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September 29, 2011

Delivered Via Email: regs.comments@federalreserve.gov

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

RE: Proposed Rule on Debit Card Interchange Fees and Routing, Regulation II; Docket No R-1404; RIN No 7100-AD63

Dear Ms. Johnson:

Preamble

We have no objection to the proposed non-prescriptive approach that establishes a general standard an issuer must meet in order to be eligible to receive an adjustment for fraud prevention costs. We ask that the Board's standard remains as non-prescriptive as possible to allow issuers to innovate and respond effectively to new, unforeseen methods of fraud perpetration. We believe a prescriptive approach would actually impede our ability to mitigate fraud. We would not be able to keep pace with criminal innovation. Furthermore, our volume limits the amount of investment we can make, and gives clear advantage to the big national issuers who will enjoy a larger total adjustment because of scale. The latitude to fight fraud using the tools of our own choosing will help us partially offset the remuneration advantage enjoyed by our larger competitors.

Who We Are

Commerce Bancshares, Inc. ("CBI") is a regional bank holding company with one bank subsidiary, Commerce Bank, N.A. ("Commerce"), and total assets of $18.5 billion at December 31, 2010. Commerce is a full-service bank, with approximately 370 banking locations in Missouri, Illinois, Kansas, Oklahoma, and. A full line of banking services, including investment management and securities brokerage, is offered. CBI also has operating subsidiaries involved in mortgage banking, credit related insurance, and private equity activities.

Commerce is one of the smaller debit card issuers included under the debit interchange provisions of the Durbin Amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). We are a highly regarded regional banking institution located in the Midwest, recognized for the safety, soundness and service we deliver to our community and customers. We believe that as one of the smallest issuers, we will be relegated to the worst possible competitive position under the proposed rules. We will be challenged to compete against banks that are exempt from regulation, and we will not be able to leverage volume discounts and economies of scale enjoyed by the big national issuers.

We appreciate this opportunity to comment on the interim final rule proposed by the Board regarding the fraud prevention adjustment, as published in the Federal Register on July 20, 2011.

Unintended Consequences

We fear that the Board's final rule on the fraud prevention adjustment could produce the following unintended consequences:

1. Big national issuers will be able to afford investment in expensive, sophisticated fraud prevention technology, leaving smaller issuers vulnerable to attack and subject to disproportionate fraud loss.
2. General standards that are too specific or unreasonable will not give issuers the adequate flexibility to respond to new forms of fraud, resulting in an increased number of legitimate authorizations being declined or increased fraud loss.

Our Comments in Response to the Board's Requests

§235.4 Fraud-prevention adjustment

We urge the Board to add the qualifier "reasonable" to all standards which an issuer must meet in order to receive the additional amount for fraud prevention costs.

As currently written, an issuer must develop and implement policies and procedures *reasonably designed* to:

- Identify and prevent fraudulent transactions;
- Monitor the incidence of reimbursements and losses;
- Respond appropriately to suspicious electronic debit transactions to limit losses and prevent future fraudulent transactions; and
- Secure debit card and cardholder data

Policies and procedures can be reasonably designed, but people may have different opinions regarding the meaning of each standard and how to measure the effectiveness of a policy or procedure. While the Board notes that "the Board does not believe that Section 920(a)(5) [of the Electronic Funds Transfer Act] requires that the program prevent all fraud in order for an issuer to qualify for the fraud-prevention adjustment" (p. 43484), people may differ in what they think constitutes an acceptable level of fraud.

What is an appropriate response to a suspicious electronic debit transaction? That standard is also subject to differing opinions. For example, some years ago Commerce and many other issuers were affected by a very large data security breach resulting from a cyber-attack on a large retailer. A large number of issuers re-issued debit cards to their entire portfolios. Commerce did not. We monitored the situation to determine patterns, placing certain accounts in queues and when the fraud loss reached a certain level in a queue, we re-issued those accounts. We know that re-issuance is a serious inconvenience to our customers and while we endeavored to protect ourselves and our customers from losses, we felt we had to balance that with maintaining a positive customer experience. As a result, we only re-issued 90,000 out of a total of approximately 500,000 accounts. Did we respond appropriately? We believe that we did and our fraud-related expenses, including losses, would appear to support that conclusion, but reasonable people could differ.

Using fraud loss at a point in time as a measure of effectiveness is also problematic. It is possible to use every method available to prevent fraud, but still experience high fraud loss in a year when a retailer data breach or some other extraordinary fraud event occurs.

We suggest that the Board clarify that while policies and procedures must be reasonably designed, the standards also must be applied in a manner that is reasonable, taking into account all the facts and circumstances of each situation. We think that issuers should be presumed to be acting reasonably unless proven otherwise since it is clearly in their best interest to minimize fraud losses while maximizing customers' satisfaction with their cards.

A Non-Prescriptive Approach to the Fraud-Prevention Adjustment

We agree that, for all the reasons the Board describes in the Section Analysis, a non-prescriptive approach to the fraud-prevention adjustment is much better than a technology-specific one.

Defining "Fraud" and "Fraudulent Electronic Debit Transaction"

We believe that the terms "fraud" and/or "fraudulent electronic debit transaction" should not be defined. However broadly the Board defines those terms today that definition may not be satisfactory tomorrow. Both the nature of fraud and the technology used to perpetrate and also fight it will change constantly. We need the latitude to evolve with the criminals that threaten the payment system. That includes the ability to define fraudulent activity.

Rewards Programs

As a result of the new interchange rules, issuers no longer have any financial incentive to promote rewards programs. In the past, issuers earned more interchange fee income if a merchant accepted signature transactions rather than PIN transactions. Issuers had a financial incentive to offer a rewards program when merchants accepted signature transactions. The new rules require interchange parity between signature and PIN transactions. Therefore, requiring an issuer to assess whether its customer rewards or similar program provide inappropriate incentives to use an authentication method that is demonstrably less effective in preventing fraud is a meaningless exercise.

Certification Program and Reporting Period

We suggest that the Board require reporting from those issuers that have greater fraud losses. For example, if an issuer keeps fraud losses to 5 basis points (.05%) of sales, then it should be required to merely certify to the payment network. When fraud losses increase, further scrutiny is warranted, even if the review ultimately shows that the fraud-prevention program implemented by that issuer meets all the required standards.

Accuracy of the Board's Estimate of the Burden on Issuers to Comply

It is difficult to ascertain whether the Board's estimate of 40 hours to review an issuer's policies and procedures is adequate. If the standard is more specific than expected, either initially or over time, the burden to comply will also increase. At this point in time, we do not have a basis for comparison of our policies and procedures with other issuers. We can assume that we utilize similar tools and procedures because we maintain low fraud losses, but we also know that the big national issuers have sophisticated fraud systems that are highly customized and reside in-house vs. technology provided by third party card processors and networks that are accessible to most issuers.

In conclusion, we contend that a non-prescriptive approach to defining and combating fraud is the best approach. Issuers should be allowed to defend their part of the payment system in the way that they consider most effective. The ultimate indicator of an effective fraud prevention strategy is reduced fraud loss and issuers have an incentive to lower that number as much as possible while they minimize inconvenience to their customer base. There may need to be some evaluation of issuers to determine if they are effective in preventing fraud but that evaluation should only take place if their fraud losses exceed 5 bps.

Sincerely,

David W. Kemper
Chairman of the Board, President
and Chief Executive Officer
Commerce Bancshares, Inc.

Carl Bradbury
Director of Consumer Card Products
and Senior Vice President
Commerce Bank