USAA®
9800 Fredericksburg Road
San Antonio, Texas 78288

February 22, 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 and RIN No. 7100 AD63

Dear Ms. Johnson:

United Services Automobile Association ("USAA"), on behalf of its bank subsidiaries, USAA Federal Savings Bank and USAA Savings Bank, is submitting this comment letter in response to the proposed rule implementing the provisions of Section 1075 (the "Durbin Amendment") of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The Durbin Amendment, among other things, requires reasonable interchange transaction fees for electronic debit transactions and sets limitations on network exclusivity and routing restrictions.

The proposed rule would implement the Durbin Amendment by setting an interchange fee cap of 12 cents and, under one alternative, requiring multiple networks for processing a debit transaction for each authorization method (e.g. Signature debit and PIN debit). It would not permit issuers to recover the processing costs for debit transactions, let alone make any profit. If interchange fees fail to adequately compensate issuers for their costs, issuers will have no choice but to increase fees charged to consumers or reduce product benefits to consumers. The proposed rule notes that issuers have "other sources...from which they can receive revenue to help cover the costs of debit card operations." But the only source for recovering debit card costs, other than through interchange fees, is from the consumer.

USAA is concerned about the substantial harm the proposed rule, if adopted, would create for our members, the U.S. military community. Today, interchange fees support many consumer benefits such as free issuance of debit cards, free use of debit cards, fraud prevention and zero liability programs, free checking accounts, reward programs, extended warranties on purchases, travel insurance, and other benefits.[1] We believe the proposed rule would eliminate most or all of these consumer benefits. Indeed, many issuers have already announced new fees and

[1] USAA debit cards currently do not offer extended warranties or travel insurance.

scaled back debit card benefits based on the proposed rule.[2] Because in many instances, issuers would need to charge consumers fees on deposit accounts and possibly on the use of debit cards, the proposed rule could make basic checking accounts unaffordable to a portion of our enlisted members, many of whom barely earn above the poverty level.[3] The impact to members of the military and other consumers is unjustified and clearly not required by the Durbin Amendment.

In addition to these significant issues, USAA has the following specific concerns with the proposed rule:

I. Interchange Standards

A. Proposed Price Controls

The Durbin Amendment adds Section 920 to the Electronic Funds Transfer Act ("EFTA"). Section 920(a)(2) of the EFTA requires the Board of Governors of the Federal Reserve System ("Board") to issue regulations relating to the price of debit interchange that banks charge merchants so that the fees are "reasonable and proportional" to the cost of transactions. The Board proposes two alternative price controls that would allow issuers to receive interchange fees of up to 12 cents for a transaction, with no provision for fluctuations or alterations. It is important to note that Section 920 ***does not require or even suggest*** the creation of such government-imposed price controls. Even Senator Durbin, the author of Section 920, did not envision this outcome.

In addition, the requirement that interchange transaction fees shall be "reasonable and proportional to the cost incurred by the issuer with respect to the transaction" does not require a card issuer to lose money on debit card transactions or preclude it from making an honest profit. The statute simply requires that the amount of the interchange fee be reasonable and proportional to the issuer's costs—not less than or exactly the same as those costs. Indeed, there is nothing in the EFTA that precludes a card issuer from making a reasonable profit on debit card transactions from interchange fees alone.

The current interchange fee structure operates on a percentage basis and can fluctuate, depending on transaction amounts and risk profiles, among other factors. The proposed price controls would change the dynamics of how interchange fees

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[2] *E.g.*, http://abcnews.go.com/Business/big-banks-threaten-debit-card-cap-jp-morgan/story?id=12951309; http://www.knoxnews.com/news/2011/feb/16/consumers-unhappy-new-checking-account-fees-turn-p/; http://bucks.blogs.nytimes.com/2011/01/21/u-s-bank-hints-at-checking-and-debit-card-fees/.

[3] For example, an enlisted person with the rank of E-3 who is married with two children, 2 years of service, and stationed in the one of the 48 contiguous states would earn $22,068 in annual gross base pay. The poverty level for a family of four in the 48 contiguous states is $22,350.

work by placing a government-imposed price cap of 12 cents for each transaction. However, the average interchange fee under the proposed rule would likely be much less than the cap because small dollar transactions would probably incur a fee of less than 12 cents, while larger transactions would be subject to the cap. [4]

Putting aside the potential policy and legal problems with the imposition of price controls at the government's behest, we are concerned that the price cap design in the proposed rule is contrary to congressional intent and eliminates flexibility that is needed in the marketplace. Thus, we urge the Board to reconsider its proposed approach and develop a mechanism that provides for more flexibility in the regulation of debit interchange fees. In particular, we ask the Board to eliminate any cap from the final rule and to provide a safe harbor that allows issuers to recover its costs and make a fair profit.

B. Proposed Fee Amounts

Section 920(a)(2) of the EFTA provides that the amount of any interchange transaction fee shall be "reasonable and proportional to the cost incurred by the issuer with respect to the transaction." We find the cap alternatives proposed by the Board to be woefully inadequate. We cannot emphasize strongly enough that an interchange fee of 12 cents per transaction ***falls far short*** of the costs to process debit card transactions.

In particular, according to the Board's own analysis of its survey of debit card issuers, while the proposed interchange standards would allow issuers to barely recover its costs to process a PIN debit transaction, issuers would be permitted to collect less than half of the costs related to a Signature Debit transaction. Indeed, as shown in the table below, the Board found the costs to process a Signature Debit transaction to be about twice as much as for PIN debit.

Industry Debit Card Costs

Type of Cost	Signature Debit	PIN Debit
Processing Costs	13.7 cents	7.9 cents
Network Fees	8.4 cents	2.7 cents
Fraud Prevention	2.2 cents	1.2 cents
Fraud Losses	2.8 cents	1.4 cents
Total Costs	**24.6 cents**	**12.4 cents**

[4] For example, a $2 cup of coffee with a 12 cent interchange fee would equal 6% of the transaction amount compared with an interchange fee today of between 4.6 and 7.1 cents (based on number of merchant's transaction at MasterCard's Consumer Debit Small Ticket Interchange Rates). We believe that the interchange fee would need to be substantially less than 12 cents on transactions under $10 or else merchants would refuse to accept debit cards on small dollar transactions . If this occurred, the average cost to process a debit card transaction would increase.

While the Board's data is useful to show the differences in costs related to Signature and PIN debit, we believe the Board's survey was flawed and therefore does not accurately reflect the true costs for processing a debit card transaction. We note that in a survey conducted by Edgar, Dunn & Company, the cost to process a debit card transaction was found to be much greater than in the Board's survey: 63 cents for a Signature Debit Transaction and 50 cents for a PIN Debit Transaction. [5] However, both surveys clearly reflect that the cost to process a Signature Debit transaction is about 13 cents higher than for a PIN Debit transaction. This means that the proposed price control of 12 cents would not even cover an issuer's increased costs to process a Signature Debit Transaction.

Because the costs to process Signature Debit and PIN Debit are significantly different, USAA urges the Board to implement different interchange standards for each. If the ratio of the number of Signature Debit to PIN Debit transactions remained constant over time and between issuers, perhaps the same, averaged interchange fee would make sense. However the ratio varies significantly from year to year and between issuers. Indeed, between 1998 and 2007, the ratio was as low as 1.45 to 1 in 1998 and as high as 1.9 to 1 in 2002.[6] According to the Board's Debit Card Survey, the ratio in 2009 across all issuers including USAA was 1.6 to 1. However, the ratios vary widely among different issuers and can be over 2 to 1.

By setting the same interchange rate for both Signature and PIN Debit, issuers will receive greater recovery of costs in years where the ratio of Signature to PIN Debit decreases and less recovery where the ratio increases. Furthermore, issuers who have a smaller ratio of Signature Debit to PIN Debit transactions will receive greater interchange revenue in relation to their costs than will issuers with a greater percentage of Signature Debit transactions. We do not believe Congress intended such a result when it required interchange fees be reasonable and proportional ***"to the cost incurred by the issuer."*** Forcing issuers to recover different proportions of costs from time to time or due to differences in types of debit card transactions does not appear to meet the statutory standard or intent.

Moreover, if there is only one interchange standard for both Signature and PIN Debit, the significant difference in costs could result in some issuers limiting Signature Debit transaction options or encouraging cardholders to choose PIN over Signature Debit. Only about 2 million of the 8 million merchant locations in the United States that accept debit cards have the equipment required to accept PIN Debit transactions.[7] In addition, PIN Debit typically is not available at hotel or car

[5] The costs referenced exclude costs not specific to particular transaction. Fully loaded costs were found to be much higher.

[6] *ATM and Debit News, EFT Data Book (*2008 Revised Edition). According the Board's survey, the ratio in 2009 was 1.6 Signature Debit Transactions to 1 PIN Debit Transaction.

[7] *See Debit Card Interchange Fees and Routing*, 75 Fed. Reg. 81749 (Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235).

rental merchants or for most Internet purchases. Thus, eliminating or discouraging Signature Debit functionality would not only harm consumers by providing them fewer payment options, but would also harm the small businesses that the EFTA was intended to benefit.

For these reasons, USAA strongly encourages the Board to promulgate two different interchange standards—one for Signature Debit transactions and one for PIN Debit transactions.

C. Comparison to Checks

In prescribing regulations to implement the interchange standards pursuant to section 920(a)(2), the EFTA directs the Board to consider the functional similarity between electronic debit transactions and checking transactions that are required to clear at par.[8]

While the Board identified many of the functional similarities and differences between the two payment methods,[9] the Board failed to adequately consider perhaps the most significant difference—the guarantee of payment that a merchant receives when it is paid with a debit card. Although the Board correctly observed that "a merchant does not know whether the check will be returned unpaid at the time the merchant accepts the check," the fact that a debit card transaction cannot be returned unpaid due to insufficient funds or that a cardholder cannot place a stop payment on the transaction, and the value of that guarantee, was not adequately recognized in the proposed rule. According to MasterCard, less than .02% of all MasterCard debit card transactions were charged back to merchants in 2010.[10] The fast and guaranteed payment for each and every debit card sale has significant value to merchants that should not be provided free-of-charge.

The Board noted "a merchant that wants to better manage its risks associated with unpaid checks can purchase value-added check verification and guarantee services from various third-party providers," but the amount merchants must pay for these services was completely ignored. ***The fees for check guarantees are substantially higher than current interchange fees on debit cards. On a check in the amount of $37.15 (the value of the average signature debit card transaction[11]), a typical check guarantee fee would be between 68 cents and 99***

[8] *See* EFTA § 920(a)(4)(A).

[9] *See Debit Card Interchange Fees and Routing*, 75 Fed. Reg. at 81734.

[10] MasterCard Worldwide. Data is for volume on U.S.-issued MasterCard debit cards acquired in the U.S. in 2010USAA's chargeback volume in 2010 was .0155% of the total number of debit transactions and .0375% of the total debit card dollar value.

[11] *See Debit Card Interchange Fees and Routing*, 75 Fed. Reg. at 81725.

cents.[12] The average interchange fee on a signature debit card transaction is 56 cents at today's rates.[13] Thus, a merchant that obtains a check guarantee pays up to 175% of the amount it would pay for a similar debit card payment.

For merchants who choose not to purchase a check guarantee, they risk that the item will be returned unpaid. According to the 2010 Federal Reserve Payments Study, the total value of returned checks in 2009 was $103 billion. This amount far exceeds the entire amount of debit interchange fees paid to issuers in 2009 ($16.2 billion) plus all fraud-related and all other debit card chargebacks incurred by merchants.[14] In terms of unit costs, the cost of returned checks equaled $4.22 per paid check—more than 35 times the proposed maximum debit card interchange rate. While merchants may recover some of the value of returned checks, the collection costs can be significant and frequently greater than the face value of the returned item. In addition, merchants must pay returned check fees and other costs related to dishonored checks. The point is that merchants receive substantial value and benefit as a result of the payment guarantee on debit cards that they do not receive on checks.

The statutory requirement to compare electronic debit and checking transactions cannot be adequately addressed without factoring the value of the payment guarantee into the analysis. The failure to compensate issuers for the value of the payment guarantee they provide on debit card transactions could well result in issuers eliminating the guarantee in the future. Such a result would be detrimental to both consumers and merchants. We urge the Board to allow issuers to recover the fair value of the payment guarantee, either through an adjustment to the interchange fee or through a separate fee as is permitted for checks.

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[12]Based on published rates at the following websites: http://www.instamerchant.com/check-guarantee.html (1.39% + $0.25 per transaction); http://www.nobouncedchecks.com/check-guarantee.html (1% + $0.14 per transaction with a minimum of $0.99 per check); http://www.1nbcard.com/content/check_guarantee_merchant_services.html (1.5% + $0.20 per transaction); and http://www.merchantseek.com/checkg.htm (1.25% + $0.22 per transaction).

[13] *See Debit Card Interchange Fees and Routing*, 75 Fed. Reg. at 81725.

[14] Based on chargebacks equal to 4 bps of debit card value (including fraud-related chargebacks), the cost to merchants in fraud and other chargebacks would have been less than $600 million.

D. Included Costs

The EFTA further directs the Board to distinguish between the incremental cost incurred for an issuer's role in the authorization, clearance, and settlement of a particular transaction and other costs that are not specific to a particular transaction. The statute requires the Board to include the first set of costs in the amount of a reasonable and proportional interchange fee, and to exclude the second set.[15] Notwithstanding these statutory mandates, the Board proposes to exclude certain issuer costs that are related to the authorization, clearing, and settlement of a particular debit transaction.

Nothing in the EFTA requires the Board to exclude from consideration the costs incurred for authorization, clearance, and settlement that are not specific to a particular transaction and costs that are specific to a particular transaction but are not incurred for authorization, clearance, and settlement. But under the interchange standards proposed by the Board, issuers would be limited only to recovery of variable costs that are directly attributable to authorization, clearance, and settlement of the transaction. By excluding all other costs, the Board effectively requires issuers to lose money on debit card transactions unless they charge additional fees to consumers. We believe that Congress did not intend variable expenses relating to "authorization, clearance and settlement" to be all inclusive, especially if such interpretation is to the detriment of the consumer. We encourage the Board to look at Section 920 in a more expansive fashion, so as not to create an unsustainable business model for issuers or, worse yet, create additional costs and inconvenience for consumers.

We urge the Board to include, among others, the following costs in the consideration of the reasonable and proportional interchange fees:

i. Network Fees

Issuers pay fees to networks for the authorization, clearing and settlement of each debit card transaction. We believe that the potential exclusion of this essential cost is a direct violation of a statutory requirement. Network services are a critical component of the authorization, clearing, and settlement of debit transactions. Issuers would be unable to provide debit services without the networks, rendering this cost an element that must be incorporated in the cost reimbursement calculation.

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[15] See EFTA § 920(a)(4)(B).

ii. Cardholder Inquiries

Issuers must take calls and receive correspondence from cardholders regarding the debit card charges they make. We estimate that more than half of our cardholder inquiries relate to specific debit card transactions as opposed to other more general inquiries. As such, they are certainly related to specific transactions made with a debit card and are arguably made in connection with the authorization, clearing and settlement of the transaction. An issuer's costs for handling cardholder inquiries related to specific transactions should be included costs.

iii. Chargeback Processing

When an issuer charges back a transaction, the costs it incurs are related to a specific debit transaction. Because a chargeback is fundamentally the reversal of the clearing and settlement of the transaction, we believe that chargeback costs are fees that must be considered in determining a reasonable and proportional interchange fee.

iv. Card Production/Delivery

In order to make a debit card transaction at the point of sale, a consumer must have a debit card. While an actual piece of plastic is not required for a mail, telephone or internet transaction, the information must be retrieved from the card. Thus, without an actual card a cardholder would be unable to make debit card purchases. The cost of imprinting, embossing, and mailing debit cards to cardholders is not insignificant. Not only must issuers incur these costs when opening new checking accounts, cards must be renewed every two or three years for fraud prevention and because the plastics wear out. In addition, cards must be replaced when they are lost or stolen or due to a security breach of a merchant's or its processor's systems. Card issuers should not be required to incur these costs with no way to recoup them except through the consumer, especially given the significant benefits inured to merchants from debit cards in the way of instant and guaranteed payment.

v. Losses

Issuers incur millions of dollars annually in fraud and other losses related to specific debit card transactions. It is unreasonable to assume that issuers should incur these losses without compensation. Merchants benefit from unauthorized transactions by making a guaranteed profit on the underlying sale. They also have the unique ability to check a cardholder's identification and/or signature to prevent unauthorized use. Permitting merchants to retain the benefits from unauthorized debit card sales only encourages merchants to ignore possible fraud by rewarding them for making the sales to fraudsters. They simply should not be permitted to retain all the benefits from the unauthorized use of a debit card without some payment for those benefits. When a merchant accepts a fraudulent check containing a forged drawer's signature, the depository bank has the absolute right to refuse to pay the check. However, when a merchant accepts a fraudulent debit card, a card issuer cannot stop the settlement of the transaction.[16] Moreover, since the EFTA prohibits card issuers from charging consumers for unauthorized charges (with very limited exceptions), card issuers would likely demand that networks provide full chargeback rights for unauthorized charges. For these reasons, we encourage the Board to allow fraud losses to be an included cost.

E. Proposed Rule Would Harm Consumers

Section 904(a)(2) of the EFTA requires the Board to consider the costs and benefits to consumers when proposing any regulation pursuant to the EFTA.[17] However, the Board failed to address or consider these issues in promulgating the proposed rule.

We already emphasized in the beginning of this letter that USAA is most concerned about the impacts the proposed rule would have on consumers in general and on members of the military in particular because it would result in the elimination of important consumer benefits and increase consumer's costs. In addition to these concerns, we also believe the proposed rule could force some issuers out of the debit card business or to limit the use of debit cards. For example, in order to limit its exposure to the risk of higher fraud losses that accompany larger dollar purchases, issuers may limit the dollar amount of debit card purchases[18] and eliminate zero-liability programs. In turn, this would result in less consumer payment options and might require consumers to carry cash or checks that lead to increased crime and fraud risks.

We also note that neither the Durbin Amendment nor the proposed rule guarantees any benefit to consumers. Nothing requires merchants to pass on the billions of dollars in savings to consumers. The result is that not only will consumers pay more to use a debit card, they will pay the same price for the goods or services they buy.

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[16] If the merchant failed to obtain an authorization from the issuer or if the merchant accepts a debit card without the physical card present, the issuer may have the right to chargeback the transaction.

[17] *See* 15 USC § 1693b(a)(2).

[18] JPMorgan Chase, Bank of America, and CitiGroup have already indicated they are considering placing maximum dollar limits on debit card transactions of $50 or $100. See http://abcnews.go.com/Business/big-banks-threaten-debit-card-cap-jp-morgan/story?id=12951309

Not only does USAA feel this result is extremely unfair to consumers, but also we believe it does not comport with the requirement to consider the costs and benefits to consumers as required by section 904.

F. Proposed Rule Would Harm Small Business

USAA further believes that small businesses will be harmed by the proposed rule. We point out that a mere 1.5% of merchants account for more than 80% of debit card transaction volume.[19] These are the large retailers that tend to have merchant discounts directly tied to the interchange rate (e.g. they have a merchant discount equal to the interchange fees plus an additional amount set forth in the merchant agreement). For these merchants, the discount would automatically be reduced when interchange rates decrease.

However, the remaining 98.5% of merchants, who are mostly small businesses, tend to have a merchant discount that is a set percentage or dollar amount per transaction. This merchant discount arrangement does not vary automatically when interchange rates change. Instead, the merchant's acquiring bank, who is the entity that actually pays interchange fees to the issuer, could simply retain the savings from the reduced interchange fees. Therefore, any gain from the proposed rule for these small merchants would be minimized, resulting in a significant competitive disadvantage for small business owners.

II. Fraud Prevention Adjustment

The EFTA provides that the Board may allow an adjustment to the debit interchange fee, if reasonably necessary, to make allowance for costs incurred by the issuer in preventing fraud in relation to electronic debit transactions and the issuer complies with fraud-related standards established by the Board.[20] The Board is required by the statute to prescribe regulations in final form not later than April 22, 2011 to establish standards for making the fraud-prevention adjustments.[21]

Notwithstanding the fact that the Board estimates that debit card issuers incur approximately 2.8 cents per signature debit card transaction in fraud losses and another 2.2 cents per transaction in fraud-prevention and data-security costs, the Board did not include any fraud adjustment because it was unable to settle on a fraud-prevention standard that it could implement by the statutory effective date of July 22, 2011. Thus, we are concerned that debit card issuers will be forced to incur

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[19] See Consumer Bankers Association White Paper on Interchange at
http://www.cbanet.org/government/content.cfm?ItemNumber=18955&navItemNumber=19007
[20] *See* EFTA § 920(a)(5)(A).
[21] *Id.* at § 920(a)(5)(B).

the significant costs of fraud prevention and fraud losses with no compensation for many months (or potentially years) while the Board develops a fraud-prevention standard.

It is unfair to ask issuers to incur the costs of fraud prevention without any compensation. While we understand the Board's challenges in developing a fraud-prevention approach and support a measured and thoughtful process, card issuers should not be punished because the task of developing a fraud prevention plan is challenging. We ask the Board to allow a fraud adjustment of ***at least three cents ($.03)*** per transaction, provided the issuer utilizes reasonable fraud-prevention technologies in place today, such as those offered through Falcon, Prism, or TYSY software.

The Board proposes two alternative fraud-prevention approaches. We support the non-prescriptive approach. We believe this approach will lead to better and more innovative fraud-prevention methods. Moreover, we are most concerned that the technology-specific approach would lead to less investment in new fraud-prevention measures. We also are concerned that such an approach could educate criminals as to issuers' fraud prevention processes and undermine their effectiveness.

III. Network Rules

A. Network Exclusivity

The EFTA requires the Board to prescribe regulations that would prohibit restricting the number of payment card networks on which an electronic debit transaction may be processed to: (a) one such network; or (b) two or more such networks owned, controlled or operated by either (i) affiliated persons, or (ii) networks affiliated with an issuer.[22] The Board proposed two alternative approaches for the prohibitions against network exclusivity. Under Alternative A, as long as an electronic debit transaction may be processed on at least two unaffiliated payment card networks, the prohibition against network exclusivity would be satisfied. Thus, under this alternative, a card issuer need only have one payment card network for signature transactions and a second for PIN transactions as long as the two networks are unaffiliated with each other. Under Alternative B, two unaffiliated payment card networks would be required for both Signature and PIN transactions. This would require an issuer to have four different networks.

[22] *Id.* at EFTA § 920(b)(1)(A).

USAA strongly prefers Alternative A for the following reasons:

a. Implementation Costs

The cost to implement Alternative A is far less than Alternative B. USAA, like many other issuers, processed PIN debit transactions across multiple networks in the past. However, no debit card issuer has ever processed Signature PIN transactions across more than one network. The system and programming changes that would be required to process Signature Debit over multiple networks are extensive. Issuers would have to invest in significant technology and developmental efforts to have the ability to send and receive files and data from different Signature Debit networks. Each network has adapted ISO standards differently, and issuers would have to build duplicate functionality to receive and transmit data. Duplicate authorization files would be required, and different stand-in authorization parameters would need to be built and maintained for each network. New debit cards would need to be issued to all cardholders. Chargeback processing would become more expensive and time-consuming because issuers would have to determine which network processed a transaction and what chargeback rules apply.

We estimate our costs to implement Alternative A to be up to one million dollars. We cannot estimate the costs for Alternative B because we do not know the precise changes that would be required to process Signature Debit transactions on a second network. That said, we believe the costs will be significantly higher both to issuers, merchants and acquirers.

The networks would also incur substantial costs to their systems. We are concerned that these costs may be passed on to issuers and acquirers (and ultimately merchants and consumers).

We ask the Board to consider the difference in network fees between the various networks that process Signature Debit transactions compared to the difference in the network fees for PIN Debit. While the difference between the fees for PIN Debit transactions can vary by several cents per transaction, the difference for Signature Debit transactions is probably less than one cent per transaction. But the cost to implement multiple Signature Debit network capabilities would likely far exceed any benefit to merchants. In fact, we question whether merchants would choose to incur the expense to upgrade their systems to allow for them to process a debit card across multiple Signature Debit networks.

b. Consumer Impact

When a consumer uses a particular network-branded debit card, certain benefits are provided for each Signature Debit transaction. For example, consumers may be offered zero liability protection for unauthorized charges, insurance benefits, such as extended warranties, rewards and other benefits. In addition, networks frequently offer community or event support (e.g. disaster relief, Junior Achievement, Junior Olympics, etc.) for each transaction carried across its network. These benefits may not be feasible if a transaction is carried across a competing network. Trying to explain to consumers that certain benefits are available only if the merchant chooses to use a specified network would likely cause confusion and dissatisfaction. Moreover, consumers simply would have no idea whether a card's benefit applies to a particular purchase or not because they would have no way of knowing which network a merchant chose to process their transaction. This would undoubtedly lead to increased cardholder complaints and confusion.

In addition, we believe Alternative B would lead to increased fraud risks. First, the ability to provide alerts to cardholders regarding possible fraudulent activity would be hindered because alerts of that nature are generally tied to specific network usage. Secondly, the use of multiple unaffiliated networks for each method of card authorization would make it more difficult to develop and implement new authorization methods, such as biometrics or other technologies. The ability to better control fraud would be adversely affected. Finally, we believe that increasing the number of networks upon which a card transaction may be processed heightens the chances that a fraudster can circumvent an issuer's fraud prevention strategies.

B. Merchant-Routing Restrictions

Section 920(b)(1)(B) of the EFTA requires the Board to prescribe regulations that would prohibit an issuer or payment card network from inhibiting the ability of any merchant to engage in direct routing of electronic debit transactions for processing over any payment card network "that may process such transactions." We strongly support the Board's interpretation of this phrase to mean that a merchant's choice is limited to the payment card networks that have been enabled on a particular card.

Conclusion

USAA urges the Board to revise the proposed rule to allow issuers to recover reasonable and proportional costs and to allow for the full recovery of fraud-prevention costs. We further request that issuers be permitted to make a fair profit from interchange for the service and guaranteed payment that we are providing merchants. Finally, we strongly favor implementation of Alternative A as the appropriate network exclusivity rule required by the EFTA.

USAA appreciates the opportunity to provide comments on the Proposed Rule. If you have any questions regarding our comments, please do not hesitate to contact Ronald Renaud at (210) 498-1095.

Sincerely,

Steven Alan Bennett
Executive Vice President
General Counsel & Corporate Secretary