing government mandate that only accounts for one part of the picture.

#### Conclusion

The provisions of Regulation II have significant negative effects on consumers and credit unions and should not be expanded in any way. I would rather spend my resources offering customers new options like faster payments systems that are becoming available now than the distraction of revisiting my Durbin Amendment compliance posture. To enable a truly competitive marketplace, I strongly encourage 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.

Sincerely,

Clifton Carney