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

Attention Docket No. R-1404
regs.comments@federalreserve.gov

Re: Debit Card Interchange Fees and Routing
Docket No. R-1404

Dear Ms. Johnson:

HSBC Bank USA, National Association ("HSBC") is writing to respectfully voice its opposition to the rule proposed by the Board of Governors of the Federal Reserve System (the "Federal Reserve") to implement the debit interchange provisions of Section 1075 (the "Durbin Amendment") of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Proposed Rule"). HSBC operates more than 475 bank branches and offers a full range of banking services, including debit and ATM cards, to its approximately 3.8 million customers.

HSBC strongly endorses the views expressed in the comment letter jointly submitted by the Financial Services Roundtable and the major bank and credit union trade associations regarding the legal and interpretive issues raised by the Proposed Rule. In particular, we agree that the price controls imposed by the Proposed Rule are inconsistent with basic American free enterprise principles and will have unintended consequences, harming the consumers that the Durbin Amendment was intended to protect. Debit cards have enjoyed a dramatic rise in acceptance by both consumers and merchants because they offer benefits that provide significant advantages over checks and cash. They are an efficient, inexpensive and secure method for consumers to access their accounts; they provide protection from fraud and eliminate the risks that come with carrying cash. Debit cards give merchants guaranteed and immediate payment for products and services, and speedier transactions at the checkout. They also make internet and telephone transactions accessible to consumers that do not otherwise have access to credit. We would submit that the Proposed Rule will prevent banks from recouping the cost of offering debit card services, which will thereby limit the availability of these services and increase the cost to the consumers that use them. HSBC urges the Federal Reserve to consider the following points with respect to the Proposed Rule.

1. **Banks Are Prevented From Recovering Actual Costs**.

The Durbin Amendment authorized the Federal Reserve to establish standards for assessing whether interchange fees are reasonable and proportional to an issuer's costs with respect to debit card transactions. This authorization, we would submit, suggests a framework, by which interchange fees should be evaluated going forward. In contrast, however, the Proposed Rule sets price caps on interchange fees. Based on our experience, these caps not only prohibit issuers from making any profit on debit card transactions, but will actually prevent them from recouping the actual costs of debit transactions. The price cap of 7 – 12 cents per transaction is far below the actual per transaction costs incurred by HSBC. Interchange fees currently allow banks to cover the costs related to debit services, including card issuance and statement production, overdraft and fraud losses, fraud prevention expenses, customer service and data processing. Requiring a for-profit business to offer products and services that cannot be priced to covers actual costs and allow for a reasonable profit does not appear warranted by the Durbin Amendment or sound banking practices.

In determining standards for assessing whether fees are reasonable and proportional to issuer costs, the Proposed Rule fails to consider many costs that are incurred by issuers with respect to debit card transactions. For example, we note that even costs that are directly related to the authorization, clearing and settlement of individual debit transactions are excluded from consideration. In particular, there is no adjustment for fraud or fraud prevention costs, even though the Durbin Amendment explicitly allows for such costs. While acknowledging that fraud losses are a specific cost of debit card transactions and that fraud losses attributable to signature debit exceeded $1 billion in 2009, the Proposed Rule would prohibit issuers from recouping even a portion of these fraud costs through interchange fees until some undefined time in the future. We note that Congress required the Federal Reserve to issue fraud prevention standards at the same time as the final rule. Because the rules are so closely linked, we would suggest that, at a minimum, if fraud prevention standards are issued later than the final rules related to interchange fees it would be reasonable for the interchange rules to estimate such fees and allow for an adjustment to the interchange fee until such time as the fraud prevention standards are established.

2. **Costs to Consumers Will Increase.**

Debit cards provide a valuable service to our customers, but, as noted above, carry certain operational costs. Thus, in order to provide debit cards to our customers going forward, the costs of debit services will need to be recovered by some means, for example, through imposition of annual or transaction fees for the use of the cards, or through additional checking account fees. Another option for banks is to curtail purchase functionality on debit cards, and offer ATM cards as the low-cost alternative. While this will still enable consumers to access their accounts, those consumers that do not have access to credit will lose the benefit of an efficient payment method for retail transactions, particularly when making phone or internet transactions. At risk are the free debit card services and low-cost checking accounts which many consumers now enjoy, and if fee structures change, those consumers are more likely to rely more on checks and cash. Such higher use of non-electronic payment methods reduces the ability of financial institutions to control fraud and increases the risk of theft and numerous other unintended consequences that may negatively impact consumers.

3. **The Exclusivity and Routing Restrictions Should Be Revised.**

The Network Exclusivity Restrictions in the Proposed Rule suggest that issuers are either required to enable at least two unaffiliated networks on each debit card. These restrictions will present networks and issuers with significant technical challenges and will require a multitude of software and hardware changes for issuers as well as all other participants within the electronic payments system. The Federal Reserve offers two alternatives for implementing the Durbin Amendment's Network Exclusivity Restrictions: Alternative A, which 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; and Alternative B, which 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.

Of the two alternatives, we believe that Alternative A achieves the intended objectives of the Durbin Amendment by prohibiting networks and issuers from limiting the number of networks available for processing a transaction to fewer than two unaffiliated networks. The adoption of Alternative B will cause unnecessary and avoidable harm to the debit marketplace through a multitude of unintended negative consequences, and will present networks and issuers with significant technical and financial challenges. As the Federal Reserve acknowledges in Commentary, adopting Alternative B would likely deprive consumers of knowledge and control regarding the network over which any particular electronic debit transaction will be routed, potentially depriving them of rights, privileges and benefits granted by certain debit card networks.

Both alternatives impose significant technical challenges. The proposed implementation date of October 1, 2011 does not allow sufficient time to establish the commercial arrangements with networks and address the technical changes that will be needed to satisfy these requirements. We strongly urge the Federal Reserve to extend the implementation date of the Network Exclusivity Restrictions to at least October 1, 2013 if Alternative A is adopted or, if Alternative B is adopted, an additional twelve months beyond that.

HSBC appreciates the opportunity to comment on the Proposed Rule. If you have any questions or require additional information, please contact Patricia Grace, Deputy General Counsel, at 716-841-5733.

Sincerely

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Head of Product and Pricing Strategy