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

Re: Proposed Rule on Debit Card Interchange Fees, Docket No. R-1404

Dear Ms. Johnson:

We are writing to offer our comments on the notice of proposed rulemaking related to new debit card interchange fees and transaction routing rules issued by the Board of Governors of the Federal Reserve System (the "Board"). Comerica Incorporated is a bank holding company, headquartered in Dallas, Texas, with offices in various states including Arizona, California, Florida, Michigan, and Texas. Comerica Bank, a subsidiary of Comerica Incorporated, is a state member bank that is an issuer of debit cards. The possible addition of new interchange fee and network routing rules will have an impact on Comerica Bank as an issuer of such cards. Accordingly and on behalf of Comerica Bank, Comerica Incorporated (collectively, "Comerica") appreciates the opportunity to comment on this proposal.

As noted in the Federal Register¹, the proposed rules were designed to further the requirements set forth in Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). Through Section 1075, which added Section 920 to the federal Electronic Fund Transfer Act², Congress required the Board to promulgate regulations regarding two general issues:

1. Establishment of standards for assessing whether a debit card issuer's fee for debit interchange transactions is not greater than the sum of (a) their costs with respect to the transactions and (b) an additional amount that satisfies the Federal Reserve's "standards for assessing" whether that amount is "reasonable and proportional" to those costs (the "Interchange Rules"); and
2. Prohibiting issuers or payment card networks from imposing restrictions on the number of payment card networks through which an electronic debit transaction may be processed (the "Network Rules").

Before detailing Comerica's comments regarding both issues, we must first note that, based on our discussions with experts in the financial services industry and Comerica's own analysis, the mere publication of the possibility of interchange fees being capped at seven cents or twelve cents has already had negative impacts on consumers. Without identifying those specific competitors of Comerica, we have taken note that, in actions similar to those that occurred in Australia when that country capped interchange

¹ 75 Fed. Reg. 81,722 (December 28, 2010).

² Codified as Section 920 of the Electronic Funds Transfer Act ("EFTA").

fees³, financial institutions have started eliminating consumer debit card rewards programs and other benefit features as a means of lowering costs associated with their debit card programs. Moreover, we are concerned those negative impacts will have far more dramatic and adverse consequences on consumers, the banking system, and the United States payments system. In this regard, Comerica urges the Board to revise fundamentally the Interchange Rules to avoid such adverse and harmful results.

Interchange Rules

Under the Act, issuers are permitted to receive a fee for debit interchange transactions that is not greater than the sum of (i) their costs with respect to the transactions plus (ii) an additional amount that is "reasonable and proportional" to those costs.⁴ This provision of the Act is self executing, meaning that irrespective as to whether the Interchange Rules are issued by the Board or blocked by some future judicial order, issuers are limited to the fees permitted by the Act.⁵ Under the auspices of the Act, the Board issued its proposed Interchange Rules to establish standards for assessing "reasonable and proportional." The Board proposes to do this through the following set of actions:

- determine the total costs incurred by the issuer with respect to the electronic debit transaction (Total Costs)⁶; and
- determine certain non-specific costs incurred by the issuer that cannot be "considered" (Excluded Costs) and deduct Excluded Costs from Total Costs⁷ (the result is "Allowable Cost") and establish standards for assessing whether the fee charged by the issuer is reasonable and proportional to the Allowable Cost.⁸

This set of actions requires the Board to first determine what costs are "Excluded Costs" and construct an assessment regime for determining "reasonable and proportional" fees. As set forth in the Act and the Interchange Rules, this regime must:

- "take into account, and allow for, the continuing evolution of electronic banking services and the technology utilized in such services";
- "prepare an analysis of economic impact which considers the costs and benefits to financial institutions, consumers, and other users of electronic fund transfers... and the effects upon competition in the provision of electronic banking services among large and small financial institutions and the availability of such services to different classes of consumers, particularly low income consumers"; and
- to the extent practicable, "demonstrate that the consumer protections of the proposed regulations outweigh the compliance costs imposed upon consumers and financial institutions."⁹

Based on the requirements of the Act and Section 920(a)(4)(B) of the EFTA, "Allowable Costs" should include all costs that are specific to a particular electronic debit transaction, irrespective of whether or not the particular activity is paid for through in-kind/in-house service allocations, through new capital

³ United States Government Accountability Office, Report: Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges, p. 46 (November 2009).

⁴ The Act specifies that certain other specific costs cannot be included. See EFTA §§ 920(a)(4)(B)(i) and (a)(4)(B)(ii). The Interchange Rules have expanded this, through the commentary of the proposal, to include other debit card features currently enjoyed and expected by both consumers and merchants, such as debit card rewards programs. See, 75 Fed. Reg. 81,734 to 81,735.

⁵ EFTA § 920(a)(2).

⁶ EFTA § 920(a)(4)(B)(i).

⁷ EFTA § 920(a)(4)(B)(ii).

⁸ EFTA §§ 920(a)(2) and (a)(3)(A).

⁹ 15 U.S.C. §§ 1693b(a)(1) to (a)(3).

investment in equipment, compensation of employees or vendors, nor whether those costs are assessable on a transaction-by-transaction basis. In addition, some network fees may be billed to issuers on a per-transaction basis, which thereby are related directly to specific electronic debit transactions and should be included in Allowable Costs. In addition, card production and delivery costs vary over time and in some instances are associated with a specific electronic debit transaction such as a fraud whereby a card or series of cards are replaced at the initiation of the issuer or requested by the customer. Accordingly, all of these costs, and possibly other costs that we have not been identified in this letter, should be included in Allowable Costs because such costs do vary over time with transaction volume and may be properly allocated to transactions that take place for the reason that they are reasonably incurred in providing for the electronic debit transaction to take place.

With respect to the costs of fraud detection and fraud management in relation to Allowable Costs, we find that all such costs should be permitted in the interchange fee computation. Both fraud detection and fraud management, which includes the cost of losses, are specific to particular electronic debit transactions and are part of the authorization, clearance and settlement of transactions. Such costs are wholly consistent with the Act and EFTA's concepts of "final settlement."

Based on our review, analysis, and consultation with expert advisers to Comerica, the Interchange Rule, as currently contemplated, would establish an interchange assessment structure that grossly understates the incremental costs incurred by Comerica and we believe all other debit card issuers. This understatement in the Interchange Rules, should it not be addressed by the Board, in light of the interchange survey responses previously submitted to the Board by Comerica and many other debit card issuers, may result in a court finding that the rule violates the Due Process and Takings clauses of the United States Constitution.

Although other comment letters to be filed with the Board in this regard will, with greater detail, explain the Constitutional issues associated with the Interchange Rule¹⁰, we note that, in our opinion, after much analysis and review, have concluded that the seven-cent and twelve-cent proposals are so far below the costs of operating Comerica's debit card program that a court would find the Board to have failed in its obligation to issue rules free of the Constitutional defects.

Should the seven-cent or twelve-cent limit be adopted, Comerica, as well as all other debit card issuers, will be required to take dramatic measures in an attempt to recover from this takings, so that it is in a position to attempt to continue operating its debit card program. Although it may seem unthinkable, those measures may include eliminating debit card payment mechanisms or completely restructuring how bank accounts with debit card access are sold and paid for. We note for you that there is no disagreement with the Board's statement that the proposed Interchange Rule not only fails to account for a reasonable rate of return on debit card services, it caps interchange fees at an amount that is far below an issuer's cost per transaction.¹¹

In the commentary to the proposed Interchange Rule, the Board acknowledges that Allowable Costs account for only a fraction of issuers' total costs of debit card services. Under the Interchange Rules, Allowable Costs are limited to the average variable costs that an issuer incurs for authorizing, clearing, and settling an electronic debit transaction.¹² The Proposed Rule excludes from the Allowable Costs, costs that are specific to particular debit transactions but which are not for authorization, clearance, or settlement. It also excludes other costs that are common to all debit card transactions on the basis that they could not be attributed to a particular transaction.¹³ Finally, apart from depriving issuers of recovery of their total costs of delivering debit card services, the proposed Interchange Rule fails to account for a

¹⁰ Letters to be filed by The Clearing House Association and Visa, with which Comerica concurs, will provide reference to those authorities upon which Comerica and others have reached this conclusion.

¹¹ See 75 Fed. Reg. at 81,733.

¹² 75 Fed. Reg. at 81,735-36.

¹³ *Id.* at 81,736.

reasonable rate of return. **For Comerica, this means an approximate forced reduction in current annual debit card interchange revenue of up to 88 Percent.**

To adjust to the proposed Interchange Rule's impact on Comerica's debit card program, Comerica, as are other non-exempt banks, credit unions, and other financial service providers issuing debit cards, is now forced to undertake one or more actions. These actions, which Comerica agrees are contrary to the long-term interests of Comerica and its customer base, as well as sound banking policy, include:

- (a) Reduce or eliminate its debit card program.¹⁴
- (b) Reconstruct the "bank account" and its attendant pricing to recover in full costs of the debit card "component" of a bank account or otherwise acquiesce to the Interchange Rules shifting of the burden of operating-cost recovery away from merchants by moving the burden to consumers.
- (c) Eliminate other features of a debit card transaction such as an immediate settlement, guarantee of payment to merchants, zero liability for fraudulent transactions, etc.
- (d) Limit or eliminate debit card use for higher fraud potential transactions (e.g., Internet purchases).
- (e) Cease ongoing and/or new investment in research and development regarding new debit card enhancements, fraud security controls, and other related innovations.
- (f) Operate its debit card program at a loss.

Comerica is particularly concerned about the unintended harm the proposed Interchange Rules will have on its customers and consumers in general and specifically with exempted card programs (e.g., governmental benefit payment and prepaid cards).

The Act may have been intended to help the consuming public under the theory that if merchants' debit card payment processing costs went down, the merchants would lower the prices of their products and services. We note for you, however, that the Act does not contain any requirement for merchants to pass on those savings to their customers and that the Board has no statutory authority in the Act to require merchants to pass on such savings. We also note for you that the lesson of history recognized by the United States Government Accountability Office in this regard is that: merchants will not pass on the savings to consumers (or be unable to prove with certainty that they have done so). When similar caps on debit interchange fees were imposed in Australia, they yielded no benefit for Australian consumers.¹⁵

The continued downward pressure on interchange fees may have the unintended effect of causing banks and other financial institutions, to cease offering government benefit payment and prepaid card programs. This may develop from the fact that, although the Interchange Rules do not apply to transactions executed through the use of the government benefit payment and prepaid cards, those transactions are dependent on the same systems, personnel, processes and procedures employed by banks and other financial institutions to manage all debit card transactions. In other words, exempted and non-exempted debit card transactions runs on the same tracks. If the issuers do not derive sufficient revenue to pay for the majority of transactions that run on those tracks (the non-exempted transaction),

¹⁴ In the past, the Board's Division of Research and Statistics, in reviewing a Congressional proposal to cap credit card fees, stated that:

"the low average profitability of bank and retail credit card plans suggests that card issuers would likely reduce costs and seek more revenue from alternative sources under the proposed nationwide interest rate ceilings. These adjustments by issuers would erode some of the benefits to borrowers and impose costs on other consumers."

73 Fed. Reserve Bull. No. 1, p. 10 (Jan. 1987). The Division also stated that "these findings suggest that tight ceilings on credit card interest rates are more likely to result in reduced availability of bank credit card accounts for lower- and lower-middle income families than for higher-income families." *Id.* at 16. Comerica's shares these same types of concerns as it is forced to evaluate this option.

¹⁵ United States Government Accountability Office, Report: Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges, pp. 45 to 48 (November 2009).

those tracks may close. If they close to non-exempt transactions, they also close to government benefit payment and prepaid card transactions.

Network Rules

The Network Rules were designed to prohibit issuers or payment card networks from including in their contracts or through any other requirement, condition, penalty, etc., a restriction on the number of payment card networks on which an electronic debit transaction may be processed to (a) a single network or (b) a set of networks which are owned, controlled, or otherwise operated by affiliated entities or a network affiliated with the card issuer.¹⁶ In setting out this prohibition, the Network Rules outlined two alternatives for implementing the Network Rules prohibition on network exclusivity. The alternatives are:

- Alternative A. Prohibits networks and issuers from limiting the number of networks available for processing an electronic debit transaction to fewer than two unaffiliated networks, regardless of the means by which a transaction may be authorized;¹⁷ and
- Alternative B. Prohibits networks and issuers from limiting the number of networks available for processing an electronic debit transaction to fewer than two unaffiliated networks for each method by which a transaction may be authorized.¹⁸

Although Comerica would be required to undertake substantial system and process changes to add a second network to its ATM cards, health savings account debit cards, and U.S. Treasury and government payment card products to implement Alternative A, Comerica finds that, with an adequate implementation period, Alternative A should be adopted instead of Alternative B. During our evaluation of Alternative B, we noted that it prohibits limiting the number of networks available for processing a transaction to fewer than two unaffiliated networks for each method by which a transaction may be authorized. This prohibition clearly exceeds the requirements of the Act and, consequently, could be construed to be an improper promulgation under the Federal Administrative Procedures Act.¹⁹

To implement Alternative A, an implementation period of not less than one year would be required. To add additional networks to all of Comerica's debit card products will require it to research, identify, and negotiate contracts with those required new networks. After new contracts have been executed, a development phase would be undertaken to design the new network access. After the designs and scope of implementation work have been configured, actions could then be undertaken to implement activation of the additional networks. During those activation tasks, it may be necessary to reissue new cards to customers, which would add time to the deployment. These implementation tasks could run as long as one year.

The Act only permits the issuance of regulations that prohibit an issuer or network from restricting the number of networks over which an electronic debit transaction may be processed to one network or two or more affiliate networks.²⁰ Although Alternatives A and B of the proposed Network Rules appear to only adopt the statutory language (prohibiting restrictions to fewer than the prescribed number of unaffiliated network options), the Network Rules, in their entirety, have created a regulatory scheme that is more restrictive. Specifically, the Board's proposed Network Rules would prohibit all arrangements by issuers or networks that in any way restrict the networks made available on a debit card for processing a transaction.²¹ In addition, the Network Rules appear to have been written with the misunderstanding of

¹⁶ EFTA §§ 920(b)(1)(A) and (b)(1)(B).

¹⁷ 75 Fed. Reg. 81,749.

¹⁸ 75 Fed. Reg. 81,749 to 81,750.

¹⁹ As with the U.S. Constitutional issues noted above, Comerica will leave the detailed discussion of the legal deficiencies of the Board's actions regarding the Network Rules to that presented in the comment letters filed by The Clearing House Association and Visa.

²⁰ EFTA § 920(b)(1)(A).

²¹ See 75 Fed. Reg. 81,751 to 81,752.

the Act's requirement that issuers have an affirmative obligation to enable the processing of electronic debit transactions on the required number and mix of networks.²² The Board's requirement that issuers and networks enable at least the requisite number of network routing options on each debit card is neither required nor authorized by a plain reading of the Act. We believe that this expansion of statutory anti-exclusivity provisions in the Act and that Act's commandment for the issuance of implementing regulations, weighed against how the Board constructed the Network Rules could be construed to be an arbitrary and capricious act that exceeded the authority of Congress granted to the Board.²³

If Alternative B is adopted, issuers will be faced with another range of choices and issues, none of which are preferred by or beneficial to consumers. Those choices and issues are:

- Possible discontinuance of certain debit-based card products where adding an additional network is no feasible or cost-effective (e.g., gift cards, health savings account and flexible benefit payment cards, etc.);
- Possible delays in authorizing transactions and other customer and merchant inconveniences (e.g., declined authorizations due to system time-out errors) if preferred/prearranged networks are not used;
- Network stress or inability to implement merchant preferred networks should all banks be required to implement on the same date; and
- Impairment or potential breach of existing contract terms regarding card exclusivity.

We should note, however, that there is a possibility that even if Alternative A is adopted by the Board, economic and competitive pressures may require financial institutions to institute any of the above actions in the same manner as if Alternative B was adopted.

In conclusion, under Alternative A, a merchant is able to direct consumers to the merchant's preferred network as long as the card used by the consumer has been configured to include that preferred network as of the two choices. If it is not, the merchant is free to prohibit the card and the transaction from being authorized through the issuers selected networks and require the consumer to pay by an alternative method. Although this may cause consumer inconvenience in that should the consumer insist on the benefits of using their debit card on the issuer's preferred networks that would not be supported by the merchant, the consumer could choose to not complete the purchase with the debit card and at least the consumer has the opportunity to make that choice. This creates a somewhat balance in the marketplace of payments between the merchant, issuers, networks, and consumers.

We also note for you our concern that Comerica's customers may lose certain benefits they enjoy through the networks Comerica has employed in its debit card program. In this regard, notice should be taken that some issuers and networks have expanded through their card agreements certain consumer fraud protections that exceed those of applicable federal law (e.g., Regulation E). Comerica is such an issuer. Accordingly, our preference for Alternative A permits those customers who have selected Comerica as their bank for debit card services to continue to have the opportunity to enjoy our enhanced fraud protections by having information available to them so they may make the choice to not use the merchant's network should the merchant prevent their card from operating as they thought it would through Comerica's selected networks. Under Alternative B, allowing or even enabling multiple network routing options per transaction authorization method would negatively impact Comerica's customers by hiding the fact from those customers that their transaction is being processed over a network that does not offer the same fraud protections and benefits as Comerica's preferred networks.²⁴ To comply with the requirements of Alternative B, issuers may have no choice but to allow the processing of electronic debit

²² *Id.*

²³ See *supra* note 19.

²⁴ Comerica's debit cards have specific benefits that are associated with debit card transactions being processed over specific networks for which Comerica has a contractual relationship. In addition to other benefits, includes customer zero-liability protection.

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transactions made using their debit cards over unfamiliar networks, including networks that may lack sufficient and satisfactory data security and fraud prevention protocols.

Closing Comments

In summary, we suggest to you that the Board should not impose price caps unless compelled to do so by clear statutory language. We find that there is no such mandatory language in the Act. Instead, the Board should revise the Interchange Rule to set forth standards for assessing whether debit interchange fees are reasonable and proportional to an issuer's total Allowable Cost. This would be a fee equal to the total Allowable Cost, including a fraud management component and other costs, plus a reasonable profit. The Interchange Rule should also include a "safe harbor" provision that would enable issuers, and the Board, to avoid undue administrative burden and uncertainty. It is essential, however, that such a provision be a non-exclusive safe harbor and not an effective cap.

At a minimum, the Board should delay implementation of its proposed rule regarding Section 1075 of the Act until it has time to collect more information and analyze how the rule will affect consumers, financial institutions, and the economy as a whole. We believe that all of the issues and controversy regarding Section 1075 of the Act and the Board's valiant attempts to craft a regulation in this area are rooted in how Section 1075 found its way into the Act. The rush to amend the Act to add Section 1075 without proper consideration and debate should not be perpetuated through rushing the proposed rule through the promulgation process. It is now the time to take pause as to what has occurred and give the issues the proper light-of-day review that such a major public policy shift requires.

We value each and every opportunity to provide comments regarding regulatory proposals. We trust that you find the comments noted above useful in formulating the final regulation. If you have any questions, please contact me at 313.222.6160.

Very truly yours,



DJ Culkar
Senior Vice President, Assistant General Counsel, and
Assistant Secretary