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February 21, 2011

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

RE: Docket No. R.1404

Dear Ms. Johnson:

We thank the Federal Reserve for the opportunity to comment on the promulgation of regulations implementing certain elements of H.R. 4173, the Dodd-Frank Wall Street Reform and Consumer Protection Act. The undersigned manage payment cards used by over five million American consumers to access various health care and employee benefits accounts. Our programs enable these consumers to make convenient payment for qualified goods and services directly from employee benefit plans through the use of a MasterCard or Visa-branded prepaid card.

We wish to express our sincere gratitude for the support for health care and employee benefit cards that the Federal Reserve demonstrated in its December, 2010 draft regulations. Specifically, we appreciate the inclusion of an exemption for general purpose prepaid cards that would, we believe, include employee benefit cards such as those used to access Flexible Spending Accounts (FSAs), Health Reimbursement Arrangements (HRAs), and Qualified Transportation Accounts (QTAs). This exemption will help to support the continued growth of and innovation in these complex card programs, while enabling program managers to continue to offer these consumer-friendly products to plan administrators, and ultimately employers, at moderate prices.

While we appreciate the support the Federal Reserve has given to these cards in the draft regulations, we believe the draft contains several provisions that will prove challenging for these card programs and which will raise costs and ultimately prices to plan administrators and employers. Below we summarize these concerns and provide additional detail regarding why they pose challenges for us, our customers, and consumers.

Background and Benefits of Employee Benefit Prepaid Cards

Prepaid cards have brought significant convenience and cash flow benefits to millions of American consumers and represent an important innovation and efficiency driver in the administration of employee benefit plans. Without the convenience of prepaid cards such as ours, consumers would be required to pay out of pocket, fill out a claim form, submit the form with accompanying documentation, and wait for reimbursement. In the absence of a card, the plan administrator must bear the cost of processing these paper claims and issuing checks or EFTs (and accompanying remittance advices). Prepaid cards generate cost savings for plan administrators (and hence for employer plan sponsors) by replacing manual paper processes with efficient electronic payment.

Employee benefit prepaid cards are heavily regulated by the Internal Revenue Service to ensure that payments made from benefit accounts using these cards are for qualified goods and services as defined by the IRS and the applicable terms of the benefit plan. In order to accomplish this objective, complex and highly sophisticated technology is employed before, during, and after the card transaction to implement effective filters and safeguards that standard bank card systems cannot support. The costs of building and maintaining the necessary technology, data exchanges, and operating support infrastructure to ensure a compliant implementation are many orders of magnitude greater than typical debit cards.

Interchange Rate Regulation

The December draft regulations recognize the special nature of these card programs and the importance of interchange fee revenue in helping defray their significantly higher costs. As noted above, we believe the draft regulations should be read to exempt all health care and employee benefit cards, although reliance on the general-use prepaid exemption could give rise to some ambiguity in interpretation. A broad exemption for all health care and employee benefits cards is clearly indicated by the legislative history, specifically the Frank-Larson floor colloquy in the House and the Dodd floor statement in the Senate. In the case of Health Savings Accounts (HSAs), however, the draft regulations appear to exempt certain cards while denying others an exemption, based solely on whether the trustee or custodian is employing omnibus accounting.

We believe that such a distinction is technical and not substantive. HSAs were created by legislation (The Medicare Prescription Drug Improvement and Modernization Act of 2003). That legislation and the enabling regulations promulgated by the IRS not only created the accounts but also established detailed regulations for product design and operation. These regulatory requirements dictate who is eligible to open and fund an HSA, the tax treatment of contributions, investments, and distributions, the maximum amount that may be contributed annually, and who may qualify as a trustee or custodian. There is no legal or other substantive difference between an HSA that uses omnibus accounting and one that is established using individual accounting. Simply put, an HSA is an HSA, regardless of the underlying accounting being used, due to these strict regulations, and yet a reliance on the general use prepaid exemption treats the two differently.

An increasingly common offering in the health care and employee benefit card market is an innovative product known as a "multi-purse card". A multi-purse card allows access to multiple accounts, with the processing system automatically selecting the appropriate account for authorization and settlement based on benefit plan rules. These innovative cards increase convenience for consumers by eliminating confusion over which account (and hence which card) to use for a given expense. They also increase cost efficiencies by eliminating redundant plastic and account maintenance expense. A common use of this product is the combination of an FSA and an HSA on the same card. If the FSA is exempt and the HSA is not (because it happens to use individual accounting), this creates a conflict for the multi-purse card. It would not be feasible to manage accounts with different interchange rates linked to the same card, since the network does not know what purse was used to settle the transaction. The existing draft regulations would, therefore, effectively make this product impractical, denying consumers, administrators, and employers its benefits.

It is for these reasons that we urge the Federal Reserve to specifically name health and employee benefit accounts such as FSAs, HRAs, HSAs, and QTAs, as exempt from the interchange regulation provisions of Durbin. This will align the regulation with the intent of Congress as expressed in the Larson-Frank colloquy and Dodd floor statement, provide for uniform treatment of HSAs, and eliminate the possibility of any ambiguity regarding whether or not other health and benefit cards qualify under the general-use prepaid exemption.

Network Exclusivity and Routing Provisions

Today, most health care and employee benefit cards support only a single signature network. These cards typically must comply with complex IRS regulatory requirements. For example, FSA, HRA, and QTA card use is restricted to certain merchant categories and is not allowed to provide cash access. Further, FSA and HRA cards must comply with IRS requirements that mandate the use of Inventory Information Approval Systems (IIAS), as noted in the proposed rulemaking.

Currently, IIAS is only supported by two signature debit networks, MasterCard and Visa. American Express and Discover have abandoned this market and are not participating in SIGIS, the industry group that has established and maintains the only IIAS standard currently in widespread use. The SIGIS standard, moreover, currently only applies to signature network transactions. To enable the use of PIN networks for IIAS transactions would, therefore, require SIGIS to change its standard, a process that would take considerable time because of the procedures mandated by the SIGIS by-laws and Intellectual Property Rights Policy.

Even if the standard were modified, enabling IIAS on PIN networks would require significant investment by thousands of merchants, acquirers, networks, and issuer processors. It is worthwhile to note that SIGIS' founding members, who established the current standard, included a diverse cross-section of participants from across the payments chain, including leading merchants and merchant trade associations (a list of the founding members is attached as Exhibit I). This group considered the inclusion of PIN network support in the standard and decided not to include it due to cost considerations. Certainly the technology changes necessary to support and implement a change in the standard would be costly and the implementation lead time would be very long.

Under the Federal Reserve's proposed Alternative A for dealing with the network exclusivity provision, all debit and prepaid cards would be required to support a PIN network by October 1, 2011. Even if SIGIS decided to change its standard, the lead time required to do so and for the industry to subsequently implement the required changes would not enable implementation by the proposed effective date. The result would be consumer confusion and frustration if IIAS merchants attempted to route transactions over the PIN network supported by the card because the transaction would decline. Moreover, it is not clear that the PIN networks would decide to make the investment necessary to support IIAS transactions – as noted above, both American Express and Discover have declined make such an investment and have exited this market.

In the transit benefit market, throughput is a key operating consideration which has led many transit authorities to install card readers (often contactless) at turnstiles and on busses. By their nature, these devices cannot be PIN-capable as the time required for a passenger to enter a PIN works against the processing speed objective of the transit authority.

We understand that a key rationale for the use of PIN networks is the claim that PIN transactions are more secure than signature debit transactions. We would assert that this claim is debatable; for example some consumers are reluctant to use PIN at the point of sale because of the risk of compromising the security code when entering it into a terminal exposed to public view. With respect to health and employee benefit cards, however, the issue is largely moot. Industry surveys indicate that the incidence of fraud loss associated with these special-purpose and limited access cards are nominal and significantly lower than other types of debit and prepaid cards.

We thank the Federal Reserve for recognizing the challenges related to PIN support in its proposed regulation and for offering an alternative proposal for complying with the network exclusivity provisions. Unfortunately, Alternative B does not overcome these challenges with respect to health care and employee benefit cards. While it is true that there are two signature networks available today in the benefits card market, the feasibility challenges to using more than one signature network are significant. The signature networks represent more than just the network technology and infrastructure – they are brands, with operating rules and regulations that govern everything from the use of marks to how transactions must be processed to consumer protections and benefits, and even to how complex products like health and employee benefit cards operate.

Enabling a card to support more than one signature network would literally require scrapping the entire operating framework of the networks and rebuilding them to accommodate this new dynamic. As a practical matter, the rules and regulations of the networks would need to conform to one another; otherwise the issuer and consumer would not know what rules govern a particular transaction. Rules such as dispute and chargeback rights and the length of time an issuer may place a hold on funds, which can and do vary by network, would need to be standardized. The result would be a least-common-denominator approach which would effectively stifle innovation in network product offerings.

In addition, the two networks today compete fiercely for benefit debit card business and provide significant marketing support for these programs. Mandating the use of two signature networks would solidify a duopoly in this market and eliminate this competitive dynamic. As the Federal Reserve Governor expressed in her recent testimony before the House Financial Services Committee, for consumers to benefit from the changes proposed in this rule, there must be a competitive environment. With regard to health benefit cards, requiring the use of both networks would eliminate the competitive environment that currently exists. As a result of entrenching a non-competitive duopoly, neither network would have incentives to innovate and improve on their network. Finally, no new network would have an incentive to join (or re-join in the case of American Express or Discover) this market because their business would never be able to negotiate an exclusive contract to guarantee the use of their product.

Finally, mandating the use of two networks, whether signature, PIN, or a combination, would over time drive volume toward lower interchange rates, negating the very economic benefit intended by the interchange rate regulation exemption for these types of cards. We recognize that there is an argument that lower interchange rates may potentially benefit consumers if merchant competition results in a pass-through of these lower rates in the form of lower consumer prices. While this argument may have merit in the broader debit card market, with respect to health care and employee benefit cards, driving to lower interchange rates will likely be anti-consumer. These cards represent a small niche in the overall debit card market, and so a preservation of interchange rates at current levels will not have a material impact on merchant costs and will therefore not affect merchants' consumer pricing strategies, pro or con. If, however, transactions are driven to lower interchange rates over time, revenues available to support these complex card programs will be materially reduced. This will force providers of these cards to take one or both of two actions. They will raise prices to plan administrators and employers, which will have a chilling effect on the expansion of these card programs and may lead some employers to cease using them altogether. This will deprive consumers of the significant cash flow and convenience benefits of these cards compared to the alternative paper reimbursement process, as described previously In addition, a material reduction in revenues will stifle further innovation in this market, which has introduced ground-breaking developments such as multi-account cards and IIAS and in which the leading providers continue to work on new innovations that will further benefit consumers.

<u>Definition of "Asset Account"</u>

With respect to FSA, HRA, QTA, and other employer-sponsored and administered plans, there is a valid argument that the requirements of Durbin do not apply at all. The Federal Reserve appears to misunderstand the very nature of these plans and associated card program structures in presuming (as indicated in the proposed regulation) that these products are "asset accounts" that are subject to the proposed regulations. In fact, FSA, HRA and QTAs are employer-sponsored benefit arrangements that generally do not involve the establishment of individual "asset accounts" for covered employees.

As a result, we believe that FSA, HRA and QTA cards are not debit cards because they do not access asset accounts. Instead, these accounts are employer sponsored and administered arrangements under which employees have an unsecured right to have up to a specified amount of health care expenses or transportation expenses reimbursed by their employer. The employer is not required to keep any funds on hand or to fund a specific legal account associated (on an omnibus or other basis) with either the underlying benefit plans or the cards used to access these plans.

Conclusion

We thank the Federal Reserve for taking the time to review this letter. We appreciate the extraordinary demands being placed on you and your colleagues as you work to promulgate regulations emanating from Dodd-Frank. We also appreciate the significant complexity of the issues with which you are dealing. We hope the information provided in this letter provides a better understanding of the need to clearly exempt all health care and employee benefit cards from both the interchange rate regulation and the network exclusivity provisions of Durbin. If these cards are not exempted, the significant reduction in revenues, combined with the increased costs of compliance, would necessitate cost increases to plan administrators, costs which inevitably would be passed on to employers and in some cases to employee consumers. This runs counter to the expressed intent of health care reform, which is to lower administrative costs. In addition, the likely effect would be less resources to devote to product innovation, which has benefitted consumers greatly over the years as these programs have become nearly paperless.

We welcome the opportunity to answer any questions you might have and to meet with you to discuss these matters further.

Very truly yours,

Evolution Benefits, Inc.

Robert E. Patricelli
Chief Executive Officer

WageWorks, Inc.

Joseph Jackson
Chief Executive Officer

PayFlex Systems USA, Inc.

Robert L. Natt
Chief Executive Officer

Exhibit I
SIGIS Founding Members

Chase Paymentech Solutions, LLC
Evolution Benefits, Inc.
Fifth Third Bank
First Data Corporation
MasterCard International Incorporated
Metavante Corporation
Visa, Inc.
Creative Benefits, Inc.
CVS Caremark Corporation
DataPath, Inc.
Discover Financial Services, Inc.
Food Marketing Institute
Humana Inc.
Longs Drug Stores California, Inc.
The Macaluso Group, LLC
Motivano, Inc.
National Association of Chain Drug Stores, Inc.
RBS Lynk, Inc.
Total System Services, Inc.
WageWorks, Inc.
Wal-Mart Stores, Inc.
Target Corporation

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