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Kelly S. King
Chairman and CEO

February 18, 2011

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

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

Dear Ms. Johnson:

Branch Banking and Trust Company and its affiliated banks and subsidiaries of BB&T Corporation (BB&T)[1] appreciate the opportunity to comment on the Board of Governors of the Federal Reserve System's (the Board) proposed new Regulation II, Debit Card Interchange Fees and Routing.

BB&T recognizes the enormous challenge the Board faced in gathering, compiling and analyzing data from a large number of industry participants, interpreting Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Durbin Amendment) and developing the proposed rules, all in a very short time frame.[2] We also appreciate that the Board provided a comment period that permits sufficient time for analysis of the proposed rules and their impact.

Notwithstanding the above, the Board's proposed rules are a serious misinterpretation of the Durbin Amendment, and in numerous instances are neither permitted by nor consistent with its provisions. Additionally, we believe the Board used significantly flawed methodology in its consideration of debit card costs, and by omitting major categories of costs related to processing of specific transactions, the Board has arrived at a price cap that is artificially low and significantly below the actual costs incurred by issuers. Government price controls are bad public policy, but when price controls set prices below the cost of providing a product or service, they become untenable.

We believe that the Board's proposed rules will result in significant and unintended harm to consumers, small businesses, and to the stability of the U.S. payments system and U.S. economy, and should therefore be fundamentally revised.

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[1] As of December 31, 2010, BB&T is one of the largest financial services holding companies in the U.S. with $157.1 billion in assets and market capitalization of $18.3 billion. Based in Winston-Salem, N.C., the company operates approximately 1,800 financial centers in 12 states and Washington, D.C., and offers a full range of consumer and commercial banking, securities brokerage, asset management, mortgage and insurance products and services. A Fortune 500 company, BB&T is consistently recognized for outstanding client satisfaction by J.D. Power and Associates, the U.S. Small Business Administration, Greenwich Associates and others. More information about BB&T and its full line of products and services is available at www.BBT.com.

[2] The Durbin Amendment amends the Electronic Fund Transfer Act by adding a new section 920, "Reasonable Fees and Rules for Payment Card Transactions", codified at 15 U.S.C.A. §1693o-2.

Additionally, and prior to redrafting its proposal, the Board should, as stipulated in the Electronic Fund Transfer Act,[3] ***"...prepare an analysis of economic impact which considers the costs and benefits to financial institutions, consumers, and other users of electronic fund transfers..." and "...the effects upon competition in the provision of electronic banking services among large and small financial institutions and the availability of such services to different classes of consumers, particularly low income consumers."*** It should also revise the methodologies it uses in the consideration of costs, and follow the Durbin Amendment's requirements to establish "standards for assessing" interchange fees and not set formal price controls, apply the term "reasonable and proportional" to fees and not to costs, and measure "incremental" costs and not "average variable costs".

We recognize that it may not be possible for the Board to complete the redrafting and circulate revised rules in time to meet the April 21, 2011 date for issuing final interchange fee rules. Therefore, we urge the Board to use its discretionary authority and work closely with Congress to make appropriate accommodations that allow sufficient time for issuing final rules and for compliance by card issuers and networks. In the event the Board determines it must meet the April deadline, we urge that the rules be issued as interim final rules with an extended compliance date, and that they not dramatically revise current interchange fee rates pending further analysis and review of issuer costs and other related factors, as noted in our comments.

Finally, we note that the Federal Reserve's 2010 Payments Study, an analysis of U.S. non-cash payment trends for the period 2006-2009, identified debit and prepaid cards as the fastest growing payment types, with compound annual growth rates of 14.8% and 21.5%, respectively. The study also found that check volumes continued their long decline, and that credit card transactions showed a decrease for the first time. We believe the Federal Reserve study is strong evidence that both consumers and merchants have recognized the value and benefits of debit card payments. It is very unfortunate that the Durbin Amendment did not permit the Board to consider the ***value*** of debit and prepaid cards to consumers, merchants and the U.S. economy, as we believe such consideration would have resulted in rules authorizing interchange fees that are fair and reasonable for all parties.

To assist the Board in finalizing the rulemaking process, our comments on specific provisions of the proposal are listed below.

Interchange Fees

The Board's two alternative proposals for interchange fees are extreme and unacceptable for a number of reasons. First, the Durbin Amendment directs the Board to "...establish *standards for assessing* whether the amount of any interchange transaction fee...is reasonable and proportional to the costs incurred by the issuer with respect to the

[3] 15 U.S.C. 1639.

transaction." The Board was not directed or given authority to establish *caps* on fees or otherwise implement such price fixing rules.

Secondly, the proposed interchange fee safe harbor and cap amounts cannot in any way be deemed either reasonable or proportional. Even the Board's own analysis, which omitted many significant categories of issuer costs, found that issuers' median total cost per transaction was 13.7¢ for signature debit, 7.9¢ for PIN debit, and 63.6¢ for prepaid cards. Given that signature transactions comprise approximately 60% of debit transaction volume, and the rapid growth of prepaid card volume, the Board's rules would virtually guarantee that the majority of covered issuers would take a loss on every debit card transaction processed.

Even more importantly, in developing its safe harbor and fee cap amounts, the Board did not factor in a number of significant costs related to authorization, clearing and settlement of debit card transactions. The Board also omitted costs related to specific transactions if they were not associated with authorization, clearing and settlement, even though nothing in the statute requires such a limited scope. These omitted costs include:

- Network fees, which are integral to the authorization, clearing and settlement process.
  - This omission is particularly significant in that the proposed rules will give merchants control over network routing of electronic debit transactions, and thus the network fee charged to the issuer, and not the merchant.
- Issuer fraud losses, which can all be associated with specific transactions.
  - According to the Electronic Payments Coalition, industry fraud losses totaled $1.4 billion in 2009.
- Customer service, including:
  - Staffing, equipment and communications costs for handling cardholder inquiries and transaction disputes.

Although the Durbin Amendment directed the Board to consider "incremental cost incurred by an issuer", it instead elected to substitute "average variable cost" in its cost analysis. In doing so, it rejected a well-defined and understood methodology, and its calculations omit any consideration of an issuer's capital investment costs and reasonable profits. This is particularly ironic given that in pricing its own services, including those for check, ACH, and other types of payments, the Federal Reserve uses a Private Sector Adjustment Factor that takes into consideration a reasonable return on equity.

Also severely flawed was the Board's comparison of the functional similarity between checks and debit transactions, which did not adequately take into account a number of differences between the two payment methods, including:

- A standard feature of debit card transactions is that the merchant is guaranteed payment, with the card issuer accepting the risk of non-payment;
    - Checks come with no guarantee of payment unless a merchant elects to utilize and pay for a separate check guarantee service;
    - Check guarantee services typically charge as much as 1.5% of the check amount, and have significant restrictions as to eligible check types and amounts;
    - Banks typically charge merchants a per item fee for each check they deposit;
    - According to the Federal Reserve's Payment Study, $103 billion checks were returned unpaid in 2010.
        - Merchant depositors are generally assessed a fee, typically from $15 to $25, for checks they deposit that are returned unpaid.
        - Merchants also incur costs for the time and effort involved in collecting on returned checks.
- Checks are not a practical payment method for a variety of transactions, including:
    - Telephone and Internet purchases
    - Purchases made while traveling out of town or overseas
    - For rental cars or hotel stays
    - Pay at the pump
    - In-flight purchases on major airlines, many of which accept only card payments
    - Purchases at a wide variety of retailers, including convenience stores and some restaurants, which do not accept checks.

Another flaw in the Board's methodology was its analysis of issuer costs for only one specific year, 2009. This approach obviously omits consideration of costs issuers will incur on an ongoing basis as a result of the rules themselves. In particular, the routing provisions will increase issuer expenses for routing transactions through additional networks, and these additional costs are addressed in our comments on the routing proposal.

For BB&T, this omission is particularly significant, as we brought debit card processing in-house a number of years ago as a means of improving client service. The significant capital investments we have made in our in-house debit card processing infrastructure over a number of years are ignored in the Board's pricing methodology. When our in-house systems reach the end of their useful life and need to be replaced or significantly upgraded, it will be difficult to justify an investment for which we will not be permitted to recognize any cost recovery or return under the Board's proposed rules.

For all issuers and the debit card payments system in general, the lack of consideration of capital investments is certain to curb future innovation, including development of contactless- and mobile-enabled payments, e-mail and mobile alerts, expense management tools and other services that benefits cardholders and merchants alike.

If the Board should decide to adopt one of its two proposed alternatives for interchange fees, we would urge the adoption of Alternative #2, a single per-transaction fee cap, as representing the lesser of two evils. Should this alternative be adopted, we would recommend the following additional changes:

- The cap should be adjusted upwards from 12¢ and vary by type of transaction to more accurately and reasonably reflect issuers' true costs, including:
    - Any caps implemented should accurately reflect issuer's true costs, to specifically include network fees, fraud losses, cardholder servicing, capital investments and a reasonable profit;
    - Separate cap amounts to reflect risks associated with certain types of transactions (e.g., card not present, and specific merchant categories determined to have elevated incidences of fraudulent transactions);
    - Separate cap amounts for signature, PIN transactions and particularly prepaid cards (which the Board found to have significantly higher costs).
- The interchange cap exemption for reloadable prepaid cards not marketed as gift cards should be expanded to exclude gift and other special use/limited life cards for a variety of reasons, including:
    - The Board's analysis found that prepaid card processing costs are significantly higher than those debit transactions that directly access a deposit account;
    - Gift cards are distinctly different products from other debit cards:
        - Gift cards are typically used for comparatively low dollar transactions and the card funds are frequently depleted shortly after purchase, often in a single transaction.
        - Under the Board's proposal, a gift card whose balance is used for a single purchase will generate a maximum of just 12¢ in interchange fees to the issuer.

- Gift card fees have already been regulated as part of the recent Credit CARD Act; any further restrictions on gift card issuer revenues will impact the viability of gift cards and force issuers to raise card issuance fees, thus making the product significantly less attractive to purchasers, or withdraw from the gift card market.
- Gift and special use prepaid cards often represent the only relationship between the cardholder and the issuing bank, thereby limiting the issuer's alternatives for recouping lost interchange revenues on these products from other product and service relationships with the cardholder, an alternative suggested in the Board's analysis.

As to how the caps will be applied, we recommend that the rules allow the cap to be applied to either a card network's average rates for all of its transactions, or to the average of a specific issuer, at the option of the issuer. This will allow for reasonable flexibility for issuers who take steps to achieve efficiencies through lower costs and for issuers without the resources to determine their own average rates that prefer to rely on network averages.

The Board has also requested comment on application of its proposed interchange fee rules to ATM transactions and to three-party card networks. We strongly oppose any attempt by the Board to regulate ATM interchange fees, network switch fees, and/or network routing, primarily because such action is neither contemplated nor authorized in the Durbin Amendment. We also note that the ATM industry operates on relatively narrow margins, and any regulation of ATM interchange fees will negatively impact the current business model to the extent that operators will be forced to remove marginally profitable machines from service, and the availability of surcharge-free ATM networks will be severely cut back, both of which will harm consumers.

As for three-party networks, we believe the Board's rules should be applied in a manner that treats both four- and three-party networks consistently and fairly, taking into consideration that for the latter, the same entity serves as issuer and card network, and thus network fees in a three-party network are typically treated as operating expenses for the issuer/network. Consistent treatment of both network categories will help ensure a fair and open market for consumers and small businesses.

Delay in Effective Date is Imperative

Finally, regardless of the interchange provisions adopted in the final rule, it is imperative that the Board take steps to delay their effective date to avoid what we believe would be a significant risk to the card payments system in the United States.

We note that routine revisions to card network interchange fee tables typically involve a four- to six-month implementation timeframe from announcement to effective date. The alternatives that the Board is proposing for interchange fees, which may entail exemptions for certain issuers and card products and distinct rate schedules for specific issuers, will require changes to transaction and fee processing systems that are exponentially more complex than previous routine changes. It will be extremely challenging for card networks, merchants, and merchant acquirers to complete the required programming and testing, rule revisions, notifications, disclosures and procedural changes in the three months between the deadline for the Board's final rules and their July 21, 2011 effective date. We believe this short implementation period risks significant disruption to the authorization, clearing and settlement of both debit and credit card transactions.

We also note that a delay would allow time for the Board to finalize rules for the fraud prevention adjustment factor in time to be implemented in conjunction with the interchange fees provisions. We strongly believe that it would be inappropriate and unfair for the Board to make its interchange fee rules effective prior to the effective date for the fraud prevention adjustment factor.

Fraud Prevention Adjustment

We do not believe that either of the two alternatives proposed by the Board for determining the standards for an issuer to be eligible for the fraud prevention adjustment to its interchange fee rates reflect all of the appropriate factors that should be considered. We believe that the standards should consider: (i) an issuer's current costs for its fraud prevention and data security programs; (ii) the costs for enhancing these programs on an ongoing basis to adapt to new techniques adopted by fraudsters; (iii) costs incurred to safeguard against fraud perpetrated against new card form factors, such as contactless cards and NFC-enabled mobile devices; and (iv) compensation for investments in new fraud prevention technologies.

We do not believe it is appropriate for the Board to assume the responsibility for certifying or designating specific technologies, techniques, or other procedures as being requirements for the fraud prevention adjustment factor. We believe such a requirement would be counter-productive, as it may actually lead to increased fraud. Fraudsters would know exactly what technologies a large number of issuers are using, and would use this knowledge to focus their resources in attacking the designated technologies and techniques.

We urge the Board to take an expansive view of fraud prevention measures, as any significant reductions in the funds available to issuers for fraud prevention is likely to result in restriction on consumers' use of debit and prepaid cards, including possible limits on transaction amounts or number of debit card purchases, or reductions in the protections currently available to both merchants and consumers, including consumer "purchase guarantee" protections against defective or non-delivered merchandise, and the payment guarantee feature for merchants.

Transaction Routing

BB&T recommends the Board adopt Alternative A as its rule for prohibiting network exclusivity, under which it would be sufficient for an issuer to issue a debit card that could be processed over one signature-based network and one PIN-based network, provided the networks are not affiliated. We would be strongly opposed to Alternative B, as it goes beyond the requirements and intent of the Durbin amendment. and would necessitate a massive redesign and restructuring of the current card network system at tremendous cost to all parties involved in debit card processing. In addition, under the Board's proposal, covered issuers would be severely restricted in their ability to recoup the costs of their investments in the restructured system.

Additionally, we strongly recommend that the Board clarify, in accordance with the provisions of the Durbin Amendment, that issuers are not required to affirmatively enable the processing of debit cards on a given number of networks so long as the issuer does not restrict its participation to fewer than two unaffiliated networks.

We also urge the Board to exempt gift, healthcare, insurance, and other special purpose reloadable prepaid cards from the network exclusivity rules. As mentioned previously, these cards are designed and generally used for limited purposes and with specific authorization methods. Additionally, by their very nature, many special use cards are not generally sold directly to the cardholder recipient, and do not support ubiquitous POS use, PIN access, or cash access. There would be significant procedural and technical challenges in allowing multiple networks and/or issuing PINs to the ultimate cardholder in a safe and secure manner. Any significant reductions in revenues or additional expenses involved in issuing these products are likely to make them unprofitable, and result in most if not all issuers exiting the market, to the ultimate harm of businesses & consumers.

Special purpose reloadable prepaid cards such as FSA and HSA or qualified transportation cards are designed for processing through signature networks only. An important feature of these cards is that signature card network processing is able to limit their transactions to eligible purchases. This feature, which significantly reduces claim processing, substantiation and other administrative costs, is not available through PIN networks. It is also important to note that Senator Durbin has stated that such cards were not intended to be covered by the Durbin Amendment.

As to the market coverage requirements for qualifying networks, we recommend that the rules allow issuers broad discretion in selecting unaffiliated networks. It will be in an issuer's best interests to select networks that adequately serve its market areas and cardholder needs, and networks with coast-to-coast national coverage are not necessarily appropriate for all issuers. Additionally, the Board should avoid any requirements that would put the viability of smaller regional networks at risk.

Finally, the Board's suggested October 2011 effective date for Alternative A is unachievable. Under Alternative A, large number of issuers will be required to establish new relationships with PIN networks, and issuers of PIN-only cards will need to do the same with signature networks. Establishing these new relationships is neither a quick nor simple process, but involves:

- Soliciting requests for proposals, conducting vendor due diligence and contract negotiations;
- Establishing and testing new communications links;
- Training staff on new network systems, reports, rules and procedures;
- Client notifications and disclosures and potentially issuance of new cards.

In accomplishing the above, a large number of issuers will be dealing with a comparatively small number of networks, which will drive up rates charged by these networks. The short timeframe is also likely to create significant backlogs and bottlenecks given limited network resources, and put smaller issuers at a disadvantage. To allow sufficient time for an orderly transition, the Board's network exclusivity provisions should be effective no sooner than July 2013.

Other Comments

We recommend that the Board clarify in its final rules that the expanded definition of "debit card" used in the Durbin Amendment applies only to section 920 of the EFTA.

We recommend that the final rules assign responsibility for certifying the exempt status of small issuers and eligible prepaid card products to the card networks rather than assigning this function to the Board. We believe the networks are in the best position to administer this function in an efficient manner with the least cost to issuers.

Finally, we recommend that the Board's rules prohibiting circumvention or evasion of rules on interchange fees recognize the revenues from network signing bonuses as being accrued over the life of the related agreement, as prescribed by GAAP, rather than as a lump sum payment.

Thank you in advance for your consideration of our comments and suggestions, and please feel free to contact my office with any questions or concerns.

Sincerely,

Kelly S King

Kelly S. King