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Submitted via email

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

RE: Regulation II; Docket No. R-1404 and RIN No. 7100 AD63
Debit Card Interchange Fees and Routing

Dear Ms. Johnson:

TSYS understands the Board is faced with a complex and challenging task in developing rules to implement the Electronic Funds Transfer Act ("EFTA") Section 920 as required by the recent Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Section 920 directs the Board to issue regulations relating to debit interchange fees, network exclusivity, and merchant-directed routing of debit transactions. TSYS provides services to many of the impacted constituents in the payments value chain and we hope the Board will find our comments constructive as it works toward issuance of final regulations.

By way of background, under the proposed rules TSYS [NYSE: TSS] would be defined as both a processor and an acquirer. As a processor, we fulfill the role for issuers of credit, debit and prepaid cards and also for merchant acquirers who enable merchants to accept credit, debit and prepaid cards. As a merchant acquirer, we contract directly with merchants to provide them with services enabling them to accept credit, debit and prepaid cards as a form of payment.

The majority of TSYS' revenues come from providing credit card processing services for issuers. While TSYS' revenues from debit card issuer processing are relatively modest, TSYS does business with firms representing a sizeable portion of the debit card issuing market as many of these firms are also credit card and debit card issuers.

From an acquiring perspective, roughly 25% of our revenues come from the merchant business, where we provide acquiring services for merchants and processing services for merchant acquirers. More than half the merchant transactions we process annually are debit transactions.

Our customers include financial institutions, small community banks and credit unions, national retail chains, small mom and pop merchants, internet retailers, nationally-recognized general-use prepaid card firms, healthcare payment card program managers, payment card networks, and other processors.

TSYS appreciates the opportunity to provide the Board with comments to the EFTA Section 920 proposed rules. Comments are organized into the following five areas: (A) Strategic Comments on Proposed Interchange Fee Standards, (B) Operational/Tactical Comments on Proposed Interchange Fee Standards, (C) Proposed Network Exclusivity and Routing Rules, (D) Proposed Definitions, and (E) Comments Regarding General Implementation Considerations.

To assist the Board in their review, Appendix A contains a brief summary of our recommendations, which are discussed in more detail in the main body of this letter.

A) Strategic Comments on Proposed Interchange Fee Standards

Throughout this letter, TSYS provides comments specifically responding to questions posed by the Board in the December 16, 2010 'Notice of Proposed Rulemaking'. However, in this section TSYS will provide general, high-level comments to the proposed rules.

The legislation containing Section 920 was passed with very limited debate on the Senate floor and no debate on the House floor. As a result, the Board is faced with the added challenge of developing rules to implement an act where divining Congressional intent is especially challenging.

However, two themes emerge from the limited record:

- It appears Congress intended to protect consumers and small businesses
- It appears Congress did not intend for the Federal Reserve to set interchange *prices*

A review of statements by the original sponsor of the amendment, which resulted in Section 920, Senator and Assistant Senate Majority Leader Dick Durbin (D-IL), indicates that Congress intended to help consumers and small businesses. Statements by other leading Senators and members of Congress, including Senator McCaskill (D-MO), Senator Mark Warner (D-VA), Congressman Barney Frank (D-MA) and others, support this view.

Statements presently available on Senator Durbin's official website indicate the legislation was not intended to result in rules whereby the Board established a specific price-cap for interchange fees (refer to attachment 1 to Appendix B for the full-text of the statements):

> *"Under Sen. Durbin's amendment the Fed would not set interchange prices. Instead the Fed would oversee the debit interchange fees set by card networks to ensure that they are 'reasonable and proportional' to the cost."*

Negative Unintended Consequences for Consumers

Setting an interchange fee rate cap, as proposed by the Board, will likely lead to negative unintended consequences for consumers, which is contrary to Congress' goal. The risk that consumers will be harmed is likely to be significant given the magnitude of change the rate cap introduces. The proposed rate cap represents an almost immediate 73% reduction in interchange fees, resulting in an estimated $11 billion improvement in retailers' margins, at the expense of an $11 billion decline in revenues to financial institutions who issue debit cards. The plan to have this $11 billion change go into effect en masse exacerbates the risk even further.

Financial institutions are likely to raise fees or introduce new fees to consumers; however, it appears unlikely these consumers will receive offsetting benefits through lower prices at the point of sale, as may have been assumed by Congress. It is unclear how, or if, merchants will pass through all, or part, of their savings to consumers, through lower prices, discounts, or neither. The net effect - consumers are likely to be worse off than before.

Negative Unintended Consequences for Merchants

The risk to merchants may be less than the risk to consumers. However, the risk that unintended consequences could ultimately be harmful to some or many merchants is not insignificant given both the magnitude of the proposed change (73% reduction in interchange fees or $11 billion) and the speed by which the Board is proposing the rules take effect. The Board's current approach for an interchange effective date, immediate rather than phased in over a period of time, prevents the market from adjusting in an orderly fashion. That alone may result in unforeseen economic disruption.

Section 920 also provides no guarantee that reductions in debit interchange fees will be passed on to merchants. Many merchants will undoubtedly realize a reduction in the fees they pay for debit card acceptance given that interchange fees represent a large portion of the total debit card acceptance fees paid by merchants. However, based on evidence from other countries, such as Australia, some merchants may not see benefits for several years. Merchants that receive an immediate reduction in their Interchange fees will therefore gain a government-directed cost advantage over those merchants who are not provided the benefit. In summary, some – or perhaps many – merchants will be harmed as the Board's proposed rules inadvertently place those merchants, potentially smaller merchants, at a disadvantage to other, potentially larger, merchants.

Another possibility is that, faced with a loss of revenues, debit card issuers might materially change the rules by which financial risk is allocated amongst issuers, consumers and merchants. Today, based on current rules and practices, when a consumer pays with a debit card the merchant is guaranteed payment even if the consumer's bank account does not have sufficient funds at the time the transaction is presented to the Issuing bank for settlement. This assumes the merchant has properly authorized the transaction and abided by other pertinent network rules. In this regard, accepting a debit card is very different than accepting a typical check, where the merchant bears the risk that payment could ultimately be denied due to insufficient funds. Today, accepting a debit card is more akin to accepting a "guaranteed" check (*i.e.,* a check accepted by the merchant in conjunction with a check guarantee service). In reaction to the rules proposed by the Board, debit card issuers and payment card networks could change their risk allocation rules. In the future, therefore, risk that a merchant faces when accepting a debit card could become more like risk faced when accepting a check that is not protected by a check guarantee service.

A host of other possible scenarios exist in which some or many merchants could be harmed. In summary, it is by no means assured merchants will be unambiguously better off than before. In fact, it is likely that even if some merchants benefit others will suffer.

<u>What Section 920 Requires and What it Does Not</u>

TSYS understands that regardless of Congressional intent, the Board is obligated to develop and implement rules based on the specific requirements of Section 920. The table below summarizes what is more fully detailed in Appendix B:

The Legislation Does Not	The Legislation Does
Require the Board establish interchange fee rate caps	Require the Board to establish <u>"standards for assessing"</u> whether interchange fees are reasonable and proportional to the [incremental/average variable] cost incurred by the issuer, in order to ensure that such fees are in fact reasonable and proportional to the [incremental/average variable] cost incurred
Mandate that interchange fees cannot exceed an issuer's[incremental/average variable] costs	Require interchange fees be reasonable and proportional to such costs – *which would seem to allow that issuers may be permitted to generate a reasonable return on their costs and investments*
Mandate establishing standards for assessing whether an issuer's *costs* are reasonable	Mandate establishing standards for assessing whether an issuer's <u>fees</u> are reasonable and proportional to the [incremental/average variable] costs incurred
Require such rate caps be established as low as proposed – *in the event* Section 920 were deemed to require establishing rate caps	Require that interchange fees be reasonable and proportional to [incremental/average variable] costs incurred – *which seems to allow that issuers may be permitted to generate a reasonable return on their costs and investment; while also ensuring the reasonableness of debit interchange transaction fees charged to merchants*
Require such rate caps be implemented en masse - *in the event* Section 920 were deemed to require establishing rate caps	Require implementation of new rules by July 21, 2011 – *which allows for the possibility that standards assessing the reasonableness of interchange fees might apply increasingly tighter over a phased-in period; the objective standard for determining the reasonableness of an interchange fee might be quite different on the day the rules take effect as compared to a date, for example, two-years later*

General Recommendations Regarding the Proposed Interchange Fee Standards

Based on the foregoing, TSYS respectfully makes the following recommendations regarding the Board's proposed rules:

1. Instead of establishing price caps - *establish "standards for assessing" whether interchange fees are reasonable and proportional to the average variable cost incurred by the issuer*.

2. When considering whether interchange fees are reasonable - *consider their reasonableness in light of their proportionality to average variable costs*, rather than their proportionality to some other measure of costs.

   Example: If the reasonableness standard for fees in a given industry meant fees should not exceed 20% of total costs nor 300% of average variable costs, then it would be "mixing apples and oranges" to apply the 20%-standard when testing the reasonableness of fees based on their proportionality to average variable costs. In this example, the 300%-standard would be the appropriate model.

3. Rather than mandating the new interchange fee standards take full effect immediately - *consider phasing in the standards over a period of time*. This will provide the Board much needed time for further study and also allow the Board to assess if the new rules regarding network exclusivity and merchant-directed routing are achieving their intent – making the market more competitive and leading to a market-based decrease in interchange fees.

4. After July 21, 2011, *continue to update and amend the rules, as necessary*, to ensure that interchange fees are reasonable and proportional to the costs incurred, recognizing that the standards for what is reasonable are likely to change and evolve over time. It would be prudent to publish a schedule that allows for planning and appropriate implementation.

Many, including a number of Senators and other Members of Congress, are urging the Board to proceed cautiously in order to avoid creating unintended consequences which could harm consumers and small businesses. The Board itself has noted such concerns.

TSYS believes the Board has the required discretion regarding Section 920 to minimize the risk of unintended consequences. TSYS also believes the recommendations above would allow the Board to carry out its obligations under Section 920 in a manner that simultaneously adheres to Congressional intent, minimizes the risk of unintended consequences to consumers and merchants, and ensures the reasonableness of interchange fees paid by merchants, without resorting to government price-setting.

B) Operational/Tactical Comments – Proposed Interchange Fee Standards

The comments outlined in the remainder of this letter are based on the assumption the Board will elect to establish an interchange rate cap and that rate cap will go into effect by July 22, 2011. As noted above, TSYS does not recommend either approach.

§235.3 - Reasonable and Proportional Interchange Transaction Fees

TSYS supports a direction in the final rules that is financially equitable to all parties and encourages value, innovation, and protection for consumers and merchants. With respect to the interchange options outlined in § 235.3, TSYS requests the board consider alternatives that are simplistic and completely avoid an issuer-specific debit interchange rate structure. Sufficient complexity will be introduced as a result of small-issuer, government-program, and prepaid issuer exemptions and the card networks likely exercise of their right to use a combination of ad valorem fees as well as per transaction fees (subject to the proposed per transaction cap).

The proposed rules set forth two alternatives; Alternative 1 – Issuer Specific Cap with Safe Harbor (b-e) and Alternative 2 – Stand-alone Cap, for determining the level of allowable interchange fees. Both alternatives will require processors and acquirers to re-design the current signature and PIN interchange structures to support the additional categories and expand to accommodate the anticipated tiers for exempt issuing institutions. This effort is significant given the compressed timeframe (less than 90 days) for implementation.

Under Alternative 1, §235.3(b), the payment card network could set interchange fees for each issuer at or below the safe harbor or at a level for the issuer that would not exceed the issuer's per-transaction costs, up to the cap. This would allow networks to establish different interchange fees for different types of transactions or types of merchants, as well as different rates for different issuers. TSYS believes the implementation of a complex, issuer-specific, interchange fee model would be operationally difficult and onerous to implement and maintain, introducing systemic and financial risk. Should some form of an issuer-specific option be adopted, TSYS requests specific guidelines that require the issuer to report a consistent cost to all networks resulting in a cap that would apply uniformly across all networks. This clarification will avoid a scenario where each issuer has a unique rate that is also unique by network; further complicating the already massive addition to interchange fee levels.

The way the debit payment systems presently work, there is no "interchange rate" data field that is transmitted along with the other transaction data. Tasking payment networks with the responsibility for identifying the specific interchange rate category at time of a transaction will ensure transactions are properly identified and assigned the proper interchange fee, allowing merchants to potentially realize the full and intended benefit.

TSYS recognizes benefits as well as challenges to adopting a variable Safe Harbor and Interchange Fee Cap by authorization method (i.e., Signature, Pin, and Prepaid). While this structure would introduce further complexity in managing interchange transaction fees for the entire payments sector, adding to the already cumbersome and expensive support structure, it also makes sense to allow fees that are reasonable and proportional relative to the cost, and risk, of the transaction type. While this is a more complex approach, TSYS supports fees by authorization method, whether as a result of actual cost/ interchange fee or risk/risk adjustment, as an overall best practice for compensation.

Of the options presented, Alternative II – Stand-alone cap is more feasible for the market to implement technically and support on-going. However, as stated, significant revisions are needed. TSYS understands the legislation has dictated an effective date of July 22, 2011. We suggest adopting an approach that either (a) allows for an effective date with a secondary mandatory compliance date or (b) phases in changes over time. While market competition and merchant pressure will drive adoption by supporting parties, additional time will allow the market to mitigate risk of negative legal and regulatory ramifications while all parties, at varying levels of sophistication, implement the resulting network requirements. We recommend the mandatory compliance date align with the standard semi-annual payment network update cycle slated for mid-April, 2012.

§235.3(b) suggests the interchange rate effective date will occur on October 1st of each calendar year, as is common with many regulatory changes. This date also aligns with the schedule previously used by the major payment networks. However, several years ago payment networks responded to growing member pressure and revised effective dates into mid-month cycles in order to reduce substantive financial risk during month-end and quarter-end processing. TSYS requests the effective dates for these debit interchange rates also fall at mid-month.

<u>§235.4 – Adjustment for fraud prevention costs</u>

The statute provides that the Board may allow for an adjustment to the interchange fee amount received or charged by an issuer if (1) such adjustment is reasonably necessary to make allowance for costs incurred by the issuer in preventing fraud in relation to the electronic debit card transactions involving the issuer, and (2) the issuer complies with fraud-prevention standards established by the Board.

TSYS supports consideration for fraud costs, including adjustments which take into account differences in costs associated with signature, PIN, and prepaid transactions; that properly compensates for burden, while avoiding unintentional ‘double dipping’, i.e., providing for cost reimbursement in instances where no cost has actually been incurred. The complexity of these fee structures and investment models bear further discovery by the Board to ensure an equitable allocation is achieved.

Technology Specific Approach – TSYS does not believe the Board is best positioned to direct technology. Successful innovation occurs best when flexibility is given to those who understand their niche and needs best. This includes defining which strategies are most effective at the consumer, merchant and product level. Requiring technology specific standards could place an undue cost burden upon issuers, acquirers, their processors and vendor partners, without the proper return on investment as it applies to their specific business model. For certain lines of business, such as prepaid and healthcare, this proposed approach could require significant innovation, including development and costly network certification to support enhanced fraud prevention techniques that may not be optimal. In addition, with ever-changing data security requirements, standards and innovation options require frequent review and implementation oversight, best provided by technology and industry experts rather than the Board.

Non-prescriptive approach – TSYS recommends the non-prescriptive approach as it relates to issuers fraud prevention. Establishing general standards an issuer must meet to receive fraud adjustment eligibility could incent issuers, in conjunction with their service partners, to keep existing fraud detection profiles current and further invest in fraud prevention strategies. This is more likely to be effective when the technology and business roadmaps intersect to deliver definitive results for their specific portfolios. TSYS suggest including in the non-prescriptive guidelines consideration for approaches that offer broader benefits, i.e., point-of-sale prevention vs. post authorization detection. TSYS concurs that issuer fraud losses should not be included.

With either approach, guidance is needed on how the adjustment should be applied to ensure a consistent framework across all networks; i.e., separate fee adjustment or blended into the allowed interchange fee. This will avoid yet another layer of variable complexity. Given that merchant and acquirer billing implications must be understood and appropriate adjustments made TSYS supports implementation that coincides with a standard, semi-annual, payment network update, preferably April, 2012.

§235.5 (a) – Exemption for small issuers

The proposed statute contains exemptions to the applicability of the interchange fee restriction provisions, specifically, to exempt small issuers, government-administered payment programs and certain reloadable prepaid cards. To avoid further burden to the processor/acquirer, TSYS requests the rules provide guidance that requires a common practice for identification of these exempt issuers/cards/transactions. Assigning the responsibility for exempt transaction identification to the issuers or payment networks, at the time of transaction, will ensure exempt transactions are properly identified and consistently receive the proper interchange fee.

TSYS is concerned regarding the negative impacts to issuers who are proposed to be exempt from both the interchange fee cap and the fraud adjustment. While on the surface an exemption seems to provide the exempt institution with the ability to retain interchange fee revenues, the long-term probability is that those fees will decrease over time. Without the benefit of a fraud adjustment, or preservation of an equitable interchange margin, small issuers could find themselves unable to maintain existing levels of fraud prevention or unable to evolve as risk factors change.

Including exempt institutions within the fraud adjustment may create further complexity to the interchange model and is not ideal; however, guidance within the rules regarding protecting this population and the spirit of the exemption is needed.

C) Network Exclusivity and Routing Rules (§235.7(a) – Prohibition on Network Exclusivity)

TSYS supports Alternative A which proposes at least two unaffiliated payment card networks are available per card, over Alternative B which requires at least two unaffiliated payment card networks for each method of authorization (signature and PIN). TSYS concurs with the Board's perspective that implementation of Alternative B would be burdensome to the payments infrastructure and extend across multiple years thereby limiting the value, if any, for all parties and detracting from investment in fraud mitigation and product innovation. Alternative B would also be detrimental to consumers and cause confusion relative to benefits and dispute rules, particularly in the signature arena. Consumers loyal to a specific signature brand will no longer have the option to retain that choice. Issuers may be required to maintain their consumer portfolios compliant with the rules of all signature networks, potentially doubling their compliance costs and significantly expanding consumer program obligations.

The proposed §235.7, contains provisions related to the limitations on payment card restrictions, prohibitions on network exclusivity and the prohibitions on merchant routing restrictions. Standard routing features typically support some level of network acceptance at an acquirer level. However, merchant-level capabilities vary. Migrating from Issuer decisions to merchant-level decisions will require technical updates by processors, gateways, and payment networks. This may require coordination across these multiple parties to implement. Further, routing through multiple payment networks, particularly expanding signature options, may increase downstream support costs, such as customer service expense due to additional agent training, increased volume and extended call duration due to consumer confusion.

We agree that, in practice, transaction-level routing decisions cannot be made at the time of transaction. TSYS supports the proposed comment 7(b)-3 that states it is sufficient for a merchant and acquirer or processor to agree to a pre-determined set of routing choices that apply to all electronic debit transactions processed on behalf of the merchant. Clarification is requested to specify that compliance is achieved at the highest level of the network routing hierarchy. Network routing options that contain more complex logic, such as transaction amount *and* network choice, are not mandated. This does not limit the ability for more sophisticated routing options to surface in the market, but merely clarifies that layered routing options are discretionary and fall outside the regulatory framework.

TSYS concurs that healthcare cards used to access FSA, HRA, HSA and other qualified benefit plans fall within the definition of reloadable general use prepaid cards and, therefore, are excluded from the interchange fee limitations. Further, TSYS supports Senator Dodd's clarification that due to the unique processing requirements and capabilities currently in place for healthcare and employee benefits programs, the prohibition on use of exclusive networks should not apply to these accounts; otherwise healthcare costs overall may rise.

> [footnote: "To Clarify That Exemption Language Applies to Prepaid Cards Used in Connection With FSAs, HSAs, HRAs and Qualified Transportation Accounts and That Prohibition on Exclusive Networks Does Not Apply," Senator Christopher Dodd, July 15, 2010, Congressional Record, Page S 5927]

The proposed dual routing requirement may result in additional costs to develop connections with payment networks not currently supported. Requiring signature as well as PIN for all prepaid cards could result in an increase in fraud risk and/or losses. TSYS anticipates shifts within the transaction mix, etc., will require alterations to fraud detection models. As indicated in the year-end 2009 survey results listed on page 14 of the proposal, only 25% of prepaid cards are enabled for use on both signature and PIN networks and 74% of prepaid cards are enabled for use on signature-only networks. The implementation of this proposal may result in a delayed deployment of new or enhanced fraud and risk controls needed as consumer and merchant behaviors shift. Overall, adoption of the expanded routing option will be substantial both technically and operationally for all participants.

TSYS offers a point of caution that inclusion of alternative payment devices, such as mobile, within the regulation may impede development of these technologies, perhaps to the point of inhibiting market penetration by greatly decreasing the financial viability for innovators and consumers. Given that some technologies offer consumers choice and security this would hinder the exact innovation consumers and merchants desire.

§235.7(a)(3) – Payment Card Network Mergers - In the instances where previously unaffiliated networks become affiliated through merger or acquisition, the Board requests comment on a 90-day window for issuers to select an alternative unaffiliated network, negotiate contracts, connect and achieve operational readiness. Mergers that are not publically communicated in advance will place issuers on the reactive side of the equation. This would also be the case should a network cease business due to bankruptcy, etc. The proposed 90-day window may not be sufficient depending upon the effort required; e.g., signing agreements through an existing gateway or installing connectivity and performing certification activities. Constraints may also exist based upon time of the year, e.g., industry standard technical freeze periods, etc. Given the issuer will have no control of this initial timeline, it is fair to provide an appropriate lead time to allow decisions that limit risk and optimize business opportunity. TSYS suggests a six month timeframe for new issuance and that existing cards comply upon expiration date or within 24 months, whichever comes first. This preserves the spirit of the regulation while avoiding incremental re-issue cost and consumer impact.

D) <u>Proposed Definitions (§235.2 – Definitions)</u>

TSYS respectfully submits comments regarding certain definitions as proposed:

<u>§235.2(f) – Debit Card</u>

§235.2(f) 2-3: TSYS requests the Board support and clarify that the term 'Debit Card' does not include credit cards enabled with consumer-selected payment preference functionality and products containing these features fall outside the scope of the proposed interchange fee restrictions. A payment preference function, as used in the context of paying credit card transactions, is simply another funds transfer option the consumer may use to pay down the balance on their account. Consequently, the Board should explicitly declare that a credit card using this functionality does not become a "debit card" for the purpose of this proposal.

Products with these features are designed to provide consumers holding credit card accounts with options that provide flexibility regarding how and when to make payments on their account. Such products do not obligate the consumer to make payments electronically in lieu of other means (i.e., by mailing in a paper check), nor do they mandate the consumer utilize the consumer selected payment preference options. The issuer's extension of an offer to allow the consumer to open a credit card account enabled with such features is also not conditioned upon the consumer's agreement to utilize this functionality. Such products do not require the consumer to establish repayment of their account balance by preauthorized electronic fund transfers, though they do allow the consumer the option of setting up a preauthorized payment plan.

Given the foregoing, final rules should also clarify that when a consumer elects to utilize consumer-selected payment preference functionality, it does not create conditions that lead to circumvention of the spirit of either Section 920 or the rules proposed by the Board.

TSYS provides the Board a more comprehensive outline of Consumer Selected Payment Functions and our position in Appendix C

§235.2(i) – General Use Prepaid Cards

TSYS suggests non-network branded *Selective Authorization Programs* be exempted from inclusion in the proposed rule. Their exemption allows a product to sustain and ultimately continue to benefit consumers and merchants by providing additional redemption choices.

§235.2(m) – Payment Card Network

Section 920(c)(11) of the EFTA defines a payment card network as an entity that (a) directly or indirectly "provides the *proprietary* services, infrastructure, and software that route information and data to conduct debit card or credit card transaction authorization, clearance, and settlement, and that" (b) "a person uses in order to accept as a form of payment a *brand* of debit card, credit card, or other device that may be used to carry out debit or credit transactions." Within §235.2(m) of the proposed rules, the Board defined a payment card network as an entity that "directly or indirectly provides the services, infrastructure, and software for authorization, clearance, and settlement of electronic debit transactions; and establishes the standards, rules, or procedures that govern the rights and obligations of issuers and acquirers involved in processing electronic debit transactions through the network."

TSYS believes the Board's proposal is an accurate definition of payment card network and is consistent with the definition proposed in Section 920. TSYS further agrees with the clarification in the Board's commentary that acquirers, issuers, third-party processors, and payment gateways are generally not considered to be card payment gateways as those firms do not establish rules, or procedures that govern the rights and obligations of issuers and acquirers involved in processing an electronic debit transaction through the network. As an example, the Board notes that an acquirer is not considered to be a payment card network because the standards, rules, or guidelines do not apply to card issuers.

TSYS encourages the Board to consider incorporating into the final definitions the concept that payment card networks provide "proprietary" services to enable acceptance of one or more specific "brands." In its commentary, the Board notes that the term payment card network includes entities that operate a three-party system, to the extent that such entities' guidelines, rules, or procedures also cover their activities in their role as an issuer, an acquirer, or both. The Board also notes that transactions involving so-called non-traditional or emerging payment systems would be covered under its proposed definition.

Distinguishing between a traditional payment system and an emerging, or non-traditional, system is difficult. For example, Discover processes nearly $100 billion in annual Discover-branded credit card sales volume; while by 2013 as PayPal's success continues, they expect to process more than $125 billion in PayPal-branded sales volume from merchants (i.e., excluding eBay transactions), up from $56 million in 2010. It is likely that by 2013, PayPal's merchant sales volume will be greater than that of the Discover Card. This raises several questions: "At what point does an emerging or non-traditional payment system become a traditional payment system?" and "If PayPal is a traditional payment system, would it be fair and reasonable to define Google Checkout as an emerging payment system, if by doing so Google Checkout was provided an advantage over PayPal?"

The Board had requested comments on whether non-traditional or emerging payment systems would be covered by the statutory definition of payment card network in Section 920 and on all aspects of applying the proposed rules to three-party payment systems given that the proposed definition of payment card networks includes such systems. TSYS comments are provided below.

Non-Traditional and Emerging Payment Systems

TSYS believes that Section 920's statutory definition of payment card network does include non-traditional and emerging payment networks to the extent such networks align with the definition noted above. Given debit cards are defined to include debit accounts where the form factor need not be a physical card, but instead could be an account number, an NFC-chip embedded in a device, or some other form factor, and given that decoupled and deferred debit cards and transactions are deemed to be debit cards and transactions, then entities operating an emerging payment system would be deemed to be playing the role of payment card network if:

- These entities directly or indirectly provide proprietary services that route information in order to conduct debit or credit card transaction authorization, clearing and settlement
- Persons, i.e., merchants, use those entities services in order to accept, as a form of payment, a brand of debit card or credit card

In the commentary, the Board cites several examples of non-traditional or emerging payment forms. As one example, the Board noted consumers may use their mobile phone to send payments to third parties to purchase goods or services and have that payment amount billed to their mobile phone account or debited directly from their bank account. Secondly, the Board cited an example where consumers may use a third party payment services provider, such as PayPal, to pay for Internet purchases, using the consumer's funds that may be held by that service provider or in a consumer's account held at a different financial institution (i.e., decoupled debit or credit).

TSYS agrees with the Board's analysis that, in both examples, the system or network used to send the payment provides the "proprietary services, infrastructure, and software for authorization, clearance, and settlement of electronic debit transactions." Furthermore, in both examples, the merchant or selling party is using the system or network to accept as a form of payment a “brand” of debit or credit card.

TSYS believes the Board has correctly interpreted the definition of payment card network as written in Section 920, and that non-traditional and emerging payment systems fall within the proposed definitions. Some of the emerging and non-traditional systems employ a four-party model, others employ a three party model, and still others employ both.

Three-Party Systems

The Board requested comment on the appropriate application of the interchange fee standards to electronic debit transactions carried over three-party systems (e.g., Discover, American Express, PayPal, Google Checkout, etc.) where the payment card network serves not only as the network, but also as the issuer, acquirer, or both.

Under a four-party model, interchange fees can be easily identified because they are explicitly established by the payment card network. Merchant acquirers pay interchange fees to the payment card networks, which then pass those fees on to issuers. Large merchants typically pay acquirers processing fees that separately identify the interchange fees (i.e., unbundled discount and interchange fees). Many small merchants typically pay acquirers a bundled processing fee which implicitly includes the cost an acquirer pays for interchange (i.e., bundled discount). When an acquirer charges bundled discount fees to a merchant, the merchant is not explicitly paying the interchange fee; instead the interchange fee is simply an expense item which the merchant acquirer incurs.

Under a three-party model, where the payment card network is the acquirer and issuer, merchants typically pay on a bundled discount basis, meaning there is no explicit interchange fee. In this regard, fees charged to merchants within a three-party model are analogous to bundled discount fees charged to merchants under a four-party model.

As the Board noted under Section 920 and within the Board’s proposed rules, the portion of the fee charged by the payment card network/acquirer to compensate the network for its role as an issuer would be deemed to be an interchange transaction fee. As the Board also noted, a payment card network employing a three-party model could avoid interchange fee regulation if the network were to apportion the entire amount of the merchant discount fees to its role as a network and acquirer. Given this challenge, the Board requested comment on an appropriate way to treat three-party networks and specific clarifications with respect to such fees that should be included within the final regulation.

TSYS does not believe there is an easy answer to this challenge. Should the Board elect to move forward with an interchange rate cap, one recommendation is as follows: Prior to establishing the specific amount of the rate cap, the Board should research the degree in which merchant discount fees (i.e., total fees charged, inclusive of explicit or implicit interchange fees) vary based on whether the accepted payment form is offered under a three-party model or a four-party model. If the Board were to conclude that the total average per transaction fees paid by merchants under a three-party model were substantially similar in amount to the total average per transaction fees paid when accepting a payment form under a four-party model, then the Board might deem three-party models to be in compliance.

If the Board had not proposed a rate cap, or if the proposed rate cap did not represent a material (i.e., 73%) reduction in current interchange rates, then determining a means for applying the interchange fee proposals to the three-party model would be of lesser importance. However, if a means cannot be found to apply the rules to three-party models, a possible market response could be that payment card networks seek to horizontally integrate and transform themselves from four-party models to three-party models.

Additional Definition – Network Routing

TSYS suggests including a definition for the 'Network Routing' function to ensure consistent interpretation of this role. The following language is proposed: "Network Routing" is "*the act of routing a transaction from point of sale to point of authorization; and does not include settlement functions or dispute handling unless the network router is also the merchant-chosen network for that transaction.*" This will clarify the Network Routing role where the merchant chosen network is not directly connected, therefore a routing/gateway service is used. The Board may also wish to clarify the rules regarding network exclusivity and merchant-directed routing serve to bind the roles of issuer and payment card network, but that, in accordance with Section 920, these rules are not applicable to the roles of merchant acquirer, 3rd party processor for merchant acquirer, or payment gateway ("merchant provider roles"). These rules would apply only indirectly to the merchant provider roles in the event a payment card network were to issue network rules which had the effect of binding the merchant provider roles.

Scope of Rule

Regarding scope of rule, TSYS has further comment that ATM transactions and ATM networks should not be included in the scope of this proposal. The ATM model does not hold the same opportunity for consumer benefit and does not have a 'merchant' as defined in the proposal.

E) Comments Regarding General Implementation Considerations

Given the highly complex systems and diverse product lines that support the payments eco-system, it is imperative that an adequate implementation timeline is provided that allows adherence to methodologies that reduce risk and preserve quality.

Payment Networks will likely publish their own rules within the required July 21, 2011 timeframe for interchange. However, this will not provide sufficient time for the payments community to analyze, develop, test, and implement prior to the July effective date, placing key players in the payments value chain out of compliance while creating financial, regulatory, and legal risk for the industry. Implementing these changes in a highly compressed timeframe will require large investments of capital and human resources. This may negatively impact market expansion during a still fragile economic recovery period, risking benefit to the very population the rules are set to benefit, consumers and merchants.

TSYS again stresses, if legislative latitude permits, the Board designate the fee update to be in effect mid-April, 2012. This falls in line with the already anticipated payment network updates that occur each April and October. This timeframe will be least disruptive to existing work queues and present the least risk to a successful end result for all parties.

Finally, TSYS requests regulator guidelines that acknowledge proper good faith execution of the final rules. Even within the existing complex interchange framework and the assignment of rates to billions of transactions, errors may periodically occur. In today's environment, players resolve issues together in good faith. Payment networks address issues of non-compliance and gross negligence via their operating rules, following an appropriate period to cure. TSYS would encourage language within the final rules that supports good faith reconciliation and does not immediately put any player into an overtly vulnerable position.

Thank you for the time and attention devoted to fully considering our commentary. Should you have any questions or desire additional or more detailed information, we welcome the opportunity for further discussion.

Sincerely,

Victoria Strayer
Senior Director
TSYS Enterprise Business Compliance

Appendix A

Summary of TSYS Recommendations

Summary of Recommendations Re: §235.3 (Reasonable and Proportional Interchange Transaction Fees)

Based on the foregoing, TSYS respectfully submits the following summarized recommendations regarding the Board's proposed rules:

1. As more fully detailed in Section A of this letter, TSYS recommends the Board not implement a specific rate cap on interchange fees, but instead establish "standards for assessing" whether interchange fees are reasonable and proportional to the average variable cost incurred by the issuer.

2. Notwithstanding TSYS' recommendation to not implement a specific rate cap , if the Board does elect to implement a specific rate cap, consider implementing a rate cap which:

   a. Is initially established at a rate that is substantially higher than the proposed $0.12 rate cap, while implement an arrangement that is fair and reasonable for all parties, including merchants, consumers, and financial institutions.

   b. Establishes a rate for dual message (e.g., signature) debit transactions and a separate rate for single message (e.g., PIN) debit transactions, recognizing the underlying costs and risks are different, and the current fees for single message (e.g., PIN) debit transactions are significantly lower than the current fees for dual message (e.g., Signature) debit transactions.

   c. Is based on Alternative II (a general rate cap applicable to all issuers), employing a network-average test. Under a network-average test, compliance would be tested based on the average rate for any given card payment network's debit transactions, which would allow some debit transactions to have a fee greater than the cap, so long as the network-average were not greater than the cap. This would allow the interchange fees for more costly transactions (i.e., transactions from high-risk merchant categories, etc.) to be priced at a rate which takes into account the higher costs.

   d. Is phased in over a time-period, perhaps in multiple steps (i.e., from the current rate to a cap of X by date X, followed by a cap of Y at date Y, etc.). This would allow the market to transition in an orderly fashion, giving the Board time to continue researching and evaluating the impact the rules are having in the market and to proactively and/or minimize unintended and unforeseen consequences.

e. Allows issuers to generate a reasonable return on their allowable average variable costs, with one test being, “Is the fee reasonable relative to average variable costs incurred, based on several factors including a benchmarking against the ratios (i.e., measures of proportionality) of fees and average variable costs in other relevant industries or product lines?”

f. Takes into account the fact that, from a merchant’s point-of-view, accepting a debit card is more akin to accepting a check which is protected by a check guarantee service, and is very different than accepting a check not protected by a guarantee service – recognizing the fees a merchant pays for a check guarantee service are higher than fees a merchant pays to accept a check that is not backed by such a service.

g. Does not provide a disadvantage to four-party payment card networks (e.g., Visa, MasterCard, Star, NYCE, etc.) relative to three-party payment card networks (e.g., Discover, Amex, PayPal, Google Checkout, Tempo, etc.). Note: Some firms use a four-party model in parts of their business and a three-party model in other parts of their business.

3. Establish mid-April 2012 as the initial mandatory compliance date (i.e., the date by which all parties must be in compliance), which would align the mandatory compliance date with the standard semi-annual payment network update cycle slated for mid-April, 2012.

4. Establish any future effective dates (including revisions to interchange regulations as well as other revisions) to occur in the middle of a month rather than on the first of a month.

5. Where feasible, adopt an approach that allows a primary effective date and a secondary mandatory compliance date for all components.

6. In the event Alternative I is adopted, avoid issuing guidelines whereby each unique combination of issuer and network could result in having its own unique set of interchange rates, as this would only serve to increase the number and complexity of interchange rates exponentially.

7. Require issuers to calculate and report a consistent cost across networks that would cap uniformly across networks in order to avoid issuer-specific and network-specific rates.

8. Establish rules that task the payment networks with the responsibility for identifying the specific interchange rate category at time of a transaction, to help ensure transactions are properly identified and assigned the proper interchange fee, allowing merchants to potentially realize the full and intended benefit.

Summary of Other Recommendations

1. §235.4 – Adjustment for Fraud Prevention Costs – Implement a non-prescriptive approach rather than a technology-specific approach. Provide guidance on the application of the fraud adjustment fee and make the adjustment effective no sooner than mid-April 2012.

2. §235.5(a) – Exemption for Small Issuers – Provide guidance for on-going identification of exempt institutions and consideration for protection of the exempt issuers to ensure they are not disadvantaged as a result of decreasing interchange and/or margin that would inhibit their ability to grow and manage risk.

3. §235.7(a) – Prohibition on Network Exclusivity – Implement Alternative A (two unaffiliated payment card networks per card). Issue rules clarifying compliance is achieved at the highest level of the network routing hierarchy and more complex routing logic is discretionary.

    a. Exclusion – Issue rules which indicate that the following would be exempt from the rules regarding Network Exclusivity: (a) Healthcare cards used to access FSA, HRA, and HSA and (b) Alternative payment form factors (i.e., mobile, key fob, etc.) would be deemed to be in compliance if they are associated with a “companion card” which is compliant, even if the alternative form factor itself may only be used to initiate transactions over a single network (i.e., a key fob associated with a mag-stripe debit card would be deemed to be in compliance even if the key fob could only be used to initiate debit transactions over a single signature debit network) so long as the companion card was enabled to support two or more unaffiliated networks (i.e., one for signature, and a different unaffiliated one for PIN).

4. §235.7(a)(3) – Payment Card Network Mergers – Issue rules which provide a six-month timeframe for cards issued after the date of the merger, and a 24-month time frame for existing cardholder accounts to be in compliance, so as to not force the issuer (or the consumer) to bear the cost of having to immediately issue new cards to all cardholders.

5. §235.2(i) – General Use Prepaid Cards – Adopt rules which indicate that non-network branded Selective Authorization Programs are considered exempt from the rules.

6. §235.2(m) – Payment Card Network – In order to be in compliance with the requirements of Section 920, issue rules which indicate that the rules apply equally:

    - To three-party models as well as four-party models, and which clarify that acquirers, issuers, third-party processors, and payment gateways are generally not considered to be card payment gateways because those firms do not establish rules, or procedures that govern the rights and obligations of issuers and acquirers involved in processing an electronic debit transaction through the network.

- To traditional as well as non-traditional or merging payment networks, to the extent a given non-traditional or emerging payment network (a) directly or indirectly "provides the proprietary services, infrastructure, and software that route information and data to conduct debit card or credit card transaction authorization, clearance, and settlement" that (b) "a person uses in order to accept as a form of payment a brand of debit card, credit card, or other device that may be used to carry out debit or credit transactions."

7. §235.2 – Additional Definitions – Include a definition for the function of network routing.

8. Scope of Rule – Issue rules which indicate that ATM Networks and ATM transactions are not included in the scope of the rules.

9. General Implementation – Establish a mandatory compliance date of mid-April 2012 for the rules which are issued with an effective date of July 21, 2011.

10. Regulator Guidance – Include regulator guidelines that acknowledge proper good faith execution of the final rules.

11. §235.2(f) 2-3: Request the Board support and clarify that the term 'Debit Card' does not include credit cards enabled with consumer-selected payment preference functionality and products containing these features fall outside the scope of the proposed regulation.

12. Request the definition of debit card be amended to clarify that products utilizing applications that enable access to funding sources, such as a cash purse or a checking account, are not automatically considered a Debit Card for the purpose of these regulations.

Appendix B

Review of Specific §920 Requirements - Debit Interchange Fees

Assessing if Interchange Fees are Reasonable and Proportional Relative to the Costs

Section 920(a)(3)(A) requires the Board to prescribe regulations to establish "standards for assessing whether the amount of any interchange transaction fee…is reasonable and proportional to the cost incurred by the issuer with respect to the transaction."

- The requirement to establish "standards for assessing" does not require the Board to establish a specific rate cap for interchange fees.

  In fact, in a legal brief recently filed in response to a lawsuit by TCF National Bank, the Board itself acknowledges this, stating that the "statute's requirement that the Board 'establish standards' for assessing debit interchange fees does not obligate the Board to set a specific rate for debit interchange fees." Brief of Defendant at 28, TCF Nat'l Bank v. Bernanke, No. 4:10-cv-04149-LLP (S.S.D. Feb. 18, 2011).

- Assessing whether a fee is "reasonable and proportional" to the "cost incurred by the issuer with respect to the transaction" does not mandate that such fees cannot exceed the cost incurred; in other words, Section 920 does not require the rates proposed by the Fed to be as low as has been proposed.

- The Board has not been given the mandate to establish standards for assessing whether the costs themselves are reasonable, but rather whether the fees are reasonable and proportional to the costs incurred.

Section 920(a)(4) requires the Board to consider only "the incremental costs incurred by an issuer for the role of an issuer in the authorization, clearance, or settlement of a particular electronic debit transaction." The combination of Section 920(a)(3)(A) with Section 920(a)(4) leads to the following: The Board is required to prescribe regulations to establish "standards for assessing whether the amount of any interchange transaction fee…is reasonable and proportional to the incremental cost incurred by the issuer with respect to the transaction."

Given the Board has proposed to define incremental cost to mean "average variable cost," this means the regulations must establish "standards for assessing whether the amount of any interchange transaction fee…is reasonable and proportional to the average variable cost incurred by the issuer with respect to the transaction."

In the commentary to the proposed rules, the Board discusses several challenges with defining incremental cost before ultimately settling on the definition "average variable costs." Many may disagree with the Board's proposal; however, TSYS believes the definition itself may not be a critical as it seems.

TSYS believes what is more relevant is how the phrase "reasonable and proportional" is interpreted. It could either be read as a compound phrase to be taken as a whole, or as two separate concepts. Under the first interpretation, the standard would be whether "any interchange transaction fee…is reasonable and proportional [relative] to the average variable cost incurred. Under the second interpretation, the standard would be whether "any interchange transaction fee…is (a) reasonable and (b) proportional to the average variable cost incurred."

For a variety of reasons, including the plain language of Section 920 itself, TSYS believes the first interpretation is the correct one. Therefore, it is appropriate to read Section 920, along with the Board's definition of incremental costs, to mean that the regulations must establish standards for assessing whether the amount of any interchange transaction fee…is reasonable and proportional relative to the average variable cost incurred and must assess their reasonableness relative to that specific type of costs, not relative to some other type of costs.

The standard for determining whether a fee is reasonable and proportional relative to the average variable cost incurred would be quite different from the standard for determining reasonableness relative to some other measure of costs (e.g., fixed costs, total costs, direct costs, indirect costs, etc.). So, it may not matter all that much whether incremental costs are defined as "average variable" costs or by the definition frequently used by economists (i.e., the difference between the cost incurred by a firm if it produces a particular quantity of a good and the cost incurred by that firm if it does not produce the good at all). What matters most is that once incremental costs have been defined, the standard for assessing the reasonableness of such costs must assess their reasonableness relative to that specific type of costs (i.e., average variable costs), not relative to some other type of costs (i.e., fixed costs).

As an example if the reasonableness standard for fees in a given industry meant fees should not exceed 20% of total costs nor 300% of average variable costs, then it would be "mixing apples and oranges" to apply the 20%-standard when testing the reasonableness of fees based on their proportionality to average variable costs. In this example, the 300%-standard would be the appropriate method to use when assessing whether fees were reasonable and proportional to average variable costs.

In summary, based on Section 920 and the Board's proposed definition of incremental costs, the Board has been tasked with establishing standards for assessing whether the amount of any interchange transaction fee is reasonable and proportional relative to the average variable cost incurred by the issuer with respect to the transaction.

Similarities Between Electronic Debit Transactions and Checking Transactions

In prescribing the proposals, Section 920(a)(4)(A) requires the Board to "consider the functional similarity between (i) electronic debit transactions; and (ii) checking transactions that are required within the Federal Reserve Bank system to clear at par."

When accepting checks a merchant has several options as listed in the table below:

Check Acceptance Option	Comments
Without using check verification and guarantee service	• The merchant accepts the risk that the account with which a check is associated will have insufficient funds at the time the check is presented for settlement. • The merchant does not incur check verification or authorization fees.
Using a check verification service, but not a check guarantee service	• By verifying a check at the time it is tendered as payment, the merchant reduces the risk a checking account will have insufficient funds at the time a check is presented for settlement. • The merchant still bears risk that the checking account will have insufficient funds at the time a check is presented for settlement, because it is possible additional transactions may occur on the account between the time a check is verified and the time it is presented for settlement. • The check verification provider will charge the merchant a fee, which will generally be a fixed fee per item (rather than an amount which varies based on the amount of the check). The fee will generally be relatively small compared to the total fee a merchant would pay to accept a given credit or debit card transaction.
Using both a check verification and guarantee service	• By verifying and guaranteeing a check at the time it is tendered as payment, the merchant eliminates the risk a check will not clear due to insufficient funds. • The guarantee service provider essentially buys the check from the merchant, at a discount (i.e., similar in concept to the discount fee associated with a credit or debit card transaction). The check guarantee service provider therefore assumes the risk that a checking account will have insufficient funds at the time a check is presented for settlement. The merchant is absolved of such risk. • For any given check transaction, the discount and other fees paid by the merchant to the check guarantee service are similar in amount and structure to the total fee (inclusive of the interchange component) that a merchant would pay to a merchant acquirer for accepting a given credit or debit card transaction.

Simply put, payment authorization (verification) and guarantee are not an inherent part of the check acceptance process. Therefore, in the absence of a verification and guarantee service, a merchant does not know, at the time the merchant accepts the check, if the check will be honored or returned unpaid. Only when a merchant uses a check guarantee service is the merchant guaranteed to receive payment, even if the consumer's checking account does not have sufficient funds at the time the check is presented to the bank.

When following the prescription of Section 920(a)(4)(A), it would seem permissible and appropriate for the Board to consider the functional similarities (and differences) between electronic debit transactions and…

- Checking transactions not backed by a verification and guarantee service
- Checking transactions that are verified using a verification service, but that are not backed by a guarantee service
- Checking transactions backed by verification and guarantee service

TSYS recommends the Board consider the fact that, from a merchant's point-of-view, accepting a debit card is more akin to accepting a check which is secured by a check guarantee service, and is very different than accepting a check not secured by a guarantee service, taking into account that the fees a merchant pays for a check guarantee service are higher than fees a merchant pays to accept a check that is not secured by such a service.

Appendix B – Attachment 1

Statement by Senator Durbin Regarding the Durbin Amendment

The document below is presently accessible on Senator Durbin's website at: http://durbin.senate.gov/issues/leg_wallstreet_swipe.cfm.

SENATOR DURBIN AMENDMENT #3989

TO HELP SMALL BUSINESSES BY ENSURING THAT DEBIT CARD INTERCHANGE FEES ARE REASONABLE

What Sen. Durbin's amendment does:

- Sen. Durbin's amendment would direct the Fed to issue rules to ensure that debit interchange fees are reasonable and proportional to the processing costs incurred. Visa and MasterCard currently charge debit interchange fees of around 1-2% of the transaction amount. These fees are far higher than the actual cost of processing debit transactions, and they mean that small businesses and merchants always get shortchanged when they accept a debit card for a sale.
- Sen. Durbin's amendment also prevents card networks like Visa and MasterCard from penalizing sellers for offering discounts to customers. The amendment would allow sellers to offer discounts for customers to use competing card networks and for customers to pay by cash, check or debit card. The amendment would also allow sellers to choose to decline credit cards for small dollar purchases (because interchange fees often exceed profits on such sales).

Why Sen. Durbin's amendment is needed:

- Sen. Durbin's amendment is a response to interchange price-fixing by Visa and MasterCard. Interchange fees are received by the card-issuing bank in a debit transaction. However, Visa and MasterCard, which control 80% of the debit market, set the debit interchange fee rates that apply to all banks within their networks. Every bank gets the same interchange fee rate, regardless of how efficiently a bank conducts debit transactions. Visa and MasterCard do not allow banks to compete with one another or negotiate with merchants over interchange rates, and there is no constraint on Visa and MasterCard's ability to fix the rates at unreasonable levels. Visa and MasterCard constantly raise interchange rates because the more interchange the banks receive, the more the banks will issue cards. Visa and MasterCard receive a fee each time a card is swiped, so rising interchange rates enrich them too.
- Visa and MasterCard have reduced debit interchange rates in other countries while increasing them in the U.S. While Visa and MasterCard continue to raise U.S. interchange rates (which are already the world's highest), GAO found that "regulators in other countries have worked with Visa and MasterCard to voluntarily reduce their interchange rates." Just last month, Visa lowered many European debit rates by 60% while increasing many U.S. debit rates by 30%.

What Sen. Durbin's amendment DOES NOT do:

- Sen. Durbin's amendment does not affect credit card interchange fees. Some have argued that Sen. Durbin's amendment would reduce credit availability by regulating credit card interchange rates. However, the amendment's reasonable fee requirement only applies to debit cards.
- The Durbin reasonable debit fee requirement exempts banks and credit unions with assets under $10 billion (this includes 99% of all banks and credit unions). Under Sen. Durbin's amendment, the requirement that debit fees be reasonable does not apply to debit cards issued by institutions with assets under $10 billion. This means that Visa and MasterCard can continue to set the same debit interchange rates that they do today for small banks and credit unions. Those institutions would not lose any interchange revenue that they currently receive.
- Sen. Durbin's amendment would not enable merchants to discriminate against debit cards issued by small banks and credit unions. Visa and MasterCard contractually require merchants to accept all cards within their networks, and the amendment does not change that requirement.
- Sen. Durbin's amendment would not have the Federal Reserve set interchange prices. Under Sen. Durbin's amendment the Fed would not set debit interchange prices. Instead the Fed would oversee the debit interchange fees set by card networks to ensure that they are "reasonable and proportional" to cost. This is the same "reasonable and proportional" standard that Congress directed the Fed to use to oversee consumer credit card fees in the 2009 Credit CARD Act.

Appendix C

Other payment features – Clarifications Requested

Request for clarification that a credit card account that provides consumers a payment preference option is not considered a “debit card” for purposes of the rule

In the Supplementary Information accompanying Regulation H: Debit Card Interchange Fees and Routing, the Board solicits comment on whether additional guidance is necessary to clarify whether certain products qualify as debit cards for purposes of the rule. Given some uncertainties associated with the proposed rules, TSYS requests the Board to clarify that credit cards that provide, as a feature of the credit card account, the consumer the option (and not the obligation) to select payment preferences for certain card transactions does not turn the credit card into a “debit card” for purposes of the rule.

TSYS maintains a credit card processing system that, since mid-2009, includes functionality that offers consumers payment preference options. This functionality allows credit card holders to pay selected card transactions before their credit card account cycles and a statement is generated for their account. The functionality operates in a manner that is no different from other automatic bill-pay instructions, i.e., by effecting preauthorized electronic fund transfers from a consumer’s designated deposit account in accordance with the requirements of Regulation E.

Consumers are issued a credit card by the issuer under normal credit procedures, i.e., a line of credit is established based on underwriting procedures, with the issuer assuming the credit risk related to the credit card account. Subsequently, the cardholders may set preferences for credit card transactions they want to “pay now” via an electronic fund transfer from a deposit account (or deposit accounts) and credit card transactions they want to leave on their credit line for later payment. “Pay now” transactions can be cleared daily or at other periodic intervals designated by the cardholder. Importantly, issuers do not condition the extension of credit on the cardholder’s agreement to “pay now.” There is no requirement that the cardholder avail himself/herself of the payment preference functionality. Cardholders may, at their option, elect to use the payment preference function to “pay now,” and, once elected, they may cancel enrollment, or otherwise change their payment preferences, at any time.

The account possesses all normal credit card characteristics, e.g., the card is not tied to a deposit account, the card carries an available line of credit, and the issuer takes the credit risk. A credit card account that features this payment preference functionality empowers the consumer with the ability to choose which transactions he or she wants to pay now, which transactions he or she wishes to leave on the credit line for later payment, and from which deposit accounts he or she wishes to use for payment. It is commonplace for creditors to offer a cardholder various auto-pay options, such as payment of the entire outstanding balance in full, payment of the required minimum payment due or payment of another amount specified by the cardholder. And, payment preference functionality is no different than providing a cardholder with enhanced auto-pay options that enable the cardholder to pay credit card transactions on a flexible timetable.

In summary, key highlights of the functionality are as follows:

- Cardholder is granted a credit line based upon typical credit underwriting processes.
- Cardholder has the right to fully utilize the established credit line and can decide whether to pay certain transactions now or later. Preferences can be changed at any time.
- Transactions conducted on the card are authorized, posted and settled to the credit account (No authorizations/decisions are made based upon the availability of deposit funds.)
- Cardholder has the right to cancel or modify “pay now, pay later” functionality at any time.
- Card issuer assumes full credit risk for the credit card account.
- Cardholders are not required to pay their credit card balances by pre-authorized electronic fund transfers from a deposit account as a condition of opening the credit card account. They have the option, and make the choice, of whether and when they add these payment preference instructions.

The importance of providing flexibility and fairness to the consumer is a primary theme woven throughout the Board’s various rules. Preauthorized electronic fund transfers are used by consumers for numerous types of transactions such as utility bills, mortgage payments, credit card payments and transfers between accounts. Today, consumers have the ability to make partial payments on their credit card lines at anytime via telephone or going online and arranging an electronic funds transfer to the issuer. A payment preference function, as used in the context of paying credit card transactions, is simply another funds transfer option for the consumer. Consequently, the Board should explicitly find that a credit card using this functionality does not make that credit card a “debit card” for purposes of the Regulation.

<u>Request for clarification that multi-purse features that provide consumer choice are not considered a “debit card” for purposes of the rule</u>

TSYS requests the Board clarify the treatment of multi-purse products such that issuers may continue to bring multi-purse technology to market with certainty about how it will be regulated. Multi-purse functionality allows a single payment instrument; such as a card or mobile phone to access funds from different sources depending upon certain pre-defined criteria.

Multi-purse products rely upon a default account and are then designed to access alternate accounts when certain pre-defined criteria are met. TSYS recommends the default account is used to determine if these proposals apply to the product.

> Example: The default account type is a credit card, or a general purpose reloadable account. Adding an additional funding source such as a cash purse or a gift account would not cause the product to lose its exemption from interchange regulation as a credit or general purpose reloadable product, as defined in the proposal. However, should the default account be a checking account, proposals would apply.

Applications of multi-purse technology continue to emerge and these product concepts promise great utility to consumers. These applications combine access to accounts of different types in a single access device. Multi-purse can bring flexible and easy to use products to the market in a way that has not existed previously.

To preserve the opportunity for multi-purse technology to bring benefit to consumers, TSYS recommends the definition of debit card be amended to clarify that products utilizing applications that enable access to funding sources such as a cash purse or a checking account are not automatically considered a Debit Card for the purpose of these regulations.