Cooperative Credit Union Association

Delaware • Massachusetts • New Hampshire • Rhode Island

Creating Cooperative Power

August 11, 2021

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

Docket No. R-1748, RIN 7100-AG15

Re: Cooperative Credit Union Association Inc.'s Comments on Interchange Debit Fees and Routing

BY ELECTRONIC MAIL: regs.comments@federalreserve.gov

Dear Secretary Misback:

On behalf of the member credit unions of the Cooperative Credit Union Association, Inc. ("Association"), please accept this letter relative to the request for comments issued by the Board of Governors of the Federal Reserve System ("Board") relative to its proposed rule on Debit Card Interchange Fees and Routing ("proposal").[1] More specifically, the proposal requests comments on Regulation II, Debit Card Interchange Fees and Routing, to clarify that debit card issuers should enable, and allow merchants to choose from, at least two unaffiliated networks for card-not-present debit card transactions, such as online purchases. The Association is the state trade association representing approximately 200 state and federally-chartered credit unions located in the states of Delaware, Massachusetts, New Hampshire, and Rhode Island, which further serve over 3.6 million consumer members.

I. Overview

The Association conducted a survey of its members regarding the provisions of the proposed rule and member views provide the basis for this comment letter. The Association notes that Regulation II does not currently require credit unions or other card issuers to enable more than one network to process debit card transactions for card-not-present transactions such as online purchases or mobile payments. As proposed, however, the Board seeks to amend Regulation II to require issuers to enable more than one network to process card-not-present transactions, such as

[1] https://www.federalregister.gov/documents/2021/05/13/2021-10013/debit-card-interchange-fees-and-routing

at least one "dual message," signature-based network (e.g., Visa, MasterCard) and at least one "single message," PIN-based, ATM-style network (e.g., Plus, Star, Co-op), and allow merchants or their acquirers to choose how to process the transaction.

As a preliminary matter, the Association cannot overstate the concern of members with the present imbalance of operational burdens and risk which would be further exasperated by adoption of the proposal. In a typical transaction, merchants utilize the least-cost routing algorithms to send transactions over the cheapest network. If a credit union adds a third debit network, as one affiliated, such as Plus, and one unaffiliated, such as NYCE, is presently used, then big merchants with the most aggressive network agreements and the most sophisticated routing technology will always get the best end of the deal and credit unions will always get the worst end of the deal. This would occur while credit unions carry the cost of producing the plastic, servicing the account, providing text alerts on potentially fraudulent transactions, and absorbing the zero-liability fraud coverage. The overriding question to be addressed is what level of burden the retailer is going to absorb in exchange for a discount. It remains the unwavering position of the Association that there is a real cost to accepting payments through cards and that merchants need to carry their fair share. The work of the Board does nothing to adjust this severe imbalance which was not intended by the statute.

II. The Proposal is Opposed Due to Increased or Unknown Operational Costs and Fraud Challenges During the Current Economic State of Flux

The Association strongly opposes this proposal and urges the Board not to finalize it. Member credit unions report that they will be burdened by operational challenges and ongoing costs resulting from the proposal.[2] It is expected that the proposal, if finalized as presented, will require credit unions to renegotiate or implement new vendor agreements, endure information technology changes, test new systems, increase staff training, adjust to changes in chargeback processing and transaction volume, and increase member education. It is also beyond any reasonable technical expectation that a credit union can issue a card that is guaranteed to support every merchant across the country who insists on an unsupported transaction configuration. In addition, survey members observed that single-message networks often do not provide the same level of fraud protection as dual-message networks for card-not-present transactions today.

Increased compliance costs are intertwined with a decrease in income under the proposal. Survey respondents also noted that the proposal is expected to result in the further loss of significant fee income. In general, credit union card providers estimate that interchange comprises approximately 80-90% profitability of debit card services, and further provides one of the biggest components of non-interest income for credit unions. This source helps drive the overall income of a credit union which is vital in the cooperative, not-for-profit, financial structure of credit unions. In addition, such sources of income are integral parts of the economic formula that

[2] One survey respondent described the proposal as one that only benefits large retailers, like Walmart and Amazon, who can negotiate bargain-basement interchange rates.

supports the growth of credit unions and leverages further core services to underserved and unbanked consumers.[3]

The recently changed economic environment from the pandemic significantly reduced debit card payment activity as members remained at home conforming to widespread quarantines and lockdowns. Improvement in debit card spend has been more pronounced with the arrival of federal stimulus payments in the accounts of members and growth in checking accounts. Yet a sustainability concern exists as federal stimulus payments are ultimately fully utilized and the eventual termination of the federal subsidy on unemployment benefits takes place. It remains to be seen if a significant degree of offset will occur from business re-openings and the potential for cardholders to return to some degree of normalcy with their spending patterns in light of emerging developments with COVID-19 variants.

III. The Proposal Lacks Consistency with the Statutory Small Issuer Exemption and Overreaches

The Association observes that this proposal is premised as a network exclusivity rulemaking and clarification. Such characterization is an overstatement. The Association suggests that the impact of the proposal is material and is inconsistent with the statutory exemption for small issuers from Regulation II’s debit interchange fee price-setting rules.

Congress exempted credit unions and banks with less than $10 billion in assets from Regulation II’s price controls pursuant to Section 1075 of the Dodd-Frank Act, 15 U.S.C. § 1693o–2(a)(6). The Board codified the statutory exemption for small issuers from its rate-setting activities in Section 235.5 of Regulation II. The Regulation II proposal was issued in light of information indicating that often only one network is enabled for card-not-present debit card transactions.

It is clear that the Durbin Amendment directed the Board to regulate debit interchange fees in an attempt to prevent card-issuers from unfairly charging merchants. The underlying expectation was that in doing so, consumers would be protected from higher costs. Further, it was expected that the merchant would do their part by supporting cards presented for payment. Without question, the rulemaking was intended to enable a process to benefit consumers with lower prices. However, there is no evidence that merchants have passed along their savings to consumers in the form of price cuts, and the regulatory burden and loss of revenue for credit unions has contributed to the difficult choice to charge for services that were once free, such as checking accounts.

The practical effect of Regulation II has been that debit card-not-present transactions are the only type of transaction where the small issuer exemption operates more or less as envisioned. Most

[3] Other survey respondents noted that interchange income is the only way to support the overhead expenses of providing card programs to members and absorb the zero-fraud liability for cardholders.

small issuers' debit card transactions processed over dual-message networks represent card-not-present transactions which unquestionably carry more risk. Association members, as small issuers, typically receive interchange fees, with helps with risk and fraud costs, from dual-message signature networks that are similar to rates once received on all debit-card transactions before the adoption of Regulation II.

Despite the exemption, the implementation of Regulation II has resulted in single-message networks typically treating small issuers' debit card-present transactions as though the small issuer exemption does not exist. Under the proposal, the Board effectively nullifies the small issuer exemption from its debit interchange price controls thereby presenting an inconsistency with the statute.

The Association notes that the proposal also raises the possibility that small merchants might not benefit. Non-bank payment processors, such as PayPal, Stripe, and Square, typically charge merchants processing fees based on the same percentage rate for both debit cards and credit cards. The United States schedule for PayPal for Business has a "standard rate for receiving domestic transactions" and currently lists processing fees that PayPal charges merchants on debit and credit cards ranging from 1.9 to 3.5 percent of the transaction value plus potential fixed fees.[4] These rates charged by the merchants' own payment processors are far in excess of the "reasonable and proportional interchange transaction fees" for debit cards that the Board has established for issuers in Section 235.3 of Regulation II.

Finally, the Association suggests the proposed rule goes too far beyond the constrained routing rights merchants acquired by statute. These transactions are often pushed on financial institutions by core providers who own the very networks that benefit from them. This marketplace structure alone does not promote competition or fairness. Credit unions that routinely cover member losses and quickly reverse fraudulent transactions also possess the most incentive to ensure consumer protection. The proposal, however, will have the opposite effect by limiting the ability of credit unions to choose the best debit networks to route transactions and best serve and protect members.

IV. Conclusion

The Board is strongly urged to abandon this proposal. The Association firmly believes that Congress never intended for Regulation II's debit card interchange rate-setting rules to apply to credit unions and banks with less than $10 billion in assets. In reality, the practical effect of Regulation II has been that debit card-not-present transactions are the only type of transaction where the small issuer exemption operates more or less as envisioned.

Finalizing the rule as proposed would likely impose ongoing operational costs and regulatory burdens, including an increased incidence of fraud losses, on small issuers. In addition, significant income would be lost, would not further congressional intent, and would not benefit

---

[4] "PayPal Merchant Fees;" https://www.paypal.com/us/webapps/mpp/merchant-fees (last visited Aug. 9, 2021).

consumers. The Association believes that significant negative effects on credit unions and their consumer members will result by adoption of the proposal and urges that the current payment ecosphere should not be expanded. Credit unions are presently focusing resources to offer members processing enhancements, such as faster payments systems, that are becoming available now rather than increasing their debit card interchange fees and routing compliance efforts. The Board is respectfully requested to withdraw the proposal to expand routing controls to card-not-present debit transactions and the requirement to have two debit networks for routing transactions.

Thank you for the opportunity to share views on the proposal relative to debit card interchange fees and routing requirements. If you have any questions about the recommendations set forth in this comment letter or require further information, then please do not hesitate to contact the Association at **govaff-reg@ccua.org**.

Sincerely,

Ronald McLean
President/CEO
Cooperative Credit Union Association, Inc.
rmclean@ccua.org

RM/mac/kb