



**International Bancshares
Corporation**

August 9, 2021

Via email submission:

Board of Governors of the Federal Reserve System
Ann Misback, Secretary
Attn: Docket No. R-1748; RIN 7100-AG15
20th Street and Constitution Avenue NW
Washington, D.C. 20006
regs.comments@federalreserve.gov

Re: Comments on Notice of Proposed Rulemaking Regarding Amendments to Regulation II: Docket No. R-1748; RIN 7100-AG15.

Dear Ms. Misback:

The following comments are submitted by International Bancshares Corporation ("IBC"), a publicly-traded, multi-bank financial holding company headquartered in Laredo, Texas. IBC maintains 186 facilities and 280 ATMs, serving 87 communities in Texas and Oklahoma through five separately chartered banks ("IBC Banks") ranging in size from approximately \$400 million to \$11 billion, with consolidated assets totaling approximately \$15 billion. IBC is one of the largest independent commercial bank holding companies headquartered in Texas.

This letter responds to the Notice of Proposed Rulemaking ("Notice") by the Federal Reserve Board ("FRB") regarding certain proposed amendments to Regulation II.

Regulation II implements many requirements of the Electronic Funds Transfer Act ("EFTA") related to debit card issuers and payment networks. Specifically, 12 C.F.R. 235.7(a) implements the prohibition on network exclusivity set out in EFTA section 920(b)(1)(A). This provision prohibits an issuer or payment card network from directly or indirectly restricting the number of payment card networks on which an electronic debit transaction may be processed to fewer than two unaffiliated networks. To comply with the network exclusivity provisions, among other things, an issuer must allow an electronic debit transaction to be processed on at least two unaffiliated payment card networks, each of which (i) must not restrict the network's operation to a limited geographic area, specific merchant, or particular type of merchant or transaction, and (ii) must have taken steps reasonably designed to enable the network to process the electronic debit transactions that the network would reasonably expect will be routed to it.

12 C.F.R. 235.7(b) implements the prohibition on routing restrictions set out in EFTA section 920(b)(1)(B). Specifically, the provision prohibits any issuer or payment card network from directly or indirectly inhibiting the ability of any person that accepts or honors debit cards for payments (such as a merchant) to direct the routing of electronic debit

transactions for processing over any payment card network that may process such transactions. Therefore, if an issuer has enabled a payment card network to process debit transactions for a particular card, then the issuer or payment card network may not inhibit a merchant's ability to route an electronic debit transaction over that network.

The FRB states that when Regulation II was first enacted in 2011, there were not sufficient market and technological solutions to support multiple payment networks for card-not-present transactions. (Notice at 26190) This is, in large part, due to the technological differences between single and dual-message authentication networks and the fact that single-message networks had limited ability to process card-not-present transactions when Regulation II was enacted. However, the FRB now believes that there is sufficient infrastructure to support multiple payment networks for card-not-present transactions, and is proposing to "clarify" Regulation II to make clear that:

debit card issuers should enable, and merchants should be able to choose from, at least two unaffiliated networks for card-not-present transactions. Specifically, the FRB 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 that card-not-present transactions are a particular type of transaction for which two unaffiliated payment card networks must be available. The Board is further proposing revisions to the rule and the 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. In addition to these changes, the Board is proposing revisions to standardize and clarify certain terms and phrases in the commentary. (Notice at 26190)

While FRB is technically correct that, due to certain technological advances, there are more payment network options for card-not-present transactions, this does not automatically mean such options are feasible, efficient, economical, or widely available. This is especially true in the case of small and mid-sized card issuers.

Take, for example, electric cars and their related technology. Over the past decade, options for electric and hybrid cars have increased and the underlying technology and specs of these vehicles have overwhelmingly improved. However, most options are still well above the price of their standard gas alternatives and the electric vehicle infrastructure is still incredibly anemic. Public charging options are not widely available, and home charging options are costly and require substantial investment and retrofitting. While the trend over the last decade is positive, there remains much to be done before electric cars are as ubiquitous as standard gas vehicles, even with the tax incentives available for electric vehicles.

The same can be said of payment networks for card-not-present transactions. While there are more options available, that does not mean those options are cost-effective or feasible, especially for small and mid-sized institutions. Unlike tax breaks to incentivize adoption of electric vehicles, the proposed amendments to Regulation II would actually force adoption of multiple payment networks to the detriment of all stakeholders. Instead

of structuring Regulation II as an incentive for card issuers to allow, and merchants to use, multiple payment networks, the FRB is creating false competition in the name of merchant protection. The FRB itself states that the number of payment networks has increased and that related technology has also improved. That, in and of itself, is proof that the market is thriving and competitive. IBC believes the FRB is incorrectly focusing on the merchant's choice of payment network in order to support its position that Regulation II changes are necessary to promote competition. As far as Regulation II's application, the payment networks compete to gain the business of the card issuers. Payment networks generally do not compete to win the business of merchants. Even if they do compete for merchant business, that competition occurs prior to a merchant choosing a network to support or a card issuer and is meant to effect that choice, not the per transaction network choice once the merchant is set up to accept certain card-not-present transactions.

Moreover, IBC believes that the FRB and Regulation II do not fully appreciate and consider the effect that Regulation E losses have on card-not-present transactions and electronic debit transactions, generally. The FRB notes that the cost of processing debit transactions, including card-not-present transactions, has decreased, but it does not consider the related increase in fraud and error resolution costs. These costs have skyrocketed due to increased electronic transaction activity, including card-not-present transactions and Regulation E and payment network obligations on card issuers. Card-not-present transactions are more prone to fraud and result in more costs and losses than typical debit transactions. Notably, most of the large payment networks provide additional liability protection to consumers for fraudulent transactions, which is included in the additional costs to card issuers. The FRB has noted that, in 2019, merchants absorbed 56% of such losses, card issuers absorbed 35%, and consumers only 9%. (FRB Memorandum re Proposed Amendments to Regulation II, page 8) The FRB lauds the increase in single-message network processing of card-not-present transactions, yet also states that the increase is due to changes like no longer requiring PIN entry. These changes are only helping to *increase* fraud, which results in increased losses due to the expansive protections provided to consumers. The FRB itself attempts to rug sweep the glaring increase in fraud losses for card issuers: between 2011 and 2019, fraud losses as a share of transaction value grew 50%. (FRB Memorandum re Proposed Amendments to Regulation II, page 8) The FRB and other agencies have placed so many additional burdens and costs on card issuers, and card holders have benefitted greatly from these additional protections, but there has been no related outlet to recover or decrease costs related to card transactions and processing. IBC strongly urges the FRB to consider these additional costs in light of the propose amendments.

With the proposed amendments, the FRB is mandating that all card issuers offer two network options to their customers for card processing, without any consideration of or concern for the costs, overhead, and revenue related to offering those options. Returning to the car analogy, if a dealership offers two cars that are functionally the same but have wildly different overhead costs and profit margins, the dealership would likely face huge losses if it was forced to provide both in equal amount. This does not even take into account the difference in required maintenance packages for each car. For example, assume the lower margin car required an extensive warranty and service package. This

is exactly what Regulation E does; it places additional, costly fraud and error resolution obligations on card issuers. The margins for card network processing fees and revenues are razor thin, and because payment networks are largely fungible, stakeholders generally have no reason to choose a slightly more expensive network and card issuers will have limited ability to adjust their offerings or related risks and costs.

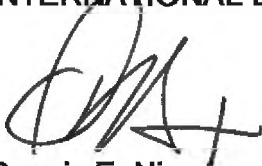
Because of this, IBC believes the proposed amendments pose a safety and soundness concern. The costs of card transaction processing and related fraud and Regulation E costs are increasing, and the proposed amendments will only fuel that increase while leaving card issuers no flexibility in adjusting and accounting for such costs and losses. These costs, along with all bank operating costs, are generally subsidized and offset against net interest income. The proposed amendments undermine safety and soundness concerns because banks will be forced to accept more credit risk to offset the additional costs, including large compliance and Community Reinvestment Act costs and obligations. This creates a feedback loop which increases the bank's overhead burden and costs, all while decreasing interchange fee income.

Finally, IBC strongly recommends the FRB extend the time for public comment due to the importance of this issue and the dearth of current information provided in support of the proposed amendments. The proposal is both substantively and technically complex, and requires data and information that is not necessarily readily available to be provided in a digestible format. IBC believes that card issuers would be able to provide a greater amount of actionable and useful data if the FRB allowed additional time to submit comments. For example, the "clarifications" regarding the inclusion of all "form factors" absolutely requires additional consideration and review. Will that only apply to form factors not provided by the card provider, such as electronic and mobile wallets? How is a card issuer to adapt and remain compliant as technology advances and increases the amount of third-party form factor options over which card issuers have little to no control? IBC also fundamentally takes issue with the FRB's cavalier description of the proposed amendments as "clarifications," as the amendments make arguably substantive changes to the regulation. Currently, card issuers must "allow" electronic debit transactions to be processed on at least two payment networks. 12 C.F.R. 237(a)(2). The proposed amendments to that section would require each card issuer to "enable" at least two payment networks for the processing of each electronic debit transaction. Clearly, the FRB believes there is a difference between this language, and IBC agrees. What is unclear is what actions card issuers will be required to take to not only "allow" but also "enable" two payment networks for debit processing. Must the option be offered at the time the merchant enters into its relationship with the card issuer? Is a card issuer required to offer the choice of two payment networks each and every time a merchant submits a debit transaction? Is a merchant's choice of one payment network to be disregarded? Moreover, given the FRB's limited economic impact analysis, including additional costs and the additional burdens required to be analyzed under the Paperwork Reduction Act and the Regulatory Flexibility Act, card issuers should have more time to provide helpful information showing the true costs and burdens the proposed amendments would have. Without additional guidance from the FRB, it is difficult to analyze what the actual effects of the proposed amendments would be without significant

additional independent analysis. If given more time, institutions would be better able to provide more accurate, specific, and useful comments to the FRB.

Thank you for the opportunity to share IBCs views on these matters.

INTERNATIONAL BANCSHARES CORPORATION

A handwritten signature in black ink, appearing to read 'DENIXON', written over the company name.

Dennis E. Nixon
President and CEO