Dear Ms. Misback:

The letter is in response to: Docket No. R-1748, RIN 7100-AG15

Thank you for inviting comment on the proposal to amend Regulation II.

I am writing as an issuer who is currently exempt from the interchange fee standard since we are under $10 billion in assets, however, disagrees with portions of both the current Regulation and the proposed amendment and have addressed each section of the proposal with comment.

I. Introduction

A. Statutory Authority:
Issuer Comment: Although we agree that networks should have the ability to compete, as an exempt issuer under $10 billion in assets who has complied with the rule by ensuring 2 unaffiliated networks are available for merchants to route transactions, the recent and ongoing consolidation of multiple competing networks puts issuers at risk of potential non-compliance when 2 previously unaffiliated networks become affiliated through mergers and acquisitions. The rule should be revised to include language to allow issuers a reasonable timeframe to replace or add additional network(s) under such circumstances.

B. Regulation II Requirements:
Issuer Comment: As an issuer under $10 billion in assets who complies with offering 2 unaffiliated networks that are nationally recognized in the United States payments landscape, there should not be any repercussions or penalties imposed on those issuers if a merchant does not/cannot participate in one of the national networks offered, therefore, leaving the merchant with only one network to choose from to complete the transaction.

C. Overview of Issue and Proposed Changes:
Issuer Comment: Although the technology has evolved to allow more networks to process card not present transactions, the Operating Rules of those networks have not evolved to address increased security concerns, fraud mitigation and chargeback/dispute rights. As an exempt issuer under $10 billion who already complies with offering 2 unaffiliated networks, we have seen the impact of card not present fraud losses increase where merchants are choosing single message/lower cost networks over dual message networks to process the transaction. In addition, the existing Regulation II has already affected interchange income that exempt entities under $10 billion in assets are supposed to be protected from. The proposed changes will exacerbate this situation.

II. Background on Network Exclusivity Issues for Card-Not-Present Debit Card Transactions
Issuer Comment: As stated in a prior comment, the technology has evolved to allow more networks to process card not present transactions, but the Operating Rules of those

networks have not evolved to address increased security concerns, fraud mitigation and chargeback/dispute rights. Single message networks were originally built for ATM/PIN POS transactions where the authentication of the PIN number did, and still does, mitigate most fraudulent transaction attempts. Since card not present transactions through most single message networks do not require additional authentication, such as 3D Secure technology used by dual message networks, more fraudulent transactions are being approved as merchants choose the lower cost/single message networks for processing these types of transactions.

This section from the Board quotes that card not present transactions comprised almost 23% of debit card transactions in 2019, and growth accelerated further in the Coronavirus-19 environment. Over 40% of our transactions are card not present transactions and they account for over 90% of our fraud. The approval rate for card not present transactions through our dual message network is lower than card present transactions since the dual network utilizes step up authentication, such as 3D Secure, to ensure the person transacting is truly the cardholder of record. To date, there are limited or no statistics from single message networks with this detailed information to ensure they are taking the same measures to mitigate fraud at time of authorization. Exempt issuers cannot sustain both a loss of interchange income due to merchants choosing the lower cost single message networks (Exhibit A) combined with higher fraud losses, as more fraudulent transactions will be approved with no additional steps for authentication. Board surveys indicated that gathered card-not-present statistics were derived from covered (assets greater than $10 billion) institutions who have exponentially more volume and results may not be indicative of those institutions who are under $10 billion in assets. We request further studies be conducted prior to finalization of impacts of these rule changes, including, but not limited to; interchange income and fraud losses on institutions under $10 billion in assets as well as single message network capabilities to detect and prevent fraud at time of transaction.

III. Section-By-Section Analysis:

A. Section 235.7 - Limitations on Card Payment Restrictions:

Issuer Comment: As an issuer under $10 billion in assets who complies with offering 2 unaffiliated networks for every particular type of transaction, we have experienced increased losses for card-not-present transactions that now flow through single message networks. We request studies be conducted prior to finalization of proposed changes.

B. Appendix A to Part 235-Official Board Commentary on Regulation II:

Comment 235.7(A)-1 Scope of Restriction:

Issuer Comment: As an issuer under $10 billion in assets who complies with offering 2 unaffiliated networks, although the revision would add cardholder authentication types that may be added in the future other than signature or PIN, there are limited or no studies to support that single message networks have the capability to properly authenticate card not present transactions to verify it is indeed the cardholder of record making the purchase. Merchants should not be permitted to route a transaction through a single message network that has no additional authentication standards for card not present transactions other than the information possessed on the card itself.

Comment 235.7(a)-2 Permitted Networks:

Issuer Comment: As an issuer under $10 billion in assets who complies with offering 2 unaffiliated networks, we have seen an increase in fraudulent transactions occurring over single message networks. We request studies be conducted prior to any regulatory changes on the trending of card not present transactions over time, the fraud to sales volume ratios and overall losses to issuers under $10 billion in assets.

Comment 235.7(A)-7 Application of Rule Regardless of Form Factor:

Issuer Comment: Including forms of payments such as information stored inside an e-wallet on a mobile phone or other device should not be part of the mandate for 2 unaffiliated networks, as there are limited to no studies on single message networks being able to support tokenization. Tokenization was created originally due to the multiple occurrences of merchant breaches where cardholder data was not being protected under PCI (Payment Card Industry) standards. There is insufficient data that single message networks are capable of tokenization to minimize exposure to critical card data elements. We request this specific revision be stricken.

IV. Regulatory Analysis:

A. EFTA 904(a):

Issuer Comment: As an issuer under $10 billion in assets who complies with offering 2 unaffiliated networks, as well as being identified as a Low-Income Designated Credit Union by the NCUA, we believe there have been and will continue to have negative impacts on small financial institutions which in turn, affect low-income consumers. There has only been one report published with 2012 data (Exhibit B) for the Impacts of Regulation II on small issuers, while covered issuers have analysis completed every two years. The report from 2012: www.federalreserve.gov/paymentsystems/files/debitfees_impact.pdf made assumptions on small issuer percentages of overall interchange income, stating an increase of overall income from 2009 to 2011 without tying that to increased transaction volume does not give an overall basis point impact. We request further analysis be completed to trend dual network, single network and overall interchange income impact to include basis point per sales volume data. This negative trend has influenced the ability for small financial institutions to provide competitive products and services to not only the low-income consumers, but all consumers.

Issuer Comment: In conclusion, we believe smaller institutions that were intended to be protected from loss of interchange revenue as proposed by Regulation II, have indeed seen a significant reduction in the overall basis point per transaction volume income. Increased interchange income has been the result of higher transaction volume; however, the overall basis points have decreased. We believe that most single message networks are least cost routing to merchants because they have not invested in the infrastructure necessary to authenticate and mitigate fraud (tokenization for contactless or 3D secure) at time of authorization. We believe to expand, clarify, and enforce the 2 unaffiliated network rule to card not present transactions will result in a significant increase in fraudulent losses to smaller institutions. The combination of increased fraud losses with less overall interchange income as a basis point function of volume will indeed have a negative impact on consumers in the form of less competitive offerings of products and services. The small financial institution industry is typically fee-averse and would not be able to recover the losses in the same manner that covered institutions historically have. We are in agreement for fair network competition, as long as all are on a level playing field regarding security and chargeback rights. We respectfully request further analysis of the overall impacts of Regulation II on small issuers be conducted prior to any further changes, or at least consider including a mandatory maximum transaction limit for card not present transactions of $50.00 that are routed through single message networks as pinless debit for small issuers under $10 billion in assets.

Exhibit A

Average Debit Card Interchange Fee by Payment Card Network

Network[1]	2019												
	Exempt transactions[2]					Covered transactions[3]					All transactions (exempt and covered transactions)[4]		
	% of total number of transactions[5]	% of total value of transactions[6]	Average transaction value[7]	Average interchange fee per transaction[8]	Interchange fee as % of average transaction value[9]	% of total number of transactions[5]	% of total value of transactions[6]	Average transaction value[7]	Average interchange fee per transaction[8]	Interchange fee as % of average transaction value[9]	Average transaction value[7]	Average interchange fee per transaction[8]	Interchange fee as % of average transaction value[9]
Dual-message[10]	**37.4%**	**36.0%**	**$38.47**	$0.54	**1.41%**	**62.6%**	**64.0%**	**$40.93**	**$0.22**	**0.54%**	**$40.01**	**$0.34**	**0.85%**
Discover	95.1%	93.9%	$31.73	$0.41	1.30%	4.9%	6.1%	$39.91	$0.24	0.60%	$32.13	$0.40	1.26%
MasterCard	54.0%	53.4%	$40.62	$0.59	1.46%	46.0%	46.6%	$41.62	$0.23	0.56%	$41.08	$0.43	1.04%
Visa	32.3%	30.5%	$37.50	$0.52	1.39%	67.7%	69.5%	$40.79	$0.22	0.54%	$39.73	$0.32	0.80%
Visa dual-message	29.9%	28.3%	$37.56*	$0.54	1.44%	70.1%	71.7%	$40.74	$0.22	0.54%	$39.79	$0.31	0.79%
Visa single-message[11]	76.5%	73.5%	$37.06	$0.37	0.99%	23.5%	26.5%	$43.34	$0.24	0.56%	$38.54	$0.34	0.87%
Single-message[12]	**36.3%**	**34.7%**	**$36.01**	**$0.25**	**0.69%**	**63.7%**	**65.3%**	**$38.57**	**$0.24**	**0.61%**	**$37.64**	**$0.24**	**0.64%**
ACCEL	82.1%	81.1%	$39.28	$0.22	0.55%	17.9%	18.9%	$41.97	$0.24	0.57%	$39.76	$0.22	0.55%
AFFN	82.0%	72.9%	$31.98	$0.23	0.72%	18.0%	27.1%	$54.14	$0.16	0.30%	$35.96	$0.22	0.61%
ATH	17.4%	20.0%	$40.56	$0.20	0.49%	82.6%	80.0%	$34.27	$0.20	0.59%	$35.37	$0.20	0.57%
Culiance[13]	100.0%	100.0%	$42.05	$0.24	0.57%	0.0%	0.0%	NA	NA	NA	$42.05	$0.24	0.57%
Interlink	13.8%	10.9%	$31.19	$0.35	1.12%	86.2%	89.1%	$41.03	$0.24	0.59%	$39.67	$0.26	0.64%
Jeanie	99.6%	99.7%	$45.79	$0.25	0.54%	0.4%	0.3%	$38.70	$0.17	0.45%	$45.76	$0.25	0.54%
Maestro	21.4%	19.2%	$31.12	$0.22	0.72%	78.6%	80.8%	$35.64	$0.24	0.66%	$34.67	$0.23	0.67%
NYCE	79.8%	79.1%	$37.18	$0.30	0.80%	20.2%	20.9%	$38.78	$0.22	0.57%	$37.51	$0.28	0.76%
PULSE	62.4%	60.8%	$39.31	$0.28	0.70%	37.6%	39.2%	$41.99	$0.24	0.57%	$40.32	$0.26	0.65%
SHAZAM	87.5%	86.7%	$34.31	$0.26	0.74%	12.5%	13.3%	$36.69	$0.21	0.58%	$34.61	$0.25	0.72%
STAR	46.9%	44.6%	$35.92	$0.20	0.57%	53.1%	55.4%	$39.44	$0.24	0.60%	$37.79	$0.22	0.58%
UnionPay	100.0%	100.0%	$31.68	$0.36	1.13%	0.0%	0.0%	NA	NA	NA	$31.68	$0.36	1.13%
All networks	**37.0%**	**35.6%**	**$37.64**	**$0.44**	**1.18%**	**63.0%**	**64.4%**	**$40.10**	**$0.23**	**0.56%**	**$39.19**	**$0.31**	**0.78%**

Exhibit B:

Regulation II (Debit Card Interchange Fees and Routing)

Interchange Fee Standards: Small Issuer Exemption

Average Interchange Fee by Network

Reports and Data Collections

Reports and Data Collections

Reports

Interchange Fee Revenue, Covered Issuer Cost, and Covered Issuer and Merchant Fraud Loss Related to Debit Card Transactions

Background: The Electronic Fund Transfer Act requires the Federal Reserve Board (Board) to biennially publish data on costs incurred, and interchange fees charged or received, by debit card issuers and payment card networks. The Board conducted the first Payment Card Network and Debit Card Issuer surveys in 2010, collecting data for calendar year 2009. The information from the first data collection assisted the Board in developing Regulation II, and was included in a report published in June 2011.

- Calendar-year 2019 (PDF)
- Calendar-year 2017 (PDF)
- Calendar-year 2015 (PDF)
- Calendar-year 2013 (PDF)
- Calendar-year 2011 (PDF)
- Calendar-year 2009 (PDF)

Data tables: revised as of April 6, 2021:

- Excel Format

Impact of Regulation II on Small Debit Card Issuers

Background: The Dodd-Frank Act exempts small debit card issuers from the interchange fee standard set in Regulation II, but not from the statute's prohibition on network exclusivity (a small debit card issuer is an issuer that, together with its affiliates, has assets of less than $10 billion). In conjunction with the issuance of the final rule for Regulation II in June 2011, the Board assessed the impact of certain provisions of the regulation on small debit card issuers. The findings were included in a report published in May 2013.

- Calendar-year 2012 (PDF)