February 22, 2011

Board of Governors of the Federal Reserve System
c/o Jennifer J. Johnson, Secretary
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Via e-mail: **regs.comments@federalreserve.gov**
Docket No. R-1404

To the Members of the Board of Governors:

We appreciate the opportunity to express to the Board of Governors of the Federal Reserve System (the "Board") our concerns about the potential impact of the proposed regulation to be codified at 12 C.F.R. Part 235 – Debit Card Interchange Fees and Routing ("Regulation II" or the "Proposed Regulation") on emerging, innovative payment systems ("Emerging Innovative Systems").

ISIS is a joint venture formed by three U.S. wireless companies – AT&T Mobility LLC, T-Mobile and Verizon Wireless – to create and operate a new, nationwide mobile payment and commerce system. As currently contemplated, this new system will involve a mobile wallet through which customers can access payment products (credit and debit) issued, managed and controlled by participating banks to pay for goods and services at retail locations through contactless Near Field Communication ("NFC"). Our new system is designed to be open to all consumers, merchants, wireless service providers and banks.

With its supporting technology, Isis holds the promise of increased competition in the payments market, innovations that will bring new choices and benefits to consumers and merchants alike, and new electronic payment options available to the unbanked. Indeed, ISIS is poised to conduct pilots in selected metropolitan areas in the near future.

Despite ISIS's promise, there should be no doubt that its success and the innovations it can engender will require substantial risk and investment. For that reason, we write to express our concern that the Proposed Regulation in its current form will have the opposite of its intended effect. It will stifle innovation, hamper the development of new payment and commerce systems and limit the number of new entrants into a payments market already dominated by a few major networks. The result will be a missed opportunity for U.S. firms to lead in this new payments frontier and create new commercial sector jobs.

More specifically, the requirement that every debit card must be capable of processing transactions through at least two networks could deprive any Emerging Innovative System of the revenues necessary to justify the investment. Why would anyone invest in a new payment system if they are forced – before they even start processing transactions – to add a scale-competitor? This would seem akin to requiring small businesses to locate only next to an established national "category killer" retailer in the same product line.

ISIS cannot be expected to proceed through the pilots and into national operation if it concludes the Proposed Regulation could make it virtually impossible to obtain an adequate return on its investment.

It is therefore our recommendation the Board reconsider the provision in the Proposed Regulation requiring the enablement of two networks in all cases.

In the initial instance, we submit the statutory language of the Durbin Amendment does not mandate this result, but instead merely prohibits issuers and payment networks from taking action to "restrict" the number of payment networks on which transactions may be processed.

However, to the extent the Board moves forward with a multiple-network requirement, we request the Board consider two exemptions for Emerging Innovative Systems:

- Exempt issuers and payment networks participating in Emerging Innovative Systems from the two-network requirement for a period of seven years.
- Exempt Emerging Innovative Systems from the "qualifying" network definition under proposed Section 235.7(a)(2) for a period of seven years.

These exemptions would provide a start. However, it is still unclear if any new debit network will emerge if there is no viable return on investment due to fee caps. We would strongly encourage the Board to consider the unintended consequences of the two-network and fee-cap provisions in the Proposed Regulation and their potential impact on innovation, jobs and the competitiveness of the U.S. payments market.

We appreciate the Board has been placed in the challenging position of interpreting a statute designed to reduce costs through government price controls instead of competition. As currently interpreted, we are concerned the Proposed Regulation will reduce competition and disadvantage the payments market in the United States. We hope the Board will find its way clear to adjust its interpretation of the statute to ensure Emerging Innovative Systems like ISIS are given a fair chance to flourish.

Respectfully submitted,

Michael J. Abbott

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Enclosure: Detailed Comments on Proposed Regulation II Submitted by ISIS

DETAILED COMMENTS ON PROPOSED REGULATION II

SUBMITTED BY ISIS

The following are the detailed comments of ISIS in connection with the impact of the proposed regulation of the Board of Governors of the Federal Reserve System (the "Board") to be codified at 12 C.F.R. Part 235 – Debit Card Interchange Fees and Routing ("Regulation II" or "Proposed Regulation") on emerging, innovative payment systems ("Emerging Innovative Systems").[1]

SUMMARY

ISIS is a joint venture formed by three U.S. wireless companies – AT&T Mobility LLC, T-Mobile and Verizon Wireless – to create and operate a new nationwide emerging and innovative mobile payment and commerce system. ISIS has serious concerns about the routing and rate cap provisions of proposed Regulation II issued by the Board.[2] These concerns, if not addressed by the Board in revisions to the Proposed Regulation, will stifle innovation, hamper the creation of Emerging Innovative Systems like ISIS, and limit the number of new entrants into a payments market already dominated by a few major networks. Such unintended consequences would be to the detriment of both consumers and merchants who have benefitted from the proliferation of new debit card products that in 2009 were used to process 37.9 billion transactions.[3]

To avoid such unintended consequences – clearly not the objective of Congress – ISIS strongly urges the Board to make the following revisions to the Proposed Regulation.

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1 An Emerging Innovative System is any new non-traditional payment system which commenced operations on or after the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

2 Debit Card Interchange Fees and Routing, 70 Fed. Reg. 81722 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235).

3 70 Fed. Reg. 81722, 81723.

1. **Eliminate the Requirement that Every Debit Card Enable Processing of Transactions Through at Least Two Networks**. This requirement is contrary to the plain language of Section 920 (the "Durbin Amendment") of the Electronic Funds Transfer Act (the "EFT Act"), which simply requires that issuers and payment networks not "restrict" the use of other networks. The requirement in the Proposed Regulation, if left intact, creates disincentives to the development of innovative technology contrary to the objectives of Congress.[4]

2. **Alternatively, Consider Refinements to the Proposed Regulation Aimed at Stimulating the Creation of Emerging Innovative Systems**. Nascent Emerging Innovative Systems must go through various developmental phases before they are able to operate nationwide, rendering them at a competitive disadvantage against established nationwide systems under the Proposed Regulation. The refinements suggested herein would achieve the Board's goal of increased competition in the payments industry while simultaneously stimulating the creation of new, innovative and emerging payments solutions.

[4] ISIS is also concerned that the Board's approach to interchange fee caps in the Proposed Regulation also creates disincentives and other consequences. It has chosen, however, not to provide detailed comments on the fee caps in this letter, primarily because it believes the possible negative consequences of the fee caps will be detailed fully in comment letters being submitted by other interested parties.

BACKGROUND ON ISIS

ISIS was formed to create and operate a nationwide Emerging Innovative System. As currently contemplated, this new system will involve a mobile wallet through which customers can access payment products (credit and debit) issued, managed, and controlled by participating banks ("Payment Products") to pay for goods and services at retail locations through contactless Near Field Communication ("NFC"). After the completion of the pilots and a decision is made to proceed, this innovative new system is designed to be open to all consumers, merchants, wireless service providers and banks.

Our new system will enable the consumer to place his or her mobile device in close proximity to the merchant's point of sale reader and consummate payment through NFC transmission of Payment Product credentials. NFC technology has been in existence for quite some time, and payment systems using it are well underway in other countries. The United States is clearly lagging behind, not in NFC technology, but in bringing NFC-enabled Payment Products to market on a nationwide basis.

This new system will be advantageous to consumers and merchants. It is expected to eliminate the need for individuals to carry cash, checks, credit, debit and prepaid cards, reward cards, discount coupons, tickets, transit passes, and the like. It will create substantial value for merchants, including providing direct consumer access and allowing merchants to communicate sales, rewards and other benefits via the mobile phone.

The "unbanked" will also benefit. Not everyone has a demand deposit account, but many of those who do not have such accounts have wireless handsets. The "unbanked" will have increased access to the products issued by participating banks.

The Emerging Innovative System will contain the latest security technology to protect the integrity of payment transactions. Access to the mobile wallet will require pass code authorization – with the customer's payment product credentials stored in a secure element within the handset – and each transaction will be enabled by dynamic authentication-based security. Once secure access has been gained, the customer need only hold the handset close to the merchant's terminal to consummate a transaction. Possession of a lost or stolen phone will not enable access to the mobile wallet, and a single phone call will deactivate the wallet. Together, these security measures will exceed those in place today for most cards.

ISIS believes it has the collective resources to pilot and eventually expand nationwide. There are risks, however, in the creation of any new payment system. As noted above, no one has yet created a nationwide mobile payment system in the United States. While ISIS believes U.S. consumers will eventually migrate to a mobile payment system, this migration is not assured, nor is the time frame within which it will occur. To mitigate against this and other risks, ISIS is planning one or more pilot phases during which technology can be field tested and consumer demand can be assessed.

ISIS is concerned the Proposed Regulation, if adopted in its present form, will exacerbate the risks by making it less financially rewarding and even more complex and difficult to create, thereby creating disincentives for companies to make substantial investments in Emerging Innovative Systems. In particular, the fee caps make debit products less attractive to offer, and the requirement for multiple networks for each debit card forces Emerging Innovative Systems to cede to major well-entrenched competitors any competitive advantage such systems acquire through the development of new technology.

ISIS is a pro-competitive offering and believes it would be consistent with Congressional objectives for the Board to make the revisions to the Proposed Regulation set forth below.

COMMENTS

Network Routing and Exclusivity Arrangements

The Board's network exclusivity and routing proposals are more restrictive than required by Section 920(b)(1) of the EFT Act.

The EFT Act provision in Section 920(b)(1)(A) relating to exclusivity arrangements provides:

> "The Board shall…prescribe regulations providing that an issuer or payment card network shall not directly or through any agent, processor, or licensed member of a payment card network, by contract, requirement, condition, penalty, or otherwise, restrict the number of payment card networks on which an electronic debit transaction may be processed to—
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> (i) 1 such network; or
>
> (ii) 2 or more such networks which are owned, controlled, or otherwise operated by—
>
> (I) affiliated persons; or
>
> (II) networks affiliated with such issuer" (emphasis added).

There were no hearings on the network routing and exclusivity arrangements of the Durbin Amendment. The legislative history is thin. Statements read into the Congressional record by Senator Durbin suggest that Section 920(b)(1)(A) ***requires*** an issuer or payment card network to offer a merchant at least two payment networks over which to process an electronic debit transaction. Whether or not that was Senator Durbin's intent, the language of Section 920(b)(1)(A) does not yield that result. This language prohibits an issuer or network from *restricting* the number of networks by contract, requirement, condition, penalty or otherwise, i.e., an exclusivity arrangement. It does not, by contrast, affirmatively require issuers to enable their cards to be routed through additional networks. The United States Supreme Court has long held that the words of a statute are more important than Congressional intent: "We have stated time and again that courts must presume that a legislature says in a statute what it means and means in a statute what it says there…When the words of a statute are unambiguous, then, this first canon is also the last." *Conn. Nat. Bank v. Germain*, 503 U.S. 249, 254 (1992) (refusing to consider legislative history where the statute was clear).

The words of the Durbin Amendment are unambiguous and should not be construed to require that each debit card be enabled to permit processing through two or more networks. Instead, the language should be given its natural and plain meaning to prohibit the issuer of a debit card or a network from taking action to restrict the number of payment card networks on which transactions may be processed.

As noted by the Board, issuers and networks have in the past imposed restrictions and engaged in other practices that limited the number of networks available to a merchant on a voluntary basis, including cases where issuers have agreed to make the payment card network, or affiliated networks, the exclusive network(s) associated with the issuer's debit cards.[5] ISIS believes these were the types of activities that Section 920(b)(1)(A) of the EFT Act was designed to prohibit. ISIS disagrees with the Board's conclusion that the network exclusivity provision

[5] *See* pp. 70 Fed. Reg. 81722, 81748-49.

should apply to voluntary arrangements in which a debit card issuer participates exclusively in a single payment card network or affiliated group of payment card networks by choice, rather than due to a specific network rule or contractual commitment.[6] ISIS believes these voluntary arrangements are not only permitted by the statutory language, but encouraged because they help create new competitors for the existing networks. Simply stated, the creation of a new payment system using a single network on a voluntary basis is consistent with the language of Section 920(b)(1)(A).

In support of its interpretation, ISIS observes that even the Board recognizes that the two network requirement is not evident in the language of the statutory provision, stating in its notice of proposed rulemaking that its interpretation "clarifies" the network exclusivity provision.[7] The Board's final regulation should foster a marketplace where innovators are able to develop new payment systems that generate revenues necessary to justify the system.

Section 920(b)(1)(B) also adopts a similar approach, prohibiting an issuer or network through an exclusivity arrangement or otherwise from taking an action to ***inhibit*** a merchant who accepts debit cards from directing the routing of a debit card transaction over any network that might process such transaction. This provision makes clear that the merchant has freedom to choose from any available option. A payment system whose transactions are processed on a voluntary basis by only one network and that is not linked to another network is consistent with this provision.

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6 *See* id. at 81750-51.
7 *See* id. at 81751.

The ISIS view is supported by antitrust laws that embody a policy of favoring innovation, and the Sherman Act is interpreted in a way "to safeguard the incentive to innovate." *Verizon Communs. v. Law Offices of Curtis V. Trinko*, LLP, 540 U.S. 398, 407 (2004); *see also United States v. Microsoft Corp.*, 147 F.3d 935, 948 (D.C. Cir. 1998) ("any dampening of technological innovation would be at cross purposes with antitrust law").

If the Board's final regulation retains the multiple network requirement in the form included in the Proposed Regulation, ISIS believes the feasibility and desirability of creating any Emerging Innovative System will be adversely affected, thereby "dampening" innovation in developing new electronic payment systems. Such a result would be at odds with the pro-competition objective of the Durbin Amendment.

Suggested Exemptions from the Two-Network Requirement

If the Board continues to conclude that each debit card must enable processing through at least two networks, ISIS proposes that the final rule allow for debit cards to be issued exclusively through an Emerging Innovative System, and permit the issuer and payment network to be exempt from the two-network rule, until such time as the Emerging Innovative System matures and achieves scale. Specifically, ISIS recommends establishing the exemption period at seven years in order to encourage investment in innovation, research and development, and hiring, as well as to provide sufficient time for these young Emerging Innovative Systems to achieve scale. This seven-year period is necessary for Emerging Innovative Systems to, at a minimum, do one or more pilot phases during which participants can field test the technology and assess consumer demand, as well as plan and implement the ramp-up required to position the Emerging Innovative Systems to expand geographically and eventually become nationwide.

As an alternative to the above exemption, to the extent that the Board requires debit cards be enabled on no less than two networks, ISIS proposes allowing Emerging Innovative Systems to be exempt from the "qualifying" network definition set forth in proposed Section 235.7(a)(2). This would permit issuers to meet the two-network rule by enabling their cards on an Emerging Innovative System that is not yet nationwide, in addition to one "national" network, until such time as the Emerging Innovative System matures and achieves scale. Again, ISIS proposes setting the exemption at seven years in order to encourage investment in innovation, research and development, and hiring, as well as to provide sufficient time for these young Emerging Innovative Systems to achieve scale.

ISIS believes either of these suggested alternatives would encourage and facilitate the development of Emerging Innovative Systems, increasing the likelihood that new competitors will emerge for the major payment networks.

It is well within the Board's authority to grant these exemptions. The Board has sufficient authority to do so under Section 904(c) of the EFT Act. In addition, Section 920 of the EFT Act does not specify an effective date by which the Board must implement the limitations on network exclusivity and merchant routing restrictions under Section 235.7. The proposed refinements above are time-limited and would sunset after a period of seven years. In adopting them, the Board would simply be establishing a staggered effective date to accommodate new and innovative payments industry providers – an action well within its legal authority.

Alternatives to the Two-Network Requirement

The Board has set forth two possible approaches (Alternative A and Alternative B) to the two-network requirement. ISIS continues to believe that the two-network requirement does not apply to voluntary arrangements but, as between the two alternatives being considered by the Board, ISIS recommends that the Board adopt Alternative A. Alternative B, which would require two unaffiliated networks for each function (*i.e.*, PIN or signature), is not only inconsistent with the Durbin Amendment's statutory requirements, but would also place an onerous regulatory burden on issuers, and would present technological and logistical hurdles to implementation. Alternative A would achieve similar competition and merchant choice objectives as Alternative B but, unlike Alternative B, would do so without requiring the burdensome and costly replacement or reprogramming of millions of point-of-sale terminals and substantial changes to software and hardware for networks, issuers, acquirers and processors.

CONCLUSION

ISIS shares the Board's goal of driving innovation, competition and merchant choice in the payments industry. Nevertheless, we fear that the Proposed Regulation may have the unintended consequences of strengthening existing payment networks and inhibiting the development of our nation's next generation of Emerging Innovative Systems. We therefore ask the Board to consider adopting the proposals set forth above aimed at increasing competition, innovation, and merchant and consumer choice in the payments industry.