Deceptive Trade Practices & Card Payment Networks

RESTRAINT OF TRADE, DISINFORMATION & INTERCHANGE THEFT

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Deceptive Trade Practices, Restraint of Trade, Disinformation and Interchange Theft

The debit card space is becoming very competitive. Every vendor is scrambling to grab market share and what The Copper River Group has observed by some of these vendors is becoming alarming.

Furthermore, the National Industry Associations have abandoned their ethics and failed to take action in fear of pressure from the perpetrating vendors and a potential loss of income they might experience by virtue of their inquiry. Of course, there is a profit motive here, so perhaps next steps are to ask the Federal Reserve, the NCUA, the Federal Trade Commission and the Department of Justice to investigate these practices.

At Risk Financial Institutions (Card Present PINLess Debit Transactions)

Community Financial Institutions (Exempt Institutions as defined by Regulation II) are very much like the small businesses in our communities. Banks and Credit Unions both struggle to compete and are being targeted by Big Box retailers and Card Payment Networks who have misused Regulation II to their disadvantage. Card Payment Networks negotiate directly with these retailers for special deals while at the same rewriting their network operating rules that increase fees and fraud risk, reduce income and direct transactions their merchant network. Small businesses are impacted and have limited options.

Community financial institutions are constantly asking why interchange income is decreasing even when their debit card volume is increasing. It just does not make sense. Frustrated, FI's reach out to their card payment network and they are told they have nothing to do with it. This is not truthful, but it is a sign that some card payment networks will do anything to get you to believe that. It gets worse. Card Payment Networks blame the Durbin Amendment and Regulation II that provide a merchant the ability to make a choice of how to route your transaction.

Sorry to break the news, but this is not the whole story. It is just ridiculous what is going on and to the degree community financial institutions are being treated. It is clearly wrong, and something needs to be done about it. There is a deception here and pertains to Card Present PINless Debit transactions that issuers have no control over and how the card payment network defines them.

Card-Present Point of Sale (PINLess Debit Transactions)

The culprit and large reason why interchange income is plummeting can be attributed to PINless Debit transactions and Card Payment Network Operating Rules. Card payment networks are where it all starts, and it pertains to the strategy of having the merchant choose and settle the transaction through their network. I call this double dip rip!

It should be pointed out that interchange is paid one of two ways. For Card Present Pinned and Card Present PINLess transactions it is a set fee by the type of transaction. For charge type transactions (signature debit) it is based on the percentage of the amount of purchase. This article will only discuss Card Present Pinned and Card Present PINLess transactions.

Here's the catch. Interchange paid on this type of transaction (by the merchant) is in some cases half of a pinned transaction even before the switch fees and other charges that even further reduce your net interchange per transaction. Merchants love this, issuers don't.

When the financial institution questions the card payment network about the transaction, the customer service representative informs the financial institution that the Card PINLess debit is a requirement to comply with Regulation II and the Durbin Amendment. This is a deceptive and untrue statement. Furthermore, some card payment networks even include a Regulation II compliance reference in their processing agreements further coercing community FI's to buckle under the pressure.

A deceptive trade practice is providing information or directing an individual/entity to make a decision. In some cases, this forces the inquirer to accept an outcome that they would not rationally make otherwise. The bottom line, if all the facts were publicly published, issuers would not agree to Card Present PINLess debit transactions. However, Network Operating Rules require banks and credit unions to comply with offering a Card Present and Card Not Present PINLess Debit option. These are one in the same transaction from the perspective of the Card Payment Network.

The Durbin Amendment, and Regulation II have nothing to do with Card Present PINLess Debit or authorizing the circumventing of EMV chip security by not entering the PIN and increasing debit card fraud. Fraud increases because issuers are unable to chargeback transactions. In addition, Regulation II does not mandate Card Present PINLess Debit and if a card payment network asserts that they do, they are misrepresenting the facts in a deceptive manner. NOT GOOD! Durbin never intended to eliminate the use of a PIN. Card Payment Networks, in order to provide an option to retailers, created the Card Not Present PINLess Debit rule while including Card Present in that definition. This then eliminates the requirement to enter the PIN when the card was present. Again, this was never the intention of Durbin or Regulation II.

How would most community financial institutions know? Debit card portfolio management is complex and requires significant knowledge. Most community financial institutions have a hard time recruiting and retaining customer service staff let alone an individual with this knowledge. So, FI's rely on card payment network vendors to assist, and the vendor knows that. Now, banks and credit unions are being exploited by a vendor they are supposed to trust.

Section 920 and Regulation II

To comply with the rule, an issuer must enable at least two unaffiliated payment card networks on each debit card. To process transactions over at least two unaffiliated payment card networks the plastic cards and the other payment codes or devices (such as card number or a key fob) that are issued and approved for use through a payment card network to debit an account must be enabled.

It is all about choice and *two unaffiliated networks* for the merchant to select from. That is all. Card Present PINLess debit has nothing to do with it.

Linkage

Card Payment Networks have added linkage to the Network Operating Rules, preventing institutions from aggressively managing their debit card portfolios in a cost-effective manner. Example: Assume a bank or credit union does not like the Surcharge Free Network their current Card Payment Network offers. The FI decides they want to join a separate network. Why? It is cost effective, it fits a customer demographic, and is available where it's customers shop. Right after notifying said current card payment network about joining, the network informs the community financial institution of the Network Operating Rule stating if they join one surcharge network, they also have to join the network they did not want to join in the first place and a fee is associated in doing so.

This can be construed as Restraint of Trade because it increases costs, reduces profitability and limits what the FI can do.

Interchange

It's not getting any better, but some Card Payment Networks have expanded the Network Operating Rules definition of Card Present PINLess debit by raising the upper limit of PINLess POS debit transactions to $100.00. Think about how high the percentage of debit card transactions fall below $100.00. This is why interchange has dropped like a lead balloon!

Furthermore, other Networks have expanded the definition of POS of how they will route transactions, and that now banks and credit unions must comply with Network and the Network Operating Rules they never intended to join.

These practices are out of control and consequently adversely impacting community banks and credit unions. Millions of interchange dollars annually are lost. At the same time, covered financial institutions under Regulation II are earning twice as much interchange per average debit card pinned transaction. The exact opposite of what Durbin intended to achieve. These rules changes are nothing short of theft.

National Associations

Where are the advocates that are supposedly watching out for community FIs? They scream regulatory burden in a battle they will never win. At the same time their pockets are padded when it comes to vendor relationships, sponsorship fees, and their for-profit interests in the payments space at the community bank's expense.

Hamilton was a Banker!

Read the network operating rules. Tell the vendors that enough is enough. The only thing that is going to gain their attention is if banks and credit unions start walking away to a competitor that is issuer friendly.

Next, FI's are going to need to create an advocacy group. All banks and credit unions at one time had a profitable EFT Debit Card portfolio. That is not necessarily the case today. Some have started paying vendors each month on their EFT invoices instead of receiving a net credit. Soon, all will have lost interchange income profitability.

Our suggestion is that you rise-up and call it out! Call state associations, file complaints with the FTC and DOJ, then send a copy to the Federal Reserve Board of Governors and ask them to take a hard look at these practices.

Durbin Was Very Clear (i.e. Regulation II)

The intent of the two unaffiliated POS networks being available was to provide small businesses a least cost option. Furthermore, the purpose of Exempt versus Covered institutions was to preserve the income for community banks and credit unions (i.e. Covered institutions). Both of these objectives are being successfully circumvented by card payment networks, ginormous merchant networks, and sweetheart preferential deals with big box stores with card payment networks.

Level the Playing Field (First Step)

Discover, Mastercard, and VISA all publicly publish their rules. The first step is to have all card payment networks including surcharge free networks publicly publish their network operating rules and charge back rules. It is important for everyone to know how the back room is working. If the card payment networks are doing nothing wrong or deceptive, then they should have no reason to withhold this information. After all, Discover, Mastercard and Visa do not hide behind their rules, neither should they. Make the rules and charge rules public so everyone can get to know what the vendors don't want you to know.

The Copper River Group also suggests that the Fed expand their Debit Card study Interchange report to include Net-Interchange. The Fed should also focus on Card Present PINless debit transactions and exempt financial institutions. Require that interchange be reported not just by exempt and covered institutions but also by Pinned transactions and Card Present PINLess transactions. TCRG also suggests requesting that Card Present PINLess fraudulent debit card transactions be reported to the industry. You will be surprised what is revealed.

TCRG's expectation is that:

1. Community Financial Institutions and Small Businesses together are being targeted
2. Relative to a percentage of transactions, community financial institutions carry the burden of Card Present PINLess Debit transactions
3. Card Present PINLess Debit Fraud in the community financial institution space is growing

Institutions have a right to run their debit card portfolios in the best interests of their customers and members, not the vendor. The card network operating rules are deliberately written with the objective of preventing the issuer from managing their debit card portfolio to their benefit. Formerly the intent of networks rules pertained to interoperability and standards, but today they are used to control transaction profits and divert them away from the issuer and to the vendor.

Community Financial institutions should not be forced, compelled or coerced in allowing the PIN to be deliberately circumvented by the vendor for the sole purpose of benefiting the vendor card payment network and the merchants they serve. A vendor's PINless Debit strategy does not lower an institutions costs, it increases them.

Community Financial Institutions should have the ability to opt-out of a product that is not in its best interest, and/or leave the vendor without penalty. They should not have to join any network (coerced via network operating rule) they do not want to. TCRG are not attorneys, but it doesn't take an attorney to figure out when something is wrong. If enough of FI's act, there will be change.

Every community financial institution is complaining about interchange income but waiting for somebody else to do something about it. Obviously, some vendors enjoy that fact that nothing is being done. Afterall, it is the bank and credit union's income in their pocket.

References:
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