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VIA EMAIL

Matthew J. Eichner
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Director – Division of Reserve Bank Operations and Payment Systems
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, D.C. 20551

Re: Regulation II Small Issuer Exemption Recommended Frequently Asked Questions

Dear Mr. Eichner:

As we wrote to you in our letter of October 23, 2020, requesting that the Board issue certain clarifications of Regulation II¹, The Clearing House Association, L.L.C. (“The Clearing House”)² believes that certain very large financial technology (“fintech”) firms that offer debit card³ access to funds they hold are misusing the small issuer exemption to Regulation II’s interchange fee limitations by selecting as card issuers for their debit card product offerings financial institutions that satisfy the asset test component of the small issuer exemption but without depositing funds at these institutions in a manner that satisfies the account holder component of the small issuer exemption. As a result, consumers and small businesses are being harmed by paying interchange fees on debit cards associated with these very large fintech firms that are well in excess of the interchange fee limitations of the Electronic Funds Transfer Act and Regulation II. Such arrangements also create an uneven regulatory playing field that unfairly disadvantages large financial institution debit and prepaid card issuers that are ineligible for the small issuer exemption (both directly and through relationships with small financial institutions) relative to similarly sized non-bank

¹ Regulation II (12 C.F.R. Part 235) implements Section 920 of the Electronic Fund Transfer Act (15 U.S.C. 1693 et seq.), which was enacted as Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203, 124 Stat. 1376 (2010)).

²The Clearing House Association, L.L.C., the country’s oldest banking trade association, is a nonpartisan organization that provides informed advocacy and thought leadership on critical payments-related issues. Its sister company, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the U.S., clearing and settling more than \$2 trillion each day. See The Clearing House’s web page at www.theclearinghouse.org.

³ Debit card (1) Means any card, or other payment code or device, issued or approved for use through a payment card network to debit an account, regardless of whether authorization is based on signature, personal identification number (PIN), or other means, and regardless of whether the issuer holds the account, and (2) Includes any general-use prepaid card. 12 C.F.R. § 235.2(f).

competitors. It also enables very large fintechs, which enjoy large economies of scale, to unfairly compete with small financial institutions.

During a subsequent meeting to discuss the issue, The Clearing House offered to provide Board staff with proposed Frequently Asked Questions (“FAQs”) that would implement the clarifications requested in the Letter that are most appropriate for the Board to resolve by FAQ. Set forth below are proposed FAQs that The Clearing House believes would clarify the intended application of Regulation II’s small issuer exemption.

The need for the clarifications requested in the Letter, and these FAQs specifically, has only become more apparent in the intervening time. In June, a major fintech company disclosed that the U.S. Securities and Exchange Enforcement Division had, by way of subpoena and informational requests, asked for information “relating to whether the interchange rates paid to the bank that issues debit cards bearing our licensed brands were consistent with Regulation II...”⁴ And late last year Acting Comptroller of the Currency Michael J. Hsu addressed the provision of bank-like services by large fintechs that sit outside of the regulatory perimeter, noting that these firms “operate out of the reach of bank regulators and free of bank rules,” and arguing that disparities “between the rights and obligations of banks and the rights and obligations of synthetic banking providers” (fintech companies providing bank-like services) must be removed.⁵

Adopting the FAQs would not only address misuse of the small issuer exemption by large fintechs, it would make clear that very large financial technology firms will be held to the same standards with regard to Reg. II as the depository institutions that compete with them. Such an approach is not only necessary to level the regulatory playing field, but is essential to ensuring that consumers and small businesses do not incur interchange fees in excess of those that were intended by the Durbin Amendment, regardless of whether debit card access is being provided by a large financial institution or a very large fintech company.

Proposed FAQs

§ 235.5 Exemptions

235.5(a) Small Issuer Exemption

Q1. Section 235.5(a) provides that an issuer is exempt from the interchange fee standards if, among other things, the issuer “holds the account that is debited.” Does an issuer hold the account that is debited if the issuer authorizes electronic debit

⁴ PayPal Holdings, Inc., FORM 10-Q, p. 26 (June 30, 2021) (available at: <https://www.sec.gov/ix?doc=/Archives/edgar/data/0001633917/000163391721000149/pypl-20210630.htm>).

⁵ Speech by Acting Comptroller of the Currency Michael J. Hsu to the American Fintech Council Fintech Policy Summit 2021, pp. 3-4 & 11-13 (Nov. 3, 2021) (available at: <https://occ.gov/news-issuances/speeches/2021/pub-speech-2021-115.pdf>).

transactions that exceed the amount of funds in the account at the issuer associated with the debit card?

A1. No. An issuer “holds the account that is debited” only if the issuer holds, in an account at the issuer associated with the debit card, all of the cardholder funds accessible through electronic debit transactions that may be initiated using the card pursuant to the terms of the cardholder agreement. An issuer only holds cardholder funds accessible through electronic debit transactions if those funds are held in an account at the issuer, reflected on the books of the issuer as a liability to the cardholder, at the time the transactions are authorized. An issuer may still hold the account that is debited where the issuer authorizes electronic debit transactions in excess of the available balance in an account pursuant to a discretionary overdraft service involving an incidental extension of credit by the issuer.

Q2. Can an issuer that does not qualify for the small issuer exemption with respect to one card program still qualify for the exemption with respect to a different card program?

A1. Yes. An issuer that does not qualify for the small issuer exemption with respect to one card program may still qualify for the exemption under a different card program. The small issuer exemption is available if the issuer holds the account that is debited and the issuer, together with its affiliates, has assets of less than \$10 billion as of the end of the calendar year preceding the date of the electronic debit transaction. If an issuer that satisfies the asset size requirement of the small issuer exemption operates two debit card programs, one in which the issuer holds the account debited for electronic debit transactions and one in which the issuer does not hold the account debited, the issuer is eligible for the small issuer exemption with respect to the first program but not for the second.

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Fintech companies that evade the interchange fee limitations of the Electronic Fund Transfer Act and Regulation II through misuse of the small issuer exemption unfairly harm consumers and small businesses and disadvantage both large and small financial institutions that offer debit cards in compliance with the requirements of Regulation II. Meanwhile, a very limited number of small issuers participate in the types of fintech issuing programs that would be affected by the Board’s enforcement of the account holder requirement. For these reasons, The Clearing House respectfully requests that the Board clarify Regulation II by adopting the foregoing FAQs.



Thank you for your consideration and review. If you have any questions or wish to discuss the comments of The Clearing House, please do not hesitate to contact us.

Respectfully submitted,

/s/

Robert C. Hunter

Deputy General Counsel and Director of Regulatory and Legislative Affairs

The Clearing House Association L.L.C.

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