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February 7, 2011

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

Re: Debit Card Interchange Fees and Routing, Docket No. R-1404, RIN No. 7100-AD63

Dear Ms. Johnson:

In response to the request of the Board of Governors of the Federal Reserve System ("Board") for public comment on proposed new Regulation II, Debit Card Interchange Fees and Routing ("Reg II"), implementing portions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"), NetSpend Holdings, Inc. ("NetSpend") respectfully submits the comments set forth below.

By way of background, NetSpend is a leading provider of general-purpose reloadable prepaid debit cards to underbanked consumers in the United States ("U.S.") who do not have a traditional bank account or primarily rely on alternative financial services. NetSpend is focused on providing the estimated 60 million underbanked consumers in the U.S. with innovative and affordable financial products tailored to their unique needs. NetSpend, through its subsidiaries, is the program manager and processor for: bank-issued general purpose reloadable ("GPR") cards offered for sale directly to the consumer through online and direct marketing, through non-bank retailers, and through employers. NetSpend's products are provided with a menu of fee plans designed to provide the most value at the lowest price to the cardholder, substantially the same consumer protections as any other bank-issued debit card (including Regulation E-compliant electronic statements and dispute rights), pass-through FDIC insurance, optional 5.00% APY savings, free immediately available direct deposit of payroll and government payments, a free $10 purchase cushion, real-time account activity and balance alerts by text and email, and overdraft protection that includes a no-fee option and other consumer protections.

We believe it is imperative the final Reg II rules and implementing regulations be structured in a manner that best protects the provision of financial services through GPR cards, as it provides an an extremely important point of accessibility to financial services for many underbanked Americans. Congress acted to protect this access with the exemptions set forth in Section 1075 of the Act for (1) debit and prepaid cards issued in connection with government payments; (2) GPR cards that are not marketed as gift cards; and (3) any issuer with assets of less than $10 billion. Entities and products that are covered by these exclusions are exempt from the portion

of the Act that imposes limitations on interchange fees. We believe these exemptions reflect Congressional recognition of the importance of GPR, prepaid and small issuers in providing financial services to the underbanked, and the importance of interchange income in supporting such businesses. While we understand we are protected by the GPR and small issuer exemptions, our comments also reach some of the general issues under Reg II that we believe could have an adverse impact on our industry generally and on the millions of underbanked consumers in the United States, including those we are honored to serve.

I. The Proposed Cap for Covered Prepaid Cards is not Reasonable and Proportional

The Act provides that the amount of interchange transaction fees an issuer receives or charges with respect to an electronic debit transaction after the effective date must be "reasonable and proportional to the cost incurred by the issuer with respect to the transaction." The term "electronic debit transaction" is defined in Reg II to mean "the use of a debit card, including a general-use prepaid card, by a person as a form of payment in the U.S." The Act further authorizes the Board to establish standards for assessing whether an interchange transaction fee is "reasonable and proportional" to the cost incurred by the issuer with respect to the transaction. 75 Federal Register 248, p. 81722.

We believe the interchange fee cap set forth in proposed Section 253.3 fails to meet the Act's requirement that the charge be "reasonable and proportional to the cost incurred by the issuer with respect to the transaction." The Board's proposed cap of 12 cents per transaction is neither reasonable nor proportional, especially in the context of prepaid cards. The Board itself concedes that the proposed cap fails to allow recovery of per-transaction variable costs for approximately 20 percent of covered issuers. *Id.* p. 81725. The Board further acknowledges the "proposed cap does not differentiate between different types of electronic debit transactions" (*e.g.*, signature-based, PIN-based or prepaid.) *Id.* While the Board acknowledges the network-reported prepaid card interchange fees averaged 50 cents per transaction, the Board also indicated that by "transaction type, the median total per-transaction processing cost was...63.6 cents for prepaid cards." *Id.* p. 81725. Accordingly, the Board appears to have determined that an issuer should lose 51.6 cents on each covered prepaid transaction.

The Board seems to justify this huge negative variance between prepaid processing costs and the Board's proposed cap by concluding that "issuers have other sources, besides interchange fees, from which they can receive revenue to cover their costs of operations and earn a profit." *Id.*, n. 44, p. 81733. Accordingly, it appears the Board has decided that prepaid card transactions should be subsidized by other fees or charges, such as cardholder fees, to help cover their costs. *Id.*, p. 81737. We question whether the Board (or Congress when enacting the law) truly intended to shift the acknowledged costs of prepaid card processing to GPR cardholders, many of whom are underbanked, especially in these challenging economic times.

The Board acknowledges that issuers of prepaid cards reported higher costs and identified certain reasons for such higher costs that are innate to the processing of many prepaid cards. *Id.*, at p. 81738. The Board specifically requests comment on whether it should initially have separate standards for debit card transactions and prepaid card transactions, and what those different

standards should be. We strongly advocate that different standards must apply, given the higher costs associated with the processing of prepaid cards, and that the interchange fee allowed be set at no less than 63.6 cents per transaction.

II. The Proposed Rule Does not Tie the Interchange Fees to the Costs of a Particular Transaction, as Required by the Act

The Board's decision to treat all types of transactions the same, and not tie the caps on interchange for a covered debit card to a particular transaction ignores the plain language of the Act, which provides in Section 1075[1]:

> (2) REASONABLE INTERCHANGE TRANSACTION FEES – The amount of any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction **shall be reasonable and proportional to the cost incurred by the issuer with respect to *the transaction*.**
>
> (3) RULEMAKING REQUIRED
>
> (A) IN GENERAL – The Board shall prescribe regulations in final form...to establish standards for assessing whether the amount of any interchange transaction fee described in paragraph (2) is **reasonable and proportional to the cost incurred by the issuer with respect to *the transaction***. ...
>
> (4) CONSIDERATIONS; CONSULTATION – In prescribing the regulations under paragraph (3)(A), the Board **shall**
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> (A) Consider the functional similarity between:
>
> (i) electronic debit transactions; and
>
> (ii) checking transactions...;
>
> (B) distinguish between:
>
> (i) the incremental cost incurred by an issuer for the role of an issuer in the **authorization, clearance, or settlement of *a particular electronic debit transaction***, which cost shall be considered under paragraph (2); and
>
> (ii) other costs incurred by an issuer which are not specific to a particular electronic debit transaction, which costs shall not be considered under paragraph (2)...
>
> [Emphasis added]

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[1] Section 1075 of the Act amended the Electronic Fund Transfer Act to include a new Section 920 on Reasonable Fees and Rules for Payment Card Transactions; the Board refers to Section 920 throughout Reg II.

We see nothing in the Act that empowers the Board to adopt a rule that causes issuers of covered prepaid card transactions to potentially lose 51.6 cents per transaction. Such a result does not comply with the language of Section 1075 of the Act, which clearly states the interchange fee must be "reasonable and proportional" to the cost incurred by the issuer "**with respect to the transaction.**" How can it possibly be "reasonable and proportional" to set a cap which causes a loss on a transaction? Accordingly, we respectfully request the Board revisit the fee cap it proposed to set on prepaid transactions, and make the fees consistent with the processing costs incurred by issuers of such cards for the transactions. We note that a failure to do so may result in increased costs to the underbanked users of prepaid card offerings, and potentially limitations in the availability of prepaid card products and programs

III. The Board Should Require Networks to Honor the Exemptions Provided in the Act

Proposed Section 235.5 of Reg II addresses the exemptions for issuers with assets of less than $10 billion, government administered programs, and GPR cards. However, the Board does not include any provisions mandating that such exemptions, where available to an issuer, be honored by the networks. We believe that when including these exemptions within the Act, Congress intended that issuers actually be able to take advantage of them, such that the underlying policy objectives of Congress in crafting those heavily negotiated exemptions would be capable of being achieved. Accordingly, we request that the Board include an express requirement that networks must honor such exceptions for qualifying issuers in its final rules and regulations. Failure to do so would risk an implementation of Reg II in a manner that fails to fulfill Congressional intent regarding the protection of small issuers, government programs, and GPR programs serving the underbanked.

IV. The Board Needs to Clarify that an Exempt Prepaid Card will not lose its Exemption so long as the Issuer Agrees to Waive Fees for the First Withdrawal per Calendar Month by the Cardholder from a Proprietary Network ATM

The exemption for certain types of reloadable prepaid cards contained in Section 235.5 of Reg II provides that the exemption is lost if, on or after July 21, 2012, (i) an otherwise exempt card may be charged with an overdraft fee or (ii) a fee is charged by the issuer for the first withdrawal per calendar month from an ATM that is part of the issuer's designated ATM network. Section 235.2(g) provides that "designated automated teller machine (ATM) network means either: (1) [a]ll automated teller machines identified in the name of the issuer; or (2) [a]ny network of automated teller machines identified by the issuer that provides reasonable and convenient access to the issuer's customers." The Board indicates in Reg II that it is proposing to clarify the meaning of "reasonable and convenient access" in a manner that would, as an example, include for each person to whom a card is issued, access to an ATM within the metropolitan statistical area ("MSA") in which the last known address of the person to whom the card is issued is located, or if the address is not known, where the card was first purchased or issued in order to access an ATM in the network. The Board notes the purpose of the comment is to clarify *if an issuer does not have its own network of proprietary ATMs* that the network the issuer identifies as its designated ATM network is one in which a person using a debit card can access an ATM with relative ease. *Id.* 81731

We respectfully request that the Board clarify that, so long as the prepaid card issuer has its own network of proprietary ATMs that identify the issuer's name, and the issuer charges no fee to the cardholder of an exempt card for the first withdrawal per calendar month conducted at an ATM within its proprietary network, that the card will continue to qualify for the exemption provided in the Act. In other words, a card should not lose an exemption where the issuer has contractual rights to allow its cardholders to use other non-proprietary ATMs in the marketplace (*e.g.*, any ATM with a CIRRUS logo), even if it advises the cardholder that his card can be used at such other locations, where the issuer charges a fee for a withdrawal at such third party ATMs. Using the CIRRUS example, the prepaid card exemption should not be lost where a cardholder chooses not to use a card at an issuer's proprietary ATM, but instead decides to use an exempt card at an ATM owned or operated by a third party which allows transactions with cards with a CIRRUS logo, even if the issuer charges a fee to the cardholder for the first withdrawal during the calendar month conducted at the non-proprietary ATM. We believe the current wording of proposed Reg II is potentially confusing, and could be construed as imposing upon the issuer the obligation to waive the first withdrawal fee each calendar month at any ATM where the card can be used, regardless of whether it is part of the issuer's proprietary network of ATMs.

We additionally request the Board expand an issuer's options for compliance where the issuer is required to offer ATMs (with no charge for first withdrawal) in the MSA area of the purchaser, or if unknown, location of purchase. We respectfully request that the Board deem an issuer who does not have a network of proprietary ATMs to be in compliance where the issuer (at issuer's option) either: (1) enters into an arrangement for access to a network of non-proprietary ATMs in the MSA where no fee will be charged for the first withdrawal via the card in a calendar month; or (2) enters into an arrangement with a local bank, or bank agent, or retail seller of such cards within the MSA to allow for an in-branch or in-store free cash withdrawal per calendar month using the card, regardless of whether there are any ATMs available for use. We believe this alternative methodology of compliance might broaden the number of convenient and safe locations from whence a customer can make the first monthly withdrawal for free, and thus be beneficial to consumers. It should be clear, however, that if an issuer has its own network of proprietary ATMs that there is no requirement for the issuer to enter into either of the two alternatives described in this paragraph.

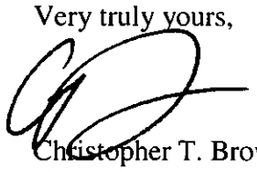
V. The Board Needs to Allow for a Signature-Only Debit or Prepaid Card, and Not Require all Covered Cards to have both a Signature Debit Routing and an Unaffiliated PIN-Based Network

The Board proposes two separate alternative approaches for implementing the Act's restrictions on debit card network exclusivity. The first alternative ("A") requires a debit card to have at least two unaffiliated payment card networks available for processing an electronic debit transaction. An issuer could comply by having one payment card network available for signature debit transactions and a second unaffiliated payment card network for PIN debit transactions. The second alternative ("B") would require a debit card to have at least two unaffiliated payment card networks available for processing an electronic debit transaction for each method of authorization available to the cardholder. The Board provides the following example: a debit

card that can be used for both signature and PIN debit transactions would be required to offer at least two unaffiliated signature debit payment card networks and at least two unaffiliated PIN debit payment card networks. *Id.*, p. 81749 Either alternative will be extremely expensive and cause operational upheavals to many in the industry , although of the two options, alternative B will multiply the costs, risks and operational upheaval. Accordingly, of the two options presented, we prefer Alternative A.

We greatly appreciate the opportunity to provide comments to the Board on Reg II. We recognize this is a particularly complex law and regulation, and that the Board and its extremely capable staff have spent thousands of hours in preparing the proposed Reg. We are hopeful the Board will make the changes we recommend above in the final Reg II rules. We would be willing to discuss any of our comments in more detail with the Board if it would like to do so.

Very truly yours,



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