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February 17, 2011

Via Email

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

Attention: Docket No. R–1404 and RIN No. 7100 AD63

Dear Ms. Johnson:

This letter is submitted to the Board of Governors of the Federal Reserve System ("Board") on behalf of the Network Branded Prepaid Card Association ("NBPCA") in response to the Proposed Rules published in the Federal Register on December 28, 2010 at 75 Fed. Reg. 81722-81763 ("Proposed Rule") relating to debit card interchange fees and routing. The Proposed Rule was introduced to implement EFTA Section 920, as added by Section 1075 (the "Durbin Amendment") of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act").

The NBPCA is a non-profit trade association representing a diverse group of organizations that take part in delivering network branded prepaid cards to consumers, businesses and governments. Network branded prepaid cards (often referred to as "open-loop" or "general use" prepaid cards) bear the logo of a payment network (for example, MasterCard, Visa, American Express or Discover). The NBPCA's members include financial institutions, card organizations, processors, program managers, marketing and incentive companies, card distributors, law firms and media firms. The NBPCA works with its members to establish and encourage best practices to benefit card users, including consumers, businesses and government agencies, as well as industry participants. Since its inception, the NBPCA has devoted significant resources to educating consumers, the media and policymakers about prepaid card products. It is important to add that, given the diversity of our membership, the comments set forth in this letter do not necessarily represent the views of all of our members; indeed, many of our members will be submitting their own comment letters separately and independently from these comments.

Prepaid cards are important and useful products. Small businesses and governments rely on prepaid cards to increase efficiencies and save money. Millions of U.S. consumers use network branded prepaid cards for the choice and protection they provide. These include unbanked or underbanked individuals who would not otherwise have a way to participate in our card-based economy, parents of college-aged

students who want a safe and secure way to provide money to their children without the risk of running up debt and recipients of government benefits who need an efficient way to receive their child support payments, food stamps, unemployment payments and other federal or state disbursements.

Given the importance of prepaid cards, the NBPCA has significant concerns regarding the Durbin Amendment and the Proposed Rules. That is why we are ultimately endorsing a delay of implementation until a thorough a study has been completed. Here are our key points as outlined in greater detail in the body of the letter below:

1. The Proposed Rules do not follow the Durbin Amendment requirements to ensure that the amount of interchange is "reasonable and proportional" to the cost incurred. Instead, they establish a framework under which issuers cannot recover their costs, much less receive a reasonable return on their investments.
2. The Proposed Rules do not follow the Durbin Amendment requirements to "prescribe regulations …to establish standards." Instead, they establish fixed caps and price controls.
3. The legislative history behind the Durbin Amendment demonstrates that the routing restrictions were never intended to apply to prepaid gift cards nor to any debit/prepaid card that is solely signature based. Instead, the Proposed Rules seek to force a round peg into a square hole by requiring the addition of unnecessary networks onto prepaid cards, adding unwarranted risk, fraud potential and cost to these cards.
4. Given the speed with which the legislation was written, as well as the timing of the Proposed Rules, there has been insufficient time to understand the full potential impact of these rules on government, consumers and businesses that use prepaid cards. Current timing requirements are not implementable and further study is urgently needed.
5. Finally, because the current Proposed Rules do not enforce the exceptions carefully outlined by the drafters of the legislation – namely those to protect small banks, government benefit recipients, health/benefit card holders and the consumers who rely on the reloadable prepaid cards to receive their monthly income and execute their day to day transactions and bill payment, we fear that the unintended consequence of these Proposed Rules, and the Durbin Amendment itself, will be to limit access or eliminate vital prepaid card products from the marketplace.

We also have serious concerns that the Durbin Amendment itself may be an unconstitutional and confiscatory taking of property, although we recognize that this is not the forum in which to address those concerns.

I. Comments on Scope of the Board's Rulemaking

The NBPCA appreciates that Congress gave the Board a difficult, perhaps daunting, task in delegating the responsibility to develop the interchange fee regulations.

Despite the inherent difficulties faced by the Board, however, we believe that the Proposed Rules go much further than required by the Durbin Amendment; indeed, some of the most proscriptive and burdensome elements of the Proposed Rules are nowhere reflected in the Durbin Amendment itself.

First, the Durbin Amendment requires that the "amount of any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction shall be reasonable and proportional to the cost incurred by the issuer with respect to the transaction." We believe that both formulations for the determination of interchange fees for prepaid card products do not reflect the reasonable and proportional costs incurred by the issuer of a prepaid product. Instead, the Proposed Rules artificially limit allowable costs and do not provide interchange fees that are either reasonable or proportional to issuers' actual costs.

Second, the Durbin Amendment requires the Board to:

> "prescribe regulations …to establish standards for assessing whether the amount of any interchange transaction fee described in paragraph (2) is reasonable and proportional to the cost incurred by the issuer with respect to the transaction."

Prescribing regulations to "establish standards" is a very different exercise than imposing fee caps. The Durbin Amendment did not require or even suggest that the Board should impose specific caps on interchange fees. That, in our view, is an extraordinary expansion of the authority granted by Congress and should not have been undertaken by the Board. Our view is supported by Senator Durbin's own position statement posted on his Website regarding his amendment:

> "Sen. Durbin's amendment would not have the Federal Reserve set interchange prices. Under Sen. Durbin's amendment the Fed would not set debit interchange prices. Instead the Fed would oversee the debit interchange fees set by card networks to ensure that they are "reasonable and proportional" to cost. This is the same "reasonable and proportional" standard that Congress directed the Fed to use to oversee consumer credit card fees in the 2009 Credit CARD Act." [1]

Moreover, we are concerned that the Proposed Rules' approaches for network routing restrictions do not reflect Congress' intentions and would create an unworkable structure that will both increase costs and confuse consumers and merchants. Again, Senator Durbin indicated that the limitations on routing restrictions were intended to restore pre-existing competition in PIN-based cards, where multiple networks traditionally had existed on a single debit card:

> Third, my amendment said that card networks cannot require that their debit cards all use exclusively one debit network.
>
> The story here is that there are a number of debit networks that merchants can use to conduct transactions. Until recently, most cards could be used on multiple networks. You used to see a number of debit network logos on each debit card.
>
> In recent years, however, the biggest networks like Visa have begun requiring banks to sign exclusive agreements under which they become the sole network on the banks' cards. This

[1] See http://durbin.senate.gov/issues/leg_wallstreet_swipe.cfm

> diminishes competition between networks and leads to higher prices. My amendment will restore this competition. [2]

The Proposed Rules' routing restrictions were not intended to apply to prepaid gift cards or to any debit/prepaid card that is solely signature based. Cards with multiple signature networks simply don't exist, and to force such a result--when it was obviously never intended--is overreaching. Because this clearly was a simple drafting error, the NBPCA submits that the Board has the authority and discretion to make—and, therefore, should include—an exception for signature-only cards from the routing restrictions.

There are many other hurdles involved in achieving a workable solution to the situation Congress was trying to correct. For example, the concept of setting fees in the context of a highly complex technological infrastructure that our entire retail economy relies upon is, in our view, not only risky and burdensome but unnecessary as well because significant competition already exists among banks and payment networks. We believe existing competition already serves to keep interchange rates at the best possible balance of risk-to-return market rate, and that no artificial limits need to be imposed.

We must also note that detrimental impact that the Proposed Rules will have on already-issued prepaid and debit cards that are currently in the wallets and purses of millions of consumers. Certainly, the costs of reissuing debit cards will be significant. However, those costs pale in comparison to the issue of trying to replace gift cards. We would urge that the Proposed Rules confirm that they apply solely to cards issued on or after the effective date. Consumers holding pre-existing cards should not wake up one day to discover their cards are no longer usable due to regulatory change.

Finally, we continue to have misgivings regarding the Proposed Rules' pricing and routing regimes that, in our view, threaten the widespread access, innovative features and even the basic functionality that has led so many consumers and businesses to embrace network branded prepaid card products.

Given the wide range of open issues and the clear and detrimental impact of this hastily-written piece of legislation, we urge that the entire Durbin Amendment be placed on hold pending the completion of a thorough study of its complex and inter-related facets. Although we acknowledge that such a study is outside of the Board's control, we hope the Board will support our efforts to request Congress to require a study rather than allowing this legislation to go forward in its current form. Such a study should include:

- The legislative goals of the Amendment and whether they can, in fact, be achieved through the current legislation;
- The operational constraints and the time required to implement the required changes;
- The costs of implementation to banks, consumers and merchants;
- The unintended consequences of the legislation and their impact on the availability and pricing of payment products; and

[2] 156 *Cong. Rec.* S10996 (2010).

- Whether there are any other reasonable and less expensive alternatives available that may achieve similar goals but with less disruption.

In further support of our request, we note that the Board's own advisory group, the Federal Advisory Council, issued its own request that the Proposed Rules be withdrawn and fundamentally rewritten:

> If enacted as proposed, the results would be extremely damaging to consumers, the U.S. payment systems and financial institutions of all sizes. Given the serious flaws in the Proposed Rule, we urge the Board to withdraw the current proposal, fundamentally revise its overly narrow interpretation of the Durbin Amendment and issue a new Proposed Rules that takes fully into account both the requirements of law and the significant consumer and economic considerations at stake.[3]

In the meantime, because we are concerned about the detrimental impact the current proposal would have on the availability and functionality of the extremely dynamic and fluid prepaid marketplace, we wish to submit the following comments on behalf of our membership.

II. General Comments to the Proposed Rules

We believe the Proposed Rules go significantly further than the intent of the Durbin Amendment in two important areas:

1. *Price Setting.* As noted above, the Durbin Amendment did not require the Board to impose price controls, nor did it require a flat, one-size-fits-all approach to interchange fees. Interchange fees and card routing options vary based on the card brand, regions or jurisdictions, the type of card, the type and size of the accepting merchant, and the type of transaction, such as whether the card is present in the transaction (e.g., in-store) or not present (e.g., on-line and phone orders). Depending on how the card may be used, the risks entailed and the stated desire of the cardholders or program sponsors, prepaid card programs can have three structures:

   (i) **Signature Based**. Some permit only transactions that are processed as a "signature" transaction, similar to a credit card. Typically, network branded gift cards (which are not reloadable and do not allow for cash access) are solely signature-based cards because providing PINs adds substantial costs and can increase fraud and money laundering risks.

   (ii) **PIN Based**. Some permit only PIN-based transactions, similar to an "ATM card," that may only be used with a PIN. For example, some small business owners prefer to give their employees prepaid business expense cards that are limited to PIN-based transactions to make it difficult for others to use the cards without permission.

[3] The Federal Advisory Council (FAC), which is composed of twelve representatives of the banking industry, consults with and advises the Board on all matters within the Board's jurisdiction. A copy of its recent official comment on the Proposed Rules may be found at http://www.federalreserve.gov/SECRS/2011/February/20110208/R-1404/R-1404_020411_64080_567728880360_1.pdf.

(iii) **Both Signature and PIN**. Some permit both signature-based and PIN-based transactions, such as payroll cards or general purpose reloadable cards.

The Proposed Rules note that the range of prepaid cards and the variety of technical capabilities among the networks that route signature- and PIN-based transactions. Moreover, per-transaction costs differ greatly among issuers, depending, in part, on the features offered and the potential for economies of scale.

The approach undertaken by the Board would impose a fixed price cap on interchange fees for a wide range of disparate products and services. This approach is flawed for many reasons. First, as noted above, the Durbin Amendment does not provide authority to the Board to establish price controls on interchange rates. Second, even if there were some basis to impose price caps on interchange fees, the two interchange fee options set forth in the Proposed Rules do not take into consideration the cost variances described above. Third, in the case of the interchange fee options, both provide an arbitrary cap of no more than 12 cents per transaction, notwithstanding that an issuer's actual costs may be much higher than 12 cents. As such, we find little evidence that the proposed interchange fees are truly "reasonable and proportional to the cost incurred" by the issuer with respect to the transaction. In short, there is no basis under the Durbin Amendment to support the imposition of a cap of 12 cents with respect to any issuer that can provide clear evidence that its incremental costs for the authorization, clearance and settlement of a transaction is more than 12 cents.

2. *Routing.* In the case of the routing options, Congress instructed the Board to issue regulations that would prohibit "an issuer or payment card network" from restricting the number of payment card networks on which an electronic debit transaction may be processed. We have two overall concerns regarding the actions taken by the Board. First, we believe the legislative history of the Durbin Amendment raises serious questions as to whether Congress ever intended signature-only gift cards to be subject to the routing restrictions. In addition, while the Durbin Amendment might restrict payment networks and issuers from imposing routing restrictions, the Durbin Amendment does not prohibit customers, users and program managers from having the ability to customize card programs to fit their needs. Provided a user, customer or program sponsor is not restricted in selecting routing options, there is no reason why, for example, a gift card sponsor should be forced to add PIN-based routing to its gift cards. Likewise, there is no reason why a small business should be forced to offer signature-based routing to its employee expense cards. The routing restrictions under the Proposed Rules require multiple routing options even in instances when neither the issuer nor the payment network has imposed any such restrictions. The routing restrictions under the Proposed Rules have not taken customer or user rights into consideration.

These general comments are discussed further in our comments to the various sections of the Proposed Rules.

III. Specific Comments: Interchange Restrictions

Section 235.3 of the Proposed Rules sets forth the proposed regulations to implement the Durbin Amendment interchange restrictions. Although some prepaid cards appear to be exempt from these restrictions, a massive number of non-reloadable cards will be subject to these restrictions, including gift

cards, reward cards, rebate cards, emergency relief cards, certain insurance claim cards and any other prepaid cards used for one-time payments. Our concerns regarding these restrictions are as follows:

Reasonableness. The Durbin Amendment requires all debit interchange fees received by an issuer to be "reasonable and proportional to the cost incurred by the issuer with respect to the electronic debit transaction." The Federal Reserve survey, which was conducted to determine the median per-transaction interchange fee for various forms of debit and prepaid payments and which was only directed at financial institutions with assets in excess of $10 billion, showed that the median total per-transaction processing cost was 13.7 cents for signature debit, 7.9 cents for PIN debit and 63.6 cents for prepaid cards[4]. Notwithstanding this research, the Proposed Rules would establish a rate of between 7 cents and 12 cents per transaction - even for prepaid transactions. We do not believe this approach reflects, with respect to prepaid cards, interchange fees that are "reasonable and proportional to the cost incurred by the issuer with respect to the electronic debit transaction."

1. *Blanket Fee Caps*. The Board did not propose interchange fees for PIN debit, Signature Debit or Prepaid separately but a one-size fits all cap. Although this blanket fee-cap framework may be unrealistic for many types of debit issuers, it is particularly unfair for issuers of non-exempt prepaid cards. For issuers of non-exempt prepaid cards, the blanket fee cap results in a per transaction median net loss of between 51.6 cents and 56.6 cents per prepaid card transaction, depending on which proposal is implemented. It should also be noted that the while the Dodd-Frank Act did require "reasonable and proportional" interchange fees, it did not require one set fee to be applied to all debit and prepaid transactions.

2. *Interchange Components*. Unlike credit cards or debit cards, which are issued directly by the issuer to a bank customer, prepaid card programs typically involve a number of non-bank parties that act as the agent of the issuer to market and support the issuer's prepaid card program. These third-party agents include program managers, distributors and retailers. The costs associated with these relationships are an essential component of the incremental cost incurred by issuers in connection with prepaid card transactions and must be included in the allowable costs that an issuer may recover as part of the interchange transaction fee.

3. *Fees Collected at the Time of Purchase or Reload that are not "Interchange" Related*. Similarly, debit and prepaid card issuers and processors provide certain benefits directly to merchants with respect to card transactions such as access to an exclusive network of purchasers (such as local university students) or protection against fraud or chargebacks. With respect to prepaid cards, fees that may be collected by merchants, such as "purchase fees" or "reload fees," should also not be considered a part of the "interchange." These additional fees and services are not part of "interchange" and are negotiated directly with the merchants. The Proposed Rules should clarify that such other fees are not subject to or impacted by such Rules.

4. *The Alternative Approaches*. Under the Issuer-Specific Standard with Safe Harbor and Cap (Alternative 1), interchange fees are determined on an issuer-specific basis, limited to the average

[4] See Footnote 25, the Proposed Rules.

"allowable costs" for all debit transactions for which that issuer receives an interchange fee. Although this approach may work quite well for many issuers, the arbitrary cap of no more than 7 cents per transaction (the safe harbor) and 12 cents per transaction is not reflective of true issuer costs, and such caps are not required under the Durbin Amendment. Even more problematic is the fact that issuer-specific rates cannot be accommodated by most payment networks. Therefore, issuer-specific rates represent an unworkable solution.

Alternative 2 sets forth a simple cap which restricts interchange fees to no more than 12 cents per transaction. While this would appear to be a simpler provision to implement for non-exempt prepaid cards, based on the Board's own surveys of payment networks and issuers, we would still maintain that the proposed cap does not come close to covering the incremental cost incurred by a prepaid card issuer in the authorization, clearance, or settlement of a particular electronic prepaid card transaction. Those incremental costs are closer to 64 cents per transaction, without considering the issuer's fixed costs and other variable costs (e.g., network fees) associated with offering a prepaid card product.

Although we have misgivings regarding both Alternatives, given the operational difficulties with Alternative 1, the NBPCA finds Alternative 2 to be preferable, provided that any applicable caps are set at a realistic level, which would include an appropriate allocation of all allowable costs, including fixed and variable costs incurred by the prepaid card issuer. In addition, we perceive no reason why separate caps cannot be established based on the type of the card and its intended use. For example, as discussed below, a prepaid card used in connection with an FSA or an HRA program must comply with IRS requirements to support IIAS, which imposes additional fixed and variable costs on the issuer of the prepaid card, and the proposal must allow for the recovery of these additional costs..

5. *Consumer Benefits*. One of the stated goals for the Durbin Amendment is the reduction of costs to consumers. Therefore, with respect to Section 235.3, we believe it is appropriate to consider adding a provision requiring incentivizing or encouraging merchants to pass on to consumers their benefits from the Durbin Amendment in the form of lower prices.

6. *Fraud Adjustment*. The Durbin Amendment allows the Board to provide for an increase in the applicable interchange fee if the increase is "reasonably necessary to make allowance for costs incurred by the issuer in preventing fraud in relation to electronic debit transactions involving that issuer." The Proposed Rules offer two approaches, although the issue overall was "reserved" for future determination:

    i. Requiring eligible issuers to implement major innovations that would reduce industry-wide fraud or
    ii. Basing the fraud increment on each issuer's costs of any reasonably necessary steps taken for its fraud prevention program.

The NBPCA believes that the Board should not prescribe specific standards that an issuer must meet to be eligible to receive an adjustment to its interchange fee. The Durbin Amendment specifically states that regulations establishing eligibility for the fraud adjustment shall "require issuers to take effective steps to reduce the occurrence of, and costs from, fraud in relation to electronic debit transactions, including through the development and implementation of cost-effective fraud prevention technology" (emphasis added). Sole reliance upon technology-specific standards, such as a mandate to utilize EMV or a comparable chip-and-PIN standard, does not provide sufficient flexibility for issuers to implement fraud prevention measures that are best-suited to their own products. This is especially crucial for many non-exempt prepaid card products due to their low balances or their inability to be reloaded.

The NBPCA believes that a non-prescriptive approach is necessary to enable prepaid card issuers to adopt security standards that are suitable to each prepaid product, based on card value and functionality. Under the second approach, we would suggest that card issuers should track and be prepared to support their investments in anti-fraud technology, staff, vendors, investigations and analysis, as well as any fraud losses that they are forced to absorb. Issuers should also have the ability to adjust their investment data to show fraud prevention investments made in the previous two years as well as for scheduled changes going forward. Different products will have different fraud risks and different fraud costs. Moreover, because fraud is a constant battle, these figures should be updated regularly, at least every two years.

With respect to prepaid cards, the Board's own research shows that prepaid cards suffer higher fraud losses than other cards. Therefore, the ability for prepaid card issuers to recoup their fraud costs and losses will be a critical aspect in ensuring that such cards can continue to be available and accessible to the underbanked and underserved.

As a final note, because fraud prevention is such an important cost element for prepaid card issuers, the NBPCA would also add its hope that, although the fraud increment determination has been "reserved," the implementation of the new Proposed Rules will be undertaken in a manner to ensure that issuers will be able to recoup their eligible fraud costs as of such time that the Proposed Rules are effective, and that issuers will not have the bear the fraud costs without the appropriate fraud increment.

IV. Specific Comments: Exemptions

Exempted from the scope of the Durbin Amendment interchange restrictions are debit and prepaid cards issued by banks with less than $10 billion in assets. Also exempted are reloadable general use prepaid cards that are not marketed or labeled as gift cards and debit or reloadable general use prepaid cards that are used solely to disburse federal, state or local government-administered payments, provided that such cards do not charge overdraft fees and allow for one fee-free withdrawal from the issuer's ATM network per month. While we applaud the positive intentions in creating these exemptions, the NBPCA nevertheless has some concerns:

1. *Exemption Enforceability*. The Proposed Rules do not require that these well-intentioned exemptions are actually provided to card issuers, noting that the rules do "not require payment card networks to distinguish between issuers with assets of more than $10 billion and smaller issuers."

We believe that this level of discretion does not reflect the intention of Congress when it passed the Durbin Amendment. For example, Senator Durbin stated that these exemptions would not impact small issuers:

> "The Durbin reasonable debit fee requirement exempts banks and credit unions with assets under $10 billion (this includes 99% of all banks and credit unions). Under Sen. Durbin's amendment, the requirement that debit fees be reasonable does not apply to debit cards issued by institutions with assets under $10 billion. This means that Visa and MasterCard can continue to set the same debit interchange rates that they do today for small banks and credit unions. Those institutions would not lose any interchange revenue that they currently receive."[5]

The purpose of these exemptions was to make sure that payment products relied upon by the underbanked and underserved would continue to be available even after passage of the Durbin Amendment's interchange rules. The exemptions were also put in place to ensure that small banks struggling to compete in today's economy would be able to continue to offer competitive debit products to their customers, and that federal, state and local governments could continue to receive cost benefits through payment of benefits with prepaid cards.

These are laudable goals. However, we understand that there may be inherent difficulties in implementing such exemptions. Moreover, the Proposed Rules make it clear that such exemptions are discretionary in any event. We are, therefore, concerned that, despite these laudable intentions, the exemptions will not be applied.

2. *General-Use Prepaid Exemption.* The Board's exemption for general use prepaid cards only applies if the cards are "not issued or approved for use to access or debit an account held by or for the benefit of the cardholder (other than a subaccount or other method recording or tracking funds purchased or loaded on the card on a prepaid basis)." (emphasis added) Although the phrase "other than a subaccount" covers most prepaid cards, the Board commentary suggests a narrower interpretation of this key phrase. These comments state that "prepaid cards where the underlying funds are held in separate accounts do not qualify for the exemption." This suggests that issuers that have subaccounts that are demand deposit accounts or NOW accounts may not be eligible for the exemption, even if those separate accounts are in fact "subaccounts." We recommend a clarification in the commentary that the general use prepaid card exemption extends to all types of subaccounts, whether or not a demand deposit or NOW account has been established, since these are a common method used by issuers for recording or tracking funds purchased or loaded on prepaid cards.

3. *Government Administered Payment Card Exemption.* This exemption allows many of the beneficial government payment programs to continue under the same business model. This important exemption recognizes that the margins for government payment programs are very thin, and any decrease in interchange revenues may hurt state and local governments. However, the exemption applies only to cards that "only" accept government administered payments and not to dual-purpose

[5] See http://durbin.senate.gov/issues/leg_wallstreet_swipe.cfm

cards. We recommend that the exemption be broadened to cover any debit or prepaid card that accepts government administered payments, whether or not other payments might also be accepted.

4. *Timing Issues*. Because there will be only 90 days between the issuance of final interchange fee rules and the statutory effective date of July 21, 2011, it will be virtually impossible for networks and processors to implement systems to facilitate processing of exempt cards. This would have the effect of subjecting all issuers and all products, including exempt issuers and exempt products, to the proposed fee caps. We believe this will cause substantial disruption of the U.S. financial systems. As noted above, we recommend that the Board support our call for Congress to order a study to evaluate the technical issues involved in implementing the exemptions and provide for a period of at least 24 months for implementation.

5. *Definition of "Account."* The Durbin Amendment defines the term "debit card" in reference to a card, or other payment code or device, that is used "to debit an asset account (regardless of the purpose for which the account is established) . . . ." That section, however, does not define the terms "asset account" or "account." Under the Proposed Rules, the definition of "account" closely tracks that of EFTA Section 903(2), which provides that the term "account" means;

> "a demand deposit, savings deposit, or other asset account (other than an occasional or incidental credit balance in an open end credit plan as defined in section 103(i) of [the EFTA]), as described in regulations of the Board established primarily for personal, family, or household purposes, but such term does not include an account held by a financial institution pursuant to a bona fide trust agreement."

Because the Proposed Rules define a covered "account" in a manner that tracks the EFTA definition (and expands it to cover business accounts), there is a question as to whether the exclusions for general use prepaid cards and government program cards apply to cards covered by Federal Reserve Regulation E (such as payroll cards) that are capable of debiting an asset account. We recommend express exclusions from the definition of account for exempt general use prepaid cards, government program cards and small-issuer cards–including payroll cards and other cards (such as those that receive federal payments under the recently issued Treasury Regulations from Financial Management Services) that are subject to Regulation E. Alternatively, a clarification in the staff commentary to the Proposed Rules' definition of "account" could be added to clarify that cards subject to Regulation E, such as payroll cards, are nevertheless encompassed within the scope of the exclusion for general use prepaid cards, government program cards and small issuer cards.

6. *Definition of Debit Cards*. The Durbin Amendment defines "debit cards" to include a "general use prepaid card as defined in section 915(a)(2)(A)." This is a reference to the definition of an open-loop prepaid card from the CARD Act. However, we believe the drafters inadvertently left off reference to the key exclusions from that definition, which were included in Section 915(a)(2)(D), and we specifically wish to emphasize the exclusion for loyalty, award and promotional cards under Section 915(a)(2)(D)(iii). Such loyalty, award and promotional cards are costly to distribute and benefit

merchants by getting customers into their stores. We do not believe loyalty, award and promotional cards should be included within the scope of the Durbin Amendment or the Proposed Rules.

7. *Certification of Exempt Cards*. The ability to implement the exclusions for government benefit cards and for reloadable, general use, non-gift cards requires "certification" to verify which payment products are exempt from fee restrictions. To reduce bureaucracy and red tape, we suggest a relatively simple self-certification process utilizing Bank Identification Numbers (BINs) and Interbank Card Association (ICA) numbers The NBPCA would welcome the chance to assist in establishing such a certification process.

8. *Requirement for a Free ATM Transaction Each Month.* The Durbin Amendment requires that, in order to qualify for the government card and prepaid card exemptions after July 21, 2012, the cards must not charge a fee for at the first withdrawal each month from an ATM in the card issuer's designated automated teller machine (ATM) network. In general, this is a requirement that the prepaid card industry is quite willing to support. However, the definition for "designated automated teller machine network" includes not only ATMs that the issuer owns or controls but also any network "identified by the issuer that provides reasonable and convenient access." This means that the free transaction may have to apply at an ATM over which the issuer cannot control the assessment of fees. The card issuers can address this by providing, after the fact, a credit for fee debited; but a card issuer cannot control whether an ATM deducts a fee when the transaction is actually occurring. Therefore, we recommend clarification that the requirements of this provision are met so long as the cardholder's card is credited within the month that the ATM fee is deducted. We also request clarification that the provision does not require a prepaid card or debit card to have ATM access to qualify for the exemption. After all, a card without ATM access could never charge a fee for an ATM withdrawal and therefore would be compliant with this eligibility requirement for the exemption.

9. *Exemption from Routing Restrictions.* Unfortunately, the important exemptions noted above only apply to the "interchange" restrictions and not the "network routing" restrictions. We believe that that may have been an oversight. Just as the exemption from the interchange restrictions were intended to ensure that these critical products continue to be available at a reasonable price for governments, businesses and consumers, the same reasoning would apply to the network routing restrictions. If the network routing restrictions are applied to these exempt prepaid card products, compliance with such restrictions will necessarily increase costs and reduce the availability of such products.

10. *The Standard Used for Determining If Prepaid Cards are "marketed or labeled" as Gift Cards.* The Proposed Rules exempt only general use prepaid cards that are not "marketed or labeled as a gift card." To apply this restriction, the Proposed Rules and the Durbin Amendment rely on the standards set forth under the CARD Act. This is a concern because the CARD Act was not drafted to cover technical pricing issues. The CARD Act standards would base the availability of the exemption not solely on how the card issuer markets or sells its prepaid cards, but also on how third parties market or sell the cards. This creates a substantial lack of certainty. We believe that the CARD Act requirements on how third parties display or sell prepaid cards should not and cannot be used to determine what interchange rate is applied to such cards. Such an approach is not workable for payment networks, merchants, processors or card issuers.

11. *Lack of Exemptions for Health Savings Account (HSA) Cards, Flexible Savings Account (FSA) Cards, Health Reimbursement Arrangement (HRA) Cards and Transportation Spending Account (TSA) Cards.* Another area in which the Proposed Rules have unintended consequences is with respect to issuers of health-related HSA/FSA/HRA cards and transit-related TSA cards, all of which permit pre-tax dollars to be used to fund health- or transit-related payments. These are highly customized cards designed to meet IRS requirements. There is ample evidence in the legislative history that these kinds of unique pre-tax benefits cards were never intended to be included in the Proposed Rules. For example, it was affirmed by Senator Dodd on the floor of the Senate that benefit cards were not intended to be covered by the Durbin Amendment.[6] In addition, members of Congress Frank and Larson engaged in a colloquy on the House floor in which they expressed their belief that these types of card products would not subject to the burdens of the Durbin Amendment.[7] Nevertheless, the Proposed Rules do not expressly exempt these benefits products, thus creating significant difficulties.

The IRS requires non-healthcare retailers to implement an Inventory Information Approval System (IIAS) in order for consumers with Flexible Spending Account (FSA) cards and Health Reimbursement Arrangement (HRA) cards to be able to make purchases of eligible healthcare products or prescriptions. If an IIAS is not implemented, FSA/HRA card issuers are required to decline purchases made with an FSA/HRA card at that merchant. Although HSA cards are not required under IRS rules to use automated substantiation of cardholder purchases, many HSA card programs include substantiation services that are similar to those for FSA/HRA cards. Any requirement to support one or more PIN networks would adversely affect HRA/HSA/FSA card programs because (a) currently IIAS functionality does not exist on the PIN debit networks and (b) it will degrade the economics associated with the products, which will increase healthcare administrative costs.

In addition, we understand that currently only two signature networks, Visa and MasterCard, support healthcare programs. With so few options available, requiring two signature networks would be counterproductive and, in some situations, potentially impossible to achieve.

Finally, we believe that the Board misconstrued Congress's intent by including bona fide trust arrangements within the scope of the proposed definition of a debit account. We note that the Electronic Fund Transfer Act (EFTA), provides for an exemption for bona fide trust accounts at a financial institution. If the Board had continued the existing exemption for bona fide trust accounts in the EFTA, such a determination could have resulted in an exemption for HSAs under the Proposed Rules.

[6] 156 *Cong. Rec.* S5927 (2010).
[7] 156 *Cong. Rec.* H5225-226 (2010).

V. Specific Concerns: Network Routing Proposals

1. *Dual Routing Proposals*. The Proposed Rules contain two proposals that would limit issuers' and networks' ability to limit methods of routing debit transactions. 12 C.F.R. § 235.7(a). Under Alternative A, issuers and networks would be prohibited from restricting processing of any card transaction to fewer than two unaffiliated networks. Under this approach, the card may have one signature-based network and one PIN-based network. Or, alternatively, two unaffiliated signature-based networks or two unaffiliated PIN-based networks. Having two of the same kind of network could alleviate the concerns raised by forcing a signature-based product from offering PIN-based services, and vice versa. Under Alternative B, a prepaid card would be required to have two unaffiliated networks for processing PIN debit transactions and two unaffiliated networks for processing signature debit transactions.

   Of the two options proposed, Alternative A is the less burdensome and disruptive. However, as noted above, we suggest a third option because Congress clearly never intended to impose these network routing restrictions on prepaid cards, and, in keeping with the stated purpose of the legislation, the Board should use its statutory authority to limit the application of such routing restrictions solely to debit cards.

2. *Difficulties in Adding PIN Debit Functionality to Non-Reloadable Prepaid Cards*. Non-reloadable prepaid cards traditionally have been routed on signature debit network platforms only and, except in limited circumstances, have not utilized PIN debit platforms. Non-use of PIN debit platforms is the result of customer expectations with regard to the various card types most prevalent in the prepaid marketplace (e.g., low-dollar gift cards, rebate cards, reward cards and loyalty cards). Establishing PINs for such cards would necessitate registration of the card by the customer and selection of a PIN, which most customers are likely to deem unnecessary for nominal value card products. For these prepaid card products, the costs of adding PIN debit functionality are grossly disproportionate to any value that may accrue to the customer or other parties to the payment system. To the extent the addition of PIN functionality provides access to cash at ATMs or at point of sale, such addition would increase fraud and anti-money laundering risks. This is an unintended consequence arising from the Durbin Amendment and should clearly be avoided.

3. *The Role of Merchants at the Point of Sale (POS).* Finally, because the Proposed Rules create new responsibilities for issuers and payment networks, they also necessitate new responsibilities for merchants. We suggest that the Board make clear that merchants will also bear some of the responsibility for proper card acceptance under the Proposed Rules. Consumers should have the right to know which routing network their transaction is being placed on, especially if the merchant's choice will impact on the consumer's ability to earn loyalty or reward points. Also, unless changes can be made to exclude entirely specialized cards like HSA cards, it will be incumbent upon merchants to ensure that the card's limitations are not breached. For example, the store clerk will have to decline requests for "cash-back" from holders of HSA cards, even if the card has a PIN-based routing feature included on the card. Because merchants are an integral part of the debit payment system, we believe that the Proposed Rules are the appropriate forum for the Board to address the responsibilities of merchants with regard to proper card acceptance practices.

VI. Responses to Certain Questions Raised by the Board

In addition to the above comments, the Board also specifically requested comments in a number of areas. While most of our major concerns are stated above, the following additional questions are addressed here by the NBPCA:

1. The Board solicits comment on whether additional guidance is necessary to clarify that deferred and decoupled debit, or any similar products, qualify as debit cards for purposes of this rule.

   RESPONSE: We believe the Board should add clarification that any card that meets the requirements for the reloadable general use prepaid exemption should receive the benefits of the exemption, whether or not it could be described or positioned as "decoupled debit."

2. The Board requests comment on whether it should allow recovery through interchange fees of other costs of a particular transaction beyond authorization, clearing and settlement costs. If so, the Board requests comment on what other costs of a particular transaction, including network fees paid by issuers for the processing of transactions, should be considered allowable costs. The Board also requests comment on any criteria that should be used to determine which other costs of a particular transaction should be allowable.

   RESPONSE: Yes, we believe other costs should be included as allowable costs. In our view, the Durbin Amendment does not require the Board to restrict allowable costs to the issuers' incremental costs of authorization, clearance, and settlement. Incremental costs which should have been considered as allowable costs would include network fees, fraud losses, fraud prevention, dispute resolution costs and the costs of card production and delivery.

3. The Board requests comment on whether it should include fixed costs in the cost measurement, or alternatively, whether costs should be limited to the marginal cost of a transaction. If the latter, the Board requests comment on how the marginal cost for that transaction should be measured.

   RESPONSE: With respect to prepaid cards, we believe some fixed costs directly related to the card service should be included, such as customer service, plastics, card production and distribution, network fees, system support and maintenance, client service costs, and the cost of capital investments in the prepaid product(s). We also believe it is Constitutionally mandated that prepaid card issuers be allowed to realize a reasonable profit/return on their investments.

4. If a network does not establish individualized interchange transaction fees above the safe harbor amount, the Board believes it is not necessary to require an issuer to report its maximum allowable interchange transaction fee to networks through which it receives electronic debit transactions. The Board requests comment on whether this reporting requirement is necessary to enable networks to set issuer-specific interchange fees.

RESPONSE: While we agree that reporting on issuer-specific interchange fees will be necessary, we do not think the Board will need to determine the parameters for that process. The industry can make its own arrangements.

5. The Board proposes that an issuer reports its maximum allowable interchange fee to each payment card network through which it processes transactions by March 31 of each year (based on the costs of the previous calendar year) to ensure compliance with the standard beginning on October 1 of that same year. The Board specifically requests comment on whether prescribing the deadline by rule is necessary. If necessary, the Board requests comment on whether March 31 is an appropriate deadline or whether a different deadline is appropriate.

RESPONSE: While we agree that reporting on maximum allowable interchange fees will be necessary, we do not think the Board will need to determine the parameters for that process. The industry can make its own arrangements.

6. The Board requests comment on how to implement an adjustment to interchange fees for fraud-prevention costs.

RESPONSE: We recommend that steps be taken to simplify this important process. One difficulty is that technology for fraud prevention has a limited shelf life. Once fraud prevention innovations are put into place, they will likely be obsolete within 18 months. Card issuers must constantly innovate. We suggest that every two years, card issuers determine and be prepared to support their total fraud costs (including investments in systems/technology; improvements and innovations; maintenance; fraud screen vendors; staffing dedicated to fraud; and fraud losses that are absorbed by the issuer). Those costs can be divided between the pool of cards as to which they apply. Issuers should also have the ability to adjust their investment data to show fraud prevention investments made in the past as well as for scheduled changes going forward. In addition, we request that the Proposed Rules permit issuers and payment networks to collect fraud response costs and losses, as well as non-compliance fees, from merchants responsible for a data security incident, either under their operating rules or at law.

7. As with the exemption for government-administered payment programs, payment card networks, as well as merchant acquirers and processors, will need a process to identify accounts accessed by reloadable general use prepaid cards that are not marketed or labeled as a gift card or gift certificate if such networks permit issuers of such accounts to charge interchange fees in excess of the amount permitted under §§ 235.3 and 235.4. The Board seeks comment on whether it should establish a certification process for the reloadable prepaid cards exemption or whether it should permit payment card networks to develop their own processes. The Board also requests comment on how it should structure the certification process if it were to establish a process, including the time periods for reporting and what information may be needed to identify accounts to which the exemption applies.

RESPONSE: With respect to prepaid cards, we believe a self-assessment process using a detailed Reporting Form, signed and certified by the issuer's Chief Financial Officer or Chief Compliance Officer, would be appropriate. The NBPCA would be willing to assist in drafting or reviewing such a Reporting Form for the prepaid card industry.

8. If Alternative B is adopted in the final rule and multiple signature debit networks are required for each debit card, the Board anticipates that significantly more time will be needed to enable issuers and networks to comply with the rule. The Board requests comment on a potential effective date of October 1, 2011, for the provisions under § 235.7 if the Board were to adopt Alternative A under the network exclusivity provisions, or alternatively, an effective date of January 1, 2013 if Alternative B were adopted in the final rule.

RESPONSE: We believe, first, that Alternative B is simply not workable and that even an additional five years would not be enough time. We would suggest for Alternative A and effective date of October 1, 2013.

9. Selective authorization programs enable a merchant to offer gift cards to its customers and ensure that card funds are spent only within the participating merchant(s) without incurring the costs of setting up a separate program. There may be little difference between these programs and closed-loop retail gift card programs operated by a single retailer, but for the fact that these cards are accepted at merchants that are unaffiliated. However, requiring these selective authorization cards to comply with the network exclusivity and routing restrictions could be problematic and costly for the participating merchants with little corresponding benefit. Accordingly, comment is requested on whether a prepaid card that is accepted at a limited number of unaffiliated participating merchants and does not carry a network brand should also be considered a general-use prepaid card under the rule.

RESPONSE: Cards that participate in selective authorization programs provide unique benefits for cardholders and merchants. These include mall cards, resort cards, university cards and many other niche payment card products. We agree that such cards, when they do not carry a network brand and are accepted at a limited number of unaffiliated participating merchants, should *not* be considered a general use prepaid card subject to the Durbin Amendment or the Proposed Rules.

VI. Conclusion

We respectfully urge the Board to consider our comments and suggestions. If you have any questions, or would like to discuss any of the matters outlined above in further detail, please do not hesitate to contact us at (201) 746-0725.

Sincerely,

Kirsten Trusko

President & Executive Director

NETWORK BRANDED

PREPAID CARD ASSOCIATION