U.S. PIRG

U.S. Public Interest Research Group

Via electronic delivery

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Secretary, Board of Governors of the Federal Reserve System

RE: Docket No. R-1748, RIN 7100-AG15

Thank you for the opportunity to comment on the Notice of Proposed Rulemaking Concerning Debit Card Interchange Fees and Routing.

As you may know, the U.S. Public Interest Research Group (U.S. PIRG) serves as the federation of state PIRGs, which are non-profit public interest advocacy organizations that take on powerful special interests on behalf of their citizen members around the country.

U.S. PIRG has long been a strong supporter of increased competition in the electronic payment system, which is dominated by a two-firm oligopoly, Visa and Mastercard, which is aided and abetted by the largest card-issuing banks. As such, U.S. PIRG strongly supported the Durbin amendment to the Dodd-Frank Act and continues to support payment card reforms.[1]

[1] Here are some examples of U.S. PIRG's support for interchange fee reform in the runup to passage of the Durbin amendment: For example, see my testimony before the Senate Appropriations Committee's subcommittee on Financial Services and General Government, at a hearing on "Oversight of Federal Payment of Interchange Fees: How to Save Taxpayer Dollars," 16 June 2010, available at https://www.appropriations.senate.gov/imo/media/doc/hearings/06_16_10%20FSGG%20Oversight%20Interchange%20Fees%20GPO%20Record.pdf, last visited 10 August 2021. Also see my testimony before the House Judiciary Committee's Hearing on HR2695, the Credit Card Fair Fee Act of 2009, 28 April 2010, available at https://republicans-judiciary.house.gov/wp-content/uploads/2010/04/Mierzwinski100428.pdf, last visited 10 August 2021. Also see my testimony before the Antitrust Task Force of the House Judiciary Committee on Credit Card Interchange Fees, 17 July 2007, available at https://babel.hathitrust.org/cgi/pt?id=pst.000063525090&view=1up&seq=1, last visited 10 August 2021.

We commend the staff for its well-reasoned proposal to clarify the debit card routing provisions of Regulation II to make clear what issuers and networks need to do to meet the Congressional intent in the Durbin amendment to ensure that the Electronic Fund Transfer Act promotes competition by giving merchants choices in routing their transactions.

Much of the bank, credit union and card network complaining about the Durbin amendment, especially during the implementation of Regulation II, had focused on its cap on certain debit card swipe fees. Now, subject to check, I presume the bulk of their comments will defend their defiance of the Durbin amendment's important routing requirements.

The Durbin amendment was always about more than stopping excessive rent-seeking and profiteering. It was also designed to promote the development of a competitive payment network marketplace. The Notice of Proposed Rulemaking sends an important signal that conduct inconsistent with the Durbin amendment's clear Congressional intent will not be tolerated.

The Federal Reserve's NPR makes simple clarifications to the regulations implementing the Section 920 routing provisions that promote competition.

In particular, the NPR would clarify that the existing provisions of EFTA Section 920 and its regulations do:

1) "forbid issuers and payment card networks from restricting the number of such networks to fewer than two unaffiliated networks ("prohibition on network exclusivity")" and
2) "forbid issuers and payment card networks from directly or indirectly inhibiting any person that accepts debit cards for payment from directing the routing of an electronic debit transaction over any network that may process that transaction ("prohibition on routing restrictions").

The staff's memorandum to the board states that, in particular in card-not-present (or online) transactions, issuers are not enabling multiple unaffiliated networks as the Durbin amendment requires:

> "…two unaffiliated payment card networks are often not available to process card-not-present transactions, such as online purchases, because some issuers do not enable multiple networks for such transactions. **Staff members view such an outcome as inconsistent with Regulation II's requirement that at least two unaffiliated networks be available to process each debit card transaction.**"[2] [Emphasis added.]

[2] Staff Memorandum, "Proposed Amendments to Regulation II, 30 April 2021, available at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20210507a2.pdf, last visited 10 August 2021.

We make three brief points in support of the NPR:

1) **Running a transaction without a PIN is not a "new and untested" practice:**

Visa's filed comment[3] in this docket asserts that "among some or all historically PIN-based debit networks, the ability to support card-not-present transactions is relatively new and untested in the marketplace."

Of course, the actual claim here is belied by the fact that running a transaction without a PIN is **not** a new and untested practice. **Signature-based debit transactions without a PIN are exactly what Visa does all the time.** Visa simply doesn't want competition from unaffiliated PIN debit networks that have developed innovative PINless transactions and other new technologies for online transactions.

As the staff memo notes, this innovation was the goal of the Durbin amendment and Regulation II:

> "When it promulgated Regulation II, the Board explained that it expected the market to develop solutions to facilitate the use of single-message networks for card-not-present transactions in the years following the adoption of Regulation II. In the decade since the adoption of Regulation II, technology has evolved to address these barriers, and nearly all single-message networks have introduced capabilities to process card-not-present transactions. At the same time, spurred by the growth in online commerce, card-not-present transactions have become an increasingly significant portion of all debit card transactions."[4]

A lack of competition has served banks and credit unions well, but harmed merchants and consumers. To reiterate, as the staff memo states that "the Board explained that it expected the market to develop solutions to facilitate the use of single-message networks for card-not-present transactions…" The marketplace is developing those solutions but the entrenched oligopolists are blocking their rollout to maintain market share; it's an old story and it is "inconsistent" with the statute (at minimum), as we explain further.

2) Making available fewer than two unaffiliated networks for online transactions is "inconsistent" with the Durbin amendment's clear statutory requirements

The staff memo further explains that, despite the pandemic's acceleration of card-not-present (CNP) transactions, "merchants are not always able to choose from at least two unaffiliated

[3] Ky Tran-Trong for Visa and Visa Inc., Comment in Docket R-1748, 23 July 2021, available at https://www.federalreserve.gov/SECRS/2021/July/20210729/R-1748/R-1748_072321_138952_363137656879_1.pdf, last visited 10 August 2021.
[4] Pages 4-5 of Staff Memo, Footnote 2, Supra.

networks when routing card-not-present transactions. Data collected by the Board document that single-message networks collectively process a small share of card-not-present transactions compared with their share of card-present transactions."

The memo further describes staff findings that the share has dropped to 6% of CNP transactions in 2019 and, further, that data "indicate that the low prevalence of card-not-present transactions over single-message networks **may have occurred because issuers have not consistently enabled** single-message networks for card-not-present transactions."[5][Emphasis added.]

This situation results in the staff's conclusion that: "Staff members view these practices by issuers for card-not- present transactions as inconsistent with the prohibition on network exclusivity in Regulation II because they restrict the number of payment card networks on which card-not-present transactions can be processed to fewer than two unaffiliated networks."[6]

One example of an innovation in the single message debit space is PINless debit. One analyst estimates that merchants could save $2.1 - $3.1 billion dollars annually, if it were enabled by more issuers, as required by the Durbin amendment. Instead, the analyst finds that:

> "many issuers are not enabling the PINless functionality when issuing bankcards – it's reported a merchant is unlikely to be able to use PINless more than 50% of the time, despite having the technology to enable a PINless transaction. This means the great majority of Card Not Present transactions have been routed to Visa or Mastercard networks, which are typically more expensive."[7]

Denying innovative competition is, of course, a classic ploy by entrenched monopolists and oligopolists. One analyst explains the "throttling" of PINless debit "by the more expensive and fraud-prone solutions offered by dual-message networks:"

> "While local debit networks have developed the technology, analysis of the Federal Reserve data indicates PINless growth is being throttled in comparison to the growth of dual-message networks. In 2017, single-message networks accounted for just 8% of CNP debit transactions. In 2019, that figure shrunk further to just 6%. While PINless's routing options seem attractive to merchants, PINless's market share in the CNP environment is consistently dwarfed by the more expensive and fraud-prone solutions offered by dual-message networks."[8]

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[5] Id. at Page 5.
[6] Id., at Page 6.
[7] Callum Godwin, "101: An Introduction to Online Routing + PINless Transactions," 17 June 2020, available at https://cmspi.com/nam/blogs/introduction-online-routing-pinless/, last visited 10 August 2021.
[8] Christian Johnson, "What Does Online Debit Routing Look Like?", 27 May 2021, available at https://cmspi.com/nam/blogs/pinless-debit/, last visited 10 August 2021.

3) Federal Reserve data show fraud is up for dual-message and prepaid transactions but down for single-message transactions

Throughout the history of implementation of Regulation II, the Board's reports have shown that signature debit (dual message) and prepaid debit have much higher occurrence rates than single message PIN debit. The latest report shows the trend continuing.

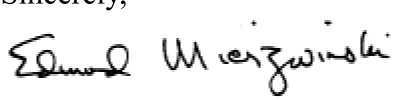
> "The increase in overall fraud losses from 2017 to 2019 was driven by rising fraud losses for dual-message and prepaid transactions. [...] By contrast, for the first time since 2011, fraud losses as a share of single-message transaction value declined from 2017 to 2019. Single-message transactions continued to experience the lowest fraud losses as a share of transaction value, at 5.7 basis points in 2019."[9]

The report does explain that this differential was "partially driven by the low use of single-message networks for CNP transactions." Nevertheless, "As had been the case since 2009, prepaid and dual-message transactions exhibited a considerably higher fraud incidence than single-message transactions in 2019."[10]

Conclusion

U.S. PIRG supports the clarifications described in the NPR. The proposed regulation will improve competition and choice and lower merchant costs, which will lower prices to all consumers. The Durbin amendment must be seen as Congress intended: it is an effort to reduce or eliminate anti-competitive practices and make payments markets work better, for all participants.

Sincerely,



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[9] At page 16, Report, "2019 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions," Federal Reserve Board of Governors, May 2021, available at https://www.federalreserve.gov/paymentsystems/files/debitfees_costs_2019.pdf, last visited 10 August 2021.

[10] Id. at pages 17-18.