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VIA E-MAIL AT regs.comments@federalreserve.gov

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20511

Re: Docket No. R-1748, RIN 7100-AG15 – Comments from Retail Industry Leaders Association on Debit Card Interchange Fees and Routing Notice of Proposed Rulemaking

Dear Ms. Misback:

The Retail Industry Leaders Association ("RILA"), on behalf of its members, is pleased to respond to the Board's request for comments on its Notice of Proposed Rulemaking ("NPRM") concerning Debit Card Interchange Fees and Routing issued on May 7, 2021 and published on May 13, 2021.

By way of background, RILA is one of the largest U.S. trade associations focused on retailers and the issues they face in the modern economy. Among its members are the largest and most innovative retailers in the United States, and all told, its membership includes more than 200 retailers, product manufacturers, and service suppliers accounting for more than $1.5 trillion in annual sales, millions of American jobs, and more than 100,000 stores, manufacturing facilities, and distribution centers world-wide. Those members, which include some of the nation's largest retailers—including Walmart, Target, Kroger, Home Depot, Dollar General, and Best Buy, among many others—have a unique interest in the proper enforcement of the Durbin Amendment. RILA thus appreciates the steps the Board has proposed to take in its NPRM to clarify the reach and requirements of the Durbin Amendment and to reign in a long-running and unfortunate pattern of regulatory evasion by debit card issuers and the dominant debit card networks.

That evasion—which flies in the face of already-existing language in the Durbin Amendment and Regulation II—represents a substantial tax on RILA, its members, their consumers and the overall United States economy. Among the $1.5 trillion in annual sales attributed to RILA's members are billions of debit transactions, both in-store at brick-and-mortar locations (which are called "card-present" transactions) and online or through smart phones (which are known as "card-not-present" transactions). And as the Board's NPRM and accompanying memorandum indicate, while the Durbin Amendment's promise of merchant choice for debit routing is generally fulfilled for card-present transactions, the dominant card networks and issuers have avoided that result for card-not-present transactions. The latter category is already a large and growing portion of all debit transactions, and given the recent COVID-19 pandemic and some of the permanent changes in consumer behavior it has

inaugurated, card-not-present debit transaction volume will only increase faster in the future—as the Board itself has recognized in recent reports on debit transactions. The lack of merchant routing choice in these transactions enriches the dominant networks and debit issuers at the expense of merchants and their consumers, in direct contravention of the competition-based regime that the Durbin Amendment sets up. This situation should not have persisted so long, and RILA and its members strongly support the Board's effort to ensure that it does not continue.

In particular, RILA and its members fully support the Board's efforts in this NPRM to clarify that issuers' failure to enable two unaffiliated networks for *all* debit transactions—whether they occur online or in-store—is a flagrant violation of the Durbin Amendment and Regulation II. RILA and its members urge the Board to quickly put its proposed clarifications into place so that issuers will be on utterly unambiguous notice that the Board will not tolerate their ongoing failure to fully enable merchant routing choice, particularly when it comes to card-not-present transactions. Ideally, such clarifications should not have been necessary; they are required only because the card network duopoly and complicit issuers have refused to accept the regime that the Durbin Amendment created. But with these clarifications in place, it will at least be clear that, if the networks and issuers remain recalcitrant, the Board and other enforcement agencies will have ample authority under the statute to seek significant penalties for non-compliance.

These comments proceed in four parts. First, we provide some background on the problem of Durbin Amendment non-compliance by issuers and the card networks, both in general and with respect to card-not-present transactions in particular. We hope in so doing to emphasize the scale and source of the problem, and the pattern of intentional non-compliance the Board is confronting. Second, we endorse the clarifications the Board has proposed, while emphasizing our agreement that these are only clarifications that do not change the substantive requirements already imposed by the Durbin Amendment and Regulation II. Third, we turn to four specific issues where we believe that the language the Board has proposed is adequate to address ongoing and anticipated recalcitrance from the dominant networks and issuers, but where we nonetheless urge the Board and other enforcers to be on the lookout for continued efforts at regulatory evasion. And fourth, we briefly address the ongoing need for the Board to reconsider its approach to rate-regulated transactions under the Amendment. Where we have a specific request or recommendation for the Board to consider in responding to these and other comments, we have marked it in underline for the Board's convenience.

I. Background

A. Intent and Design of Durbin Amendment and Regulation II

As an initial matter, the intent and design of both the statute and Regulation II has always been clear. As the NPRM and accompanying memorandum put it—over and over—the simple goal of the Durbin Amendment regime was "to ensure that merchants have at least two unaffiliated payment card networks available when routing [debit card] transactions." Mem. at 1; *see also id.* at 3 ("Regulation II aim[s] to ensure that merchants or their acquirers can choose from at least two unaffiliated payment card networks when routing debit card transactions."); 86 Fed. Reg. 26,189, 26,190 (May 13, 2021) ("To comply with the network exclusivity provisions, among other things, an issuer must allow an electronic debit transaction to be processed on at least two unaffiliated payment card networks[.]"). Simply put, the aim of the Durbin Amendment is that merchants should be able

to choose between at least two routing options *for every debit card transaction*, and the statute and implementing regulations thus require issuers to equip every debit card with at least two unaffiliated networks and prohibit issuers or networks from doing anything to impede merchant choice among the available networks on the card.[1]

The language of the statute and Regulation II is perfectly clear in this regard: 15 U.S.C. §1693o-2(b)(1)(A) prohibits any "issuer or payment card network" from taking any action that "restrict[s] the number of payment card networks on which an electronic debit transaction may be processed to" less than two unaffiliated networks, and 15 U.S.C. §1693o-2(b)(1)(B) provides that "an issuer or payment card network shall not, directly or through any agent, processor, or licensed member of the network … inhibit the ability of any person who accepts debit cards for payments to direct the routing of electronic debit transactions for processing over any payment card network that may process such transactions." Regulation II adopted essentially identical language, *see* 12 C.F.R. §235.7(a)(1)-(2), and the Board accordingly explained at the time Regulation II was adopted that its language "in practice … means that merchants, not issuers or networks, will be able to direct the routing of transactions" over the two or more networks authorized on the debit card. 76 Fed. Reg. 43,394, 43,452 (July 20, 2011).

Nor is there any question whether this language applies to online transactions. In fact, during rulemaking for Regulation II, concerned industry participants and retailers raised questions about electronic transactions, and the Board explicitly answered that the definition of "electronic debit transactions" as provided in Section 235.2(h) of the proposed regulation included online transactions. 76 Fed. Reg. at 43,410 ("Section 235.2(h) does not limit the term 'electronic debit transactions' to transactions initiated at brick-and-mortar store locations; the term also includes purchases made online or by telephone or mail. Accordingly, electronic debit card transactions initiated over the Internet are within the scope of this part."). And so there is no doubt that, under the terms of the Durbin Amendment and Regulation II, merchants must have a choice between two networks for routing debit transactions, whether they occur in store or online.[2] Or, put another way, if that choice is not available "in practice," 76 Fed. Reg. at 43,452, for online or in-person transactions—or any other medium created in the future—then the dominant networks and issuers are flagrantly violating the Durbin Amendment and its implementing regulations.[3]

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[1] Thus, Visa is incorrect in claiming in its Response Letter to the NPRM that the NPRM would introduce a "*new* mandate that two unaffiliated networks be available to every merchant and for every particular type of transaction." Visa Letter at 5-7 (July 23, 2021) (emphasis added), *available at* https://bit.ly/3xARlrI. The fact that Visa now claims that complying with the plain language of the Durbin Amendment and Regulation II is somehow a "new mandate" demonstrates exactly why Board enforcement of the statutory and regulatory text is imperative.

[2] This is in direct contrast to Visa's erroneous claim that it was unanticipated that the Durbin Amendment and Regulation II would apply to online transactions such as card-not-present transactions. Visa Letter at 3-4.

[3] The Biden Administration recently reiterated the importance of promoting competition under the Dodd-Frank Act, including through the Durbin Amendment, in its Executive Order on *Promoting Competition in the American Economy*. Exec. Order 14,036, 86 Fed. Reg. 36,987 (July 14, 2021).

B. Evasion of the Regulatory Design By The Dominant Card Networks And Debit Card Issuers In Online Transactions

Despite this simple design, the dominant card networks and complicit debit issuers have done everything in their power to frustrate or evade the routing-choice regime the Durbin Amendment aimed to create. The proof here is in the pudding. When it issued Regulation II, the Board clearly predicted that technological innovation would permit an *increasing* number of debit transactions to be processed over multiple networks, particularly as the traditional "single message" or "PIN" debit networks developed products capable of processing card-not-present transactions. But the reality has been the exact opposite: The share of transactions that comply with the Durbin Amendment and thus can be routed over more than one network has *declined* since the Durbin Amendment was enacted. The experience of RILA members is accordingly that the technological innovation of competing debit card networks has not been rewarded and, instead, the dominant networks and their complicit issuers have poured their innovation skills into designing more and more creative ways to evade the regulatory design.

Another way to see this is to compare the issuers whose debit cards can and cannot be routed to multiple networks when used in card-not-present transactions. Among the largest debit issuers, Durbin Amendment compliance in online transactions is terrible: As the Board's NPRM correctly put it "issuers that accounted for … approximately 50 percent of all card-not-present debit transactions did not conduct *any* card-not-present transactions over single-message networks in 2019." 86 Fed. Reg. at 26,191. Indeed, the experience of RILA members is that, among the five largest debit issuers, four have not enabled a second network to conduct card-not-present transactions on essentially any of their debit card numbers (or BINs), while the fifth has enabled two networks for online transactions on less than half its BINs. In contrast, it is routine for many smaller banks to have two enabled networks for card-not-present transactions on *all* their BINs. In other words, greater size and sophistication among banking institutions is associated with *less* Durbin Amendment compliance. This means that neither cost nor technological complications can be blamed for Durbin Amendment non-compliance in the online space. Instead, that non-compliance is traceable to sophisticated efforts launched by the dominant card networks and debit card issuers to affirmatively avoid the outcome the Durbin Amendment requires.

The Board is already familiar with one such design. Shortly after the Durbin Amendment was enacted, chip debit cards were introduced, and merchants needed devices in brick-and-mortar locations to read them and extract the necessary BIN information to process debit transactions. But the dominant debit networks used these new terminals to maintain their grip on debit transactions. They did this by developing implementation guides for terminal manufacturers that instructed them to either default to routing over the dominant network on the card or to provide the choice of networks to the *consumer* on the terminal, displayed as "Visa" or "Mastercard" for the dominant network, and the peculiar term "US Debit" for the other option. With no information about this choice or reason to choose an unknown generic option, consumers predictably defaulted to choosing the branded network. Accordingly, while the Durbin Amendment required that routing choice be provided to *merchants*, the global networks had found a way to ensure that this routing choice never made it to the merchant in practice.

This problem persisted for nearly a year before regulators responded, and its effects have been felt for several years since. Some larger merchants were able to "hack" the software in the terminals to remove the bias towards the global networks in routing choice, but mid-size and small merchants did not have the capacity to develop these work-arounds, and were therefore left—often without their knowledge—implementing a scheme that cost them millions of dollars in extra transaction fees each year. It was only after RILA, its members and other merchant groups notified the Federal Trade Commission of these anticompetitive practices (and many months of regulatory review and analysis) that the networks finally stopped—and then only because the FTC sent letters to the global networks about the practice and the Board created an FAQ to clarify that this practice violated the statute and Regulation II. But the technology had already been installed in many places, and some merchants are still using the terminals with the offending design, unaware that they should never have been installed to begin with. It was, of course, always clear that this practice "inhibit[ed] the ability of any person who accepts debit cards for payments to direct the routing of electronic debit transactions" within the meaning of the statute and regulation. But the dominant networks were happy to violate the plain language and force the agencies to "clarify" that their violation really was a violation before changing their behavior, and impose the costs of challenging this misbehavior on merchants—including small retailers who do not fully understand their rights under the Durbin Amendment and assume that the parties with whom they deal would not so flagrantly violate the law.

The practice of issuers failing to "enable" card-not-present transactions over alternative networks—which they likely do because they are following advice from the dominant networks or otherwise chasing those networks' volume discounts—fits squarely within the same pattern. Again, it is *already* quite plain that this practice is a Durbin Amendment violation: As the Board's NPRM repeatedly puts it, "these practices by issuers with respect to card-not-present transactions are inconsistent with Regulation II because they restrict the number of payment card networks on which card-not-present transactions can be processed to fewer than two unaffiliated transactions." *See* 86 Fed. Reg. at 26,191-92; *see also* Mem. at 2 (same), Mem. at 6 (same). And attributing this behavior to technological difficulties or an oversight is untenable: As noted above, smaller banks have already complied, and RILA members understand from their experience that, in many instances, the so-called failure to "enable" card-not-present transactions on an alternative network actually requires *affirmatively turning off* the relevant functionality. Meanwhile, the Board clarified when it issued Regulation II that it applied to online transactions. And when RILA members have confronted issuers and asked them to explain how a debit card that cannot be routed in online transactions complies with the statute and regulation, issuers have been unable to provide *any* statutory or regulatory basis for that conclusion.

The Board—and other enforcers—should thus be aware of the regulatory context in which they are acting. It should not be necessary for the Board to clarify that its regulations mean what they say, and the Board is correct that issuers *already* have the responsibility to avoid "an *outcome*" where "two unaffiliated networks" are not "available to process *each* debit card transaction." Mem. at 2 (emphases added); *see also* 86 Fed. Reg. at 26,191 (stating that "practices by issuers" that "result[] in only one network … being available to process card-not-present transactions" are "inconsistent with Regulation II"). As we further explain below, we nonetheless support the "clarifications" the Board is now making insofar as they further underline that same conclusion. Doing so should make clear that further

recalcitrance from issuers and the dominant networks will result in severe regulatory sanctions and not another round of "clarifications."

II. RILA And Its Members Support The Board's Proposed Clarifications And Agree That They Do Not Substantively Change Regulation II.

RILA and its members agree with the Board that, while it is certainly helpful to clarify Regulation II to "*emphasize* the important role of the issuer in ensuring that at least two unaffiliated payment card networks have been enabled for *each* debit card transaction," 86 Fed. Reg. at 26,192 (emphases added), "these amendments" do not enact "a substantive change to the section but rather" represent "a clarification of the existing language." *Id.* The distinction is important here because defining this NPRM as a clarification underlines that issuer and network behavior that has inhibited merchant routing of card-not-present transactions has violated the Durbin Amendment and Regulation II all along. The additional emphasis is nonetheless helpful because it clearly warns issuers that it is their responsibility going forward to make "*each* debit card transaction" for which one of their cards is presented routable at the merchant's election, and that further efforts to frustrate the result intended by the Durbin Amendment will precipitate a response from the enforcement agencies. RILA and its members thus strongly support the Board's approach to this NPRM.

It is unsurprising that the Board labelled this NPRM a clarification. As noted above, *supra* pp.2-3, there is nothing in the Durbin Amendment or Regulation II that supports differential issuer and network treatment of card-present and card-not-present transactions in terms of merchant routing choice. Accordingly, while the NPRM reorders the key language of Section 235.7(a)(2), it does so merely to highlight that the burden of compliance is on the issuer. 86 Fed. Reg. at 26,192. As the NPRM explains, this reordering does not expand or contract what actually counts as compliance with the network exclusivity rules imposed by the Durbin Amendment and Regulation II. Nor does it alter the focus of compliance, which remains on ensuring that each debit transaction can be processed over at least two unaffiliated networks. Instead, it merely recognizes that it is *the issuer* who must guarantee that "at least two unaffiliated payment card networks" have been enabled on the card for "every … particular type of merchant[] and particular type of transaction for which the issuer's debit card can be used." *Id.* at 26,194. This, of course, is implicit in the original language since it is the issuer that must enable a network and its various features, and transactions cannot be processed over a network absent such enablement. The NPRM also proposes adding new, additional examples for how issuers can comply with Section 235.7(a) in its commentary to the regulation, but it would be a stretch to view further explanations—provided in commentary to help issuers understand how the regulation has long operated—as a substantive change to the regulation itself. *Id.*

In response to the NPRM, many small issuers have submitted comments, almost all of them structured as form comments, challenging whether the NPRM is merely a clarification of existing regulations. But these form comments betray themselves. Small issuers are *already complying* with the Durbin Amendment and Regulation II, *see supra* p.4, probably because they have not been offered the same volume inducements Visa and Mastercard have given to the largest issuers (and most persistent offenders). The fact that these small issuers do not even realize they are already complying is a vivid demonstration that the non-compliance of the larger issuers is not due to a happenstance or

technological hurdle (as Visa's letter wrongly suggests), and is instead the product of intentional regulatory evasion, likely undertaken at the urging of Visa and Mastercard themselves.

Regardless, RILA and its members also agree that it is a helpful addition—but not a substantive change—for the Board to clarify that card-not-present transactions are a "particular type of transaction" for purposes of Regulation II. Again, such a clarification should not be necessary: A kind of transaction that encompasses more than 23% of all debit transactions is plainly a "type of transaction" that a card's design must address if the purposes of the Durbin Amendment are to be fulfilled. Such clarifications are required, however, only because the dominant networks and complicit issuers are willing to rig their systems such that large classes of transactions will evade merchant routing choice based on the kind of cardholder authentication those transactions commonly use.[4] *See* 86 Fed. Reg. at 26,190-91 (explaining that card-not-present transactions are now non-routable because issuers have not enabled PIN-less authentication on networks that support it).

Accordingly, it is clear from the context of this regulatory action that if a card's second authorized debit network cannot accommodate a "particular type of transaction" *in practice*—because, for example, that network does not support a common form of authentication or the issuer has not enabled that form of authentication on the network it has chosen to place on the card—that card does not comply with the statute and the Board's implementing regulations. RILA and its members thus understand that, when the proposed commentary says that a card can comply even if its second network does not support every method of authentication, *see* 86 Fed. Reg. at 26,192, 26,194, this does *not* permit issuers or the dominant networks to impose rules or policies or make design choices the effect of which is to exclude any substantial set of transactions from merchant routing choice. In other words, a card can still comply with Regulation II even if occasional or esoteric transactions cannot be routed because a card's second network does not support an atypical form of authentication that a particular merchant has chosen to accept or use. But if that feature excludes any substantial set of transactions—if there is any identifiable "type of transaction" that the card will never support—that card does not comply with the Board's requirements.[5] If the Board does not share this understanding,

[4] Visa attempts to evade the Durbin Amendment's clear requirements for routing choice by blaming other parties in the transaction pathway, including merchants themselves. Visa Letter at 7-10. But as the Board correctly recognized, it was *issuer* decisions, in response to dominant network pressure, that has caused the lack of card-not-present routing options for merchants, 86 Fed. Reg. at 26,191-92. If an issuer has not enabled its debit cards to process card-not-present transactions over a particular network, there is nothing the merchant or anyone else in the transaction pathway can do to route such transactions over that network.

[5] Visa attempts to misdirect this argument by claiming that the Board's clarification would require "operational availability of two unaffiliated routing choices for *any conceivable* transaction." Visa Letter at 6 (emphasis added). This is a strawman. As Visa of course knows, there is no prospect of enforcement action being taken against an issuer whose card cannot be routed because of some esoteric issue that unexpectedly arises in some "conceivable" transaction. But what it is important to clarify—and what RILA and its members believe the Board has well clarified—is that if any identifiable set of transactions cannot be routed between at least two networks at the merchant's election, the card violates Regulation II with respect to that "type of transaction." Moreover, the clarifications make very clear that any practice *designed* to make an identifiable subset of

we think it imperative to clarify this point further in discussing what counts as a "type of transaction" for purposes of Regulation II.

Moreover, we think this regulatory action clarifies another point that should always have been clear—namely, that while an issuer is free to choose which networks to authorize on its cards, the issuer cannot impose its *own* restrictions that prevent that chosen network from handling transactions it is equipped to handle. This is, after all, the exact practice that the Board's current action is meant to address. *See* 86 Fed. Reg. at 26,191. Regulation II's existing language prohibits this behavior in two ways: (1) because a network that cannot, for whatever reason, handle a typical form of authentication is restricted from processing a "particular type of transaction" under Section 235.7(a), and (2) because the practice of failing to enable all the forms of authentication that network could otherwise support is a practice that "inhibit[s] the ability of any person who accepts or honors debit cards for payments to direct the routing of electronic debit transactions for processing over any payment card network that may process such transactions" in violation of Section 235.7(b). Notably, any other understanding fails to support the innovation incentives the Board attempted to set up when it issued Regulation II: If issuers need not enable all the products that alternative networks develop—or can affirmatively turn those products off in order to maximize the volumes the issuers can provide to Visa and Mastercard in exchange for discounts—then there will be no reward for innovations like PIN-less single-message authentication or the like.

To put the same points another way, RILA and its members believe that the most important clarification this NPRM makes is a clarification of the *intent* of Regulation II and the Durbin Amendment that merchant routing choice should be available for "*each* debit card transaction." *See* 86 Fed. Reg. at 26,191-92 (emphasis added); *see also* Mem. at 2, 4-6. To merchants, that intent has always been clear. But the experiences detailed above, *see supra* pp.4-5, and in the NPRM, make clear that the dominant networks and issuers have nonetheless felt comfortable taking actions the intent and effect of which is to exclude identifiable sets of transactions from merchant routing choice. Henceforth, we believe it is unambiguously clear that any such actions by issuers or the dominant networks reflect willful non-compliance with the design of the statute and Regulation II, and that the enforcement agencies would thus be justified in imposing harsh consequences on such behavior. Again, if the Board does not share that understanding, it should make its contrary understanding clear by explaining how any identifiable set of transactions can avoid being a "type of transaction" for purposes of Regulation II.

III. RILA and Its Members Believe The Board Should Be Vigilant In Policing Further Non-Compliance In At Least Four Important Areas.

To date, the dominant networks and issuers have taken an approach to Durbin Amendment compliance that should be explicitly repudiated. That approach is to find the out-of-bounds line, inch over it, and then continue pushing past it indefinitely until the Board "clarifies" that the line always was where it appeared to be. The response to such clarifications, however, is simply to innovate new colorable approaches to regulatory evasion, secure in the knowledge that each violation will be

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transactions routable only to Visa or Mastercard would be a flagrant and willful violation of the statute and regulation.

addressed only through further retrospective clarifications, rather than appropriate penalties. This is a regulatory coup for the scofflaw: It incentivizes evasion, allowing recalcitrant parties to keep the benefits of their long-running violations and imposing the costs of constant clarifications on the Board itself. The better approach by far is to clarify Regulation II in broad and prospective ways as the Board has proposed to do here, while squarely warning that efforts to evade the intent of the regulation in new ways going forward will be met with appropriate sanctions. As noted above, we think the language the Board has chosen and the understanding conveyed in the NPRM and accompanying memoranda are adequate to send this message. But RILA members nonetheless want to alert the Board to four areas where we anticipate the dominant networks or issuers will take actions calculated to evade the Durbin Amendment, and encourage the Board to consider explicit warnings that these particular forms of behavior will not be further tolerated.

A. Authentication

As noted above, RILA and its members are concerned that novel authentication measures will be used to further limit merchant choice in routing—just as the networks did with chip cards in terminals and just as networks and issuers have done by failing to enable PIN-less debit for online transactions. Novel authentication methods—like fingerprint authentication, iris scan, or facial recognition—are continually developed, with third-party developers often serving as gatekeepers to these new technologies. As demonstrated above, the parties regulated by the Durbin Amendment and Regulation II have shown enormous creativity in using both their own policies and the incentives they can create for third parties to transform such technological innovations into barriers for merchant routing choice. The enforcement agencies should be prepared for that pattern to recur.

Of course, the clarifications proposed in this NPRM should be helpful in this regard. RILA and its members believe those clarifications suffice to tell the dominant networks and issuers that using authentication techniques to create barriers to merchant routing is now strictly prohibited, no matter what form those barriers take, insofar as they make it impossible for a merchant to choose between at least two networks for *any* "particular type of transaction." This may not require issuers to ensure that two authorized networks exist for every single kind of authentication that currently exists or may be developed. *See supra* pp.2-3. But as the proposed guidance expressly emphasizes, that is true only "as long as the two payment card networks [on a given card] are not affiliated and *each network* can be used to process electronic debit transactions for every geographical area, specific merchant, particular type of merchant, and particular type of transaction for which the issuer's debit card can be used to process an electronic debit transaction." *Id.* (emphasis added). Moreover, Section 235.7(a)(2) of Regulation II still provides that the "two unaffiliated payment card networks" requirement is not met unless "each" network "has taken steps reasonably designed to enable the network to process the electronic debit transactions that the network would reasonably expect will be routed on it, based on expected transaction volume," and that requirement, as the NPRM clarifies, applies to "every particular type of transaction (as well as every geographic area, specific merchant, and particular type of merchant)." 86 Fed. Reg. at 26,192. This should unambiguously bar the dominant networks and issuers from gaming the authentication methods available on certain networks and in certain kinds of transactions to create debit cards that evade merchant routing choice for *any* substantial set of transactions.

Nonetheless, RILA and its members urge the enforcement agencies to stand ready to condemn future practices by the dominant networks or issuers related to authentication that have this purpose or effect. RILA and its members understand that the clarifications proposed in this NPRM are designed to address not only the ongoing problem in card-not-present transactions, but to "future proof" the regulation against continued misfeasance or non-feasance by regulated parties as well. *See, e.g.*, Mem. at 7 n.20 (noting that NPRM proposes adding certain language "to capture means of access that *do not yet exist* and that would still be captured by Regulation II if they were to be developed" (emphasis added)). That goal is addressed particularly well by the changes that clarify that it is the *issuer's* obligation to ensure that its cards are routable in practice for all types of merchants and transactions. We urge the enforcement agencies to strictly enforce this requirement as written against dubious authentication practices going forward.[6]

B. Tokenization

A similar concern about the manipulation of new technologies to evade merchant routing choice arises from what is called "tokenization." In many modern transactions, a debit card's sixteen digit identification number—which includes the BIN and all other information necessary to route and process a transaction using that card—is replaced by a digital "token" that encodes and scrambles this information. This often happens when a debit card is stored in an e-wallet or otherwise saved on a digital device like a desktop computer. The process for creating these tokens is often controlled by the dominant card networks, who are able to use their massive market share to force preferred terms on third-party technology providers and others in the payment system with a role in the tokenization process. And this creates another opportunity for entities regulated by the Durbin Amendment and Regulation II to use novel technologies and assertions about their intellectual property to try to insulate large sets of transactions from the merchant choice requirement.

For example, RILA members' initial experience with tokenized transactions has shown that the dominant networks have hindered merchant choice at the detokenization stage. Mastercard has flatly refused to detokenize a transaction for which it created the token under an agreement between Mastercard and the issuer (including, for example, e-wallet companies), arguing that its detokenization technology is proprietary. Further, Mastercard refuses to return the unscrambled information to the acquirer, instead insisting that Mastercard both detokenize *and* route the payment

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[6] Visa presages future attempts to circumvent Regulation II by injecting uncertainty into the definition of "means of access" involving online payment technologies. Visa Letter at 14-17. That ambiguity, however, is false at best—the definitions provided in the Durbin Amendment make clear that its requirements apply to any "debit card transaction." *See supra* pp.2-3. And "debit card" itself is defined broadly to include any "payment code or device" used to "debit an account," 12 C.F.R. § 235.2(f), which would necessarily include the sort of information transfer Visa claims is ambiguous under Regulation II. Visa Letter at 14-16. Visa further makes its intentions obvious when (erroneously) arguing that Regulation II somehow created "a distinction, albeit an artificial one, between physical devices and non-physical means of authentication," *id.* at 15-16, when no such distinction ever existed, *see supra* pp.2-3, 6-8. In this way, Visa seeks to be rewarded for its own creativity in refusing to read the words for their obvious intent. But such creative non-compliance with the obvious intention of Congress and regulators should be eliminated, not rewarded.

over its global network.[7] The lack of a merchant routing option is obvious here, and, contrary to Visa's assertions, *see, e.g.*, Visa Letter at 16, there is simply no way that this practice complies with Durbin Amendment and Regulation II, whether the tokenization and detokenization processes are proprietary or not.

Visa, on the other hand, is willing to perform detokenization for transactions covered by its tokenization technology and send the unscrambled information back to the acquirer for routing. But while Visa unscrambles the information, it strips necessary security information from the transaction when returning it to the acquirer, and issuers will then frequently reject the transaction as unsecure. One can readily see how this technological process can be used to recreate the exact same situation that currently exists where issuers do not in practice accept card-not-present, tokenized transactions unless they are routed over the dominant Visa networks.[8]

Thankfully, this is yet another brazen effort at circumventing the Durbin Amendment and Regulation II that is already addressed by existing language and whose illegality is further clarified by the changes proposed in this NPRM. At present, Section 235.2(f) defines a debit card to include "any card, *or other payment code or device*, issued or approved for use through a payment card network to debit an account, regardless of whether authorization is based on signature, personal identification number (PIN) or other means." *Id* (emphasis added). A token is unquestionably a "device" "approved for use through a payment card network to debit an account," and therefore must be treated as a "debit card" under Regulation II—such that all the requirements of Section 235.7(a) apply to the token as if it were the debit card itself. And that means that, unless the merchant can choose to route each transaction for which the token is presented, it does not comply with the statute and regulation. That the tokenization technology is deployed by Visa or Mastercard is no excuse for this noncompliance, just as it is no excuse that the debit card and its branding, magnetic strip, or chip technology belongs to the issuer.

RILA and its members appreciate that the Board has taken steps to further clarify this exact point in the NPRM. 86 Fed. Reg. at 26,192-93. In particular, the NPRM's proposed updates to Comment 235.7(a)-7 replace the term "form factor" with "means of access" to clarify that *any* means used to access the account information associated with a debit card must comply with Regulation II's requirements. *Id.* at 26,192. Although that change removes mention of tokens in the commentary, it adds that an example of a means of access is "information stored inside an e-wallet on a mobile phone or other device." *Id.* The "information stored" in the wallet is in fact a payment token. That clearly includes tokenized transactions, and as the accompanying memorandum makes clear, the NPRM also "proposes adding 'or another means of access that may be developed in the future' to capture means of

[7] Although, unsurprisingly, Visa and Mastercard have come to an agreement to detokenize each other's transactions. PYMNTS.com, *Mastercard and Visa Tag-Team Tokens* (Dec. 16, 2016), https://www.pymnts.com/news/mobile-payments/2016/mastercard-and-visa-tag-team-tokens/.

[8] The Department of Justice, in its complaint filed to block Visa's acquisition of Plaid, recognized that Visa's tokenization scheme created a clear "technological barrier[]" to merchant choice in routing. Complaint ¶ 32, *United States v. Visa, Inc.*, No. 20-cv-07810 (N.D. Cal. Nov. 5, 2020), *available at* https://www.justice.gov/opa/press-release/file/1334726/download/.

access that do not yet exist" or any other effort at terminological evasion. *See* Mem. at 7 n.20. Nonetheless, the Board should consider expressly referring to "digital tokens" as covered by Regulation II in the commentary or, if it deems that express reference unnecessary in light of the very broad language it has wisely adopted, state so explicitly in the rulemaking process in order to discourage ongoing non-compliance.

C. Third Parties

Next, RILA and its members continue to be concerned that issuers or networks could attempt to circumvent the requirements of the Durbin Amendment or Regulation II by relying on third-parties to perform parts of the routing process. For example, if an issuer partners with a technology company—like Google or Samsung—to include the issuer's cards in a digital wallet, and then the technology company only routes debit transactions to a global network based on agreements between the technology company and the network, the issuer could argue that *it* did not violate the statute or regulations because it was not the one who restricted merchant routing—that was instead the result of the technology company's proprietary methods.

RILA and its members believe that such conduct clearly falls within the scope of the existing language in the Durbin Amendment and Regulation II. Specifically, Sections 235.7(a)(1) and 235.7(b) state that restrictions on network exclusivity apply to "issuer or payment card network[s]" *and* to "any agent, processor, or licensed member of the network." And, quite helpfully, this is yet another context in which the clarifications of this NPRM will help to dispense with potential arguments to the contrary from the regulated entities, because the reordering of Section 235.7 has clarified that the burden is fully on *the issuer* to ensure that at least two unaffiliated payment card networks have been *enabled* for each debit card transaction. *See* 86 Fed. Reg. at 26,192, Mem. at 6-7. Requiring that financial institutions ensure their vendors are providing services in a legally compliant manner is hardly novel.

RILA and its members appreciate that the Board has taken this step to clarify that the regulations put the onus of compliance on the issuer, such that, even though third-parties are subject to Regulation II if they are acting as an "agent" or "processor" of an issuer or network, the issuer is ultimately responsible for third-party non-compliance. But we nonetheless urge the enforcement agencies to be on the lookout for this specific form of misbehavior.[9] Because of their market power, the dominant networks have both the motive and the opportunity to use volume discounts or other

[9] Indeed, Visa's letter itself provides an early look at how the dominant networks will attempt to evade the focus on issuer responsibility under the Durbin Amendment by arguing that placing the onus on issuers is somehow unfair, improper, or unenforceable. Visa Letter at 10-11. But the Durbin Amendment and Regulation II do not create the specter of "vicarious liability" for issuers, *id.* at 6; they merely require that issuers enable at least two, unaffiliated networks for each "particular type of transaction" so that *merchants* can make an educated routing decision based on all of the various costs and restrictions facing merchants along the payment pathway. Issuers' consistent failure to comply with that regulatory mandate prevents most merchants from *even attempting* to weigh these various considerations in making a routing choice. And Visa's claim that re-emphasizing the focus on issuer responsibility will create insurmountable costs on issuers falls flat when considering that it is the *largest* issuers that consistently fail to comply with the Durbin Amendment while smaller issuers have routinely enabled two unaffiliated networks for card-not-present transactions. *See supra* p.4.

contract techniques to try to induce third parties to skirt the rules, placing a level of not-that-plausible deniability between themselves and the Durbin Amendment violation. Indeed, that seems to have been what happened with the card-not-present transactions addressed by this NPRM: The issuers are the ones who failed to make their cards comply with Regulation II, but the dominant networks are the ones who created the incentive to do so through volume discounts and other tactics. Particularly given the clarifications proposed in this NPRM, future incarnations of the exact same pattern should be met with swift and stern enforcement action.

D. Issuer Incentive Agreements

Finally, RILA and its members again highlight for the Board that many of the aforementioned concerns exist in large part due to volume-based incentive agreements between networks and issuers and due to other contractual tactics designed by the dominant networks to create an incentive for other parties (including technology companies) in the payment process to prevent merchants from routing transactions over cheaper alternative networks. As RILA and its members have previously explained to both the Board and the FTC, these agreements provide the necessary impetus for issuers and other parties to collude in the networks' continued violations of the Durbin Amendment. RILA and its members believe that it is now time for the Board to indicate its concern with how these agreements distort the minimally competitive marketplace for debit transaction routing the Durbin Amendment aimed to create.

Networks can increase routing fee revenue in one of two ways. First, networks can increase traffic over their network (thereby increasing the total revenue from per transaction charges) by beneficial actions such as innovating in terms of payment methods and fraud prevention devices or by providing incentives *to merchants* to choose their network over competitors. These tactics reflect the benefits of competition: they either improve the quality of the debit product or reduce the monopoly rents the dominant networks extract by reducing the effective price to the merchants who pay the networks' fees (along with the end consumers who ultimately bear a portion of those costs). In other words, *outcompeting* other networks results in greater innovation and lower prices for merchants and customers.[10]

On the other hand, dominant networks can increase total revenue by offering to share their monopoly rents with *other* parties in the system who can help them to eliminate inter-network competition and ensure that Visa or Mastercard retain their debit volume. A volume discount directed at issuers has this precise character. Because the Durbin Amendment sets up a merchant choice regime, there should be no way for *an issuer* (as opposed to a merchant) to guarantee transaction volume to Visa or Mastercard in exchange for a discount. But in exchange for a chunk of the dominant networks' profits, issuers have found techniques—like the failure to enable PIN-less debit at issue here—to achieve exactly what the Durbin Amendment prohibits. This rent-splitting destroys all the benefits of the Durbin Amendment regime and the competitive system it sets up: Fees imposed on merchants and their consumers stay high and the incentive to improve product quality is eliminated. Thus, restricting routing options through volume-based incentives for issuers leads to the opposite

[10] This is in contrast to Visa's refrain that competition created by the plain language of the Durbin Amendment and Regulation II would somehow deter innovation. *See, e.g.*, Visa Letter at 3-5, 11-12, 14-16.

result of incentivizing choice by merchants—higher fees that are passed on to consumers as higher prices.

RILA's members, although they are not privy to the terms of these confidential volume-based incentive agreements, can attest that networks have strongly favored use of issuer incentive agreements over straightforward competition in the market. Indeed, the Board's data show that networks provided almost $2.5B in incentives in 2019, with issuers historically receiving a majority of those payments. Volume-based agreements provide substantial economic incentives for issuers to violate the Durbin Amendment and Regulation II by pushing ever increasing amounts of debit transaction volumes through the global networks. But this merely acts to further solidify duopoly control over that market, with *no positive effect whatsoever* on merchant routing choice.

Such agreements are thus violations of Regulation II. Section 235.7(b) bars an issuer or network from "directly . . . by contract" "inhibit[ing]" merchants from making routing decisions. These incentive contracts clearly fall within this prohibition—by incentivizing issuers to minimize routing options for merchants and forcing more volume through global networks, the contracts push issuers to create prohibited "routing restrictions." *Id.* RILA and its members therefore suggest that the Board clarify in its commentary accompanying the final rule that such agreements are noncompliant under the statute and regulation. Or, in the alternative, the Board can explain how the clarification of the issuer's responsibility to ensure that its cards are routable will serve to discourage such illegal agreements going forward.

* * *

RILA and its members repeat their appreciation for the Board's efforts in issuing clarifications through this NPRM. But the reality is that, once these clarifications have been made, the time for serious regulatory enforcement against willful noncompliance has come. The unfortunate truth is that the dominant networks have every incentive to try anticompetitive tactics that are illegal under the Durbin Amendment to protect their duopoly, and many issuers share those incentives because they have been offered a piece of the action. That is particularly true because, to this point, extremely dubious behavior that lacks any colorable legal justification has been met with further "clarifications" of already clear language rather than the severe enforcement action it deserves—allowing the obstinate parties to keep all the profits they reaped in the interim. RILA and its members sincerely hope that the unambiguous clarifications proposed in this NPRM will finally discourage the dominant networks from such ongoing efforts to evade the Durbin Amendment—and will likewise discourage issuers from playing along. But, perhaps more so for this reason than any other, RILA and its members support these proposed clarifications because they will fully arm both enforcement agencies to respond to the next iterations of the behaviors above with severe penalties for willful noncompliance. *See, e.g.*, 15 U.S.C. § 1693o-2(d); 12 C.F.R. § 235.9.

IV. RILA and Its Members Believe The Board Should Now Focus On Lowering The Interchange Rate Cap Given The Board's Own Data On Transaction Costs Over the Past Decade.

While the NPRM's main purpose is to clarify the requirements imposed on issuers and networks that provide merchants with the choice of at least two unaffiliated routing options for debit card transactions, the NPRM also briefly mentions the other crucial component in the Durbin Amendment: the regulated rate.

RILA and its members believe it is vital to recognize that the Durbin Amendment was meant to not only inject competition into the debit market but also to protect merchants, and by extension consumers, against the unchecked escalation of debit interchange fees. Electronic debit transactions have evolved significantly since 2011 and substantial changes in the interchange fee standards established by the Board are long overdue. RILA and its members strongly suggest that the base component be reduced to reflect current data on allowable costs, and that both the ad valorem component and the fraud-prevention adjustment be eliminated.

Meanwhile, we strongly believe that the Board should establish an objective and repeatable process to re-evaluate the rate periodically in response to updated information. The regulated rate established by the Board in 2011 has remained static for almost a decade now, despite the steady reduction in issuer costs that is evident from the Board's bi-annual surveys. Merchants have not enjoyed the benefit of the efficiencies that have reduced issuers' allowable costs, as the Board originally contemplated. Instead, RILA and its members—and by extension, the consumers they serve—are once again paying an unreasonable and disproportionate premium. The Board must expeditiously revise the current rate structure and implement changes that reflect the fair and reasonable fees the Durbin Amendment requires.

* * *

In conclusion, RILA and its members support the Board's on-going efforts to induce compliance by issuers and networks with the plain language of the Durbin Amendment and Regulation II and urge the Board to take strong enforcement action—in place of further, unnecessary clarifications—if there are continued, flagrant violations of provisions of the Durbin Amendment and Regulation II that have been in place for over a decade. We look forward to partnering with the Board to ensure that the purpose of the Durbin Amendment—providing merchants with routing choice to lower costs for both merchants and consumers in debit transactions—is met. If you have any questions or requests for additional information, please do not hesitate to contact me by phone or email at the contact information listed above.

Sincerely,

Brian Dodge, President
Retail Industry Leaders Association