February 22, 2011

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Docket No. R-1404 and RIN No. 7100 AD63

Dear Chairman Bernanke:

In response to the Federal Reserve's request for comments on the proposed rule on debit card interchange fees and routing, the Electronic Transactions Association ("ETA") submits the following comments. While these comments reflect the distinct concerns of ETA's membership, our concerns are likely to coincide with those of many other associations, industries and consumers throughout the United States.

Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("the Act") involves an end-to-end chain of varied players who must continue to function efficiently together to make payment systems work as reliably as we have come to expect. Though this section of the Act was focused on networks and issuers, the proposed rules will have immense economic and functional impact on all of the links in this chain. The Notice of Proposed Rulemaking recognizes the various complexities of tailoring the highly specific provisions of the Act to the vast, diverse, complex and dynamic business and technical environment of the electronic debit card industry. These far-reaching proposals will undoubtedly affect the quality of services provided and challenge underlying business models as they reconstitute the payments industry at the furious pace mandated by the statute.

ETA has serious concerns regarding the amount of time, effort, and resources required to best address the intent of the statute. Some of the alternatives under the rule

could require a complete industry transformation regarding the way debit transactions are identified (i.e., by issuer and type of card instead of by type of transaction). Some of the alternatives proposed could require systems to be restructured, imposing substantial, unrecoverable costs to acquirers, processors, and third party service providers. Also, it is important to note that increasing the complexity of interchange (as this rule does) will increase the number of questions and inquiries to our businesses by merchant clients. We will need to spend time and financial resources to educate our employees and to develop the personnel and materials to effectively explain all the changes to our merchant clients and assist with changes to their point-of-sale equipment and processes. Therefore, it is critical for proper implementation that all stakeholders are given an appropriate amount of time to incorporate changes of the magnitude detailed in this rule. It is important to note that the businesses represented by ETA are in third place in the implementation chain; they cannot act on or even formally plan for their own implementation and compliance until 1) issuers have determined and announced their interchange cost model(s); and 2) networks have determined and announced implementation plans. ETA urges the Board to undertake further review and examination of the downstream impacts and unintended consequences of this fundamental restructuring of the electronic payments universe.

After the final rule is issued, we urge you to solicit information from impacted downstream industry participants regarding necessary system development and other activities required to support the new interchange standard. From these responses, informed and reasonable timeframes for compliance, possibly including a phased approach, can be determined.

Debit Interchange Fee Standards

The Act contains two alternative interchange fee standards, one being a cost-based approach with a safe harbor and a cap, and the other a stand-alone cap. Both proposals could potentially result in greater usage of credit and prepaid cards in place of debit cards and an increase in fees for consumers on other banking services (such as ATM withdrawals, deposit account fees). Both proposals could result in decline or lack of growth in the expanding small ticket transactions market, resulting in loss of utility to consumers. Consumers value the convenience and security of debit cards; issuers may impose new fees on consumers to compensate for the reduction in debit interchange

revenue that would arise from the Board's proposed regulations or may cease to offer debit cards if the proposed regulations cause them to operate card programs at a loss. At the same time, there is no ability to guarantee that retailers will pass savings from lower interchange fees on to the consumer. While the intent would seem to be to benefit both consumers and retailers by lowering the cost of business, government price controls usurp the market's price setting mechanism and virtually always lead to unintended negative consequences.

Fraud-Prevention Adjustment

§920 of the Act allows for adjustment to the interchange fees for costs related to fraud-prevention measures and proposes two possible approaches to adjusting for fraud prevention costs. One approach is to identify new technologies reducing debit-card fraud and to use the costs of the new technologies to set the fraud-adjustment amount. The second approach would be to set standards that need to be met for eligibility for a fraud-prevention adjustment, which would then reimburse the issuer for some portion of the costs of current security and fraud prevention activities and the costs of researching and developing new ones. ETA's primary concern is that the Board avoids adopting technology-specific or prescriptive standards for fraud prevention that an issuer must meet in order to be eligible to receive an adjustment to its interchange fee. Should the government choose one particular security technology over another, there would be inherent anti-competitive issues to address and all issuers would be subject to the same security vulnerabilities. Additionally, it would be exceedingly difficult for a rule-making body such as the Federal Reserve to effectively involve itself in the management of rapidly evolving cyber threats combated daily by the electronic transactions industry.

We ask that you consider a standard, fixed amount across all issuers for the interchange adjustment for fraud prevention compliance. A different adjustment amount for each issuer would add unnecessary and troublesome complications to an already complex system. We also ask that you consider that fraud prevention initiatives can originate with card networks and be carried out by issuers. Again, this instance would best lend itself to a standard approach for price adjustments to interchange rates.

Exemptions

As per B Sec 235.3b (p. 81743) it will be important to have a mechanism by which payment products that are exempt from interchange rate regulation are identified as such when introduced in the market. This is necessary to prevent confusion and conflicting interpretations over what constitutes an exempt payment vehicle. We ask you to consider establishing consistent standards for networks to follow when certifying and notifying acquirers and processors that particular financial institutions and card programs qualify or fall out of qualification for exempt status, including minimum requirements for advance notice (with a minimum of 180 days) from the time the networks give notice, to the time that industry participants have to update their systems.

The lack of a consistent certification process and consistent reporting periods across all networks for making exemption determinations with respect to small issuers, government-administered programs and reloadable prepaid cards, would lead to the potential for confusion by merchants as to costs for card acceptance and an unnecessary administrative burden on acquirers and processors to keep track of different exemption determinations among payment card networks for the same issuers and card programs. For example, if the exemption certification process or reporting period used by one payment card network for a particular issuer or card program was different than the certification process or reporting period used by a different payment card network for the same issuer or card program, the potential exists for different payment card networks offering the same authorization method on a particular card to assess substantially different interchange fees, one being subject the interchange fee standard and the other not. This would cause confusion at the point of sale, because merchants would not be able to readily determine the cost associated with accepting a particular card.

ATM Withdrawals

ETA believes that ATM withdrawals should be exempt from interchange rate regulation as they do not qualify as transactions for goods and services and they do not involve a merchant.

Limitations on Payment Card Network Practices

Restrictions on certain payment card network practices, in particular the prohibition against Network Exclusivity Arrangements, will certainly have widespread impact on issuers, payment card networks and merchants. ETA believes that a fair application of the prohibition on Network Exclusivity Arrangements would continue to allow unaffiliated dual exclusivity arrangements – that is, exclusivity between an issuer and a PIN debit payment card network, on the one hand, and between the same issuer and a signature debit payment card network, on the other hand, so long as the exclusive PIN debit and signature debit payment card networks are not under common ownership or control.

Network Exclusivity

ETA urges the Fed to adopt routing "Alternative A," which would require issuers to provide debit cards that can be used over two unaffiliated networks (such as a PIN-based network and an unaffiliated signature-based network). While Alternative A would avoid significant incremental compliance costs and would not require material changes to current network infrastructure, Alternative B would require a completely new payments architecture to be created, including (but not limited to) hardware and software systems, BIN assignments, network rules, merchant agreements, and international standards. For example, some of the requirements for Alternative B to function are: 1) the creation of Least Cost Routing system and integration with the authorization system(s); 2) an increase in BIN management complexity; 3) a breaking of systematic assumptions about one BIN/one payment network -- these assumptions are currently pervasive in processing systems and would have to be thoroughly scrubbed to eliminate the one-BIN assumption; 4) a general increase in payment network compliance complexity; 5) potentially significant security concerns if changes require looking at more than first 6 digits of the BIN to determine payment network; 6) a 18-36 month implementation schedule; 7) the cost to ETA businesses of lost opportunity -- i.e., to implement such a change, a substantial portion of all development resources would have to be focused on this implementation; and 8) an increase in internal processing costs that could be passed on to merchant. The magnitude and expense of undertaking Alternative B cannot be overstated.

Merchant Routing Restrictions

The prohibition on Merchant-Directed Routing Restrictions in the Dodd-Frank Act appears fairly straightforward in its preemption of such payment card network rules. One particularly important point of clarification required from the Fed, however, is whether the prohibition on Merchant-Directed Routing Restrictions extends to payment card network rules that prevent merchants from blocking certain transaction options at the point-of-sale (*e.g.*, where a merchant may instruct a cardholder that a debit card with both PIN debit and signature debit functionality may not be used to initiate a signature debit transaction unless PIN debit functionality is unavailable for the transaction). If the Fed determines that such payment card network rules are precluded by the prohibition on Merchant-Directed Routing Restrictions, then merchants may be able, to the extent sustainable from a customer relations perspective, to take control over the determination of signature debit versus PIN debit at the point-of-sale – a decision currently in the hands of the cardholder.

Clarifications:

ETA supports the definitions of "Acquirer" and "Payment Card Network" set forth in the proposed rule.

"Acquirer" is defined to include entities that contract with merchants and provide settlement. The Acquirer definition explicitly excludes entities that act only as a processor. This indicates that an acquirer would include only those institutions that actually move the monetary value over the networks, and is consistent with the meaning of the term in the industry and with the intent of the law. Other entities in the payments chain, such as processors, gateways, and independent sales organizations, should rightfully not be included within the ambit of the "Acquirer" definition.

"Payment Card Network" is defined in the proposal to include only those organizations that establish the procedures governing both issuers and acquirers, and does not include an entity that only provides "services, infrastructure and software" necessary for processing transactions. This, too, is the correct interpretation of that phrase. ETA supports Proposed Comment 2(m), which clarifies that the term excludes acquirers, issuers, third party processors, payment gateways, and other like entities. Including such entities in the definition of Payment Card Network is beyond the true intent of the law, and would cause unintended consequences in the application of the Regulation.

ETA acknowledges that the Act has provided the Federal Reserve Board with co ısiderable and unique analytical challenges, and we urge the Board to take sufficient time t‹› consider industry and consumer feedback. ETA appreciates the opportunity to provide bɜ ckground information and to contribute our comments.