Before the
FEDERAL RESERVE BOARD OF GOVERNORS
Washington, D.C.

In the Matter of	)	
	)	
Debit Card Interchange Fee and Routing	)	Docket No. R-1404
	)	RIN 7100-AD63
	)	

COMMENTS OF THE SECURE ID COALITION

The Secure ID Coalition (SIDC) hereby submits the following comments regarding the Board of Governors of the Federal Reserve System (Board) Notice of Proposed Rule Making (NPRM) on Debit Card Interchange Fees and Routing.[1] The SIDC applauds the Board for looking into possible frameworks for adjusting interchange fees to incentivize fraud-prevention measures to safeguard consumers from credit and debit card theft and fraud. As explained below, the SIDC has great confidence that the Board will recognize how Chip-and-PIN fraud prevention technologies have become the *de facto* standard for securing payment cards worldwide, and will adopt Chip-and-PIN technology standards to the benefit of American consumers, give financial relief of American merchants, thwart fraudsters both online and off, and enable American travelers abroad to use their credit and debit cards worldwide without fear of merchant rejection or swindle.

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[1] Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81742 (2010) (proposed December 28, 2010).

INTRODUCTION

Founded in 2005, the Secure ID Coalition works with industry experts, public policy officials, and federal and state agency personnel to promote identity policy solutions that enable both security and privacy protections. Because of our commitment to citizen privacy rights and protections, we advocate for technology solutions that enable individuals to make their own decisions about the use of their own personal information. Members of the SIDC subscribe to principles that include the increased deployment of secure identity solutions, as well as advise on – and advocate for – strong consumer privacy protections and enhanced security to eliminate waste, fraud, theft, and abuse. The SIDC is headquartered in Washington, D.C.

As we slowly make our recovery from of one of the worst financial downturns in modern memory, American consumers are facing a second, equally crippling credit crisis: credit card fraud. In 2007 the Federal Bureau of Investigation estimated in its *Financial Report to the Public* that credit card fraud cost the US $52.6 billion dollars annually. In fact, a recent study by ACI Worldwide states that in the past five years, 29% of credit/debit card users have experienced card fraud, a number that is up 62% since 2009. Industry observers believe the amount of fraud in the system is dramatically higher because the financial industry – which includes banks and credit card issuers – refuse to release their fraud losses each year.

To add insult to injury, not only are the victims forced to bear the burden of putting their life back in order after being hit by fraud, but they are forced to compensate the credit card industry for their increased costs through higher interchange fees and rates – usually at a profit. These fees are above and beyond the actual cost of fixing fraud, which could have easily been *prevented* by the use of a simple and inexpensive anti-fraud technology already used worldwide: Chip-and-PIN cards.

It is in this interest that the SIDC submits these comments on the Debit Card Interchange Fee and Routing Proceeding (Proceeding), so that the Board may develop a robust plan to best foster an environment where businesses and consumers may use their debit and credit cards both online and around the world safe in knowing that thanks to Chip-and-PIN, they are protected by the globally accepted gold-standard of payment card fraud protection technology.

DISCUSSION

A Technology-Specific Solution to Protect Consumers from Financial Fraud

The SIDC supports a technology-specific solution to protect consumers from financial fraud – as opposed to a non-prescriptive standard – for a number of reasons. Up to now, financial institutions have long had the opportunity to implement fraud prevention measures in the US market; at their best, they have measured up to be fraud-appeasing, and at its worst, fraud-inducing. For instance, the federal Fair Credit Billing Act[2] limits the liability of card holders to $50 in the event of theft of the actual credit card, regardless of the amount charged on the card, if reported within 60 days of receiving the statement. Once successfully charged back to the financial institution, the financial institution then charges back the merchant, who is then forced to pass the costs back on to the consumer. Amounting to a never-ending shell-game, fraud is never *prevented,* it is only *passed back to the consumer*.

Further, current protections against credit card fraud are a mere fig leaf of security. Currently issued credit and debit cards are easily skimmed and duplicated, and comparing a fake signature on a fake credit card is fool's errand. Stolen credit card numbers are routinely used in Card Not Present (CNP) transactions, especially online. And up until this month, a common security practice was to ask for the ZIP code associated with the debit/credit card's billing address – that is, until the California Supreme Court unanimously decided[3] that retail stores may not ask a customer to provide a ZIP code in the course of a credit card transaction, as to do so would be a violation of their state privacy rights.

While the SIDC strongly agrees that generally markets should be allowed to pick 'winners and losers', the SIDC strongly believes that the market *has* spoken, as evidenced by the global adoption of Chip-and-PIN as the global standard in financial card fraud prevention.

As evidenced by the chart below, *almost* every G-8 and G-20 nation has adopted the Chip-and-PIN standard; we highlight 'almost,' as the only G-8/G-20 nation not to do so is the United States. In this, we have the dubious distinction of joining countries such as ***Afghanistan,***

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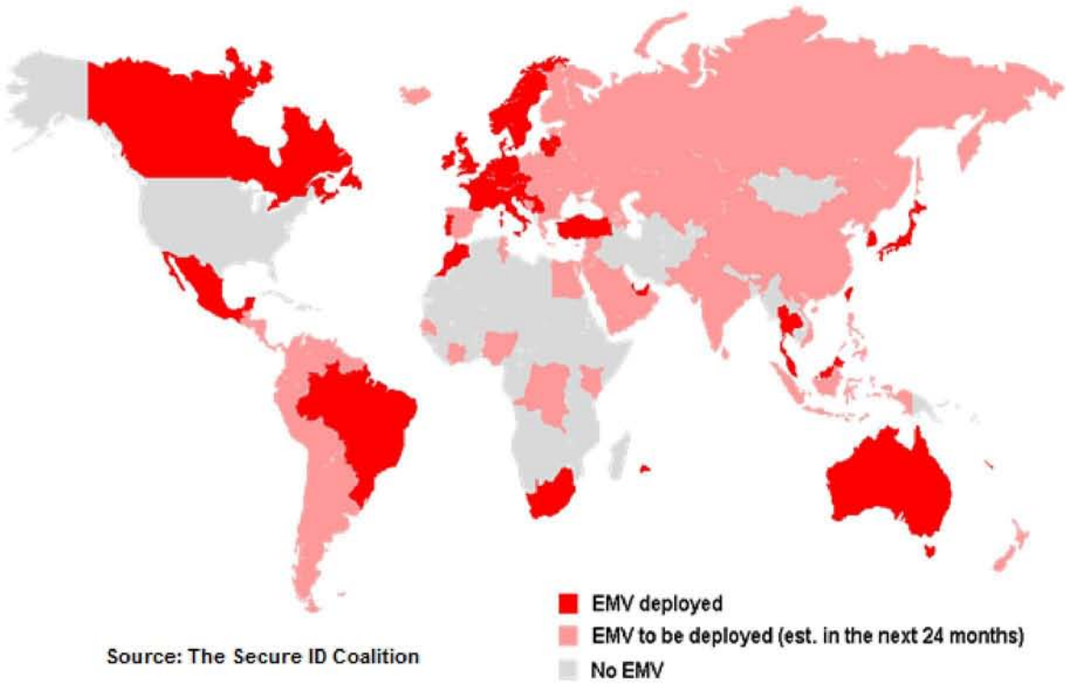
[2] 15 U.S.C. § 1601 et seq.

[3] Pineda v. Williams-Sonoma Stores Inc, California Supreme Court, No. S178241 (Feb. 2, 2011).

Angola, Bangladesh, Cambodia, Eritrea, Ethiopia, Iran, Iraq, Libya, Liberia, Mozambique, Pakistan, Papua New Guinea, Rwanda, Somalia, Tajikistan and Turkmenistan where the financial payments industry is not interested in protecting its customers with secure card technologies.

Global Chip-and-PIN Adoption, by 2013



Source: The Secure ID Coalition

The following countries currently use CHIP-and-PIN for credit/debit transaction:

Armenia
+Australia
Austria
Belgium
+Brazil
+*Canada
Croatia
Czech Republic
Denmark
+*France
+*Germany
Ireland
+*Italy
+*Japan
Latvia
Lithuania
Malaysia
Mauritius
+Mexico
Morocco
Netherlands
Norway
Portugal
Serbia
Slovenia
+South Africa
+South Korea
Sweden
Switzerland
Taiwan
Thailand
+Turkey
UAE
+*UK

****G-8 Countries***
+G-20 Countries

The following countries by 2012 plan to deploy CHIP-and-PIN for credit/debit transaction:

+Argentina
Azerbaijan
Belarus
Belize
Bolivia
Bosnia and Herzegovina
Bulgaria
Cayenne
Chile
+China
Columbia
Costa Rica
Cote D'Ivoire
Ecuador
Egypt
El Salvador
Estonia
Finland
Georgia
Greece
Guatemala
Guyana
Honduras
Hungary
+India
+Indonesia
Israel
Jordan
Kazakhstan
Kenya
Kuwait
Macedonia
New Zealand
Nicaragua
Nigeria
North Korea
Oman
Panama
Paraguay
Peru
Philippines
Poland
+*Russia
+Saudi Arabia
Senegal
Slovakia
Spain
Sri Lanka
Suriname
Syria
Tunisia
Ukraine
Uruguay
Venezuela
Vietnam
Yemen
Zaire

The following countries do not have/nor plan CHIP and PIN deployments:

Afghanistan
Albania
Algeria
Angola
Bangladesh
Benin
Bhutan
Botswana
Burkina Faso
Burma
Burundi
Cambodia
Cameroon
Cape Verde
Central African Republic
Chad
Djibouti
Equatorial Guinea
Eritrea
Ethiopia
Gabon
Ghana
Guinea
Guinea-Bussan
Iran
Iraq
Kyrgyzstan
Lesotho
Liberia
Libya
Laos
Luxemburg
Madagascar
Malawi
Mali
Mauritania
Mongolia
Mozambique
Namibia
Nepal
Niger
Pakistan
Papua New Guinea
Republic of Congo
Rwanda
Sierra Leone
Soa Tome and Principe
Somalia
Sudan
Swaziland
Tajikistan
Tanzania
The Gambia
Togo
Turkmenistan
Uganda
+*United States
Western Sahara
Zambia
Zimbabwe

***G-8 Countries**
+ G-20 Countries

Subjective non-prescriptive standards are appropriate when there are multiple technologies that can more-or-less achieve the same goals when the market is still deciding on the best way to deliver a consumer benefit, such as home video recording (e.g., VHS vs. Beta), or personal computing platforms (e.g., Mac vs. PC). However, the Board faces a far more urgent situation – not only in deciding how to rein in rampant fraud both online and off costing consumers billions of dollars a year, but in ensuring that US citizens will be able to transact business globally.

To that point, the European Payments Council[4] has announced their plans to allow merchants to *refuse magnetic stripe transactions altogether,* thus denying US travelers abroad the ability to use their current credit and debit cards, as well as mandating that all CNP transactions on both the issuing and acquiring side have an appropriate authentication solution by the end of 2013. When this goes into effect, US citizens using their current payment cards will be utterly unable to participate in CNP transactions with merchants across the European Union.

The Board notes in the NPRM that "the drawback of adopting technology-specific standards is the risk that it would cause issuers to under-invest in other innovative new technologies, not included in the Board's standards, that may be more effective and less costly than those identified in the standards."[5]

American consumers do not have the luxury to wait until *another* alternative standard is determined, nor should they when a proven, mature standard is already at hand that actually *prevents* fraud. By adopting the internationally accepted Chip-and-PIN standard, the Board may ensure that they will be taking advantage of a powerful network effect granted by Chip-and-PIN: in utilizing an *internationally tested, accepted, and mature method of securing financial cards*, they will ensure that US consumers will be able to take advantage of strong privacy, security and fraud prevention mechanisms *and* allow American citizens to continue financial transactions across the European Union, our largest economic trading partner.

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[4] European Payments Council, *Resolution: Preventing Card Fraud in a Mature EMV Environment,* Doc. EPC424-10, 31 January 2011.

[5] *See* Debit Card Interchange Fees and Routing, at 81742.

Chip-and-PIN Technology Discussed

Inherently secure, Chip-and-PIN cards have a microchip embedded in them that electronically authenticates the point-of-sale terminal while the terminal simultaneously authenticates the card, to make sure both are legitimate. As an additional layer of security, the card holder needs to prove that they're authorized for the account, which they do by entering their secret PIN number at the time of the transaction. If it matches, the transaction is approved. Having both the authentication of the terminal and the card, plus the cardholder inputting their PIN provides a security measure known as *two-factor authentication,* and is considered an exceptionally secure type of transaction by security experts.

Unfortunately, credit and debit cards now in use across the US do not use Chip-and-PIN, and as a result American consumers are far more susceptible to credit card fraud. Instead, the US financial industry uses magnetic strip cards, an outdated technology that allows anyone in possession of the card to conduct a transaction. A merchant may check to see if the signature on the back of the card matches the signature on the receipt. Since a signature can easily be forged, security experts consider this an inherently insecure type of transaction. Mag-stripe debit cards are still considered a risk because the cards are easily cloned, spoofed or copied.

As mentioned above, the majority of developed nations have determined that the type of credit cards used in America are an ongoing threat to the economic safety of its card holders due to its susceptibility to being used in fraudulent transactions. As a result, almost every other developed country in the world has transitioned, or is transitioning, to a Chip-and-PIN financial payment card infrastructure. As a result, customers in countries outside the US are the victims of credit card fraud less

often, and credit card companies have been able to reduce their fees and rates, with the savings being passed on to their customers.[6]

Moreover, because financial institutions in the United States refuse to deploy this more secure form of payment; American consumers continue to suffer increased incidents of fraud. Publicly, card issuers and merchants blame each other for not deploying newer, more secure Chip-and-PIN cards. In private however, there's no incentive to change, as it comes down to simple economics: it's far more profitable to pass the cost of fraud on to the merchant (who raises their retail prices to offset the cost of the fraud and the credit card company's chargeback fees, plus an added premium) than to use card solutions that will eliminate the fraud and expose the true cost of the interchange of a transactions.

The cost of transitioning to a safer system is negligible. The Federal Reserve Bank of Boston reports that in 2008, there were over 858 million debit and credit cards in the US[7]; if every credit and debit card holder was transitioned to a Chip-and-PIN card over the next three years, economies of scale would dictate that the cost of each new card would be under $3. Most merchants already have payment terminals that accept Chip-and-PIN cards which can be activated with a software upgrade. Those that are not already upgraded as part of a three-to-five year life cycle can be upgraded for minimal investment, about $10 more per terminal. If the cost of saving Americans from financial fraud is relatively inexpensive, why then have issuers been extremely resistant to protect cardholders and merchants from fraud? The answer is both disheartening and frustrating.

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[6] At this point in our discussion, the SIDC would like to raise an issue with Footnote 77 of the NPRM which states:

> *The Board understands, however, that in countries with broad chip and PIN adoption, fraud levels are not necessarily lower than those experienced in the U.S. because fraud has migrated to less secure channels, for example to Internet transactions where PIN authentication is not yet a common option.*

We encourage the Board to not be dissuaded by the 'perfect solution fallacy,' in that it seems to presuppose that a perfect, fraud-eradicating solution exists and a Chip-and-PIN solution should be therefore rejected because some part of the problem may still exist after it was implemented. While thwarting fraud may be akin to holding back the rising tide, we may take the Dutch example as instructive; like fraud, the tide can never be fully tamed, although through ingenuity and perseverance, it can be managed and mitigated. To this footnote's very point, the EU is currently putting into place steps to crack down on fraudulent Internet transactions by requiring appropriate online authentication solutions. *See id.*

[7] The Survey of Consumer Payment Choice, Federal Reserve Bank of Boston, January 2010.

Consumers Ultimately Bear the Cost of Credit and Debit Card Fraud

In the end, consumers must pay the cost of credit card fraud. While merchants hit by fraud are bound to absorb the cost of the actual fraud and the chargeback fees (as well as the original transactional fees), they pass these costs directly back to consumers along with a hefty premium. Ultimately, consumers are victimized *twice* by credit and debit card fraud: first as they spend time and resources remedying the identity theft harm from the original crime and then again, as they compensate both issuers and merchants for the fraud by paying higher prices, rates and fees. To put it plainly, there's an economic *disincentive* for the payment card industry to put in place consumer fraud protection mechanisms like Chip-and-PIN cards as there is significant profit for them in 'remedying' fraud.

As our nation works to climb out of the worst economic downturn in recent memory, struggling consumers are relying upon all responsible parties – credit/debit card issuers, banks, merchants, legislators and regulators – to do all they can to reduce unnecessary costs. The financial payment industry is the largest beneficiary of the approximately $11 trillion a year Americans spend,[8] as they make a tidy profit on each of the 8.3 billion card transactions per year.[9] In 2008 alone, credit card companies collected $130 billion in revenue, realizing profits of over $17.7 billion.[10]

Is it too much to ask that the financial payments industry take every step necessary to prevent fraud and protect US consumers' personal information by utilizing secure technology? If nations throughout Europe, Asia and Africa are protecting their citizens from credit card fraud, perhaps it's time the US follow suit.

CONCLUSION

The SIDC commends the Board for a remarkable job in broaching the issue of financial card fraud prevention through the issuing of this NPRM. By doing so, it has signaled its consideration of the

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[8] Economic News Release: Consumer Expenditures in 2009, US Bureau of Labor Statistics, October 5, 2010.

[9] *See Id.*

[10] The Evolution of Credit Cards, Robert D. Manning, Credit Union Magazine, October 2009.

American consumer's best interests, not only with regard to their economic health, but to their financial privacy and data security. During the past economic crisis, we have been reminded that our financial system is an ecosystem, its health dependent upon the health of each constituent component – banks, issuers, financial service providers, merchants, and most important of all, consumers.

The SIDC offers its full support to the Board as it works with Congress to determine and develop the proper, explicit legal authority to address the adoption and implementation of a secure financial payment card system in the United States. Further, we encourage the Board to work with privacy professionals and data security experts to create ways to ensure a robust, secure payment system that will protect American consumers both here and abroad, and serve US business interests globally. We look forward to working with the Board to ensure the future of the payment industry, while avoiding solutions that might raise costs to consumers, limit efficiency, or disrupt efforts to provide and manage a global solution to preventing credit and debit card fraud.

Respectfully submitted,

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ATTACHED: *Myths & Facts About Chip-and-PIN*, Secure ID Coalition

MYTHS & FACTS about Chip-and-PIN

1) **MYTH: New, more expensive cards have to be issued and that will cost the banks extra money.**

   FACT: Banks issue new cards everyday to customers – especially those who experience breaches to their accounts. The cost of that reissuance would cover the cost of the transition to Chip–and-PIN. Not to mention the amount of money saved from the prevention of fraudulent transactions.

2) **MYTH: Merchants will not want to purchase new hardware required for the system.**

   FACT: The point-of-sale (POS) terminals used in most US retail establishments already have a Chip-and-PIN slot, as they are manufactured for a worldwide market. All that is required is a software upgrade to make the slots operational. In the cases where the Chip-and-PIN slot is not currently in the POS terminal – there are two options:

   1) In the case of leased terminals, which most small business use, the leasing agent could provide a new terminal that includes the slot, or
   2) Large stores that purchase their own terminals need to regularly purchase new equipment. POS terminals are typically on a three-to-five year lifecycle and are regularly replaced. In the small instances where terminals have not already been upgraded, the cost of upgraded terminals compared to old swipe terminals is negligible.

3) **MYTH: Consumers will not know how to use the Chip-and-PIN cards and readers and will need to change behavior.**

   FACT: Americans are already acquainted with how Chip-and-PIN technology works. They use a card and enter a PIN millions of times every day at the ATM. Consumers are happy to do anything that is going to protect their personal and financial information. In most retail transactions, a clerk will be present to help those that need assistance.

4) **MYTH: Merchants must already adhere to the Payment Card Industry Data Security Standard (PCI DSS) that requires them to annually validate their compliance or be fined by the issuers (VISA and MasterCard). Why do we need more?**

   FACT: All of the security efforts of the payment system are focused on back-end detection, as opposed to front-end prevention. In recent years PCIDSS has not been an indicator of security, especially considering recent data breaches, such as Heartland Payment Systems in of October 2008. Those standards do nothing to prevent a card number from being used by an unauthorized person for fraudulent purposes. When asked about Heartland, Gartner analyst Avivah Litan, said what's needed is a sweeping overhaul of how payments are handled. "It's a collective problem, it's not just Heartland's problem," she said. "It's Visa's, it's MasterCard's, it's the banks'. … You've got to make some improvements to card technology and cardholder authentication." That is what Chip-and-PIN does for the payment system. Chip-and-PIN will provide the payment industry front end prevention.

5) **MYTH: Networks and processors the process transactions between merchants and banks will need to change their systems and adapt.**

   FACT: Currently, networks and processors are processing transactions for many other countries around the world that are using Chip-and-PIN. Transaction processing of Canadian and Mexican Chip-and-PIN card payments is already happening by these entities without any problem. The suggestion that processors are not already undertaking this transition to Chip-and-PIN is disingenuous.

6) **MYTH: To effectively implement Chip-and-PIN cards from the issuance to the transactions themselves, you're talking about a massive overhaul of the system.**

FACT: Our entire payments system is based on a culture of detection and not prevention. As a result, American consumers are paying for it through fraud and ID theft. Last year identity theft cost Americans $54 billion as reported by Javelin. This only accounts for the fraud we can identify. Clearly the American payments system is broken and needs to be overhauled.

7) **MYTH: The U.S. had already accepted mag-stripe as the industry standard while other countries were still developing their card infrastructure. U.S. card users will not be able to quickly and easily adapt to a new type of payment card.**

FACT: Americans adapt to upgrading technology pretty easily. There were few problems with the transition from VHS tapes to DVDs or the transition from analog to digital television. Upgrading credit card technology to protect personal and financial information is a simple change and less painful than upgrading a cell phone.

8) **MYTH: Telecom in the United States is cheap, ubiquitous and very reliable. As a result, each transaction can be verified online unlike in other nations around the world where the cost of communication is very expensive and it is prohibitive to verify every transaction at point of sale.**

FACT: Even though online verification is easy and cheap in the US, the current payment system is still riddled with fraud, theft and abuse. As a result of superior infrastructure the US market should have the best, most secure and privacy enhancing payments system in the world. Instead, the credit card industry has forced the use of outdated 50-year-old technology that puts personal and financial information at risk and at the same time puts the burden on the consumer to monitor their accounts for fraud that could have been prevented by using Chip-and-PIN.

Chip-and-PIN is an open standard that is used in every G-8 and G-20 country around the world except the U.S. Because the rest of the world is using the more secure Chip-and-PIN, criminals from other countries have flooded the U.S. to take advantage of our unsecure payment system making the US an easy target for fraud, ID theft and criminal activity.

Other technology solutions have been discussed in the media as a possible way to secure the credit and debit card markets and stem the on-coming tide of fraud. Many of those are proprietary technology solutions from companies that have not engaged in any major credit card market. Using such technologies will do nothing to ensure U.S. traveler's credit cards will be secured and accepted at payment terminals in every other country around the world.

It's now up to the industry to begin adopting chip and pin technology currently available and used around the world in order to more securely lock down the sensitive, personal information that is transacted every day. Adopting Chip-and-PIN will allow for more efficient and seamless business, reduce the true cost of fraud in the credit and debit card systems and give consumers stronger faith in the security of the personal information in the financial system.