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Submitted via www.federalreserve.gov

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: NOTICE OF PROPOSED RULEMAKING (NPR) ON REGULATION II (REG II): DEBIT CARD INTERCHANGE FEES AND ROUTING [DOCKET NO. R-1748, RIN 7100-AG15]

Dear Sir or Madam,

The Independent Community Bankers of America (ICBA)¹ appreciates this opportunity to comment in response to the Board of Governors of the Federal Reserve System’s (the Board) NPR on Reg II: Debit Card Interchange Fees and Routing.² The proposal seeks 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, 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, and standardize and clarify the use of certain terminology.”³

Reg II prohibits an issuer from restricting the number of payment card networks on which an electronic debit transaction may be processed to less than two unaffiliated networks.⁴ When Reg II was originally promulgated, “for card-not-present transactions, such as online purchases, the market had not developed solutions to broadly support multiple networks over which merchants could choose to route those transactions.”⁵ The Board has concluded, however, that, “in the decade since Regulation II was adopted, various innovations have emerged, and most single-message networks are now capable of processing card-not-present transactions.”⁶

As a result of this change in technology, the Board “is proposing revisions to the commentary to Regulation II that clarify the applicability of the prohibition on network exclusivity to card-not-present transactions. These proposed revisions to the commentary *clarify* [emphasis added] that

¹ The Independent Community Bankers of America creates and promotes an environment where community banks flourish. ICBA is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education, and high-quality products and services. With nearly 50,000 locations nationwide, community banks constitute 99 percent of all banks, employ more than 700,000 Americans and are the only physical banking presence in one in three U.S. counties.

² 86 Fed. Reg. 26189.

³ *Id.*

⁴ 12 C.F.R. 235.7(a)(1).

⁵ 86 Fed. Reg. 26190.

⁶ *Id.*

card-not-present transactions are a particular type of transaction for which two unaffiliated payment card networks must be available.”⁷ In addition, the Board is proposing to “clarify [emphasis added] 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.”⁸

Background of the Durbin Amendment

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) amended the Electronic Funds Transfer Act (EFTA) to add a new section limiting interchange transaction fees for electronic debit transactions and rules for payment card transactions.⁹ The Federal Reserve Board was given responsibility to enforce the Durbin Amendment through regulations, known as Reg II.¹⁰

The Durbin amendment imposed a cap on interchange fees for covered banks, defined as those with assets of more than \$10 billion dollars. Most, though not all, community banks fall below this threshold. However, even for banks below the \$10 billion threshold, the Durbin Amendment forbid exclusivity arrangements and routing restrictions, imposed limitations on restrictions on offering discounts for use of a form of payment, and imposed limitations on restrictions on setting transaction minimums or maximums.¹¹ Though the restrictions for “exempt” issuers are not explicit price controls, they have the same practical effect.

Ironically, the Durbin Amendment was intended to help consumers and small businesses, but in practice it has functioned as a subsidy for “big box” retailers, ultimately harming consumers. Researchers at the University of Chicago examined whether merchants passed savings to consumers in the form of lower prices and better services and concluded that consumers ended up worse than they were before the Durbin Amendment was implemented.¹² Instead, the vast majority of the reduction has been retained by the merchants, with the majority accruing to the largest retailers in America. Those large merchants have not passed on any savings to consumers to date, and we have no reason to believe they would now or in the future. The result of the Durbin Amendment hasn’t been a reduction in consumer prices – it has been a wealth transfer from community financial institutions to “big box” and large ecommerce retailers.

According to a study by the Federal Reserve Bank of Richmond, “[t]he results suggest the [Durbin Amendment] has had a limited impact on prices. Averaging across all sectors, it is estimated that the majority of merchants (77.2 percent) did not change prices post-regulation, very few merchants (1.2 percent) reduced prices, while a sizable fraction of

⁷ *Id.*

⁸ *Id.*

⁹ See 15 U.S.C. 1693o–2.

¹⁰ See 12 CFR Part 235.

¹¹ 15 U.S.C. 1693o–2(b).

¹² Evans, Chang, and Joyce, “[The Impact of the U.S. Debit Card Interchange Fee Regulation on Consumer Welfare: An Event Study Analysis](#)” (2013).

merchants (21.6 percent) increased prices.”¹³ In addition, a collateral effect of the Durbin Amendment has been a reduction in the availability of debit card rewards like cash-back, further harming consumers who relied on the monetary benefits earned through their everyday spending.

Critically, while the Durbin Amendment “exempted” small institutions from the price caps, Federal Reserve data clearly shows that interchange revenue fell for community banks.¹⁴ Since 2012, issuers have lost nearly \$107 billion in interchange revenue — including an estimated \$15.2 billion in 2020 alone. A continued loss of revenue for exempt issuers is untenable – it threatens the ability of community banks to continue to serve their communities.

Summary of Position

- 1) **Opposition to Additional Revisions to Reg II:** While we agree with the Board’s classification of this proposal as a clarification rather than a substantive policy change, we also note the Board’s comment that it “may propose additional revisions in the future.” We strongly oppose any additional substantive revisions to Reg II, particularly those that could threaten the competitiveness or stability of community banks.
- 2) **Transaction Types:** The Board should not expand the definitions of transaction types to include subcategories of card-present and card-not-present (CNP) transactions, which would deter innovation by preventing issuers from supporting new transaction types or cardholder authentication methods. Similarly, the Board should eliminate proposed changes that create a new, highly subjective requirement that issuers ensure that there are two unaffiliated networks enabled for every geographic area, merchant, type of merchant, and particular type of transaction.
- 3) **Fraud Mitigation:** Because certain types of transactions present greater fraud risks, we urge the Board to preserve the ability of banks to engage in responsible risk mitigation practices by prohibiting high risk transactions or transactions from high-risk merchants. Additionally, we ask the Board to engage an independent auditor to conduct analysis of the risk and fraud mitigation capabilities for all networks that process debit card transactions.
- 4) **Liability for the Conduct of Third Parties:** As a result of this proposal, we are concerned that debit card issuers could be put at risk of non-compliance solely because of actions taken by third parties involved in the transaction. We believe an issuer’s obligation not to restrict the number of payment networks on which an electronic debit transaction may be processed should only apply to actions under the issuer’s control.

¹³ Zhu Wang, Scarlett Schwartz, and Neil Mitchell, “The Impact of the Durbin Amendment on Merchants: A Survey Study.” Federal Reserve Bank of Richmond Economic Quarterly, Third Quarter 2014, vol. 100, no. 3, pp. 183–208 at 194.

¹⁴ “Average Debit Card Interchange Fee by Payment Card Network,” Board of Governors of the Federal Reserve System (2021), available at: <https://www.federalreserve.gov/paymentsystems/regii-average-interchange-fee.htm>.

- 5) **Additional Regulatory Analysis is Required by the EFTA:** Before finalizing any of the proposed changes, we believe that the EFTA requires the Board to conduct further analysis of the proposal's effects on both consumers and financial institutions. In addition to being required by statute, this analysis will allow all stakeholders to submit more well-informed comments.
- 6) **Implementation Period:** If a rule based on this proposal is finalized, we urge the Board to include an effective date no earlier than two years after the final rule's publication in the Federal Register.

ICBA Comments

The Durbin Amendment is poor public policy that has been empirically proven to harm consumers and the viability of community banks. This harm has disproportionately fallen on the smallest community banks and lowest income households. As we correctly warned before the Amendment's enactment, and as subsequent Federal Reserve analysis has shown, it is a highly unsuccessful policy, amounting to government price controls that were always destined to benefit large retailers at the expense of the consumers it purported to serve. It should be swiftly repealed.

Despite our objections to the Durbin Amendment on policy grounds, we acknowledge the Board's statutory duty to promulgate regulations to enforce the law. We believe that most community banks are already in compliance with Section 920 of the EFTA. Feedback we have gathered indicates that most community banks' Bank Identification Numbers (BINs) are enabled for two unaffiliated networks, even for card-not-present transactions, as required by the Durbin Amendment. We further agree with the Board's characterization of the proposal as a clarification rather than new policy; and as such, we believe the NPR will have a relatively minor impact on most community banks as compared to the largest financial institutions. **ICBA is nonetheless concerned about the practical application and unintended consequences of some elements in the Board's proposal**, as explained in our comments below.

Data collected by the Federal Reserve Board indicated that two unaffiliated networks are often not available to process card-not-present debit card transactions because some issuers do not enable two networks for those transactions – we believe this is not the case for the vast majority of community banks. Additionally, we have received feedback that some community bank issuers are already seeing increased volumes processed over PIN debit networks, including for CNP transactions, and these bankers reported a resultant decrease in interchange revenue.

Issuer Risk and Fraud Mitigation Capabilities

As the Board is aware, certain types of transactions present higher fraud and data security risks. ICBA urges the Board to preserve the ability of banks to engage in responsible risk mitigation practices by prohibiting high risk transactions or transactions from high-risk merchants.

The Board should ensure such fraud and risk mitigation policies would not render an issuer noncompliant in satisfying Reg II requirements, as long as the issuer has enabled two unaffiliated networks on their debit cards for card-present and card-not-present transactions.

Furthermore, there is an increasing trend of fraudsters moving from targeting card-present transactions to the CNP environment. Data from a Federal Reserve Bank of Atlanta study shows that payment cards with an embedded EMV chip have a significant positive impact on reducing counterfeit fraud at the physical point-of-sale.¹⁵ As the Board’s data indicates, “CNP fraud, at 6.9 basis points, accounted for more than half of overall fraud in 2019.”¹⁶ This is despite CNP transactions accounting for only 22.8 percent of total debit card volume.

Before proceeding with this rulemaking, the Board should conduct an analysis of the fraud prevention measures of all networks that process debit transactions to assess the proposal’s effect on the prevalence of both Card-Present and CNP fraud. ICBA suggests that the Board engage the services of a qualified independent auditor to conduct analysis of the risk and fraud mitigation capabilities for all networks that process debit card transactions and publish the findings for industry review and comment.

Opposition to Additional Revisions

ICBA appreciates the Board’s statement in the NPR, “The Board does not intend these amendments to be an expansion of coverage to any additional small entities that were not already subject to the rule.” We oppose any changes to Reg II that would impact community banks, particularly while the nation is emerging from the worst pandemic in over a century, during which the Board undertook unprecedented emergency measures to protect the nation’s economy and financial system. In our view, it would be ill-advised to alter the Reg II framework at a moment when such changes could alter the regulatory environment for banks, which have been vital to the still-nascent economic recovery, and further harm low-income consumers who were disproportionately harmed by COVID-19.

The Board should clarify, in Comment 7(a)-7 of the Commentary, that a “means of access” does not encompass a means or method of transaction authentication or communication of debit card credentials. Given the overlap between a means of access and a means or method of communication, ICBA believes that the proposed requirement could result in an outcome where issuers would be required to enable two unaffiliated payment card networks for each means or method of authentication or communication, which would be inconsistent with Section 1075 of the Dodd-Frank Act. ICBA strongly opposes any expansion of transaction types that would include subcategories of card-present and card-not-present transactions, which would add

¹⁵ King, Doug, “The Future of U.S. Fraud in a Post-EMV Environment,” Federal Reserve Bank of Atlanta Retail Payments Risk Forum (June 2019), available at <https://www.atlantafed.org/-/media/documents/rprf/publications/2019/06/23/future-of-us-fraud-in-post-emv-environment-king-doug.pdf>

¹⁶ Board of Governors of the Federal Reserve System, “2019 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions” (May 2021), available at: https://www.federalreserve.gov/paymentsystems/files/debitfees_costs_2019.pdf.

unnecessary complexity and deter innovation by preventing issuers from supporting new transaction types or cardholder authentication methods.

We urge the Board to eliminate proposed changes that create a new, highly subjective requirement that issuers ensure that there are two unaffiliated networks enabled for every geographic area, merchant, type of merchant, and particular type of transaction. In practice, no issuer can guarantee that a merchant has two or more routing options available in every conceivable context. Holding issuers liable for ensuring that every merchant will accept two routing options in every context is not operationally feasible, as issuers have no control over which networks a particular merchant chooses to accept. Additionally, some networks have established a dollar amount limit for PINless transactions that are routed to them. Issuers that have in good faith enabled two unaffiliated networks on their debit cards for both Card-Present and Card-Not-Present transactions should not be held responsible for the disposition of transactions based upon such decisions by networks and merchants.

Most concerning, however, is a sentence in the NPR that states, “[t]he Board will continue to review the regulation in light of the most recent data collected by the Board pursuant to EFTA section 920 and may propose additional revisions in the future.”¹⁷ **ICBA respectfully urges the Board in the strongest possible terms to refrain from additional revisions to Reg II at this time. Not only could further revisions have a destabilizing effect on community banks and the economic recovery, but they would also increase the complexity of already burdensome and ineffective regulations.**

Preventing Liability for the Conduct of Third Parties

Section 920(b)(1)(A) of the EFTA requires the Board to “prescribe regulations providing that an issuer or payment card network shall not directly or through any agent, processor, or licensed member of a payment card network, by contract, requirement, condition, penalty, or otherwise, restrict the number of payment card networks on which an electronic debit transaction may be processed” to a single network or to less than two unaffiliated networks.¹⁸ The statute neither requires nor authorizes the Board to prescribe regulations creating an obligation for issuers to ensure that two unaffiliated networks are enabled to route debit card transactions for every merchant and particular type of transaction. In our view, **an issuer’s obligation not to restrict the number of payment networks on which an electronic debit transaction may be processed should only apply to actions under the issuer’s control.**

As a result of this proposal, we are concerned that debit card issuers could be put at risk of non-compliance solely because of actions taken by third parties involved in the transaction. For example, merchants could put issuers at risk of non-compliance if a retailer decided to stop accepting transactions from a specific network, making all issuers that have that network as the secondary, unaffiliated network non-compliant. The Board should clarify that an issuer should not be deemed to be out of compliance if a particular merchant or its service provider elects to

¹⁷ 86 Fed. Reg. 26190.

¹⁸ 15 U.S.C. 1693o—2(b)(1)(A).

discontinue the acceptance of debit cards issued on one of the networks the issuer enabled on its debit cards.

In another scenario, if a card brand network acquired a regional PIN debit network, all issuers that have that identified the acquired regional PIN debit network as their secondary, unaffiliated network would now be considered non-compliant. Achieving compliance after an unexpected event such as this would place a tremendous operational burden and cost on issuers and require sufficient time to address. We encourage the Board to consider the impact of these scenarios in its rulemaking process.

Inadequate Competitive Analysis Under EFTA

While most community banks already provide two unaffiliated networks for CNP transactions, the Board’s abridged regulatory analysis makes it difficult to fully understand or comment on the effects of the proposed change. In order to promulgate a regulation under EFTA, the Board is required to “prepare an analysis of economic impact which considers the costs and benefits to financial institutions, consumers, and other users of electronic fund transfers, including the extent to which additional documentation, reports, records, or other paper work would be required, and the effects upon competition in the provision of electronic banking services among large and small financial institutions and the availability of such services to different classes of consumers, particularly low income consumers.”¹⁹ **We do not believe that the Board has conducted a sufficient analysis of the competitive effects of the rule change on issuers, payments networks, or consumers, and therefore we urge the Board to pause this rulemaking until it conducts a more complete analysis and makes it available for public comment.**

In Section IV of the NPR, in an effort to satisfy its requirements under EFTA, the Board concludes, “[w]ith respect to the competitive effects of the proposed amendments, the proposed amendments clarify that at least two networks must be enabled for card-not-present transactions, allowing merchants or their acquirer to choose among multiple competing networks to process the transaction. Because the proposed amendments apply to all issuers regardless of their size, they are unlikely to have an effect upon competition among large and small financial institutions in the provision of electronic fund transfer services.”

As the Board is aware, the net interest margin of commercial banks has shrunk to historic lows.²⁰ This trend is in no small part due to the unprecedentedly low interest rates set by the Federal Reserve. As NIM declines, non-interest income becomes an increasingly more important part of a bank’s profitability and, consequently, viability. Therefore, because this proposal may lead to a decrease in interchange revenue for community bank issuers, we believe that it is incumbent on the Board to conduct a robust regulatory analysis of this proposed clarification on the financial stability of community banks.

¹⁹ 15 U.S.C. 1693b(a)(2)(2).

²⁰ Federal Financial Institutions Examination Council (US) and Federal Reserve Bank of St. Louis, Net Interest Margin for all U.S. Banks (DISCONTINUED) [USNIM], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/USNIM>.

Board Analysis of Consumer Impact

The Board's analysis of the impact of the proposal on consumers falls short of its obligations under EFTA. The NPR states:

With respect to the availability of services to different classes of consumers, particularly low-income consumers, *consumers are typically unaware of the networks used to process debit card transactions today* [emphasis added], including card-not-present transactions where at least two unaffiliated networks are already available. Nevertheless, the effect of the proposed rule on the availability of services to consumers will likely depend on various factors, including each consumer's payment and purchase behavior, as well as market responses to the increased availability of multiple networks for card-not-present transactions. *Ultimately, the costs and benefits of the proposed revisions are uncertain and will depend on the adjustments that different parties may make and the market response to the proposed rule* [emphasis added].²¹

The fact that most customers, including low-income customers, are unaware of the networks used to process their payments does not mean that the network that is ultimately utilized will not affect them. Furthermore, we believe that the Board's conclusion that the effects of the proposed rule are too uncertain to quantify ignores the evidence that prior restraints on network choice have led to a reduction in free checking services and debit card reward programs while resulting in barely quantifiable price reductions.

In any case, the Board's reasoning that effects are too uncertain to forecast because market participants may react in unpredictable ways could as easily be applied to any proposed rule change and is not a sufficient substitute for a quantitative analysis. Declining to do more analysis here would do a disservice to the customers that the Durbin Amendment was ostensibly designed to protect.

Effective Date

While we believe most community banks are currently compliant with the requirements of the proposal, it is critical to provide other issuers adequate time to implement steps to achieve compliance. Therefore, **we suggest that the final rule should include an effective date no earlier than two years after the rule's publication in the Federal Register.**

Conclusion

Once again, ICBA appreciates this opportunity to provide feedback on the Board's NPR on Reg II: Debit Card Interchange Fees and Routing. It is our belief that most community banks are compliant with the changes proposed. However, we urge the Board not to proceed to a final rule until it has completed a full analysis of the competitive effects of the rule change and determined that it is in the best interest of consumers.

²¹ 86 Fed. Reg. 26193.

Furthermore, we strongly urge the Board not to proceed with any additional changes to Reg II which could have a destabilizing effect on the financial system, lead to further industry consolidation, and threaten the business model of community banks in favor of enriching large merchants.

Please feel free to contact me at (202) 821-4411 or Michael.Marshall@icba.org if you have any questions about the positions stated in this letter.

Sincerely,



Mickey Marshall
Director, Regulatory Legal Affairs