By Email: regs.comments@federalreserve.gov

August 10, 2021

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Docket No. R-1748, RIN 7100-AG15, Comments from SHAZAM, Inc.

SHAZAM, Inc. ("SHAZAM") appreciates this opportunity to provide comments in response to the notice of proposed rulemaking ("NPR") issued by the Board of Governors of the Federal Reserve System (the "Board") regarding proposed clarifications to Regulation II.

SHAZAM is a national member-owned debit network, processor, and core provider. Founded in 1976, SHAZAM delivers choice and flexibility to community financial institutions throughout the U.S. and is a single-source provider of credit card, debit card, core, fraud, ATM, merchant, marketing, training, risk and ACH services. As a long standing, nationally-recognized pioneer and innovative service provider in the payments system, we have dedicated our organization to providing and enhancing the opportunity for approximately 1,000 community financial institutions to compete effectively and profitably in the marketplace through the delivery and support of quality, comprehensive, and timely electronic funds transfer ("EFT") services. SHAZAM provides EFT services to financial institutions and processing services to merchants throughout the U.S.

It is important at the outset to highlight the differences and similarities of debit transactions. Some industry stakeholders may consider unaffiliated networks' PINless and signature transaction sets as somehow less proven. This of course is not accurate. A PINless debit transaction leverages the same cryptography as a signatureless transaction. Card-not-present and e-commerce transactions have historically been the transaction set with the highest levels of fraud. This is driven because of a lack of card or cardholder authentication. In contrast, PIN has historically been the most secure transaction for a reason-- it was based on robust strong ANSI standards ensuring a consistent experience, which is why it continues to be the worldwide default for multi-factor authentication of debit and in many countries credit transactions.

New cardholder authentication types like biometrics and payment processes like secure remote commerce (now known as Click to Pay) are being implemented in a manner that restricts debit routing capability. SHAZAM is a participant in EMVCo and contributes both technical and industry expertise to help drive new standards, however, once the technical standard is created, EMVCo stops short of defining implementation standards. The work of stakeholders across the industry are then ignored as the owners of EMVCo wrap uniqueness around what the industry creates and then restricts the use of it through proprietary implementations. Without a standards implementation approach, it creates additional expense to issuers and merchants and contributes to the strategy others utilize to prevent competition and maintain their control of the payment ecosystem.

We are also concerned with inaccuracies regarding the security of PINless versus signature transactions and the capabilities of national unaffiliated networks like SHAZAM. SHAZAM, as well as other networks, use state of the art AI and Neural engines to evaluate the security, risk, and legitimacy of all transactions, ensuring a consistent consumer experience regardless of the network the transaction is routed on. All networks process and validate the cryptography regardless of the network it is routed over. It is important to understand that signature transactions and PINless transactions are essentially the same, in that they both lack cardholder authentication and are thus susceptible to increased consumer fraud. The use of PINless transactions does not introduce new fraud into the payment ecosystem as that risk already exists with signature transactions, which can be seen in the lower levels of fraud reported on card-not-present PINless transactions (single message) versus signature (dual message). The following chart illustrates this point:

Type of transaction	PIN	PINless	Signature / No Signature
Chargeback and representment rights	✓	✓	✓
Lower risk of fraud due to real-time authentication	✓		
Use fraud neural engines to score and block fraudulent transactions	✓	✓	✓
Card authenticated via card chip	✓	✓	✓
No delay in settlement of the transaction, reduced chance of consumer overdrafts	✓	✓	

As one of the oldest national debit networks in the nation, SHAZAM has observed first-hand how technology has been implemented and used to encourage large issuing banks to apply Regulation II in a way that makes merchants' routing choice for all debit transactions difficult, especially when the merchant does not obtain a PIN—including single and dual message transactions and certain card-present "PINless" transactions, and virtually all card-not-present transactions, the fastest-growing segment of debit transactions. Organizations which own processors, networks, and acquirers who may choose to restrict which networks are enabled for transactions, especially the aforementioned transactions when the merchant does not require a PIN, weaponize the technology and further limit routing choice. The conduct of network-owned acquirers may point to a gap in Regulation II, which can be filled by requiring acquirers owned by debit networks to enable all existing debit network transactions supported by unaffiliated networks.

We appreciate the Board's efforts to clarify Regulation II, which in SHAZAM's view already prohibits denying routing choice on any type of debit transaction. Our comments propose further clarification, however, in light of the current state of Regulation II in the debit market, to further clarify the rules and their application to all debit transactions through any point of interaction to avoid continued evasion of Regulation II's requirements.

I. Routing Options Required Regardless of Means of Access.

We appreciate that the Board intends to make clear in Official Commentary to §235.7 that Regulation II's network non-exclusivity provisions require that a debit card be enabled on at least two unaffiliated payment card networks "regardless of means of access," including explicitly "means of access that may be developed in the future." Comment 7(a)(7). SHAZAM supports the Board's proposed commentary that such means include a debit *card*—a device which may cease to exist entirely in the future—as well as card proxies such as a device like a fob, or "information stored in an e-wallet on a mobile phone or other device." *Id.*

The proposed commentary properly requires that for any means of access that carries debit information—whether a card or other device—two unaffiliated payment networks must be enabled by the issuer. In light of the history of practices in the payments market that necessitated both the passage of the Durbin Amendment and the Board's current proposal to clarify Regulation II, SHAZAM believes that the Board should address payment tokens—*i.e.*, the "information stored in an e-wallet" or the "card on-file environment"—more directly.

In the market today, various networks or third-parties offer solutions using payment tokens that store tokens that are not based on accredited standards. These payment tokens which allow merchants to store customer debit cards "on file" or in e-wallets that enable customers to make in-app purchases routinely deny merchants the ability to route to unaffiliated networks. SHAZAM urges the Board to make clear that deploying tokenization, used under card-present or card-not-present conditions during the payments process, must not impair a merchant's ability to access unaffiliated networks enabled on the debit card. Without further clarification, industry stakeholders will claim that it is the responsibility of e-wallet providers or other third parties, rather than the solutions issuers may be required or choose to support, that inhibit the ability of merchants to route transactions to unaffiliated networks.

Regulation II has a gap in its application in that it applies only to issuers and networks and does not require that acquirers enable support of routing to all existing national debit networks. In other words, if an issuer enables an unaffiliated network for a certain transaction set, an acquirer that does not support this network for this type of transaction will effectively deny the merchant routing options for this type of transaction. The lack of support of routing to all nationally-available networks by acquirers is not consistent with the expectations placed on both issuers and networks and may put both in a position of not being able to satisfy the obligations of Regulation II. The Board should consider closing such gaps to ensure networks nor issuers are put into a position in which they have little to no ability to resolve. At a minimum, networks, issuers, acquirers, and processors should take reasonable steps to ensure that the parties they do business with properly support routing to unaffiliated networks.

II. Routing Options and Cardholder Authentication.

The Board's proposed commentary and modification to § 235.7(a)(2) does not require that an issuer enable two unaffiliated networks for "each method of cardholder authentication (e.g., signature, PIN, biometrics, any other method of cardholder authentication that may be developed in the future, or the lack of a method of cardholder authentication)." Comment 235.7-7(a)(1). While SHAZAM applauds the explicit inclusion of future authentication methods in the NPR as a whole, SHAZAM remains concerned about the continued evasion of the Board's exclusivity requirements through the enablement of unaffiliated networks for only certain authentication methods.

Specifically, the Board should expand the current proposed language concerning non-exclusivity for every "particular type of transaction," 235.7(a)(2), Comment 7(a)(2)(iii), to include all forms of authentication. This clarification would avoid any ambiguity about whether a particular transaction is a discrete *type* of transaction—e.g., card-present—or uses a discrete *method of authentication*, such as biometrics. SHAZAM therefore proposes that the Board modify the proposed language "for every . . .

particular type of transaction" to be more inclusive of new transaction types and include the language "for every particular type of debit transaction, regardless of authentication (e.g., signature, PIN, biometrics, any other method of cardholder authentication that may be developed in the future, or the lack of a method of cardholder authentication)."

To address any concern as to innovative authentication methods, SHAZAM suggests that the Board import the standard in §235.7(a) concerning whether a "network[] has taken steps reasonably designed to be able to process the electronic debit transactions that it would reasonably expect will be routed to it, based on expected transaction volume." In other words, the Board should clarify that an issuer should enable all the cardholder authentication methods properly supported by a given payment network but is under no obligation to enable such methods if they are not properly supported. This would encourage innovation—as innovative methods may provide exclusivity for a certain limited period—but would also maximize routing options for all means of access and all methods of authentication, furthering the goal of increased competition that is at the heart of the Durbin Amendment and Regulation II. SHAZAM also proposes that any token, card, or account number acquired at the point of interaction should be able to be sent directly to the issuer or issuer processor. To enable this, a network agnostic token based on accredited standards should be used and keys to encrypt/decrypt should be owned by the issuer, not a specific network or service provider.

Over the last several years authentication technology has included new methods of authorizing transactions. A recent example of this is the use of biometrics. Today, biometric authentication is performed on the device and is not an authentication specific to any one network—for example, on the iPhone, face or fingerprint recognition is performed by hardware and software developed by Apple. However, there are restrictions in place that restrict the unaffiliated networks from being able to use the EMVCo-defined cardholder verification method when using the Common AID—specifically, the "CD-CVM" or cardholder-device CVM, is restricted —not technologically limited—only to the Global AIDs. Through these restrictions, a method of authentication that is available on the device is artificially restricted from being routed using the appropriate authentication that the device used to enable the transaction—routing from these devices is currently accomplished using "No-CVM" despite the fact that biometric authentication (CD-CVM) was used.

The debit networks compete on the value they can return to the financial institution and merchant. Only a select few can mandate acceptance throughout the industry without pushback. As experienced in the 1990's, the introduction of and acceptance of signature debit was mandated for the merchants, with subsequent mandates for issuers to participate in new PIN solutions like PAVD and mandates to participate in affiliated PIN networks like Maestro were quickly implemented and enforced as soon as Regulation II was implemented in a manner to protect transaction volume. Another issue that creates routing challenges is that the issuers no longer own the BINs of their cards—these are licensed to them by the global networks--and lack portability between networks thus restricting their ability to negotiate between payment providers. These market realities require the Board to actively monitor and enforce Regulation II.

III. The Role of the Processor or Other Agents.

SHAZAM generally supports the proposed amendments to Section 235.7(a)(2), with SHAZAM's proposed clarification above to include all methods of authentication along with all transaction "types." However, SHAZAM notes that the new proposed language appears to shift the obligation of issuers, from requiring issuers to "allow" transactions to be processed on two unaffiliated networks to requiring that the "issuer enables at least two unaffiliated payment card networks to process an electronic debit transaction . . . ."

SHAZAM points out that payment card networks authorize, clear, and settle transactions, rather than *process* them. As noted above, unless affiliated with a payment card network, processors may not be included within the scope of Regulation II. This potential gap can create challenges for issuers—especially community financial institutions—because an issuer can only support the transaction types that its processor supports. As a result, if a processor makes the decision not to enable card-not-present transactions for a specific network, no issuer using that processor will be able to enable those transactions. The Board should therefore clarify that if an issuer contracts with a processor that does not permit the issuer to properly enable unaffiliated networks, this may be a violation of Regulation II.

IV. Nomenclature - Comment 235.7(a)-2 Permitted networks.

The Board is also proposing revisions to comment 235.7(a)-2. The proposed revisions clarify that card-not-present transactions are a "particular type of transaction" for which at least two unaffiliated payment card networks must be available. The Board is also proposing to add a new comment 235.7(a)-2(iii) to provide examples of how an issuer could comply with the rule.

The language in the proposed change uses the term "card not present" and "dual-message" interchangeably; however, the two terms are not synonymous.[1] The inclusion of card-not-present transactions is vitally important; however, a broader call out for dual message transactions would be valuable.

V. Conclusion.

For the reasons stated above, we believe it is necessary for the Board to implement the proposed clarifications to Regulation II in light of the proprietary and manipulative manner that many in the payments industry are currently frustrating the letter and intent of the law. We would also encourage the Board to include some of the additional changes that we have addressed in this letter to add further clarification.

We would be happy to have a discussion or provide additional feedback regarding this matter. If you have any questions, please do not hesitate to contact me.

Sincerely,

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[1] The Board recognized these changes in the marketplace in its recent data report: "Over time, the distinction between single-message and dual-message networks has become less clear from a functional perspective, as methods of cardholder authentication change and both types of networks develop new functionalities." *2019 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions*, Board of Governors of the Federal Reserve System (May 2021) p. 6 &n.12, https://www.federalreserve.gov/paymentsystems/files/debitfees_costs_2019.pdf.