Consumers Union

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

February 8, 2011

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

Dear Ms. Johnson,

Consumers Union, the nonprofit publisher of *Consumer Reports*, offers several policy recommendations with respect to the Board's proposed rule on debit interchange. Consumers Union did not take a position on the amendment to the Dodd-Frank Act which this rule is to implement. We now offer focused comments on specific issues raised by the proposed rule. Our key concern is continued access for consumers to non-statutory remedies provided for by current network rules for the return of funds in the event that the goods or services paid for are not delivered as agreed or are not accepted by the consumer. This remedy, called "chargeback," is available now to consumers who pay by debit under private network rules such as those of VISA and MasterCard. The interchange fee rule should be structured to maintain and enhance the availability to consumers of debit chargeback by network rule.

Consumers Union recommends:

- The definition of a "payment card network" should include a requirement that the network's rules bind its participants to provide consumers with the remedy of debit chargeback when the goods or services are not delivered as agreed or not accepted by the consumer. This would provide a means for payment reversal stemming from disputes about non-delivery, delivery of the wrong item, and delivery of defective goods or services.

- The interchange pricing alternative which is selected should be structured to support, encourage, and pay for the consumer remedy of debit chargeback.

- The approach chosen for network non-exclusivity should not interfere with the offering of cards with enhanced security features.

- The comment characterizing one ATM per metropolitan statistical area as reasonable and convenient access for prepaid card holders should be deleted.

All qualifying payment card networks should be required to provide debit chargeback to consumers for disputes about the delivery or quality of the goods or services paid for by debit card.

Consumers who pay by credit card are guaranteed by law a remedy that is available to debit cardholders only by network rule. That is the ability to dispute, request reversal, and receive a

chargeback of an authorized payment because the goods or services were not delivered in accordance with the agreement or were not accepted by the consumer. The Fair Credit Billing Act gives consumers this right for credit card and certain other credit transactions.

Both the VISA and MasterCard network rules provide for chargeback of debit card payments. Each has rules including chargeback codes for reasons such as merchandise not received, services not received, and defective/not as described. Consumers Union recommends that the Federal Reserve Board ensure that the effort to provide additional network choice does not result in the use of networks which fail to offer consumers the debit chargeback remedy by network rule.

Because the VISA and MasterCard network rules are used with both debit and credit card processing, it is perhaps not a surprise that they provide for chargeback for both debit card payments and credit card payments. However, as new networks develop, which may include new debit-only networks, there is a risk that they will omit this important consumer protection unless the definition of "payment card network" requires inclusion of the chargeback consumer protection mechanism as part of the network rules.

Consumers Union recommends that the Board preserve the availability of debit chargeback by network rule by augmenting the definition of "payment card network" in proposed section 235.2(m) to require certain minimum standards that a network must achieve. These standards should include a requirement that the network rules provide individual cardholders with a debit chargeback, that is, a right to reverse a payment, when the goods or services are not delivered as agreed or are not accepted by the consumer. Failure to deliver as agreed may involve payment with no delivery, late delivery, or delivery of the wrong item. Non-acceptance of the goods or services is likely to be due to a defect or other dispute about the quality of the goods or services.

The change could be accomplished by adding to the second prong to the two part definition of "payment card network" at proposed section 235.2(m)(2):

> Such rules, standards, or procedures shall include a right and a process to reverse a payment made by a consumer by debit card in connection with goods or services not accepted by the consumer or his designee or not delivered to the consumer or his designee in accordance with the agreement made at the time of the transaction.

There are strong policy reasons for promoting the availability to consumers of an effective debit chargeback mechanism. Chargeback is a simple, self-help remedy for consumers that returns money without having to resort to the courts. Only a fraction of the U.S. population can use the credit card chargeback remedy without cost, because some households lack a credit card and others carry a balance. A 2010 Consumer Reports National Research Center survey showed that 37% of U.S. households do not hold a credit card. Of the 63% of U.S. households who held at least one credit card, 42% reported that they carry a balance. Balance-carrying families will have to pay an interest charge to get access to the chargeback protection, since each new purchase will incur a finance charge from the date of purchase. The results from our survey show that only 26% of U.S. households both hold a credit card and do not carry a balance. Just over one quarter of U.S. households, then, have access to the credit card chargeback remedy without paying an interest charge on the purchase.

There is no evidence that, in adopting the Durbin amendment, Congress intended to give consumers reduced access to the practical remedies available to them by network rule. Under

both the VISA and MasterCard debit card rules, those practical remedies include debit chargeback. The Board can preserve that remedy by defining an eligible payment card network as one which provides through its rules and procedures for consumers to obtain a debit chargeback when the goods or services were not delivered as agreed or not accepted by the consumer or his or her designee.

Interchange fee caps should include an element to pay for the consumer debit chargeback remedy for disputes about the delivery or quality of the goods or services paid by debit.

The structuring of the interchange fee cap rule provides an opportunity to encourage debit card issuers to make the debit card chargeback opportunity better known to their consumers. This would be facilitated by choosing a method of setting the interchange compensation which permits recovery of chargeback costs. An issuer's chargeback costs are mostly processing costs, but in the relatively rare case where the merchant is no longer available to absorb the chargeback, the issuer may also incur unrecovered costs in replacing the disputed funds in the consumer's account.

Alternative One includes the processing costs for chargeback as part of the allowable costs which may justify an interchange fee above seven cents and not exceeding twelve cents. The proposed regulation or accompanying commentary should be clarified to indicate that when the merchant has gone out of business or ceased to participate in the payment network in such a manner that the chargeback cannot be processed against the merchant's account, the issuer may include the cost of the funds returned to its cardholder through chargeback in its allowable costs.

Alternative Two in its current form is far less likely to support a vigorous process to make the chargeback process under existing network rules known by, widely available to, and used by consumer debit card holders. Under Alternative Two, an issuer will receive the same revenue whether or not its cardholders know about and use the debit chargeback remedy. However, a simple variation in Alternative Two could create an incentive for issuers to provide an effective debit chargeback program. If Alternative Two is selected, the twelve cent cap could be reduced, perhaps by one cent. That last cent would be includable in the issuer's interchange compensation only if the issuer provides an effective debit chargeback program for consumers.

To accomplish this, Alternative Two would be reduced to eleven cents, with an addition something like the following:

> One additional cent may be added to issuer compensation for any issuer who maintains a program which: 1) provides to each of its consumer debit cardholders by contract a right of chargeback when the goods or services paid for by debit card are not delivered as agreed or not accepted by the consumer or his or her designee; 2) effectively informs consumers about the availability of debit card chargeback as a remedy for disputes with providers of goods or services; and 3) returns funds to consumers on a regular basis under the debit card chargeback program.

It is poor public policy to tie access to the best consumer protections to borrowing money (credit card chargeback) rather than paying as you go (debit card chargeback). The interchange debit fee setting process mandated by Congress creates an important opportunity to address this problem. Incentivizing issuers to provide consumers with the chargeback remedy would deliver

a specific and measurable benefit to consumers from the change in interchange pricing, and it would bring paying by debit closer to being as safe as paying by credit card.

The approach selected on network non-exclusivity should be designed so that it does not interfere with the offering of cards with enhanced security features.

The proposed rule will require each card issuer to provide either two unaffiliated networks, or two unaffiliated networks per method of card use, such as signature or PIN. Whichever alternative is selected, it should be structured so as to not eliminate the possibility of an issuer choosing to provide its cardholders with a debit card which is PIN-only, or a debit card which requires a newer form of security for card use. Consumers and personal finance writers sometimes ask Consumers Union's staff whether consumers should use PIN or signature for maximum security. Unfortunately, a consumer's consistent choice of PIN doesn't protect him or her from theft when a thief remains free to choose signature. Most debit card consumers have Electronic Fund Transfer Act rights to a recredit of stolen funds within a short time after reporting an unauthorized electronic debit transaction. However, the consumer's finances can still be disrupted by funds going missing from a checking account after a thief obtains or counterfeits the debit card or otherwise accesses the consumer's account through an unauthorized debit card transaction.

A debit card is only as secure against misuse by thieves as the least secure of any of its multiple functionalities. The network non-exclusivity rule should be designed to permit an issuer to provide its customers a PIN-only debit card, or a debit card usable only with the next generation of security feature.

The comment characterizing one ATM per MSA as a reasonable and convenient ATM network for prepaid card holders must be deleted.

Finally, we ask the Board to withdraw proposed comment 2(g)-1. The statute exempts prepaid cards from the interchange fee cap and provides that the exemption is lost after one year if the issuer imposes a fee for the first ATM withdrawal per month from an ATM that is part of the issuer's designated ATM network. The proposed regulation defines the issuer's designated ATM network to mean either all ATMs identified in the name of the issuer, or any network of ATMs identified by the issuer that provides reasonable and convenient access to the issuer's customers. [Proposed section 235.2(g)] Proposed comment 2(g)-1, however, seriously undercuts the notion of reasonable and convenient. That comment states that an issuer provides "reasonable and convenient access" if it provides one ATM in the metropolitan statistical area of the card holder's last known address. No reasonable banking customer would travel the distance of a metropolitan statistical area to use an ATM, and no prepaid card holder should be expected to do so.

One ATM per MSA is not reasonable or convenient. MSAs can cover thousands of square miles, be inaccessible by public transit and simply be too large to meet any sensible notion or reasonable and convenient. For example, the Los Angles-Long Beach-Santa Ana MSA stretches 4,850 miles, encompasses five counties, and has a population of nearly 11.8 million people. Using public transportation to travel across that one MSA, from Lancaster to San Clemente, would take five hours and cost a consumer $27 in fares. Under comment 2(g)-1, a single ATM in that MSA where prepaid card holders could make a no-fee withdrawal would be sufficient to qualify for the prepaid card exemption. The Appendix to this comment offers

additional examples of the distance and inconvenience that a "one per MSA" standard would permit.

We appreciate and agree with the Board's statement in the supplementary material that "…having to travel a substantial distance from where the person is located, as determined by the last known address of the person to whom the card is issued, for an ATM in the network is neither reasonable nor convenient." [Supplementary material, Section by Section Analysis, G, Federal Register p. 81731] Proposed comment 2(g)-1 is inconsistent with this statement. We respectfully suggest that it be deleted.

We appreciate the opportunity to comment on these issues of importance to consumers.

Very truly yours,

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Appendix: Some Examples of Metropolitan Statistical Areas in the U.S. Which Illustrate Why One ATM Per MSA is Not A Reasonable or Convenient ATM Network

New York–Northern New Jersey–Long Island MSA

- Includes 23 counties in NY, NJ, PA
- Pop. - 19,069,796 (2009 est.)
- 6,720 sq. mi.
- 4 hours to drive across West (Mt. Pocono PA) to East (Montauk)
- Not entirely accessible by public transportation

Los Angles-Long Beach-Santa Ana MSA

- 5 Counties
- Pop. - 11,789,487
- 4,850 sq. mi.
- 2.5 hours to drive from Lancaster (North) to San Clemente (South)
- 5 hours by public transportation at a cost of $27 in fares

Chicago-Joliet-Naperville MSA

- 14 Counties in WI, IL, IN
- Pop. - 9,569,624
- 9,581 sq. mi.
- 3 hours to drive across (Kenosha to Jasper County, IN)
- Mostly accessible by public transportation, except portions of NW IN

Grand Rapids-Wyoming MSA

- 4 Counties
- Pop. - 778,009
- 2,890 sq. mi.
- Kent County 46/429 are surcharge free
- North (Fremont) to South (Hastings) 2 hour drive
- Neither accessible to Grand Rapids by public transportation

Birmingham-Hoover MSA

- 7 Counties
- Pop. - 1,131,070.
- 5,371 sq. mi.
- 2 hours to drive from NE (Oneonta) to SW (Centreville)
- Not entirely accessible by public transportation

Tulsa MSA

- 7 Counties
- Pop. - 929,015
- 6,240 sq. mi.
- 2 hour drive North (Pawhuska) to South (Okmulgee)
- Not regionally accessible by public transportation