From: Kathy Burrows

Subject: Reg I I - Debit card Interchange

Comments:

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Comments:
Ms. Jennifer J. Johnson Secretary Board of Governors of the Federal Reserve System 20th Street and Constitution Avenue, NW Washington, DC 20551 Re: Regulation II; Docket No. R-1404 Dear Ms. Johnson: Thank you for the providing us the opportunity to respond to the Request for Comment issued by the Federal Reserve Board (FRB) regarding proposed Regulation II and its supplementary information. As Assistant Vice President and Compliance Officer at Bankers Trust Company, a banking institution in Des Moines, Iowa with $2.7 billion in assets, I am writing to express my serious reservations about the proposed rule. Bankers Trust Company is the largest, independently-owned bank in Iowa, with 10 locations throughout the Des Moines metropolitan area, in addition to offices located in Ames, Iowa and Phoenix, Arizona. Bankers Trust provides well-paying jobs with top-notch benefits to over 450 employees. We offer a full breadth of banking services including: consumer retail banking products, treasury management services, international banking services, consumer and commercial lending, and trust and wealth management services. A corporate leader in the community, Bankers Trust has received numerous awards and recognitions for its philanthropy, volunteerism, and support of the community, as well its commitment to promoting diversity and inclusivity. As an institution with assets totaling less than $10 billion, we realize we are part of the carve-out and not subject to the interchange fee restrictions. After careful analysis of the rules, however, we believe nonetheless our bank will be detrimentally affected by the proposed interchange fee restrictions. Merchants benefit greatly from the payment systems. Many merchants choose to accept card payments because, for both them and their customers, they are safer, faster, more reliable, and more convenient than checks or cash. So long as the merchant swipes the card and obtains appropriate authorization, the merchant is guaranteed payment. Moreover, Internet and mail order merchants have additional safe guards that allow them to process card-not-present transactions with virtually no risk of bearing a loss. Even in cases of insufficient funds or

outright fraud, the merchant is paid and the bank suffers the loss. In fact, the single largest loss on consumer accounts for our bank results from claims of fraudulent debit card transactions. In 2010 alone, we charged off in excess of $50,000 in fraudulent debit card transaction claims. Although we are fortunate to have lower fraud charge-offs than the industry on average, this figure is the equivalent of a full-time employee's salary. Our bank offers free debit cards to all of its accountholders. Furthermore, we own, maintain and service a fleet of 165 ATMs throughout the Des Moines metropolitan area. Additionally, we participate in the Privileged Status program offered by the SHAZAM network, allowing our debit cardholders' access to thousands of ATMs throughout the United States without incurring a surcharge. We incur considerable annual expenses to provide our customers free or low-cost, convenient access to payment networks throughout the country. Again with a potential 80% reduction in interchange income, we will be forced to consider: charging debit card fees, reducing our fleet of ATMs., and charging fees for checking accounts and other banking services which are currently free. This will result in increased consumer and small business costs and decreased network access for cardholders. In late 2008, we invested in and deployed "Instant Issue" card machines at all of our offices. Instant Issue provides accountholders the convenience of having their debit cards issued in the office, on the spot. The accountholder is no longer forced to wait for a debit card to be mailed; the accountholder can select his or her own PIN by accessing a specially-designed keypad. The initial investment for hardware and software for the Instant
Issue program was in excess of $150,000. This figure does not include labor hours, training costs, or the ongoing costs of maintaining the Instant Issue program. The potential 80% percent reduction in interchange income, Bankers Trust will no longer be able to provide cutting-edge, innovative technology and services to its debit cardholders. This will result in decreased ability to compete with large, national banks and fewer services provided to our customers. Currently we provide two types of risk management services to our debit cardholders: Proactive Risk Management and Real-Time Decisioning. Proactive Risk Management detects unusual patterns of debit card activity, warm-cards a suspect card, and the product vendor places a call to the cardholder or bank to ensure the activity is legitimate prior to reactivating the card. Real-Time Decisioning detects highly unusual debit card transactions and stops the transaction prior to completion. Again, the product vndor places a call to
either the debit cardholder or bank to determine the legitimacy of the transaction. Bankers Trust has incurred costs in excess of $40,000 in the past 12 month for these fraud monitoring services. With a potential 80% reduction in interchange income, our costs for maintaining fraud monitoring services may need to be passed on to cardholders. This will also result in increased cost to consumer and small business customers. Limiting interchange income as proposed will result in higher costs to consumers and small businesses, less innovation in the payment networks, and will restrict the products and services banks offer their communities. In spite of the carve-out for small issuers, market forces are likely to force interchange fees down to the federally-mandated rate, if not lower. Below are our specific comments regarding each section of Regulation II: the proposed interchange fee, transaction processing restrictions, and fraud-prevention costs. Proposed Interchange Fee In order to preserve the intent of the small issuer interchange rate exemption included in the law, we ask that you issue additional rules to guarantee the small issuer exemption in the marketplace and protect the interchange revenue of all small issuers. As dictated in the law, you need to fully consider the "role" of the issuer in the authorization, clearing, and settlement of an electronic debit

transaction. For example: In order to have a transaction processed on a payment network, an issuer needs to be a network participant. Participation requires the payment of various fees, including but not limited to network fees, participation fees, and debit card residency fees. The FRB also needs to expand its view of settlement. The primary objective of the Electronic Funds Transfer Act is to protect individual consumers engaging in electronic funds transfers (EFTs). Network operating rules, which also provide consumer protections, require an issuer to maintain responsibility and liability for settlement until a cardholder's dispute rights have fully expired. Any costs incurred by an issuer throughout this settlement process should be considered allowable costs, including the cost of inquiries and disputes; fraud losses and fraud-prevention costs; and fixed costs, including capital investments, used to support settlement. The law specifies that the interchange fee shall be "reasonable and proportional" to the costs (not the exact costs) to authorize, clear, and settle a debit transaction; therefore, an allowance should also be made for a reasonable profit. If you do not take into account these factors, the proposed interchange cap is not a "reasonable" fee. Additionally, in calculating the permissible interchange fee, the proposed rule does not recognize important value-added differentiators between debit cards and checks. For example: When a merchant obtains a proper authorization for a debit transaction, payment is guaranteed and the issuer suffers the loss in the event there are insufficient funds or the transaction is determined to be fraudulent. Checks may be returned non-payable, and merchants suffer the loss. Alternative 2 (cap only) is the better alternative. Alternative 1 (safe harbor and a cap) would require the creation of a separate interchange rate for each covered issuer, as each such issuer would have different costs. This would require payment card networks to create a new interchange system for each covered issuer. Alternative 1 would be more expensive to all issuers, including small issuers, as the network implementation costs would be passed on to issuers. Transaction Processing Restrictions Per the transaction processing restrictions portion of Regulation II, Alternative A (two unaffiliated networks) would be the most cost-effective alternative because community financial institutions, such as Bankers Trust Company, would not have to join additional payment card networks. Additionally, if ATM transaction routing is included within the final rule's scope, Alternative A would be the most cost-effective alternative. Alternative B (two unaffiliated networks per authorization type) may require reissuance of cards in order to comply with network branding requirements. This is an unnecessary expense and an inconvenience to our cardholders due to such things as recurring payments. If the FRB mandates Alternative B, it should require that an interchange adjustment be made to cover the increased cost to issuers for participation in multiple networks. Additionally, the law states that merchants are not authorized to discriminate between debit cards within a payment card network on the basis of the institution that issued the debit card. The FRB should specifically address the discrimination aspect of the law in the final rules to provide protections for all issuers within a payment card network. The FRB also needs to make allowances in the final rules fr issuers to make decisions on debit card acceptance or routing in order to mitigate fraud. An issuer needs to have the ability to place restrictions or acceptance blocks on its debit cards to maintain or restore the security of an account or the EFT system without being cited for violating routing rules. Fraud-Prevention Costs In discussing fraud-prevention costs, the FRB should organize and oversee a fraud consortium comprised of representatives of all stakeholders in the electronic payments industry. Its purpose would be to develop a holistic approach to fraud-prevention and liability allocation issues. Primarily, the consortium

should come up with fraud-prevention alternatives that not only reduce fraud but also provide a positive return on investment for all stakeholders. The consortium should develop non-prescriptive, fraud-prevention standards for merchants. Implementation of these standards could be monitored through an enhanced review of regulated merchant-sponsoring financial institutions. The consortium should also ensure
that all parties have an equal opportunity to implement new technologies, and that small issuers are not denied such implementation opportunities due to excessive cost. Finally, Alternative 2 (non-prescriptive) is the better alternative. It is not practical for the FRB to mandate specific technologies. We believe Alternative 1 (technology-specific) would stifle technological changes, as the FRB is not an expert regarding technologies that could reduce fraud. Thank you for your time. Sincerely, Kathy Burrows Bankers Trust Company