Bank of America

Legal Department

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

Delivered via Email to: regs.comments@federalreserve.gov

Re: Docket No. R-1404

To Whom It May Concern:

Bank of America offers its comments to the Board of Governors of the Federal Reserve System ("Board") regarding the Board's proposed rule ("Proposal") to implement portions of Section 920 of the Electronic Fund Transfer Act ("EFTA") as amended by Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Durbin Amendment").

Bank of America ("Bank") is the leading debit card issuer in the country and has a deep understanding of the debit card product, its functionality, and its appeal to consumers and merchants alike. In 2010, the Bank's customers conducted more than 6.1 billion debit transactions on approximately 22 million debit cards representing approximately $238 billion of purchases. On an average day the Bank processed more than 16 million transactions representing $652 million of consumer and small business spending. This means the Bank processes roughly 192 transactions *per second.* Debit cards are wildly popular among our customers, and are a growing share of consumers' payment choice. Debit cards are also a preferred method of payment acceptance among millions of merchants in the United States. One needs only to compare check and debit card acceptance among retail merchants to understand the value merchants assign to debit card acceptance relative to checks.

Executive Summary

The Proposal will harm consumers by fundamentally altering the economic value exchange in the debit card market. While providing a significant monetary windfall to large merchants, the Proposal will force the Bank and others in the industry to consider the recovery of lost revenue in a variety of ways. This could include recovery through increased consumer costs, reduced consumer debit card benefits, and reduced merchant debit acceptance benefits. This is not the outcome required, or even supported, by Section 920 of the EFTA.

Bank of America, NC1-027-20-05
214 N. Tryon Street, Charlotte, NC 28255

As we describe below, we believe that the Proposal is legally deficient in critical ways. The Proposal amounts to price fixing of debit interchange fees, an activity that is not authorized by Section 920(a). Furthermore, the Board's general approach fails to consider the basic statutory provision that debit card issuers may receive interchange fees that are reasonable and proportional to their costs, including fraud-related costs. Debit interchange rates of between 7 and 12 cents per transaction, as proposed by the Board, fall well short of rates that would be reasonable and proportional to issuers' costs as permitted under the law. With respect to the implementation of Section 920(b), one of the two alternative exclusivity provisions suggests the Board is considering a complete redesign of a successful payment product infrastructure with no statutory authority or congressional directive.

Given the significant impact of this rulemaking on payments markets, the Board has not gathered sufficient information to assess the overall impact of the Proposal. Although the Board considered information from a number of larger debit card issuers, the Proposal was not prepared on the basis of cost information from all impacted issuers; nor has there been sufficient consideration of the effects on small issuers, which technically are not subject to the rule. Chairman Ben Bernanke recently acknowledged the need for additional time to study these impacts in a Senate hearing on February 17, 2011 ("Dodd-Frank Hearing") in which he said he was "uncertain" about whether smaller debit card issuers would truly be exempt from the impact of the final rule, and that "there is some risk that the [smaller bank] exemption will not be effective and that the interchange fees available through smaller institutions will be reduced to the same extent that we would see for larger banks."[1] We believe it is incumbent on the Board to collect sufficient information regarding the full impact of this Proposal on issuers of all sizes, consumers (in particular, low- and moderate-income ("LMI") consumers), fraud, and payment markets. The Board should delay the issuance and implementation of a final rule to allow sufficient time to complete this comprehensive analysis and to address the Proposal's deficiencies.

In sum, the Proposal should be revised to successfully balance a variety of interests and concerns. We urge the Board to take the time necessary study the impacts and then implement the Durbin Amendment in a manner that is faithful to the statute, while mitigating harm to consumers, and ensuring an appropriate cost allocation among beneficiaries of debit card acceptance.

Fundamental Changes to the Debit Card Market

The Proposal will significantly harm the business case associated with debit card operations, which ultimately harms consumers. If the Board adopts the Proposal as drafted, the Bank would receive approximately $1.8 billion to $2.3 billion less in debit interchange a year than it does today. This shortfall would cause the Bank's debit card operations to lose money absent significant mitigation efforts. Naturally, neither the Bank nor any other bank can operate in a safe and sound manner if significant business lines operate at a loss.[2] As the Board states in the Proposal, card issuers may attempt to recover some of the lost interchange revenue from consumers.[3] Sheila Bair, the Chairman of

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[1] *See* "Risk Retention Will Not Harm Small Banks, Bair Pledges; Interchange Rule Criticized," BNA Banking Daily, February 18, 2011.

[2] The final rule is certain to have a significant impact on *all* debit card issuers. Competition will make it difficult for these issuers to offset all losses through debit fees, as the Proposal suggests. Accordingly, we believe the Board should carefully study the impact of the Proposal on bank earnings, in consultation with the other prudential regulators, as provided in Section 920(a)(4)(C).

[3] *See, e.g.,* 75 Fed. Reg. 81722, at 81737 ("...issuers have other sources of revenue in addition to interchange fees, such as cardholder fees, to help cover their costs.").

the Federal Deposit Insurance Corporation ("FDIC"), also highlighted this risk during the Dodd-Frank Hearing. She noted, that with respect to the institutions the FDIC supervises, if interchange were reduced as proposed by the Board, "I think [debit card issuers] are going to have to make that up somewhere, probably by raising...fees."[4] Increased consumer costs are not what Congress intended when it adopted Section 920 as an amendment to the EFTA, heretofore a consumer protection statute.

The Proposal will significantly harm consumers. The Bank will need to re-evaluate how it prices its debit-related products if the Proposal were adopted in its current form. The Bank simply cannot support 6.1 billion debit transactions a year without adequate compensation. If debit card acceptance costs are shifted from merchants to consumers, as suggested by the Board, consumers will face increased debit costs with no corresponding debit benefits. Not only might the Bank re-evaluate its debit pricing for consumers, but we may also need to reconsider the consumer (and merchant) benefits associated with debit cards to reduce our costs.

The Proposal's overarching theme appears to be that someone other than merchants should pay for the benefits merchants receive when merchants accept debit cards. According to one industry estimate, the Proposal would transfer approximately $12 billion annually from debit card issuers to (primarily large) merchants, in the form of reduced debit card acceptance expenses.[5] Merchants receive significant benefits when they accept debit cards. These benefits include payment guarantees, reduced payment fraud, increased customer satisfaction, enhanced customer purchasing power, increased efficiency at the cash register, and reduced losses from theft (including employee theft). These benefits are provided primarily by the debit card issuer—and these benefits cost the debit card issuer money. We understand that merchants would prefer not to pay for the benefits they receive when they accept payment cards, but we do not understand why the Board believes that the EFTA requires an alteration in the debit payment system that results in card issuers and consumers absorbing approximately $12 billion a year while merchants attempt to retain the benefits of debit card acceptance for free.

Merchant lobbyists have proffered a variety of benefits that will allegedly "trickle down" to consumers upon implementation of the Proposal. But there is no statutory requirement that merchants provide any benefits to consumers as a result of a reduction in debit interchange; and merchant promises of consumer benefits do not necessarily entail consumer price reductions. For example, a merchant trade association representative recently testified before Congress that consumers should be happy to receive such "benefits" as free gift wrapping as a result of government-imposed interchange reductions.[6] Furthermore, there is, in fact, no concrete evidence that merchants have reduced prices for consumers in other jurisdictions where the government has regulated interchange. When Australia regulated credit card interchange, Australian consumers paid significantly higher prices for their cards with no demonstrable evidence of reduced prices at the point of sale.[7]

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[4] The quote is from an unpublished transcript from the hearing. *See also* "Risk Retention Will Not Harm Small Banks, Bair Pledges; Interchange Rule Criticized," BNA Banking Daily, February 18, 2011.

[5] *See* Joint Letter (as defined below) at 9. Roughly 80% of merchants' monetary benefits under the Proposal will flow to only the top 1.5% of merchants by debit volume. We also note that the Proposal will also affirmatively *harm* the countless small businesses debit cardholders that do not themselves accept debit cards.

[6] *See Hearings on H.R. 2382, the Credit Card Interchange Fees Act and H.R. 3639, the Expedited Card Reform for Consumers Act Before the Comm. on Financial Services*, 111th Cong. 31 (2009) (statement of Mallory Duncan, Senior Vice President and General Counsel, National Retail Federation, on behalf of the Merchants Payments Coalition).

[7] *See generally* Robert Stillman, William Bishop, Kyla Malcolm, and Nicole Hildebrandt, "Regulatory intervention in the payment card industry by the Reserve Bank of Australia: Analysis of the Evidence" (28 April 2008). ("As expected, the

The Proposal would also create other public policy problems unnecessarily. The natural consequence of increased costs associated with debit cards is that consumers will "consume" fewer debit cards. Not only will this lead to consumers using less efficient forms of payment with fewer consumer protections (and merchant benefits), but it will result in greater numbers of consumers becoming unbanked. We believe that LMI customers would be disproportionately affected, because of the relatively high concentration of debit card usage within this customer segment. For example, the Bank's customers who have less than $25,000 in income use debit cards for approximately 60% of their purchases. In short, these likely debit price increases will present greater challenges to LMI consumers seeking to maintain financial security through traditional banking relationships. These challenges and barriers may force LMI consumers to use riskier and more costly forms of payments such as cash, checks, and check-cashing services. Such a result would be directly contrary to public policy and the modernization of the country's payments infrastructure.

Of course, as consumers shift tender from debit cards to cash and check, there will be other consequences, such as greater anti-money laundering risks and tax compliance risks. Merchants' cash and check receipts will not be reported to the Internal Revenue Service in the same manner as credit and debit receipts. Law enforcement will have a more difficult time tracking illicit payment activity when it is conducted outside of an electronic network. The inevitable decreased efficiency in the government's anti-money laundering and tax compliance efforts will result in increased costs (or reduced revenue) for the federal government.

Interchange

In General

We believe many of the consumer and other harms resulting from the Proposal could be mitigated if the Board exercised the flexibility and discretion that it was provided in the statute to provide standards for assessing whether debit card interchange is reasonable and proportional to issuers' costs with respect to debit transactions. Indeed, we believe the Proposal is legally defective in the following ways:

- The statutory requirement to establish "standards for assessing" whether debit card interchange is reasonable and proportional to issuers' cost does not authorize the price caps proposed by the Board—it instead requires the Board to provide a framework or guidelines by which interchange fees should be evaluated.
- The Proposal incorrectly interprets the statutory direction to provide standards for assessing whether interchange is "reasonable and proportional" to issuers' costs to mean that debit interchange should equal those costs. The statute actually provides for interchange fees to include a reasonable return on those expenses.

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reductions in interchange fees have led to reductions in merchant service charges," but "[m]erchants however have not presented any empirical evidence documenting the extent to which reductions in merchant service charges have been passed through to consumers, and neither has the [Royal Bank of Australia] or anyone else," pp. 3, 24-25. *See also* U.S. Government Accountability Office, *Credit Cards: Rising Interchange Fees Have Increased Costs for Merchants, But Options for Reducing Fees Pose Challenges* (2009) at 54.

- The Proposal's cap on debit interchange is far below what it actually costs issuers to provide customers with debit card services, and provides for no return to issuers. As such, the Proposal is confiscatory and, if adopted, would violate the Takings and Due Process Clauses of the Fifth Amendment of the United States Constitution. The Board is legally compelled to issue regulations that avoid even the question of constitutional validity.
- The Board failed to follow the statutory mandate under Section 904 of the EFTA to consider the Proposal's impact on consumers, financial institutions, and the payment system. Had it done so, the Board would have certainly permitted debit card issuers to receive higher interchange amounts to avoid harm to these groups.

These points, among others, are presented in greater detail in the joint letter filed by every major bank and credit union trade association ("Joint Letter"). We agree with, and hereby incorporate by reference, the Joint Letter.

One of the Proposal's most significant failings was not considering a variety of allowable costs that should be included in any standards issued by the Board. The Bank and other affected banks provided detailed information regarding cost classifications and actual expenditures with respect to debit transactions to Morrison & Foerster for analysis in conjunction with Argus. The Morrison & Foerster comment letter, which we incorporate by reference, identifies material categories of costs contemplated by, and clearly allowable under, Section 920(a)(4)(B)(i) that were excluded from the Proposal.[8] The Bank strongly urges the Board to reconsider allowable costs in light of this analysis.

Fraud Prevention

Fraud prevention is a key component of the allowable costs for purposes of debit interchange fees. The Board's failure to include these costs when setting the permissible interchange amounts is contrary to the statutory requirements of Section 920. Furthermore, the Board has incorrectly excluded fraud *losses* from the allowable expenses that issuers may recover, either through interchange or through specific fraud reimbursement. In those circumstances when a fraud cost is not included as a component of interchange, we believe that the Board should permit issuers to receive reimbursement in connection with the implementation of reasonable fraud prevention policies as well as the adoption of paradigm-shifting technology. Unless the Board revises its approach to fraud-related costs in the final rule, and allows issuers to recover those costs beginning on July 21, 2011, the Bank believes that there could be significant consequences for consumers and for merchants.

Fraud Prevention Cost as a Component of Interchange

By the terms of Section 920, the Board's standards for interchange fees should address issuers' costs with respect to debit transactions. This includes costs incurred in connection with the authorization, clearing, and settling of a debit card transaction. Fraud costs are, in fact, among the costs

[8] The Board should read these costs in the context of the general formula provided in the Joint Letter describing how the Board must first calculate total costs incurred by an issuer with respect to debit transactions, and then exclude other costs not associated with a particular debit transaction.

"incurred by the issuer with respect to the [debit card] transaction,"[9] and they are incurred "in the authorization, clearance or settlement…of a particular [debit card] transaction."[10] In a debit card transaction, fraud prevention is one of the key components of—and cannot be segregated from—authorizing a debit transaction. The Bank also incurs costs in connection with resolving fraudulent charges for consumers and reversing the settlement for those fraudulent charges.[11] Accordingly, under the plain language of the statute, fraud costs should be allowable costs for purpose of the interchange fee standards.[12]

Allowing issuers to continue to recover fraud prevention costs through interchange also appropriately balances the value exchange between merchants and issuers. We believe that issuers' fraud prevention efforts prevent more than 40% of attempted debit card fraud. If these fraudulent transactions were not prevented by issuers, a portion of the resulting losses would be charged back to merchants. These fraud detection efforts provide a direct benefit to merchants, one for which they should provide fair compensation.[13]

Fraud Losses Should Be Reimbursable

In the Proposal, the Board would disallow any reimbursement from merchants associated with fraud losses.[14] By this extraordinary reversal of the *status quo,* the Board has ignored relevant statutory language and misaligned incentives among the parties.

The Board suggests that reimbursing issuers for fraud losses is distinct and separate from reimbursing them for fraud prevention costs, only the latter of which is specifically referenced in the statute according to the Board. This is simply incorrect, in two respects. First, when an issuer takes a loss and reimburses a cardholder for a fraudulent transaction, the issuer has prevented fraud from the cardholder's perspective. In this instance, "fraud losses" and "fraud prevention" are one and the same. Second, the statute expressly acknowledges that fraud losses incurred by issuers are costs issuers should recoup. Section 920(a)(5)(B)(ii)(V) clearly directs the Board to consider the costs of fraudulent transactions absorbed by issuers (*i.e.*, fraud losses) when considering the fraud reimbursement. In addition, Section 920(a)(5)(A)(ii)(I) makes no sense if fraud losses are not to be considered for reimbursement, since it indicates that separate fraud reimbursements directly from a merchant are to be excluded from the calculation of reimbursable costs. There would be no reason to deduct direct fraud loss reimbursement amounts for purposes of calculating a fraud adjustment if the issuer is not to be compensated for fraud losses. A basic canon of statutory interpretation is that each provision of a statute

[9] § 920(a)(2).

[10] § 920(a)(4)(B)(i).

[11] If such costs are not "incurred by the issuer with respect to the transaction" as described Section 920(a)(2), then reimbursement for such costs would not be in connection with the issuer's "involvement in an electronic debit transaction" and therefore fall outside the definition of "interchange transaction fee" in Section 920(c)(8). If the reimbursement for such costs is not an interchange transaction fee, it is not subject to the limitations under Section 920 or the Proposal.

[12] We recognize that there is a separate consideration of certain fraud costs in Section 920(a), but the better reading of the statute is that such additional compensation is intended for fraud costs that may be outside the scope of what the Board is permitted to consider for purposes of establishing interchange standards.

[13] Throughout the Supplementary Information, the Board suggests that it is guided by the principle that merchants should pay only for those activities that are common between check processing and debit card transactions. The Board does not provide explanation for why merchants should be relieved of the costs associated with the significant incremental benefits that debit card issuers provide, such as fraud prevention, relative to check acceptance.

[14] *See* 75 Fed. Reg. at 81742, n79.

should be read as consistently as possible to give effect to each other.[15] The Board's position that fraud losses are not reimbursable ignores these relevant statutory provisions.

Reimbursement for fraud losses also better aligns the incentives among the parties involved to reduce fraud, as contemplated by Section 920(a)(5)(B)(ii)(VI). Issuers handle and resolve more than 70% of debit card fraud losses, either by declining fraudulent transactions, by challenging consumer claims for transactions that appear to be authorized, and/or by paying claims for which they are not reimbursed. Furthermore, 80% of the debit card losses the Bank incurs are a direct result of merchants' failure to protect cardholder information.[16] If merchants, rather than card issuers, bear the costs associated with their own behavior, merchants have incentives to reduce fraud.

Compensation for Reasonable Policies/Procedures <u>and</u> Paradigm-Shifting Technology

With respect to the two concepts proffered by the Board for purposes of fraud reimbursement, the "paradigm-shifting" approach and the "reasonable policies and procedures" approach, we do not believe that the two concepts are mutually exclusive, and both should be means by which issuers are compensated for costs. Specifically, to the extent issuers adopt reasonable policies and procedures to prevent debit card fraud, the Board should permit them to be eligible for those costs that are not otherwise included in the interchange fee calculation.[17] In addition, to the extent issuers implement a "paradigm-shifting" approach to fraud prevention, the Board should allow issuers to be compensated for such innovations. To allow for reimbursement for only one of the above two circumstances does not reflect the reality that issuers must engage in both types of activities to effectively prevent fraud. Conversely, a provision that reimburses issuers only for paradigm-shifting technologies may dis-incent spending on anti-fraud approaches, in favor of spending on "paradigm shifts" that may or may not be as effective.

Unintended Consequences

If the Board does not address fraud reimbursements appropriately, there could be significant unintended consequences, as detailed below.

Without sufficient economic incentives, debit card issuers may reduce investment in fraud prevention technologies.[18] Instead, issuers may decline to authorize valid transactions that have any perceived risk of fraud associated with them, or issuers may impose limits on the dollar value or

[15] *See Gustafson* v. *Alloyd Co., Inc.*, 513 U.S. 561, 575 (1995) (a statute must be interpreted to "avoid ascribing to one word a meaning so broad that it is inconsistent with its accompanying words, thus giving 'unintended breadth to the Acts of Congress'"); *Richards* v. *United States*, 369 U.S. 1, 11 (1962) ("a section of a statute should not be read in isolation from the context of the whole Act and . . . in interpreting legislation, we must not be guided by a single sentence or member of a sentence, but (should) look to the provisions of the whole law, and to its object and policy'") (internal quotation marks omitted).

[16] The Bank also incurs additional, but less quantifiable, costs as a result of merchant data breaches. These include reputational costs and operational costs in the aftermath of a merchant data breach.

[17] As noted above, reimbursement for most costs associated with debit fraud should be included in the interchange fee itself.

[18] In the Supplementary Information, the Board states that financial institutions make investments today to reduce the risk of fraud in non-card forms of payment without reimbursement of those costs from the counterparty to the payment. See 75 Fed. Reg. at 81742. We do not claim that issuers will cease all investment in fraud prevention if the Board does not provide for appropriate compensation. We claim only that those investments may be less robust without market-based interchange or, in the absence of such funding, sufficient reimbursement for fraud prevention efforts.

frequency of transactions. Furthermore, as investment in fraud prevention is reduced, the types of "at risk" transactions will increase—and therefore declined transactions may increase—if issuers are not compensated for fraud prevention tasks. The net result is fewer sales and higher fraud losses for merchants, and increased inconvenience for consumers, with no corresponding consumer benefit. When debit card transactions are declined, customers may choose to use cash or checks, neither of which provides the same consumer or merchant protections as debit cards.

Without sufficient economic incentives, debit card issuers may also impose additional costs on consumers. In addition to increasing fees, debit card issuers could eliminate voluntary "zero liability" policies associated with unauthorized debit card transactions and other consumer protections beyond the provisions of Regulation E.

Without sufficient economic incentives, robust claim processing could deteriorate. When issuers review transactions challenged by customers, they find some transactions that, in fact, were authorized, resulting in the denial of those claims or the customers' withdrawal of them, before the merchants become involved. If cost pressures cause issuers to cut back on staffing, these claims may not be resolved by the issuer on the front end, and submitted as a chargeback requiring investigation by the merchant. This would force merchants to become more involved in the investigation and processing of claims, and prolong the process for consumers (although still within the permissible timeframes established by Regulation E).

In short, there could be broader impacts for issuers, consumers, and merchants if the fundamental structure of a debit card transaction must be altered to reflect the new economics associated with draconian interchange reductions and no fraud reimbursement.

Circumvention/Evasion

Board Authority

The Proposal's attempts to prevent circumvention of the interchange standards required under the Durbin Amendment exceed what is permitted under the plain language of the statute and could negatively impact existing commercial relationships, as described below.

Section 920(a)(8) grants the Board the authority to regulate "network fees" to the extent necessary to, among other things, prevent the circumvention or evasion of the interchange provisions in Section 920. Section 920(a)(1) also grants the Board the authority to regulate any "interchange transaction fee" to, among other things, prevent circumvention or evasion of Section 920(a). The Board relies on these two grants of authority to prevent circumvention or evasion of the interchange restrictions. The definitions of both "network fee" and "interchange transaction fee" make clear the statute clearly seeks to regulate *compensation paid by acquirers to issuers*.[19] However, the circumvention/evasion portion of the Proposal attempts to regulate *compensation paid by networks to*

[19] A network fee is "any fee charged and received by a payment card network with respect to an electronic debit transaction, other than an interchange transaction fee." Section 920(c)(10). An "interchange transaction fee" is a fee "established, charged, or received by a payment card network for the purpose of compensating an issuer for its involvement in an electronic debit card transaction." Section 920(c)(8).

debit card issuers. Accordingly, the statutory authority for this provision of the Proposal is questionable.

Facts and Circumstances

The Bank agrees with the Board's general approach that circumvention or evasion of the interchange restrictions should be based on the facts and circumstances of a particular arrangement between an issuer and a network. We are concerned, however, that the Board deviates from its own proposed "facts and circumstances" approach and proposes that circumvention or evasion would be "indicated" if the issuer receives net compensation from the network—regardless of the actual facts and circumstances of the relationship. Such a "net compensation" standard is overly broad and fails to recognize appropriate payments made by networks to issuers in the ordinary course of existing network arrangements.

Networks provide monetary compensation to issuers for services issuers render to the networks, such as marketing or for innovation and research. Marketing funds received by issuers are just another way networks promote their brands to consumers. Payments could also stem from the co-development of new or enhanced payment capabilities or form factors, or could support infrastructure investments that issuers need to make in order to participate in a network. These are examples of common arrangements, some of which could result in net compensation from a network to an issuer. There is no suggestion in the legislative record that these arrangements should be regulated. The Board acknowledges the appropriateness of at least one form of compensation paid by networks to issuers—signing bonuses. We agree that signing bonuses enable networks to expand and attract new business while helping the issuers cover the cost of establishing or maintaining a relationship with the network.

In sum, the Bank acknowledges that Congress intended to prevent networks and issuers from using network fees to circumvent the Board's new interchange standards. However, the Bank does not believe the statute authorizes the Board to regulate "net compensation" arrangements as articulated in the Proposal. We are alarmed the Proposal's overly broad approach to preventing circumvention may inadvertently (and inappropriately) disrupt legitimate business arrangements.[20]

If the Board adopts a "net compensation" prohibition, a signing bonus should be excluded from the calculation. And if signing bonuses are in the calculation, we ask that the Board allow the issuer to account for the signing bonus in a *pro rata* manner, such as by allocating a proportional amount to each year of the contract's duration.

Moreover, any circumvention/evasion restriction should not apply to contracts between issuers and networks that were executed before the date of the final rule (or at least the date of the Proposal). To apply the final rule to existing contracts would be unfair. Contract terms that pre-date the Proposal cannot possibly have been drafted with a view toward evading the Proposal. Retroactive application also would cause significant disruption to existing commercial relationships of hundreds of issuers at a time when these issuers will be additionally burdened with compliance with the exclusivity requirements in the final rule, discussed below.

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[20] The fact that networks have compensated issuers long before the Board's Proposal is proof itself the practices is not means to circumvent the Durbin Amendment.

Exclusivity

Alternative A v. Alternative B

Section 920(b)(1)(A) directs the Board to issue regulations "providing that an issuer or payment card network shall not...restrict the number of payment card networks on which an electronic debit transaction may be processed" to one such network, or two or more affiliated networks. The direction from Congress is clear and unambiguous—the Board's regulations must require an issuer to enable at least two unaffiliated networks on its debit cards. Instead of proposing a regulation that meets the statutory requirements, the Proposal includes two alternative approaches. The first alternative, labeled "Alternative A," implements the plain language and intent of the statute, proposing to require debit card issuers to enable at least two unaffiliated networks on its debit cards. The second alternative, "Alternative B," would require an issuer to enable at least two unaffiliated debit networks for each type of debit authorization/authentication method enabled on its card. Alternative B clearly goes beyond the statutory mandate, which contains no reference to authentication methods.[21] The plain language of the statute is clear on this point.

In addition to its statutory infirmities, Alternative B also has practical problems. Under this alternative, the number of networks that must be enabled on the card would be limited only by the number of authentication methods enabled on the card. In the future, for example, if there were four methods of authentication, the issuer would be required to enable up to eight networks on a single card.[22] Requiring two networks per authentication type will create additional cost and complexities that will be significant and borne by networks, acquirers, issuers, and processors. This would increase debit issuers' costs, resulting in an increase of the interchange fee permitted under Section 920(a)(2). Furthermore, a requirement for a debit card issuer to enable two of every authentication/authorization method would stifle innovation, negatively impact services customers receive, and limit the ability of customers to use their network of choice. If the Bank must enable two signature networks, and consumers have no decision how the signature-based transaction will route, those networks will have little incentive to compete in ways that benefit consumers. Consumers will also receive uneven, and unpredictable, benefits and experiences in connection with their debit card usage. For example, if one network offers enhanced liability protections, but the other does not, the consumer would have no way of controlling the outcome of that purchase.

Nationwide Coverage

For purposes of network exclusivity, the Proposal requires that a qualifying network (or combination of networks) is one that has "nationwide coverage." We generally agree with the Board's proposed measurement of a network's coverage for purposes of compliance, *i.e.*, whether the network is available for acceptance in the purported area of coverage. We urge the Board to avoid trying to set minimum acceptance standards or similar measures, as any such requirement would be difficult to

[21] The Board suggests that one justification for a two signature requirement is that many merchants do not accept PIN-enabled debit card payments. PIN acceptance is a business decision made by merchants. PIN debit payments are available in virtually every payment environment, including card not present. Accordingly, if merchants prefer to have at least two routing choices, they have the option to do so. It is also not reasonable to require payment card issuers and debit card networks to reconfigure entire networks as a result of merchants' decisions not to accept PIN debit transactions.

[22] It is less clear how an issuer could comply with the requirement if only one network offered one of the enabled authentication methods on commercially reasonable terms.

measure, would be arbitrary, would create competitive disadvantages for regional networks, and would create barriers for new entrants in the marketplace. We also believe that a debit card issuer that has enabled two unaffiliated networks on its debit card where such networks have general acceptance availability within the general area in which the cardholder resides at the time of issuance should be deemed to be in compliance with the final rule. This would allow continued competition between the national and regional PIN networks (and ATM networks, if the final rule applies to ATM networks), while ensuring that merchants most likely to accept the cardholder's card (*i.e.*, those within the general area of the cardholder's address) will benefit from the routing provisions in the final rule.

Reasonable Exceptions

The Board should use its exemption authority to mitigate some unintended harmful consequences of the exclusivity provisions. For example, the Bank strongly urges the Board to exempt various limited purpose debit cards from the exclusivity provisions. There are a variety of circumstances in which there is no commercially viable manner in which a debit card issuer could enable two unaffiliated networks for many of these cards without destroying their purpose or creating greater societal harm.[23] For example, there are limited purpose debit cards that are not PIN enabled so as to better manage anti-money laundering and fraud risks. Furthermore, certain health care debit cards simply cannot run on PIN networks at this time because they are not compatible with IIAS authorization. To require them to do so would effectively eliminate the card program.[24] These types of cards generally have relatively low purchase volumes, and the costs associated with enabling additional networks far outweigh any economic benefits merchants may recover through additional routing options.[25]

Application to ATM Networks

The Board asks in the Supplementary Information whether the exclusivity and routing provisions of the Proposal should apply to ATM networks. It should not—the statute is clearly not intended to apply to ATM networks. The Durbin Amendment relates to costs associated with *merchant* acceptance of debit cards, which is unrelated to ATMs. That is why the statute regulates *debit* interchange, but not *ATM* interchange. There is simply no support for the theory that Congress intended to regulate the exclusivity and routing arrangements of ATMs networks. We also believe that the better reading of the plain language of the statute excludes ATM networks from the requirements of Section 920(b). The exclusivity provisions pertain to "payment card networks," which by definition are limited to those networks "that a person uses in order to accept as a form of payment a brand of debit card." We believe that, given the context of the Durbin Amendment, an interpretation that an ATM "accepts as a form of payment" an ATM card is strained, especially with no suggestion Congress intended to address ATM arrangements. Finally, we agree with the Board that there would be some irony that the combination of the exclusivity and routing provisions in the ATM environment *increased* the cost of ATM transactions.

[23] The types of cards at risk include government cards, health care cards, and school supply cards.

[24] To require such cards to run over two signature networks also could not be done quickly, and would be a case of the tail wagging the dog. The costs associated with making such adjustments would be difficult to justify given the limited benefits that would result.

[25] If the Board does not grant such exceptions, it must allow for a delayed effective date for these types of cards. Without such relief, issuers may choose to simply disable those cards because achieving compliance by the proposed deadline is not feasible.

Network Requirements on Issuers

The Proposal would prohibit a debit card network from prohibiting an issuer from contracting with any other debit card network. This portion of the Proposal appears to be directed at rules-based, blanket prohibitions against an issuer enabling a competing network, but we ask the Board to clarify the intent of this provision.

Effective Dates

The proposed effective dates of the exclusivity provisions in the Proposal are not sufficient to ensure a smooth transition. Assuming the Board adopts Alternative A, it is unreasonable to assume that issuers can comply by October 1, 2011. Although the Bank has relationships with a variety of networks, it is not clear that each (or any) of the contending networks would be able to handle our significant transaction volume. This need for lead time is compounded by the assumption that thousands of issuers will be required to negotiate new contracts with networks and test/implement BIN changes. This is a process that typically takes six to nine months for the most efficient issuers to complete in the best of circumstance (*e.g.*, not one in which the entire industry is attempting to enable new networks simultaneously). Without sufficient lead time to accomplish the specific steps referenced above, networks, issuers and acquirers will not be able to handle the business shift efficiently and accurately, resulting in considerable harm to consumers from poor operations, increased fraud and data security risk, reduced transaction approvals, and other technological issues. We therefore believe that June 1, 2012 is the more reasonable compliance date.

For the reasons described above, the Board should not adopt Alternative B. If it does, however, a more appropriate effective date is June 1, 2013. The Board clearly recognizes that substantial lead time is necessary to implement such an approach. However, a requirement to be compliant by January 1, 2013 is essentially a requirement for all development efforts to be completed in mid 2012 (at the latest), as neither the issuers nor the networks will be in a position to complete testing and conversion during the holiday shopping period when transaction volumes spike. Issuers, networks, and acquirers typically have technology freezes during this time of the year to ensure customer transactions are not disrupted. And the middle of 2012 is simply too soon to expect issuers and networks to have developed compliant approaches to such an enormous regulatory burden.

Miscellaneous

- The Bank agrees with the Board's approach to the routing requirements in the Proposal. A merchant should be permitted to route over a network enabled on the debit card. A merchant should not have the right to route the transaction over any network it chooses, regardless of whether such network has an agreement with the issuer. To require such a result is plainly contrary to the statute and congressional intent. It would also completely eliminate an issuer's ability to manage and govern its network relationships. Not only is this important from a commercial standpoint, but our customers hold us responsible for the performance of our debit cards, regardless of whether an issue arises due to a network failure.

- The Proposal would require by regulation, and therefore under penalty of Section 8 of the Federal Deposit Insurance Act, that at least some debit card issuers provide certain data to debit card networks by a specific deadline. This is a matter that should be handled between issuers and networks as a commercial matter. In light of the fact that the issuer is ultimately responsible for its own compliance with Section 920 of the EFTA, the issuer has every incentive to ensure that it provides the necessary information to debit card networks in a timely manner.

- The Board asks for comment as to how it should apply the final rule to emerging/alternative payment systems. To the extent that systems otherwise meet the appropriate generally applicable definitions in the final rule, they should be subject to the applicable requirements. It is not clear, for example, why any particular debit card network should be given arbitrary regulatory advantages relative to its functional competitors by virtue of its "emerging" or "alternative" nature. Either the entity is a debit card issuer/network and should be subject to the final rule, or it is not.

- We ask the Board to clarify that the non-debit functionality of a multi-purpose access device that has debit functionality is not regulated by the final rule. For example, if an access device can serve as a credit card and a debit card, the interchange restrictions would not apply to those transactions otherwise regulated by Regulation Z. This appears to be the Board's intent.

Conclusion

We thank the Board for the opportunity to comment on the Proposal. We strongly urge the Board to delay the issuance of the final rule and make significant revisions to the Proposal. We believe such revisions are necessary to reflect the statutory requirements, to implement the congressional intent, and to protect consumers, debit card issuers, and even merchants from the unintended consequences of the Durbin Amendment. Please do not hesitate to contact me at (980) 387-5894 if we can be of further assistance.

Sincerely,

Karl F. Kaufmann
Associate General Counsel