

State Employees' Credit Union



Administrative Offices

August 11, 2021

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

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

Dear Ms. Misback:

This letter is submitted by State Employees' Credit Union (SECU) of Raleigh, North Carolina to provide comments on the Notice of Proposed Rulemaking (NPRM¹) issued by the Board of Governors of the Federal Reserve System (Board) concerning the Board's proposed amendment to Regulation II and its commentary (the Proposed Rule²) addressing Debit Card Interchange Fees and Routing.

SECU is the nation's second largest credit union serving over 2.5 million members through 274 branch offices, more than 1,100 ATMs, 24/7 Member Services via phone, a website (www.ncsecu.org) and a Mobile App. Since 1937, SECU has provided vital consumer financial services to its members—predominately North Carolina state employees, teachers and their families—as it has grown in asset size from approximately \$500 to \$50 billion today. As part of its member service commitment, SECU has issued over 2 million debit cards actively being utilized by its members, and SECU has authorized and settled hundreds of millions of debit transactions—constituting tens of billions in debit card activity—in the past year alone.

We welcome the opportunity to provide comments on the Proposed Rule. Although SECU appreciates the Board's attempt to provide clarity on the complex issue of applying Regulation II to card-not-present (CNP) transactions, SECU respectfully requests that the Board withdraw the Proposed Rule for two primary reasons. First, SECU has serious concerns that the Proposed Rule would impose **new, significant, and expansive compliance obligations on issuers** such as SECU that extend to all debit transactions, not just CNP transactions. SECU respectfully views the proposed revisions to Regulation II and its commentary addressing issuer compliance as **overbroad and unnecessary** with potentially **far-reaching and unintended consequences**. Second, SECU opposes the Proposed Rule's issuer mandate to enable multiple unaffiliated payment networks on CNP transactions. This mandate would effectively require issuers to enable at least one single

¹ Board of Governors of the Federal Reserve System, Notice of Proposed Rulemaking, Debit Card Interchange Fees and Routing [Regulation II; Docket No. R-1748], RIN 7100-AG15, 86 Fed. Reg. 26189 (May 13, 2021).

² NPRM at 26194-95 (proposed revised 12 C.F.R. § 235.7(a)(2), 12 C.F.R. Part 235, Appendix A).

119 N Salisbury St PO Box 27665 Raleigh, NC 27611-7665 919-839-5000 Fax 919-839-5353

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message payment network for CNP transactions, even though these networks are **still developing support for and relatively untested in processing CNP transactions**. Accordingly, the Proposed Rule, if finalized, risks an **increase in fraudulent transactions**, leading to increased issuer expenses related to chargebacks and consumer fraud.

As detailed below:

- Even though the Board intended the Proposed Rule only to clarify existing issuer obligations, the Proposed Rule's language imposes a new, expansive and unwarranted compliance burden on issuers.
- Issuer compliance with the Proposed Rule's revised obligations would be practically impossible.
- The Proposed Rule's revisions to the text of section 235.7(a)(2) and that section's corresponding commentary are unnecessary.
- The Proposed Rule's mandate surrounding CNP transactions will force issuers to enable CNP transactions to be processed over relatively untested single message networks, likely leading to an increase in fraud and corresponding expenses to issuers and other market participants.
- SECU respectfully requests that the Board withdraw the Proposed Rule. Alternatively, to the extent the Board decides to enact any part of the Proposed Rule, SECU respectfully requests the Board revise the language and provide additional clarity and detail regarding the Board's expectations for issuer compliance.

Far from being a clarifying change, the Proposed Rule proposes a significant, substantive shift in compliance burden onto issuers.

Throughout the NPRM, the Board reiterates that the aim of the Proposed Rule is to "**clarify**" the compliance obligations that Regulation II imposes on issuers.³ Indeed, the NPRM expressly states that the Board "**does not intend these amendments as a substantive change to the section but rather as a clarification** of the existing language."⁴ But, as explained below, the Proposed Rule, read literally, would effect a transformative shift in issuer compliance responsibility, one that we believe no issuer could meet. Since the Board's stated aim was clarification, it seems likely that the Proposed Rule's reconceptualization of issuer compliance obligations was inadvertent. But regardless of

³ See, e.g., NPRM at 26189 (The Board's proposal is "to amend Regulation II to...clarify the requirements that Regulation II imposes on debit card issuers to ensure that at least two unaffiliated payment card networks have been enabled for debit card transactions."), 26190 ("The Board is further proposing revisions to the rule and commentary that clarify the responsibility of the debit card issuer in ensuring that at least two unaffiliated networks have been enabled to comply with the regulation's prohibition on network exclusivity."), 26193 ("The proposed amendments clarify Regulation II's existing requirements by emphasizing the role of the issuer in ensuring that at least two unaffiliated networks have been enabled in compliance with the regulation's network exclusivity provisions.").

⁴ *Id.* at 26192 (emphasis added).

the Board's intent, the Proposed Rule represents a major, expansive increase in issuer compliance obligations not currently present in Regulation II.

Under current law, an issuer satisfies Regulation II's prohibition on network restrictions as long as the issuer generally "**allows**" electronic debit transactions on its debit card to be processed on at least two unaffiliated payment card networks.⁵ In addition, each network enabled by the issuer, whether **by rule or policy**, may not restrict the operation of its network to limited geographies, merchants, merchant types or transaction types, and must have enacted reasonable steps to process the transactions that it could reasonably expect would be routed to it.⁶ The current commentary clarifies that Regulation II only "requires a debit card subject to the regulation to be **enabled** on at least two unaffiliated payment card networks."⁷ This administrative direction hews to the Durbin amendment's legislative text and its prohibition of network "restrict[ions]" by prohibiting issuers and networks from taking certain actions to restrict payment card networks and providing concrete operational steps, within the issuer's reasonable control, to ensure compliance with the prohibition.⁸

Currently, issuer compliance obligations under Regulation II are well understood and, at this point, workable: the regulation simply requires that issuers **generally allow** two unaffiliated payment networks on their debit cards and ensure that these networks—with whom issuers have a business relationship and contractual privity—**do not restrict** the networks' operation **by rule or policy** to limited geographies, transaction types, or merchants. These compliance obligations are all under an issuer's reasonable control. An issuer would also remain in compliance with Regulation II even if a particular merchant could not access one of the networks for reasons outside the control of the issuer or for reasons not involving a network's rule or policy.

However, the Proposed Rule represents a potential sea change in issuer compliance obligations. The Proposed Rule suggests that issuers would bear responsibility for **affirmatively ensuring** that each debit transaction initiated with the issuer's card can be processed on at least two unaffiliated card networks **no matter the location** of the transaction, **no matter the transaction type**, and—perhaps most significantly— **no matter the specific merchant** that processes the transaction.

In particular, the Proposed Rule's revision to Regulation II reads:

An **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

⁵ 12 C.F.R. § 235.7(a)(2).

⁶ *Id.*

⁷ 12 C.F.R. Part 235, Appendix A, Comment 7(a)-1 (emphasis added).

⁸ 15 U.S.C. § 1693o-2(b)(1)(A).

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, and where each of these networks 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.⁹

This affirmative obligation on issuers is echoed in the Board's proposed revision to the Regulation II commentary:

Section 235.7(a) **requires an issuer to configure** each of its debit cards so that each electronic debit transaction initiated with such card can be processed on at least two unaffiliated payment card networks. In particular, section 235.7(a) **requires this condition to be satisfied 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. ...**

For example, it is **sufficient** for an issuer to issue a debit card that can process signature-authenticated transactions only over one payment card network and PIN-authenticated transactions only over another payment card network, **as long as** the two payment card networks are not affiliated and **each network can be used to process electronic debit transactions 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.¹⁰

Although the Board's stated aim may be clarification, issuer compliance burdens under current Regulation II are far different than the Board's Proposed Rule, and the Proposed Rule strays far from the Durbin amendment's command to focus rulemaking on prohibiting certain network restrictions. Under a literal reading of the Proposed Rule, it would be no longer sufficient for an issuer to enable at least two networks on its card and verify through reasonable due diligence that the network does not have rules or policies restricting the network's operation. Instead, issuers would be under a much more **expansive obligation to affirmatively ensure and guarantee that any transaction** using the issuer's debit card could be processed on at least two payment networks **for every merchant**. Perhaps most significantly, under the Proposed Rule, an issuer could potentially be deemed non-compliant if a particular merchant cannot process a transaction on the issuer's debit card through at least two unaffiliated networks—even if that inability is due to no fault of the issuer or is not caused by a payment network rule or policy. For example, the text's implication is that issuers could be liable even if actions taken by third parties, such as

⁹ Proposed Rule, 12 C.F.R. § 235.7(a)(2) (emphasis added).

¹⁰ Proposed Rule, Comment 7(a)-1 (emphasis added).

acquirers or the merchants themselves—with whom issuers do not have contractual privity and over whose actions issuers have no control—cause a merchant to be unable to process an issuer’s debit card over at least two unaffiliated networks.

Issuer compliance with the Proposed Rule will be practically impossible.

Not only is the shift in issuer compliance burden broad, there is **no reasonable, practical way for issuers to comply**. The Proposed Rule requires an issuer “configure each of its debit cards so that each electronic debit transaction initiated with such card can be processed on at least two unaffiliated payment card networks,” and that this condition be satisfied “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.”¹¹ But it is not at all clear how issuers, such as SECU, can be reasonably expected to be responsible or liable for **every single merchant** having at least two payment networks available **in each and every circumstance**, nor does the NPRM provide additional clarity on how it expects issuers to comply.

Every Specific Merchant.

It is simply impossible for an issuer to ensure that at least two unaffiliated payment networks will be available at each and every merchant that accepts the issuer’s debit card. There is no reasonable or practical way for an issuer to know what networks are accepted at which merchants, nor track a merchant’s changes in network acceptance in real time. There is no universal merchant “directory” that lists every merchant in the United States, let alone the payment networks that each merchant uses. To add even more complexity, in some cases issuers may not even know which exact merchants are accepting the issuer’s debit card for payment, especially if the merchant utilizes a third-party payment aggregator or processor. Further, a particular issuer is not in contractual privity with, does not have business relationships with, and cannot control the actions of merchants that accept the issuer’s cards. Issuers have no control over a merchant’s actions or transaction choices. Issuers have no control if a merchant suddenly stops processing over a certain network through no fault of the issuer, for example because a merchant attempts to utilize an unsupported transaction configuration that prevents multiple unaffiliated networks from being available. Yet the Proposed Rule suggests that issuers may not be in compliance with Regulation II in precisely those circumstances.

Every Geographic Area.

But even if the Board removes the requirement that at least two unaffiliated networks be available for each and every “specific merchant,” applying the same requirement “for every

¹¹ *Id.*

geographic area” would also pose likely insurmountable compliance challenges. The Proposed Rule suggests that an issuer could be violating Regulation II if a particular network utilized by an issuer is not available in each and every geographic area of the United States—including remote areas far outside the issuer’s geographic base. An issuer might be non-compliant even if the issuer did not have knowledge of the lack of geographic availability, or the lack of availability was caused by reasons beyond the control of an issuer or network (like a payment network’s rule or policy). This could pose particular problems for issuers whose business is focused in a particular geographic area—such as SECU, whose branches are located entirely in North Carolina and whose membership consists overwhelmingly of North Carolinians.

Every Merchant Type and Transaction Type.

Finally, it is equally problematic for issuers to guarantee availability of multiple networks for every “particular type of merchant” and “particular type of transaction.” Certain categories of merchants or certain transaction types may not generally process PIN or PINless debit transactions. Accordingly, whether due to industry practice or for other reasons, these merchant categories or transaction categories may not currently process transactions on single message networks. If an issuer enables its debit card to be processed either over one single message network or one dual message network, that may mean that certain merchant types and transaction types may only have access to a single dual message network to process transactions. If these merchant or transaction types are only processed over dual message networks for a reason not controlled by the issuer, must an issuer enable at least two dual message networks on its debit cards? This would effectively require issuers to allow its debit card transactions to be processed over at least two dual message networks—far outside the current industry practice—or disallow the transactions entirely, benefitting no one in the payments ecosystem, especially the consumer.

*The only apparent solution is to enable **every** payment network.*

Based on the above, the only way an issuer can approach compliance with the Proposed Rule—that is, ensure that **any** merchant accepting the issuer’s debit card is able to process a debit transaction on at least two unaffiliated networks—is to enable **all payment networks** on their debit cards, regardless of a network’s security, risk practices, rules or fees. Even then, the issuer could not guarantee compliance, as the merchant may only participate in one network, yet the Proposed Rule appears to foist liability on the issuer for the merchant’s decision in that circumstance. SECU respectfully submits that it does not believe that the Board could have intended this far-reaching and overbroad action to be the only compliance solution to the Board’s Proposed Rule.

The Proposed Rule’s language on issuer compliance is unnecessary.

Moreover, SECU respectfully submits that the Proposed Rule's revised language regarding issuer compliance obligations is unnecessary. Even if the Proposed Rule were merely a clarification—which SECU respectfully submits it is not—the Board has not explained why a clarification of issuer compliance obligations is necessary. The Board does not state that the existing compliance language of Regulation II was unclear, or ambiguous, or subject to misinterpretation or confusion by issuers. Additionally, at no point in the NPRM does the Board articulate a concern that the thousands of issuers in the United States have generally not been in compliant with Regulation II's issuer obligations since Regulation II's issuance over ten years ago.

The Proposed Rule's mandate on enabling multiple networks to process CNP transactions will likely lead to increased fraud.

The Proposed Rule Board effectively issues another new requirement on issuers—to enable at least two unaffiliated payment networks on CNP transactions.¹² The Board again maintains that the Proposed Rule merely “clarifies” that Regulation II's restrictions apply to CNP transactions.¹³ However, SECU respectfully submits that this purported “clarification” could lead to **disruptions in the payment network marketplace and an increased level of fraudulent transactions.**

The Board notes that in 2019, only 6% of CNP transactions were processed over single message networks.¹⁴ One reason for that low percentage may be the potential for fraud—which is generally higher in CNP transactions—and the network and merchant investments necessary to effectively mitigate it. If single message networks were equally as effective as dual message networks in preventing fraud, that would likely be reflected in the market, like it is currently for card present transactions. But this has not yet happened. **Put simply, single message networks are still often less developed and less experienced than dual message networks in detecting fraud in CNP transactions.** Because single message networks developed from card-present PIN transactions and often handle lower-

¹² See Proposed Rule, Comment 7(a)-2(iii) (“For every...particular type of transaction (*e.g.*, **card-not-present transaction**) for which the issuer's debit card can be used to process an electronic debit transaction, an issuer **must enable at least two unaffiliated payment card networks....**”), 7(a)-2(iii)(B) (“For example, an issuer could comply with the rule by enabling two unaffiliated payment card networks **that can each process....card-not-present transactions.**”) (emphasis added). Compare with 12 C.F.R. § 235.7(a), 12 C.F.R. Part 235, Appendix A, Comment 7(a)-1, 2, 3 (containing no reference to CNP transactions).

¹³ See, *e.g.*, NPRM at 26189 (The Board's “proposal [is] to amend Regulation II to clarify that the requirement that each debit card transaction must be able to be processed on at least two unaffiliated payment card networks applies to card-not-present transactions.”), 26190 (“[T]he Board is proposing changes to Regulation II to clarify that debit card issuers should enable, and merchants should be able to choose from, at least two unaffiliated networks for card-not-present transactions.”), 26192 (“[T]he Board is proposing revisions to the commentary to Regulation II to clarify the applicability of the regulation's prohibition on network exclusivity to card-not-present transactions.”), 26193 (“The proposed amendments clarify Regulation II's existing requirements ... by clarifying that [the network exclusivity] provisions apply to card-not-present transactions.”).

¹⁴ *Id.* at 26191.

risk or low-dollar transactions, these networks may have less expertise in preventing fraud in e-commerce CNP transactions. The Board may be correct that, since Regulation II's initial enactment, "various innovations have emerged" that have allowed CNP transactions to be processed over single message networks, and that many such networks are "now capable of processing [CNP] transactions."¹⁵ But just because single message networks may be **capable** of processing CNP transactions does not mean these networks are yet as **effective** as dual message networks on fraud matters.

By requiring issuers to enable multiple networks on CNP transactions, issuers in all likelihood will be forced to enable processing of CNP transactions on single message networks. Issuers will be mandated to process these CNP transactions, even if fraud models have not yet properly captured CNP transactions on single message networks, and even if the issuer has determined that single message networks are less effective at preventing fraud. This will very likely lead to increased fraudulent transactions and the corresponding expenses to address that fraud, not only for issuers, but other market participants. The only other alternative for issuers is attempting to enable multiple dual message networks on its debit card transactions, but as the Board acknowledges in the NPRM, such a solution would go against long-standing industry practice.¹⁶ SECU instead respectfully requests that the Board withdraw the Proposed Rule and allow single message networks and other market participants time to continue to develop appropriate CNP processing capabilities. This would allow the single message networks to demonstrate through market forces their capability in processing CNP transactions—including fraud prevention measures.

SECU respectfully requests that the Board withdraw the Proposed Rule.

For the reasons discussed in this comment letter, SECU respectfully requests that the Board withdraw the Proposed Rule.

First, the Proposed Rule's additional compliance burdens would be far-reaching, unnecessary, and possibly inadvertent given the Board's stated intent of "clarifying" existing obligations. SECU views itself in compliance with current Regulation II. However, for the reasons discussed throughout this letter, SECU is not confident that it or any issuer could fully comply with the Proposed Rule. In particular, SECU cannot (nor could any other issuer) reasonably ensure that each and every merchant in each and every circumstance will be able to process debit transactions on SECU debit cards through multiple unaffiliated networks. This is true even though SECU has generally enabled multiple unaffiliated networks on its debit card and has reasonably concluded that the payment networks which its debit card utilizes do not have policies or rules placing restrictions on certain geographies, transaction types, or merchants.

¹⁵ *Id.*

¹⁶ *Id.*

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Second, SECU is concerned that the Proposed Rule's mandate on issuers to utilize often underdeveloped and untested payment networks for CNP transactions would lead to an increase in fraudulent transactions. SECU urges the Board to allow market forces to continue to spur development of single message networks processing CNP transactions in a prudent and orderly manner. However, until such networks are more fully developed from a fraud prevention perspective, the Proposed Rule's mandate could increase fraud-related costs.

Alternatively, to the extent the Board retains any part of the Proposed Rule, SECU respectfully requests that the Board revise the Proposed Rule's language regarding compliance obligation and more clearly address the concerns of SECU—and undoubtedly other issuers—of how an issuer can be expected to comply with the Proposed Rule's updated compliance obligations. In particular, SECU would respectfully request that the Board clarify that issuers would not be deemed to be not compliant with the Proposed Rule due to the actions of third parties—such as merchants or acquirers—which are out of the control of issuers.

We again thank you for the opportunity to provide comments on the Board's Proposed Rule.

Sincerely,

A handwritten signature in black ink, reading "Michael J. Lord". The signature is fluid and cursive, with the first name "Michael" and last name "Lord" clearly legible.

Michael J. Lord
President/Chief Executive Officer