

February 10, 2023

Ms. 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:

The American Bankers Association (“ABA”), Consumer Bankers Association (“CBA”), Credit Union National Association (“CUNA”), National Association of Federally-Insured Credit Unions (“NAFCU”), and The Clearing House (“TCH”), which together represent virtually all of the Nation’s regulated financial institutions, write to request that the Board of Governors of the Federal Reserve System (“Board”) extend the effective date for the recent final rule amending Regulation II (12 C.F.R. Part 235, the “Final Rule”),¹ in order to provide debit card issuers, which are predominantly community banks and credit unions, time to implement the requirements of the Final Rule.

Banks and credit unions of all sizes provide innovative and competitive payments products and services to consumers and commercial customers. Unique to the American market, *thousands* of regulated financial institutions form a large and diverse network of payments providers that originate and receive funds. Financial institutions provide these payment services using a variety of technologies and vendors within product systems that are interrelated and often complex.

Accordingly, we remain concerned, as articulated in our prior comment letters^{2 3} and those from financial institutions,⁴ that the new mandate imposed by the Final Rule provides debit card

¹ 87 Fed. Reg. 61,217 (Oct. 11, 2022).

² Joint Bank and Credit Union Comment Letter on Proposed Rule on Debit Card Interchange Fees and Routing, Docket No. R-1748, RIN 7100-AG15 (Aug. 11, 2021). The Clearing House Comment Letter on Debit Card Interchange Fees and Routing, Docket No. R-1748, RIN 7100-AG15 (Aug. 11, 2021)

³ [ABA, CBA, CUNA, ICBA, NAFCU, NBA Comment Letter on Paperwork Reduction Act Notice Re: Recordkeeping and Disclosure Requirements Associated with Regulation II \(FR II; OMB No. 7100-0349\), Docket No. R-1748, RIN 7100-AG15 \(Feb. 1, 2022\)](#)

⁴ *See comments of community banks, credit unions, and state associations re: Docket No. R-1748, RIN 7100-AG15:*

- Kent M. Franzen of Henderson State Bank (Henderson, Nebraska)
- Michael J. Lord of State Employees Credit Union (Raleigh, North Carolina)
- Robert W. Hoxworth of First National Bank of Texas (Killeen, Texas)
- Luanne Cundiff of First State Bank of St. Charles (St. Charles, Missouri)
- David Pace of League of Southeast Credit Unions (Duluth, Georgia)
- Donald J. Seeterlin of Chesapeake Bank (Kilmarnock, Virginia)
- Richard J. Baier of Nebraska Bankers Association
- Carrie R. Hunt of Virginia Credit Union League

issuers, including thousands of community banks and credit unions, with insufficient time to undertake time-consuming and resource-intensive efforts to change their core banking software and payments infrastructure. In many cases, these will include selecting, contracting with, onboarding, and testing potential vendor solutions while prudently managing operational and security risks. The rushed timeline for these efforts will create unintentional negative consequences for consumers while banks and credit unions are forced to reprioritize implementation of the Final Rule over other consumer-oriented and security-focused improvements.⁵

The Final Rule’s effective date of July 1, 2023 (“Effective Date”) fails to take into consideration the implementation obstacles facing small issuers and the impact on community banks and credit unions, which will be forced to rush implementation in a way that could jeopardize the safety and soundness of the implementation process and compromise the integrity and reliability of the ultimate result. As such, we respectfully request that the Board extend the Effective Date one and a half years, to January 1, 2025, in order to protect consumers and the integrity of the U.S. payments system.

We acknowledge Governor Bowman’s dissent to the passage of the Final Rule,⁶ and we affirm the concerns she raised in her statement.

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The Effective Date Fails to Consider the Time Required for Banks and Credit Unions to Operationalize the Rule’s Requirements.

The Board should permit financial institutions an additional one and half years to come into compliance with the Final Rule. Given the thousands of small issuers affected by the Final Rule, it will take a significant amount of time for issuers to come into compliance. Adding a new debit card network for card not present (“CNP”) transactions will require significant time and resources, and a technology project of this scale can have significant cardholder impact if rushed into production.

More time is needed to mitigate anticompetitive exploitation of the final rule

Networks and debit card processors will be inundated by the demand and may be unable to ensure that all issuers, particularly small issuers, can come into compliance by the Effective Date. Such time pressure also places issuers at a disadvantage during contract negotiations, as processors and their subsidiary debit networks may leverage the issuer’s legal obligations and short deadline for compliance as effective leverage to force concessions from issuers, increasing

⁵ We note that the Final Rule Effective Date coincides with the mid-2023 launch of date of FedNow Service.

⁶ Board of Governors of the Federal Reserve System, *Statement on Final Amendments to Regulation II to Clarify the Prohibition on Network Exclusivity by Governor Michelle W. Bowman* (Oct. 3, 2022).

issuer costs and fraud liability and potentially compromising reliability and security for consumers. For example, since the Final Rule was issued, processors have expressed to issuers that the only way the processor can operationalize the required changes prior to the Effective Date is by requiring issuers to enable the processors' affiliated debit networks.

These types of requirements, which would leave many issuers with just one choice of debit network, run counter to the spirit of the Final Rule, which is intended to encourage competition. More time would by no means eliminate the competition problems posed by consolidation among bank software companies, processors, and debit networks. But by extending the Effective Date, the Board could ensure that community banks and credit unions issuing debit cards are able to engage in meaningful negotiations to utilize the networks of their choice and maximize value for consumers.

The Effective Date Fails to Consider the Impact on Small Issuers and Community Financial Institutions.

Governor Bowman's dissent recognized that the implementation burden of this nationwide conversion and upgrade process were not sufficiently reflected in the Final Rule. Specifically, the modifications that issuers need to make to their own systems to comply with the Final Rule fall most heavily on small community bank and credit union issuers. These small issuers will have difficulty getting the attention of national networks and service providers and, as a result, will be stuck at the back of the queue or cobbling together a patchwork of more regional, and potentially less reliable or scalable networks. Moreover, some will be forced to default to the first-available solutions, even if there are better solutions they would select if given more time. Simply put, more time means more flexibility, more options, and better outcomes.

These challenges are in no way a reflection on the quality of payments services provided by small institutions under reasonable circumstances, it is merely the natural and foreseeable consequence of the demand for technical services created by and the complexity of the Final Rule's mandate.

Smaller issuers are particularly at risk, because they do not have adequate personnel to put the necessary systems in place and rely heavily on vendors. There are a limited number of vendors who are capable of putting these systems into place and thousands of small issuers who would need to come into compliance in the same timeframe.⁷ Small issuers may also need to issue new EMV-chip cards to comply with the Final Rule at a time when public reporting suggests that a global chip shortage, which is expected to last through mid-decade, is driving up the per-unit costs of these payment credentials. Indeed, market experts are recommending that issuers maintain three to six months of advance EMV chip inventory and avoid marketing programs or initiatives that require card re-issuance due to global market shortages.⁸ These obligations

⁷ The Board estimates that there are 8,000 small entities who will be impacted by the Final Rule. 87 Fed. Reg. 61,229 (Oct. 11, 2022).

⁸ US Payments Forum Market Snapshot: Continued Contactless Growth, Buy Now Pay Later Takes Holder & Chip Supply Challenge Persists, US Payments Forum (Dec. 15, 2021), <https://www.uspaymentsforum.org/us-payments->

impose substantial burdens on the resources of community banks and credit unions that are already threatened by razor thin margins.

The high cost of implementing the Final Rule will result in community banks and credit unions reprioritizing strategic initiatives, which is likely to undermine the availability of affordable, core deposit products like free checking, and undermine the ability of community banks and credit unions to compete in an era where payment system costs are rising, including as a result of increased fraud costs.⁹ The challenges and increased costs that small issuers will face in implementing the Final Rule on such a short timeline will inevitably result in other negative consequences for consumers, including potentially decreased investments in fraud protection and feature enhancements. As a practical matter, the work needed to enable additional networks cannot happen all at the same time, and it is likely that smaller issuers would be at the back of a long line of financial institutions needing to contract with various additional networks for CNP capabilities.

Crucially, a short timeline deprives card issuers of meaningful planning and choices regarding implementation, such as whether to embark on a multi-year core conversion or other major upgrade as the best method to achieve compliance. For issuers that need to switch providers for fraud costs or because being defaulted into their core provider's wholly-owned debit network is problematic, two years is barely enough time to complete this switching process. The only way that banks and credit unions can meaningfully access competing vendor options is if they have sufficient time to shop the market.

In its regulatory flexibility analysis, the Board notes that some small entities may not face a high compliance burden because they are either already in compliance with the Final Rule or they already contract with a network that is capable of processing CNP transactions. However, the Board provides only anecdotal evidence that a large number of small issuers fall within these two categories when, in fact, the Board acknowledges that it is unable to estimate the actual number of small issuers in these categories.

It is important that the Board recognize the reality that banks and credit unions will have to not only “[contract] with a network that is capable of processing CNP transactions” *but also* ensure that such network has:

- i. Built the technology functionality to accept the CNP transactions (including the removal of any errors),
- ii. Ensured same fraud strategies are in place as existing networks,
- iii. Piloted the new functionality,

forum-market-snapshot-continued-contactless-growth-buy-now-pay-later-takes-hold-and-chip-supply-challenge-persists/.

⁹ In addition, increased competition for implementation resources during such a short timeframe may result in issuers being forced to accept card processing from networks that do not meet their fraud security standards, which, coupled with an already fraud-prone CNP processing environment, could exacerbate fraud experienced by consumers. Single-message networks simply have not had the time to develop the robust security systems necessary to safely administer CNP processing, particularly while PIN networks work to scale to the volume that will be required for issuer compliance with the Final Rule. *See* Mercator Advisory Group: Debit Regulation II Clarification, Sophia Gonzalez (Dec. 2022), pg. 7.

- iv. Enabled their BINs (thoughtfully and over a gradual period of time, to ensure fraud chargebacks do not increase or there are declines occurring),
- v. Established Fraud monitoring.

Furthermore, the Board acknowledges that a number of small issuers are not already in compliance with the Final Rule, and do not currently have a network enabled that would be able to process CNP transactions. Small issuers in this category will be challenged to comply in a timely manner for several reasons, including those issues raised above. Indeed, the Board notes that “the compliance costs associated with this category of small entities could be significant[,]”¹⁰ which, coupled with a short compliance timeline, impacts a small issuer’s ability to provide consumers competitive products and features.

The Reasoning Supporting the Effective Date of the Rule is Insufficient.

The Board argues that nine months is a sufficient timeframe for issuers to comply with the Final Rule because the Board believes that “many” issuers are already in compliance with the Final Rule, and nine months is the timeline that applied when Regulation II was initially adopted.¹¹ This assertion is arbitrary and capricious.

First, as discussed above and consistent with the sentiment of Governor Bowman, mere speculation as to the number of issuers already in compliance with the Final Rule, when the Board is unable to estimate the number of issuers *actually* in compliance with the Final Rule, is an insufficient basis against which to develop a reasonable and appropriate Effective Date. In contrast, prior to issuing its final rulemaking in 2011, the Board staff analyzed the market to establish that approximately 70 percent of debit cards already enabled dual functionality that would be compliant with Regulation II requirements, informing the Board’s view of a reasonable and appropriate implementation timeframe.¹²

Second, in promulgating Regulation II in 2011, the Board’s final rulemaking engaged in a reasoned analysis of the operational and implementation challenges posed by the rule and mandated varying timelines for compliance with network exclusivity provisions depending upon the entity and the product. For example, payment card networks had a three-month implementation timeline and issuers generally had a nine-month implementation timeline, whereas certain debit card products that presented heightened technological or other operational impediments had an implementation timeline of almost two years.¹³ For example, the Board determined that cards requiring additional point-of-sale substantiation and authorization procedures or cards that were not conducive to a PIN network could not adequately operationalize Regulation II requirements within the generally applicable compliance timeline.¹⁴

¹⁰ 87 Fed. Reg. 61,230 (Oct. 11, 2022).

¹¹ 87 Fed. Reg. 61,224 (Oct. 11, 2022).

¹² 76 Fed. Reg. 43, 454 (July 20, 2011).

¹³ 76 Fed. Reg. 43,454-55 (July 20, 2011).

¹⁴ 76 Fed. Reg. 43,455 (July 20, 2011).

These technical and operational impediments bear a substantial resemblance to the same security and fraud protection concerns that issuers face today and should have a prominent bearing on the Board’s determination of an appropriate Effective Date for the Final Rule. These timelines were developed based on the Board’s timely research regarding the number of issuers already in compliance with the rule and Board outreach regarding the reasonable timeframes for enabling additional PIN networks on debit cards, as opposed to the arbitrary selection of an Effective Date for the Final Rule based on outdated and inapplicable research.¹⁵

Third, the Board incorrectly extrapolated statements about the readiness of some community financial institutions to every small card issuer – and used this leap in reasoning to justify the Final Rule’s approach. To our knowledge, no financial institution or organization has indicated that significant and prolonged compliance challenges would not be faced by some small financial institutions. To the contrary, financial sector commenters demonstrated awareness of the varied capabilities and compliance burdens among smaller issuers. This is evident from these commenters’ requests for an implementation period as well as advocacy for improvements in a Final Rule that might reduce the pool of small issuers facing compliance challenges.

It also became clear over time that the merchant community’s interpretation of the Proposal’s obligations was broad and fractured, with some merchants asserting that virtually no issuers were complying with their conception of the Board’s Proposal and frequently urging immediate (and even retroactive) implementation of the Proposal. Other major retailers, most prominently Walmart, argued that some issuers were compliant but that a Final Rule was needed to compel compliance from other issuers. These comments could not have led the Board to reasonably believe that there was a consensus position in any sector that debit card issuer compliance was approaching ubiquity. The financial services industry was united in requesting reasonable timelines in the event that the Board promulgated a Final Rule.

On February 1, 2022, a coalition including ABA, CBA CUNA, ICBA, NAFCU, and NBA urged “the Board to reconsider its recent proposal to reopen Regulation II and to resist requests from retailers for further changes that would increase the regulatory burden associated with the Durbin Amendment to the Dodd-Frank Act.” These sentiments were echoed by over 1,700 financial institutions in their own letters and public comments. The record demonstrates consistent and well-argued bank and credit union support for a flexible and reasonable implementation period of at least two years.

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Conclusion.

In conclusion, America’s banks and credit unions respectfully request that the Board postpone the Effective Date to January 1, 2025 to ensure that issuers have the time needed to comply fully with the Final Rule while continuing to protect and serve consumers and the broader U.S. economy.

¹⁵ 76 Fed. Reg. 43, 454 (July 20, 2011).

Thank you for your attention to this request. We would appreciate the opportunity to answer questions you may have.

Sincerely,

AMERICAN BANKERS ASSOCIATION

CONSUMER BANKERS ASSOCIATION

CREDIT UNION NATIONAL ASSOCIATION

NATIONAL ASSOCIATION OF FEDERALLY-INSURED CREDIT UNIONS

THE CLEARING HOUSE

cc: Board of Governors of the Federal Reserve System
Governor Michelle W. Bowman