August 11, 2021

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

RE: Comments on Clarification of Regulation II, Docket No. R-1748, RIN 7100-AG15

Dear Ms. Misback:

The National Association of Convenience Stores (NACS) supports the Board's proposed clarification of Regulation II. For too long, debit card issuers and networks have failed to adhere to the terms of Regulation II because they have not made available two networks to process debit transactions on large numbers of debit transactions. NACS hopes that the Board's clarification will be implemented swiftly and end these failures. In order to achieve that goal, however, below we recommend that the Board make some changes to strengthen its clarification.

By way of background, NACS is an international trade association representing the convenience store industry with more than 2,200 retail and 1,600 supplier companies as members, the majority of whom are based in the United States. The convenience industry employed about 2.34 million workers and generated more than $548.2 billion in total sales in 2020, representing more than 3 percent of U.S. gross domestic product. The industry processes more than 160 million transactions every single day. That means about half of the U.S. population visits our members on a daily basis. In fact, ninety-three percent of Americans live within 10 minutes of one of our locations. The average time a customer spends in one of our stores is about three and one-half minutes and the industry competes to ensure the customer's needs are met as efficiently as possible – saving them time and money.

- **The Proposal Appropriately Addresses Internet Transactions**

The Board's proposal properly addresses the problem of card issuers refusing to enable debit networks that compete with Visa and Mastercard to carry Internet and mobile phone application transactions. This is a widespread problem and the Board's clarification that the networks on a card must be enabled to handle all types of transactions is appropriate.

- **The Proposal Helpfully Clarifies Regulation II's Applicability to Form Factors**

The Board's clarification that two networks must be enabled to process debit transactions applies to all form factors is a positive change that will help effectuate compliance with Regulation II. Today, many transactions on mobile phone applications or through mobile wallets do not have network options in spite of Regulation II. The Board making clear that these and other form factors, access devices and the like must also have two network options is a positive change as these types of payments are becoming much more common.

- **The Board Should Protect Against Regulatory Violations Based on Methods of Authentication**

The Board's clarification that two networks do not need to be enabled for each method of authentication should be further clarified. While the Board made this point during litigation challenging Regulation II, the facts in the market have changed such that it is no longer consistent with the state of the market. As correctly predicted by the Board, debit networks, many of which were previously referred to as PIN debit networks, have all developed the technology to handle not only PIN authenticated transactions but also transactions that do not include a PIN.

The Internet and mobile app and wallet transactions, which the Board is attempting to make clear must have two enabled networks available, typically do not have PIN authentication available. If a card issuer were to enable a debit network and block its ability to handle non-PIN transactions (which is precisely the problem with card-not-present transactions today), the Board's language regarding authentication would present that card issuer with an argument that it was fulfilling the rule because it was simply having one PIN and one non-PIN network available. Of course, such an arrangement would violate the Board's clarification that two networks must be available for every specific type of transaction. Nonetheless, the Board's language on authentication will invite card issuers to engage in precisely this behavior which will undermine the intent and effectiveness of the rest of the Board's clarification.

While the Board's language on authentication may be an attempt to "future-proof" Regulation II so that networks that cannot immediately handle a new method of authentication when it first comes to the market are still sufficient for issuers to use to achieve compliance, that language is likely to be misinterpreted in a way that undercuts the rest of Regulation II. In order to avoid this problem, and the predictable problem that issuers will refuse to enable networks that compete with Visa and Mastercard to handle transactions that are authenticated through technologies such as biometrics, the Board should include in its clarification language indicating that issuers must enable the networks they choose to put on their card to handle all methods of authentication that those networks are able to handle.

And, the Board should include language making clear that the dominant card networks (Visa and Mastercard) cannot prevent competitor networks from handling certain methods of authentication. Such a clarification is particularly important because Visa and Mastercard already interfere with their competitors' ability to handle biometric authentication data when it comes from mobile payment platforms such as Apple Pay. Unless the Board further clarifies that neither issuers nor networks can limit the methods of authentication that competitor networks on debit cards are able to handle, then the clarification on authentication will be counterproductive and will require the Board to revisit these types of violations of Regulation II in the future.

- **The Board Should Ensure Regulation II is Properly Followed for Card Present Transactions**

The suggested language above should clarify that issuers must enable, and networks cannot interfere, with the ability of competitor debit networks to handle transactions made using all methods of authentication that such networks are able to handle in order to ensure that those transactions that occur in-person with the physical card present (and in all other settings) have adequate network options to comply with Regulation II. There remain instances in which the dominant card networks manipulate how point-of-sale terminals are configured and what merchants are able to do with respect to authentication in a way that limits the networks available to handle non-PIN transactions. While it is often difficult to get to the root of the many ways in which the dominant networks effectuate these restrictions, a clear statement from the Board that authentication cannot be used to limit the types of transactions that certain networks can handle when those networks have the technical ability to handle such transactions is critical to avoid the gamesmanship that this market has seen during the past decade.

One area where this type of clarification would be particularly helpful is with transactions at gasoline and diesel pumps - automated fuel dispenser or AFD transactions in the card networks' rules. NACS members often lack network choices on fuel dispenser transactions because the issuing banks have not enabled networks that compete with Visa and Mastercard to handle PINless transactions (which are common at self-serve fuel pumps). This problem can be overcome by the Board making clear that issuing banks must enable the networks on their cards for all methods of authentication those networks can handle. The problem could also be dealt with by making clear that fuel dispenser transactions are a "type" of transaction under Regulation II such that two networks must be available for those transactions. Doing both of those things would be the most effective way to ensure that the longstanding evasion of Regulation II comes to an end and the Board's requirements are followed.

The Board has an opportunity with its proposed clarification to put an end to many of the problems this market has struggled with to date, but the currently proposed language – while helpful – is not fully up to the task. These further clarifications should send a clear statement that the issuers must fully enable the networks on their cards and that no network can encumber the ability of its competitors to handle debit transactions.

- **The Board Should Reduce the Debit Fees Allowable Pursuant to Regulation II**

It is now clear beyond any doubt that the Board should reduce the level of allowable debit interchange fees. According to the Electronic Funds Transfer Act (EFTA), the Board is obligated to limit those fees to a level that is "reasonable and proportional" to card issuers' costs. As the Board has found, those issuer costs have fallen dramatically since the Board initially wrote Regulation II. As the Board's report shows, the average costs of authorization, clearance and settlement of debit transactions by covered issuers is 3.9 cents.[1] That is nowhere close to the Board regulation allowing debit fees of 21 cents plus 0.05 percent of the transaction amount plus one additional cent for fraud prevention costs (which has become a standard charge regardless of whether an issuer effectively prevents fraud). The report also showed that allowable debit fees now exceed issuer's costs for 99.4 percent of the transactions covered by Regulation II.[2] There is simply no justification in the law for the limits set in Regulation II to so dramatically exceed issuer costs.

Given these figures and the consistent pattern of issuer costs falling for the past decade, we strongly urge the Board to revisit the interchange fee standards in Regulation II and reduce them to a level that is consistent with the language of EFTA.

Sincerely,

Doug Kantor
General Counsel
NACS

[1] Board of Governors of the Federal Reserve, "2019 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions," May 2021 at 4.
[2] *Id*.