First State Bank
Member FDIC

July 14, 2022

Hon. Jerome Powell, Chair
Hon. Lael Brainard, Vice Chair
Hon. Michael S. Barr, Vice Chair
Hon. Michelle W. Bowman
Hon. Lisa D. Cook
Hon. Philip N. Jefferson
Hon. Christopher J. Waller
Board of Governors of the Federal Reserve System
Washington, DC 20510

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

Dear Chair Powell, Vice Chair Barr, Vice Chair Brainard, and Governors:

First State Bank of St. Charles, MO is a $470 million community bank that serves both the St. Louis and Kansas City metropolitan areas. Our dedication to the success of local small businesses and families is reflected in our strength and longevity in our markets. Looking to the future, we see continued stability for the bank, with new innovations, new ideas of what it means to be a local bank, and new opportunities to be of service to all areas of the communities we serve. The last two years have accentuated the fact that certain headwinds develop at times that force us to pause our strategy and re-focus our attention on the critical issues at hand. That's just business. However, as a community bank that relies on our regulators to provide a thoughtful approach to decision-making on new and changing regulations, I become concerned when I see abrupt changes made that could potentially create obstacles to our customers being served in the best way possible.

I am concerned that the Federal Reserve has not yet withdrawn its proposal to expand Regulation II, nor has it provided the public with important facts about this new mandate's impacts despite that information being requested by more than a thousand commenters. Those facts, including estimates of the proposal's impacts on community banks and competition, are required to be disclosed to the public before a major rulemaking like this can be enacted. I urge the Board of Governors to pause any further action until there is transparency and clarity about the real-world burden this proposal will create.

The proposal did not include any estimate of the costs that community financial institutions would be forced to bear to implement it. However, if that analysis were conducted today, as discussed further below, it would be apparent to the Fed that the price tag for compliance has grown significantly even since the proposal was released in May 2021 and prior assumptions are outdated.

Most importantly, the proposal is likely to necessitate the reissuance of debit card fleets. Retailers and banks have both acknowledged that card reissuance could be a consequence of Board action.[1]

Card-issuing banks across the country are already facing significantly higher costs and longer wait times[2] for new debit cards. Industry estimates of these increases are all in the double digits, on a percentage basis.[3] This is due to global neon and semiconductor shortages, which have left payment cards vying for scarce raw materials and manufacturing capacity. Neon, a key component in chip manufacturing, has increased 900% in price since March 2022. The global card technology association reports "persistent, and wide-reaching global chip shortages" and that "chip supply challenges [are] expected to continue in 2022 and throughout 2023."[4] As President Biden said this year when directing federal agencies to take action, "Because supply is low, we find ourselves in a position that we're really behind the curve. Prices are going up."[5] The urgency represented by President Biden's Executive Order[6] was an important step in organizing ongoing and coordinated federal stakeholder action to mitigate the economic damage from this problem. Supply chains are now a cross-cutting regulatory and compliance consideration.

Every card needs at least a "contact" chip and many now also include an additional "contactless" chip. Demand for these two-chip cards has grown during the pandemic, both here and abroad, adding 270 million new unit orders and pushing global issuance past the 2 billion card mark in 2021. Unfortunately, this mismatch between rising global chip card demand and diminished manufacturing capacity is forcing hard decisions at U.S. issuers such as whether to issue cards without contactless capabilities, a factor that some consumers will consider when picking a card and will represent a downgrade for consumers who have a contactless card now. In light of these constraints, banks are developing strategies to prioritize and support customers who may need a new card immediately.

But the Fed's proposal would act as a shock to the market, undermining this focused and delicate distribution of scarce card supplies by requiring a large number of cards to be reissued earlier than expected – and essentially all at once. To be clear, these cards that the Fed's proposal will render prematurely obsolete are fully functional and Durbin-compliant and already carry two unaffiliated networks. They meet the latest published standards for security and Durbin routing and are not technologically outdated in any way. However, the Fed's proposal would push many banks out of compliance unless they add networks/processors that "enable" newly-mandated transaction types and

[1] "...it is the Board's responsibility to enforce the law and ensure that merchant routing choice is real. **This is true even if banks must reissue cards to replace those that do not allow meaningful choice.**" Comment letter of Walmart and its subsidiary ecommerce brands to the Federal Reserve Board of Governors. Docket R-1748. August 11, 2021, Michael A. Cook, Assistant Treasurer of Walmart Inc.

[2] https://tearsheet.co/payments/how-the-microchip-shortage-is-affecting-the-payments-industry/
[3] https://www.paymentsdive.com/news/chip-shortage-drives-up-card-costs/624317/
[4] https://www.prnewswire.co.uk/news-releases/smart-payment-association-spa-releases-2021-smart-payment-card-and-module-global-shipment-figures-860943589.html
[5] Remarks by President Biden: "On Increasing the Supply of Semiconductors and Rebuilding Our Supply Chains." January 21, 2022. https://www.whitehouse.gov/briefing-room/speeches-remarks/2022/01/21/remarks-by-president-biden-on-increasing-the-supply-of-semiconductors-and-rebuilding-our-supply-chains
[6] Executive Order 14017: "On America's Supply Chains." February 24, 2022. https://www.whitehouse.gov/briefing-room/presidential-actions/2021/02/24/executive-order-on-americas-supply-chains/

an array of new merchant routing rights. Chip cards cannot be reprogrammed once issued and the only way to add these capabilities is via new chip(s) on a new card.

This new mandate is arbitrary and unfair, since banks like mine issued these chip cards in support of the Fed's own payment security roadmap and did so at significant expense, with many of the subsequent benefits accruing to merchants through a nearly 90% decrease in counterfeit card fraud. When we issued chip cards, the Fed's expectation was that we provide two unaffiliated networks, which we did, and the Board's FAQs issued during the transition gave no hint about a fundamental shift in the Fed's stance on compliance, nor could banks anticipate the creation of new merchant rights not found in the Durbin Amendment. For smaller banks, these en masse reissuances are big ticket costs that need to be forecast over a multi-year period. This is why banks are compensated for card reissuance after some merchant data breaches, but there will be no compensation in this case. We have continuously made investments in new chip cards in good faith reliance on the Fed's guidance, with the typical lifespan of a card known to the Board when the FAQs were issued.

Even if the compliance date is set for after the worst of the shortage is over, community banks would not be well positioned for potentially the biggest chip card reissuance in history. Moreover, it is unclear whether it will even be feasible to always provide both contact and contactless capabilities. The vast majority of community banks rely on third-party vendors who print, emboss, program, activate, and mail cards to customers. They charge higher prices to smaller banks and forecasts show the costs rising through the middle of the decade, yet the proposal's analyses do not include this key information. This new network onboarding and card reissuance would require a mobilization across several companies, but ultimately it's the bank that is accountable for compliance. Public reporting details how the capacity of some of these vendors is being strained by supply chain conditions. Additional public burdens such as disruptions to recurring payments are possible. Though the proposal does not estimate the number of additional chip card orders this regulatory change will generate, it is difficult to imagine a scenario where current shortages are not exacerbated by it going into effect – a risk we should not take with a payment card system that enables much of American commerce.

This is all unnecessary. The Federal Reserve is under no legal obligation to respond to merchant demands to rewrite Regulation II routing requirements, or to finalize the Fed's proposal and trigger these consequences. Continuing down the road of a federal agency artificially creating a surge in demand for chips feels inconsistent with the pragmatism and partnership embodied in the Administration's whole-of-government semiconductor strategy. I hope that with this information, you will agree that the wiser and more appropriate course is to withdraw this incomplete proposal, or at a minimum, for the Fed to complete a fulsome impact analysis and subject it to the public's scrutiny before proceeding further.

Sincerely,

Luanne Cundiff

Luanne Cundiff
President & CEO

c: Office of Information and Regulatory Affairs