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Subject: Reg I I - Debit card Interchange

Comments:

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Proposal: Regulation II - Debit Card Interchange Fees and Routing
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From: Paul Close, President of Retail Automation Research To: reqs.comments@federalreserve.gov Subject: Regulation II - Debit Card Interchange Fees and Routing - a simple quick solution From: Paul Close 15039 SW Royalty Pkwy Tigard, OR 97224 February 21, 2011 To: Jennifer J Johnson Secretary, Board of governors of the Federal Reserve System 20th St. and Constitution Ave. NW Washington, DC 20551 Comments on the Federal Reserve Board's proposed changes to interchange rules, are Respectfully submitted to the Board of Governors of the Federal Reserve System. I have been a consultant to a broad range of retailers and payment system providers (including Visa, American Express and CitiCorp) since the early days of Point-of-Sale. My work required a close monitoring of payment systems from the get-go. The following comments will attempt to briefly present several important issues that do not appear to be covered by the Durbin Amendment itself and/or the Board's proposed rules. It is already
clear that there will be legal hurdles for implementation of the proposed rules, and a complex, expensive implementation. The following comments may provide unique suggestions for review of the Amendment and Proposed Rules, and a simple solution that would quickly achieve much of the goals without non-productive dissent and regulation. First, it is recommended that action on the amendment should be delayed as being discussed in Congress. It is further suggested that Senator Durbin and his staff should re-visit the amendment with appropriate hearings to consider the issues more thoroughly. It is suggested that the delay be used to determine the actual total cost of card acceptance to Retailers of all classes and sizes, because issuer Interchange may only be a part of their total cost. The simple proposal presented later, would deliver immediate impact with literally no need for dissent and regulation, It would give the Congress and the Fed room to improve the system without unnecessary and unproductive regulation. It is also uncertain how much of the savings would filter down to merchants, much less to consumers, but read on. A

number of very good rule changes that would involve little cost and controversy have been proposed: • Network compensation to issuers • Transaction Routing choice by the retailer. • Restrictions on offering discounts for use of a form of payment at the POS. • Restrictions on setting transaction minimums or maximums at the POS. • Discrimination between debit and credit cards on the basis of the issuer. It is suggested that some underlying assumptions be re-considered. For example the first statement in the amendment under section 920 (a), REASONABLE INTERCHANGE TRANSACTION FEES FOR ELECTRONIC DEBIT TRANSACTIONS and sub-paragraphs (4) (A) "(A) consider the functional similarity between- "(i) electronic debit transactions; and "(ii) checking transactions that are required within the Federal Reserve bank system to clear at par; The
foregoing is just one of the assumptions that may be flawed as described below. There are others. It is believed that both checks and Debit card transactions technically clear at PAR, they have to or no one could reconcile them. This statement infers that the Debit card is a new cost that did not exist when checks were predominant. That may be true, but it appears to overlook the fact that in the days when checks were more prevalent at the Point-of-Sale, the retailer paid an even bigger cost of authorizing, balancing and delivering them to the bank (which probably charged for accepting the deposit), and who in turn paid the Federal Reserve an ACH fee. Retailer's also bore the cost of collecting returned fraudulent checks (and the retailer sustains the loss unless covered by the insurance they have purchased), It might be more correct to say that Debit transactions transferred all those functions at a lower cost to a more efficient system using Debit cards, a system paid for by the Issuers of the cards who deserve to receive an Interchange fee at the end of the month. The argument is how much should the interchange fee be, since it has grown rapidly over the past five or six years, coincidentally since the settlement of the Wal-Mart suit. It is also suggested that the question of Signature vs PIN should be examined more carefully. The staff's recommendation did not adequately address the factors suggested by the Amendment (shown below) although they did develop a comprehensive statistical analysis that showed a difference in Interchange between Signature and PIN verification of about 1% of sales. This might indicate that, if PIN were implemented at all Points-of-Sale, the 1% savings would quickly pay the cost of equipment upgrading for many retailers and the savings would continue after that. The staff's recommendations did not appear to address the savings from PIN as directed by the amendment. '(B) RULEMAKINGREQUIRED.- '(i) IN GENERAL.-The Board shall prescribe regulations in final form not later than 9 months after the date of enactment of the Consumer Financial Protection Act of 2010, to establish standards for making adjustments under this paragraph. "(ii) FACTORS FOR CONSIDERATION-In issuing the standards and prescribing regulations under this paragraph, the Board shall consider- "(I) the nature, type, and occurrence of fraud in electronic debit transactions; "(II) the extent to which the occurrence of fraud depends on whether authorization in an electronic debit transaction is based on signature, PIN, or other means; '(III) the available and economical means by which fraud on electronic debit transactions may be reduced; (which seems a little far afield from the basic intent). Mandating PIN for all Debit transactions within some reasonable period of time would be simple, and effective. Basically, standardization on PIN would eliminate the dual mode debit card over time. It is believed to be unique to the United States. This
could reduce cost of Debit to retailer's who cannot take PIN now by about 1% of the Debit sales and eliminate the fraud losses and confusion of signature Debit which were not anticipated. The expense savings would probably be even more because the rewards cost of signature Debit would be eliminated too (see

exhibit 1). While such a change would cause a reduction of Debit revenue to the issuer, the net effect on Issuer's revenue might be less than if the Fed were to impose an Interchange cap with all the expense that would entail, and might not include allowance for Fraud. While there is some discussion as to whether the 1% savings would be passed through to merchants, it would be relatively easy for Merchants to measure and acquirers to explain (see exhibit 2). The push for Mobile/NFC might bring pressure to (at retailer's option) forego PIN on low-value transactions