NAVY FEDERAL Credit Union

Office of the President

5 August 2021

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

Re: Board Notice of Proposed Rulemaking – Debit Interchange Fees and Routing

Dear Ms. Misback,

Navy Federal Credit Union (Navy Federal) appreciates the opportunity to respond to the Board of Governors of the Federal Reserve System's (the Board) proposed rule regarding Debit Card Interchange Fees and Routing.[1] We believe the proposed rule is premature and unnecessary, and would, if finalized, materially impair Navy Federal's ability to serve its members.

We are the nation's largest credit union with over $145 billion in assets and more than 10 million members. We are committed to serving the needs and improving the financial condition of our members, including servicemembers, veterans, and their families. As a not-for-profit, member-owned financial institution, we have no shareholders. That means we reinvest all revenue into the credit union to benefit members through improved products and services. It also means that any cost increases or losses we experience are borne by our members through their shared ownership.

We believe in the value of the debit market. Because so many of our members are young and just beginning to build their credit profiles, our members overwhelmingly rely on their debit cards, and for many of these members, their Navy Federal debit card is their ticket to financial stability and independence.

Our membership has already experienced significant costs as a result of the Durbin Amendment and Regulation II, without the purported benefits to consumers at the point of sale. The reduction in interchange revenue, coupled with the increased cost of integrating with multiple debit networks, has resulted in our members having to pay more for certain products and services that we were previously able to offer at competitive costs or even for free. At the same time, the promise that routing choice for merchants would result in savings for consumers through lower prices has not borne out, as evidenced by research from the Federal Reserve Bank of Richmond which found that, "[a]veraging across all sectors, it is estimated that the majority of merchants (77.2 percent) did not

[1] Board of Governors of the Federal Reserve System. "Debit Card Interchange Fees and Routing." *Federal Register* Vol. 86, no. 26189 (May 13, 2021). https://www.federalregister.gov/documents/2021/05/13/2021-10013/debit-card-interchange-fees-and-routing

PO Box 3000 Merrifield VA 22119-3000

change prices post-regulation, very few merchants (1.2 percent) reduced prices, while a sizable fraction of merchants (21.6 percent) increased prices."[2]

We are concerned that the proposed rule would shift to issuers the cost of merchants' and acquirers' failure to develop a robust market for card-not-present (CNP) debit networks. Rather than promote competition and lower consumer costs, the proposed rule would actually increase costs to our members and reduce innovation, which would outweigh any marginal benefits. In particular, we urge the Board to seriously consider three broad consequences of the proposed rule:

- Less secure and unreliable transactions. The proposed rule would restrict our ability to choose to partner only with safe and reliable networks. Instead, we would be required by law to accept the significant risks of working with new unaffiliated processers, many of whom have less reliable and secure systems. This would expose our members to greater risks of fraudulent transactions and the inconvenience of transactions failing to transmit properly at the point of sale, undermining our members' confidence in Navy Federal as their debit card issuer.

- Ambiguity as to scope, potential for misapplication. The proposed rule includes ambiguous language that could be interpreted to require that we guarantee every merchant will always have the ability to select between two unaffiliated debit routing options. But this requirement is infeasible and goes well beyond the text of the Durbin Amendment. Neither Navy Federal nor any other issuer has visibility into each merchant's agreement with its acquirer. This means issuers would have to enable *all* payment networks on their debit cards to ensure compliance with Regulation II, which cannot be what the Board intended.

- Increased compliance costs resulting in fewer or more expensive services for members. Issuers like Navy Federal would bear the disproportionate burden of negotiating new relationships with many unaffiliated networks and maintaining a significantly larger and more complex debit infrastructure. These costs have no offsetting benefit for issuers and would further reduce Navy Federal's ability to support our debit card program and other critical low- or no-cost services for our members of modest means. If merchants truly want routing choice, the cost of developing a robust market of CNP debit networks would be more appropriately directed towards merchants and their acquiring partners.

Given the magnitude of these likely consequences, Navy Federal opposes the proposed rule and requests that the Board conduct and publish an analysis of the amendments' impacts on cardholders prior to publishing a final rule. The welfare of consumers is the most effective measure of the health of the debit card market and should therefore be at the center of the Board's analysis into whether further regulatory interventions are warranted.

**1. The proposed rule would expose our members to less secure and unreliable networks.**

Debit card markets function better when issuers like Navy Federal can exert a degree of control over the selection of the networks that cardholders will rely on to facilitate their transactions for at least two reasons. *First*, an issuer's payments infrastructure is incredibly complex and difficult to manage.

[2] *See* Zhu Wang, Scarlett Schwartz, and Neil Mitchell, "The Impact of the Durbin Amendment on Merchants: A Survey Study," *Economic Quarterly* 100, no. 3 (2014): 183-208. https://www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_quarterly/2014/q3/pdf/wang.pdf

Before we facilitate a single debit card transaction, we negotiate comprehensive contractual agreements with payment networks that meet legal, regulatory, security, business, and audit standards. Next, we develop back-end systems and technologies to ensure our debit cards communicate effectively with the enabled networks and merchants. Far from a "set it and forget it" business, we continually invest in our infrastructure to ensure it functions properly in a variety of environments across time. We go to great lengths to ensure each aspect of our debit card program works best for our members over the long term, but the proposed routing requirements would undermine these objectives.

*Second*, Navy Federal – not the merchant – is ultimately responsible for serving our members in a secure manner. As such, we choose to enable networks that have high market penetration and the best-developed and secure processing infrastructures and technology because our reputation, and the confidence of our members, is at stake with each transaction. Our members rely on us, so it is important that we have confidence in our payment networks' ability to authenticate and process a significant volume of transactions at as many merchants as possible. We make continuous investments in fraud prevention and remediation to protect our members from financial harm, and we ensure our enabled networks make similar investments. These investments, while costly, have provided value as our fraud losses have fallen over the last four years. The proposed routing requirements would undermine our ability to maintain a high level of security and fraud prevention.

It is particularly important for Navy Federal to have flexibility and control over routing CNP and other high-risk transactions, which impose disproportionate fraud risks on our members.[3] CNP transactions require innovative and dynamic systems and processes, and the environment is constantly evolving. As our world experiences increased cybersecurity breaches and ransomware attacks, it is important that we store and route members' CNP transactions over the most developed and secure payment networks.

We appreciate the Board's attempt to clarify what it perceives to be a misinterpretation of the law. However, we believe the proposal represents a new regulatory intervention against unchanged circumstances, rather than a mere clarification. Indeed, the Board acknowledges in its proposal that, "[a]t the time the Board promulgated Regulation II, for card-not-present transactions…the market had not developed solutions to broadly support multiple networks over which merchants could choose to route those transactions,"[4] and the Board's initial perspective remains true today.

The Board's proposal would therefore require us to route data over payment networks that have not made the investments necessary to meet our high security standards. Just because a payment network has developed the *ability* to process CNP transactions does not mean our members should be exposed to increased risk of loss of fraud or less reliable services in order to accommodate merchants' self-serving and dubious claims that routing choice benefits consumers. Further, increasing the number of payment networks enabled on a card in order to enforce routing options on *every* conceivable transaction type would lead to significantly more network regimes enabled on a

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[3] *See* Board of Governors of the Federal Reserve System. *Changes in U.S. Payments Fraud from 2012 to 2016: Evidence from the Board Payments Study*. Washington, D.C. October 2018. https://www.federalreserve.gov/publications/files/changes-in-us-payments-fraud-from-2012-to-2016-20181016.pdf

[4] Board of Governors of the Federal Reserve System. "Debit Card Interchange Fees and Routing." *Federal Register* Vol. 86, no. 26189 (May 13, 2021). https://www.federalregister.gov/documents/2021/05/13/2021-10013/debit-card-interchange-fees-and-routing

card, each with their own dispute and recovery rights, leading to member confusion during especially disruptive times.

Restricting issuers' discretion over the routing of CNP transactions could also have negative long-term impacts. Absent the investments and innovations by issuers and payment networks, merchants would have to increasingly rely on payments by cash or check, which introduce significant costs, risks, and challenges. Issuers have removed these barriers and enabled levels of commerce that were previously unimaginable. By reducing control, the proposal could disincentivize issuers from making future investments and enhancements to the operations of their debit card program. Further, by essentially guaranteeing enablement on a debit card, absent the requisite technology and security standards that issuers like Navy Federal demand on behalf of its members, the proposal will disincentivize networks and acquirer-processors from making the ongoing investments that are necessary to support advanced technology like secure CNP transactions, undermining incentives for the development of a robust market for CNP-enabled networks. These market forces could accelerate the movement of payments to non-debit rails that could be less convenient or secure for cardholders and merchants, such as the unregulated fintech space.

2. **The proposed rule includes ambiguous language that could be read to create overly broad and infeasible requirements on issuers.**

We are also concerned that ambiguity in the proposal could lead to future misapplications of Regulation II. Specifically, current 12 C.F.R. § 235.7(a)(2) requires issuers to enable at least two unaffiliated payment card networks each of which does not, by rule or policy, restrict the operation of a network to a limited geographic area, specific merchant, or particular type of merchant or transaction. Existing Board commentary 235.7(b)-1 states, "[t]his rule does not permit a merchant to route the transaction over a network that the issuer did not enable to process transactions using that debit card."

The language in proposed 12 C.F.R. § 235.7(a)(2), however, states that "[a]n issuer satisfies the requirements of paragraph (a)(1) of this section only if, for every geographic 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, such issuer enables at least two unaffiliated payment card networks to process an electronic debit transaction..."[5]

Industry stakeholders and future regulatory authorities could interpret this proposed language as establishing a new positive requirement that issuers guarantee every merchant in the United States will always be able to select between two unaffiliated debit routing options. Because the issuer does not have visibility into a merchant's agreement with its acquirer, this could require issuers to enable *all* payment networks on their debit cards to ensure compliance with Regulation II. We understand this is not the Board's intent and urge the Board to revise the language in the final rule to clarify – and emphasize – that issuers are not required or expected to enable more than two unaffiliated payment networks on their debit cards to comply with the provisions in 12 C.F.R. § 235.7.

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[5] *See* Board of Governors of the Federal Reserve System. "Debit Card Interchange Fees and Routing." *Federal Register* Vol. 86, no. 26189 (May 13, 2021). https://www.federalregister.gov/documents/2021/05/13/2021-10013/debit-card-interchange-fees-and-routing

**3. The proposed rule would result in higher costs to our members.**

Because we are owned by our membership, the additional costs of routing choice will be shifted to our members, without countervailing benefits to them at the point of sale. In order to ensure that merchants can choose between two unaffiliated networks for *every* transaction, we would likely need to partner with a significant number of networks with which we do not currently have relationships, for the reasons discussed above. The cost of negotiating complex contracts with each network would be substantial. We would then need to allocate resources to monitoring and auditing each of the enabled networks to ensure they operate in a compliant manner, as well as increase our budget for ongoing maintenance costs. In effect, the proposal will force us to bear the cost of artificially developing a CNP network market — costs that would be passed on to our members in the form of more expensive financial products, less accommodative policies, and diversion of funds away from innovation.

Navy Federal invests its resources in our debit card program, systems, and technologies to ensure we best protect and serve our members. All debit card transactions are covered by our Zero Liability policy; when a member is a victim of fraud, we commit to making that member financially whole, often the same day. Moreover, if a member requests a new or replacement card when visiting one of our 346 branches, we provide the new card the same day and at no cost. We have also thoroughly vetted and invested in our payment network partners to ensure members experience a reliable, convenient, consistent, and secure debit experience. These investments support market innovations like enhanced fraud detection and faster payments, while ensuring we maintain the integrity of our regulatory commitments.

It is critically important that the Board considers the unseen costs that the proposed rule would impose on financial institutions and their customers. If finalized, we anticipate the proposal would increase debit card program costs and compound the existing compliance burdens of debit interchange regulation, thereby reducing our ability to invest in products, services, and experiences that our members value.

**Conclusion**

As a not-for-profit, member-owned financial institution, we reinvest revenue into products and services that provide market-leading value. We are proud to serve millions of members that are young and working to establish good financial habits as they are new to the mainstream financial system. Many of our members are living paycheck to paycheck, and our ability to offer free and low-cost options are essential tools that help them manage their finances. We offer four different checking accounts with no monthly service fees or minimum balance requirements, such as our Free Active Duty Checking account. Recently, our ability to invest resources in our members allowed Navy Federal to reduce and waive more than $3 million in savings and checking account fees during the COVID-19 pandemic.

Before the Board considers finalization of a rule that would hinder our ability to provide low-cost products and services to our members, we believe the Board should conduct and publish an analysis of the proposal's impact on cardholders. Given that our member cardholders are end users, the Board should place them at the center of its analysis when considering the benefits and costs of its proposed amendments. While the Board seems to be considering only the impact to merchants in the proposed rule, the Board correctly recognizes that "[a]n electronic debit transaction typically involves at least five parties: (i) A cardholder, (ii) the entity that issued the debit card to the cardholder (the issuer), (iii) a merchant, (iv) the merchant's depository institution…and (v) a payment card network."[6] We ask that the Board reflect on the impact to issuers and, most importantly, our members before proceeding with rulemaking.

Thank you for the opportunity to comment on this proposal. If you have any questions, please contact me or my point of contact, Emily Troncoso, at (703) 206-1541.

Sincerely,

Mary A. McDuffie

Mary A. McDuffie
President/CEO

MM/jc

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[6] *Id.*