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February 22, 2011

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

RE: Debit Card Interchange Fees and Routing Proposed Rule, Docket No. R–1404
RIN No. 7100 AD63

Dear Ms. Johnson:

Fiserv, Inc. ("Fiserv," "we," "us," and "our") submits this letter to the Board of Governors of the Federal Reserve System (the "Board") in response to the Board's proposed rules published in the Federal Register on December 28, 2010, relating to electronic debit transaction ("EDT") interchange fees, payment card network exclusivity restrictions, and routing restrictions (the "Proposed Rules").[1] The Proposed Rules were introduced to implement Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Durbin Amendment").[2]

Fiserv is the leading global provider of information management and electronic commerce systems for the financial services industry, offering integrated information management and electronic commerce systems and services, including transaction processing, electronic bill payment and presentment, business process outsourcing, document distribution services, and software and systems solutions. Fiserv serves approximately 16,000 clients worldwide, including banks and thrifts, credit unions, savings institutions, retailers and merchants, leasing companies, lenders, government agencies, and publicly and privately owned companies, and operates centers in the United States for full-service financial data processing, software system development, item processing and check imaging, technology support, and related businesses. In addition, Fiserv operates the ACCEL/Exchange network, an expansive national debit card and ATM network that covers all 50 U.S. states, U.S. territories and Canada.

Fiserv recognizes that implementation of the Durbin Amendment is a difficult and challenging task. With this letter, Fiserv aims to provide suggestions that will assist the Board in the rulemaking process. Accordingly, we respectfully submit the following comments to the Proposed Rules.

[1] Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722 (December 28, 2010).
[2] Pub. L. 111-203, 2010 H.R. 4173, 111^{th} Cong. (July 15, 2010).

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I. Interchange Transaction Fee Limitations

The Durbin Amendment, which establishes new Section 920 under the Electronic Fund Transfer Act ("EFTA"), directs the Board to prescribe regulations that implement EDT interchange fee limitations (the "Interchange Fee Limitations"). The Proposed Rules include two Interchange Fee Limitation implementation alternatives for public comment.[3] Under Alternative 1, the interchange transaction fee charged by an issuer for each EDT is limited to the allowable costs incurred by the issuer, but may not exceed $.12 per EDT. Additionally, under Alternative 1, interchange transaction fees set at $.07 per EDT or lower fall within a safe harbor, under which issuers are not required to demonstrate allowable costs. Under Alternative 2, the interchange transaction fee charged by an issuer for each EDT is limited to $.12 per EDT regardless of, and without the need to demonstrate, allowable costs.

a. Implementation of Proposed Rules

i. Interchange Transaction Fee Caps

The Durbin Amendment instructed the Board to "establish standards for assessing whether the amount of any interchange transaction fee" is reasonable and proportional to the issuer's costs with respect to the EDT.[4] Instead of establishing standards, as it was directed to do, the Board impermissibly and arbitrarily decided to establish fixed interchange transaction fee caps under both of its proposed Interchange Fee Limitation alternatives. These fee caps represent the Board's substitution of its policy objective for the legislative intent of Congress. The Durbin Amendment does not direct or authorize the Board to use its rulemaking authority to pursue an objective of coercive efficiency, but the Board nevertheless set about this self-defined goal by limiting interchange transaction fees to a narrow range of costs and providing for a cap that denies many issuers recovery of even their variable costs—thereby penalizing those issuers that have cost structures that the Board has arbitrarily decided are too high. The Board acknowledged as much in the Proposed Rules, writing that "[a]n issuer with costs above the cap would not receive interchange fees to cover these higher costs. As a result, a high-cost issuer would have an incentive to reduce its costs in order to avoid this penalty."[5]

ii. "Reasonable" and "Proportional" Standard

The Durbin Amendment directed the Board to "establish standards for assessing whether the amount of any interchange transaction fee . . . is *reasonable and proportional* to the cost incurred by the issuer with respect to the transaction,"[6] suggesting that the "reasonable" and "proportional" standards should be applied as multipliers to an issuer's allowable costs. This directive implicitly requires a two-part test for determining allowable interchange transaction fees: (1) calculation of the costs incurred by the issuer with respect to an EDT (the "Cost

[3] 75 Fed. Reg. at 81,726.
[4] EFTA § 920(a)(3)(A).
[5] 75 Fed. Reg. at 81,737.
[6] § 920(a)(3)(A) (emphasis added).

Baseline"), and (2) determination of whether an interchange transaction fee is both "reasonable" and "proportional" to that Cost Baseline. Instead of adopting this statutorily mandated approach, the Board unjustifiably and inexplicably determined that the "reasonable" and "proportional" standards permit the limiting of interchange transaction fees to a capped amount of allowable costs. By limiting interchange transaction fees to narrowly-defined and capped allowable costs, the Proposed Rules failed to permit issuers to recover the full cost of EDTs or debit programs, much less earn a reasonable return on their investment. Allowing for full recovery of costs plus a reasonable return on investment is required under the well-settled understanding of a statutory requirement to set "reasonable" prices whenever the government establishes price controls.[7] Further, the application of an absolute interchange transaction fee cap will have a random and variable—as opposed to proportional—impact on different issuers with different cost structures. For example, if one issuer had allowable costs of $.24 per EDT, then the application of the $.12 interchange transaction fee cap would result in an interchange transaction fee that is 50% of allowable costs; if another issuer had allowable costs of $.48 per EDT, then the application of the same cap would result in an interchange transaction fee that is 25% of the allowable costs. However, in order for an interchange transaction fee to be "proportional" as required under the Proposed Rules, the ratio of interchange transaction fee to allowable costs should be the same for both issuers.

iii. Allowable Costs

The Durbin Amendment requires the Board to distinguish between "the incremental cost incurred by an issuer for the role of the issuer in the authorization, clearance, or settlement of a particular electronic debit transaction," which shall be considered in determining allowable costs, and "other costs incurred by an issuer which are not specific to a particular electronic debit transaction,"[8] which shall not be considered in determining allowable costs.

First, the Board erroneously chose to limit allowable costs to only those costs related to authorization, clearance, and settlement. The Durbin Amendment required only that the Board *consider* the costs of authorization, clearance, or settlement–Congress did not mandate that the Board limit recovery to these costs alone.[9] The Board arbitrarily excluded from allowable costs other costs that, although not attributable to the acts of authorizing, clearing, and settling, are nonetheless linked to particular EDTs, such as costs of actual fraud losses, payment card network fees, customer service call center costs, and rewards. The Board excluded those other costs because it believed the Durbin Amendment prohibited it from considering those costs in determining standards for assessing reasonable and proportional interchange transaction fees. But, fairly read, the Durbin Amendment did not do so. Nothing in the Durbin Amendment stated that the Board may not consider as allowable costs those costs that are "specific to a particular

[7] *See, e.g., FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944), where the U.S. Supreme Court determined that regulations pertaining to ratemaking should permit a utility to set rates that allow it to recover operating and maintenance costs as well as a reasonable return on its investment.
[8] § 920(a)(4)(B).
[9] § 920(a)(4).

electronic debit transaction," but that are not an "incremental cost" of authorizing, clearing, and settling the EDT.

Second, the Board chose to disregard commonly-accepted economic definitions of "incremental cost."[10] After reciting several economic definitions of incremental cost, the Board disregarded all of them, and invoked its own economic judgment to substitute average variable cost per EDT at the current level of production in lieu of "incremental cost."[11] In substituting its economic judgment for that of Congress, the Board limited allowable costs to the separately calculable per-EDT costs specifically associated with the issuer's authorizing, clearing, and settling of individual EDTs. In contrast, many commonly-used economic definitions of "incremental costs" would have resulted in a broader range of allowable costs. The Board's interpretation would exclude many variable costs reasonably related to EDTs (as discussed above), as well as fixed or overhead costs attributable to EDTs.

b. Effects of the Proposed Rules

Section 904 of the EFTA required the Board to consider the costs and benefits to consumers (particularly low-income consumers), financial institutions, and other users of electronic fund transfers when proposing any regulation pursuant to the EFTA[12] and "to the extent practicable . . . demonstrate that the consumer protections of the proposed regulations outweigh the compliance costs imposed upon consumers and financial institutions."[13] The Proposed Rules do not provide evidence of the Board's compliance with such requirements. Specifically, the Board provided no analysis of the Proposed Rules' impact on consumers, financial institutions (such as debit card issuers), or other users of electronic fund transfers (such as small and mid-sized merchants). In addition, the Board did not demonstrate that the protections and benefits of the Proposed Rules outweigh its costs to consumers and financial institutions. The required analysis of the impact of the Proposed Rules would almost surely have shown that the Proposed Rules would be harmful to debit card issuers, consumers, and small and mid-sized merchants.

i. Harm to Debit Card Issuers

The Interchange Fee Limitations would severely lower the revenue that debit card issuers currently receive from interchange transaction fees. The Board's own analysis revealed that, on average, the regulated interchange transaction fees required by the Proposed Rules would be approximately 75% below the interchange transaction fees currently received by issuers.[14] As a result of the Proposed Rules, issuers would be prevented from recovering all of their actual costs associated with operating debit card programs or a reasonable return on capital.[15] Certain issuers

[10] 75 Fed. Reg. at 81,735.
[11] *Id.*
[12] 15 U.S.C. § 1693b(a)(2)-(3).
[13] *Id.*
[14] *See* 75. Fed. Reg. at 81,725.
[15] *Id.* at 81,736.

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would be prevented from recovering even their variable costs associated with authorization, clearance, and settlement of EDTs. Further, even smaller issuers that are technically exempt from the Interchange Fee Limitations may not be able to sustain interchange transaction fees sufficient to cover their costs of operating a debit program because the deep interchange transaction fee cuts applicable to regulated issuers would undoubtedly result in market pressure to reduce their interchange transaction fees as well.[16]

The Board suggested that issuers may be able to ameliorate the negative impact of reduced interchange transaction fees through "other sources, besides interchange fees."[17] Issuers would surely pursue avenues to restore revenue lost from the deep interchange transaction fee cuts, and would also seek out opportunities to reduce costs. However, given the severity of the Interchange Fee Limitations, it is highly speculative that additional revenue sources and/or cost-cutting efforts would spare issuers from the negative financial impacts of regulation. There is no guarantee that issuers would be able to successfully recoup lost revenue from other sources, particularly without damaging their relationships with customers. Further, customers faced with additional fees may choose to terminate certain costly products that they receive from their financial institutions or may terminate their relationships with their financial institutions altogether.

ii. Harm to Consumers

Not only are the proposed Interchange Fee Limitations unauthorized by the Durbin Amendment, but they also have the potential to cause considerable harm to consumers in contravention of the EFTA, which states that the primary objective of the EFTA is the protection of consumer rights.[18] As discussed above, the inability of issuers to recover debit card program costs through interchange transaction fees would likely require issuers to pursue offsetting revenue from consumers through higher fees and/or offsetting cost savings through reduced consumer benefits and protections. Specifically, the Interchange Fee Limitations are likely to have the following effects:

(1) issuers that cannot continue to operate debit programs on a fiscally sound basis will likely discontinue their debit programs, decreasing market competition and consumer choice in debit card services;

(2) issuers may offset losses mandated by the Proposed Rules through other revenue sources such as new or additional fees charged to consumers for debit and other demand deposit account services;

[16] In order for the exemption in Section 920(a)(6) of the EFTA to have any practical import to smaller issuers, networks would need to adopt two-tiered interchange transaction fee structures, which they are not required to do. And even if such two-tiered interchange transaction fee structures were adopted, merchants may steer customers to use debit cards issued by regulated issuers.
[17] 75. Fed. Reg. at 81,736.
[18] 15 U.S.C. § 1693(b).

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(3) issuers may reduce costs that are unrecoverable under the Proposed Rules by no longer offering benefits currently enjoyed by debit program consumers, such as usage rewards, overdraft protection, and fraud and liability protections beyond legal requirements; or

(4) issuers may reduce costs that are unrecoverable under the Proposed Rules by prohibiting certain types of EDTs that result in higher risk, and therefore higher cost, to the issuer, including by prohibiting or curtailing the use of debit cards in card not present (e.g., internet) EDTs and for high dollar value EDTs.

Thus, among other adverse consequences, the Proposed Rules are likely to reduce the availability and increase the cost of EDTs and other demand deposit account services to the detriment of consumers.

In addition to the direct impacts to consumers described above, capping interchange transaction fees below issuer costs would also result in significant secondary harm to consumers. When issuers charge additional fees to consumers for debit and other demand deposit account services to offset the effects of the Proposed Rules, certain consumers, particularly low-income consumers who can ill-afford increased fees, may forgo the use of debit services and/or demand deposit accounts altogether. Many of these disenfranchised consumers would likely turn to expensive check cashers and similar high-cost alternative non-bank service providers, incurring what are often exorbitant fees for services currently performed by financial institutions at a much lower fee and with less risk to the consumer.[19]

In contrast, the consumer protections and benefits of the Proposed Rules are, at best, uncertain. The Proposed Rules would lower the interchange transaction fees paid by acquirers to issuers for EDTs, but there is no requirement under the Proposed Rules for acquirers or their merchants to pass along savings from these lower interchange transaction fees to consumers. Evidence from other countries where interchange transaction fees have been lowered due to regulation indicates that merchants passed along the resulting savings to consumers *only* where required by law or regulation to do so.[20]

iii. Harm to Small and Mid-Sized Merchants

Larger merchants typically pay separate—and often negotiated—interchange transaction fees on a pass-through basis from acquirers. In contrast, smaller and mid-sized merchants are often charged bundled merchant discount rates, which bundles the interchange transaction fee component with other charges, instead of separately identifying interchange transaction fees to the merchant. As a result, smaller and mid-sized merchants often have less visibility into how

[19] *See, e.g.*, Zywicki, Todd, Dodd-Frank and the Return of the Loan Shark, WALL STREET JOURNAL, Jan. 4, 2011, http://online.wsj.com/article/SB10001424052748704735304576058211789874804.html?KEYWORDS=return+of+the+loan+shark.

[20] *See, e.g.*, Reform of Australia's Payments Systems: Preliminary Conclusions of the 2007/08 Review, Reserve Bank of Australia, April 2008.

much of the card acceptance fees they pay is attributable to interchange transaction fees, and, therefore, may not receive the benefits of the lower interchange transaction fees that result from the Interchange Fee Limitations. Due to small and mid-sized merchants' relative lack of pricing visibility and negotiating power, it is likely that the bundled merchant discount rates charged to small and mid-sized merchants would remain at current levels despite the implementation of the Interchange Fee Limitations. Merchant acquirers could simply continue charging small and mid-sized merchants the same merchant discount rates as they do today and reap a windfall because the interchange transaction fees paid by the acquirer to the network would be reduced to regulated amounts. Because interchange transaction fees are generally charged to larger merchants on a pass-through basis, such merchants would likely realize the entire benefit of the lower, regulated interchange transaction fees immediately. The potential unequal impact of the Interchange Fee Limitations to smaller and mid-sized merchants on one hand and larger merchants on the other hand has the potential to exacerbate larger merchants' cost advantages over smaller and mid-sized merchants, reducing the ability of smaller and mid-sized merchants to compete and potentially even driving some smaller and mid-sized merchants out of business.

c. <u>Functional Similarities Between EDTs and Checking Transactions</u>

The Durbin Amendment required the Board to "consider the functional similarity between electronic debit transactions; and checking transactions that are required within the Federal Reserve bank system to clear at par."[21] While there are certain similarities between these transaction types, there are also significant differences. In the Proposed Rules, the Board acknowledged this fact; however, despite recognizing at least some of the additional beneficial features of EDTs to merchants, including guarantee of settlement and faster settlement, the Board incorrectly reasoned that the statutory requirement to *consider* the functional similarity between EDTs and checking transactions required it to *limit* costs recoverable through interchange transaction fees to "only those costs associated with the process of authorizing a debit card transaction" and that allowable costs should "not be expanded to include additional costs that a payor's bank in a checking transaction would not recoup through fees from the payee's bank."[22] There is no indication in the statute that the requirement to consider the functional similarity between EDTs and checking transactions was intended to limit—as opposed to expand—the scope of allowable costs recoverable through interchange transaction fees. In fact, this interpretation is entirely inconsistent with the express Durbin Amendment mandate to consider other costs, including those costs incurred in the clearance or settlement of an EDT, in determining allowable costs.[23]

As a result of its narrow view of the comparison between EDTs and checking transactions, the Board failed to account for many of the cost savings to merchants associated with EDTs relative to checking transactions. For example, instant validation of funds, real-time authentication, and instant guarantee of settlement are inherent benefits of EDTs not generally

[21] § 920(a)(4)(A).
[22] 75 Fed. Reg. at 81,735.
[23] § 920(a)(4)(B)(i).

experienced by merchants for checking transactions unless the merchant chooses to pay additional fees for these types of services. The fact that costs to merchants of paying interchange transaction fees are mitigated by cost savings associated with acceptance and processing of EDTs relative to checking transactions should have been considered by the Board in prescribing the Interchange Fee Limitations.

Additionally, the Board failed to consider many of the significant benefits to consumers associated with EDTs relative to checking transactions, including wide acceptance by merchants, ease of use, and speed of transaction.[24] That consumers view debit cards as far more widely accepted by merchants and easier to use than checks is hardly surprising; many merchants no longer accept checks, merchants that do accept checks often require significant proof of identity and are reluctant to accept checks from out-of-town customers, and merchants generally do not accept checks for internet-based purchases.

The benefits to merchants and consumers associated with EDTs (and not with standard checking transactions) positively impact the economy as a whole, resulting in increased sales, lower labor costs (stemming from reduced tender time at check out and the elimination of time required to handle and process deposits of physical checks), and reduction or elimination of bad check losses.[25] The significance of the advantages of EDTs over checking transactions to both merchants and consumers is clearly evident in payment choice trends over the last several years, as debit usage and acceptance has continued to increase just as the usage and acceptance of checks has decreased.[26] It is no coincidence that merchants have willingly continued to accept debit cards as a means of payment even under existing interchange transaction fees. However, the benefits of EDTs to consumers and merchants are not without costs. Financial institutions that offer debit card programs incur significant costs in connection with operating debit card programs and processing EDTs that they do not incur in connection with checking transactions. Debit card issuers make continuous investments to the debit card infrastructure that have no direct correlation in the checking system, and which are required to ensure the effective authorization, clearance, and settlement of EDTs. These requisite costs, on which merchants and consumers rely for the efficient, convenient, and secure use and acceptance of debit cards, were unreasonably excluded from those costs that are allowed to be recovered through interchange transaction fees under the Proposed Rules.

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[24] *See* The 2008 Survey of Consumer Payment Choice. Federal Reserve Bank of Boston, April 2010, 38-39; Mercator Advisory Group, Special Report: The Durbin Amendment: Impact Analysis, June 2010.

[25] *See* Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges, U.S. Government Accountability Office (GAO), November 2009; Zywicki, Todd J., The Economics of Payment Card Interchange Fees and the Limits of Regulation, Research Paper 10-26, George Mason University School of Law and Economics, June 2010.

[26] The 2010 Federal Reserve Payments Study. Federal Reserve System, December 8, 2010 at 4.

d. Fraud-Prevention Adjustment

The Durbin Amendment permitted the Board to allow for an adjustment to the Interchange Fee Limitations if "(i) such adjustment is reasonably necessary to make allowance for costs incurred by the issuer in preventing fraud in relation to electronic debit card transactions involving that issuer; and (ii) the issuer complies with fraud-related standards established by the Board."[27] The Board sought comment on several questions related to two proposed approaches to a fraud-prevention adjustment set forth in the Proposed Rules.[28] We submit that (i) the adjustment should become effective simultaneously with the effective date of the Interchange Fee Limitations, and (ii) the Board should not limit the adjustment to specific fraud-prevention technologies.

i. Effective Date

The Interchange Fee Limitations are scheduled to take effect on July 21, 2011.[29] The Proposed Rules did not include specific regulatory proposals to implement the fraud-prevention adjustment or indicate a date by which the adjustment would take effect;[30] however, the Board should ensure that the fraud-prevention adjustment and Interchange Fee Limitations take effect simultaneously. If there is a gap between the date the fraud-prevention adjustment and the Interchange Fee Limitations take effect, issuers would be unable to recover their costs relating to fraud-prevention even as they experienced a substantial reduction in interchange transaction fees resulting from compliance with the Interchange Fee Limitations. Without a fraud-prevention adjustment in place, there would be little incentive—or revenue—for issuers to invest in new fraud-prevention tools, or even to maintain their current fraud-prevention mechanisms. As a result, issuers' fraud-prevention efforts could decline overall, which would be harmful to both consumers and the payments system as a whole.

ii. Non-Prescriptive Approach

The Board offered, and specifically requested comment on, two alternative frameworks for an adjustment to interchange transaction fees for fraud-prevention costs: a technology-specific approach and a non-prescriptive approach.[31] We support the adoption of a non-prescriptive approach, which would allow individual issuers flexibility in meeting the Board's fraud-prevention standards, and would encourage efficiency as they do so. A variety of tools may be used to prevent fraud. The adoption of technology-specific standards would limit issuers to predetermined fraud-prevention measures that might become outdated or ineffective over time. Such an approach would unnecessarily limit issuer fraud-prevention techniques and

[27] § 920(a)(5)(A).
[28] 75 Fed. Reg. at 81,740.
[29] § 920(a)(9).
[30] 75 Fed. Reg. at 81,740. The Durbin Amendment did not set an effective date for implementing the fraud-prevention adjustment; however, the Board is required to issue final rules to establish standards for making fraud-prevention adjustments by April 21, 2011. § 920(a)(5)(B)(i).
[31] 75 Fed. Reg. at 81,740 and 81,742-43.

innovation by preventing issuers from embracing innovative fraud-prevention technologies based on specific card and transaction characteristics. Instead, the Board should adopt a more general, non-prescriptive standard that encourages issuers to seek out the best available fraud-prevention options. In light of the constant evolution of fraud-prevention technologies, the market, not the Board, is better positioned to determine those technologies that are most effective in preventing fraud.

e. Anti-Evasion and Anti-Circumvention Provisions

Congress granted the Board authority to enact rules to prevent the use of payment card network fees to circumvent or evade the Interchange Fee Limitations.[32] Specifically, the Durbin Amendment granted the Board broad latitude to prescribe rules that generally prohibit (1) the use of payment card network fees "to directly or indirectly compensate an issuer with respect to an electronic debit transaction" or to circumvent or evade the Interchange Fee Limitations,[33] and (2) any other forms of circumvention or evasion of the Interchange Fee Limitations.[34] To implement these prohibitions, the Board proposed a rule under which any net compensation from a payment card network to an issuer, other than allowable interchange transaction fees, that is made "with respect to electronic debit transactions" would be deemed to constitute circumvention or evasion of the Proposed Rules (the "Prohibition on Net Compensation").[35] The Prohibition on Net Compensation falls squarely within the rulemaking authority granted by Congress. And, as the Board noted in commentary to the Proposed Rules, the prevention of circumvention or evasion of the Interchange Fee Limitations requires that the Prohibition on Net Compensation prohibit any net compensation "for debit card related activities."[36]

The Board sought specific comment regarding how signing bonuses should be treated under the Prohibition on Net Compensation.[37] We believe signing bonuses should be included in determining whether prohibited net compensation exists because signing bonuses are made "for debit card related activities." As the Board correctly noted in its discussion of the Proposed Rules, "if such signing bonuses are not taken into account in determining whether an issuer receives net compensation for EDTs, a network could provide significant upfront incentive payments during the first year of a contract or space out incentive payments over several years to offset the limitations on interchange transaction fees that could be received by the issuer over the course of the contract."[38]

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[32] § 920(a)(1).
[33] § 920(a)(8)(B)(i).
[34] § 920(a)(1).
[35] 75 Fed. Reg. at 81,756.
[36] *Id.* at 81,762.
[37] *Id.* at 81,748.
[38] *Id.*

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II. Network Exclusivity Requirements

The Durbin Amendment required the Board to prescribe regulations prohibiting a payment card network or issuer from restricting the networks on which an EDT may be processed to a single network or affiliated group of networks (the "Network Exclusivity Requirements").[39] The Proposed Rules offered two alternatives for implementing the Network Exclusivity Requirements: (i) Alternative A, which prohibits payment card networks and issuers from limiting the number of networks available for processing an EDT to fewer than two unaffiliated networks, *regardless of the means by which an EDT may be authorized*; and (ii) Alternative B, which prohibits payment card networks and issuers from limiting the number of networks available for processing an EDT to fewer than two unaffiliated networks *for each method by which an EDT may be authorized.*[40]

The Board should adopt Alternative A because it (i) achieves the intended objectives of the Durbin Amendment by prohibiting payment card networks and issuers from limiting the number of networks available for processing an EDT to fewer than two unaffiliated networks, and (ii) is less burdensome to industry participants.

a. Intended Objectives

The Durbin Amendment directed the Board to prohibit payment card networks and issuers from limiting the number of networks available for processing an EDT to fewer than two unaffiliated networks. Alternative A fully meets the objectives of and is consistent with the letter and intent of the Durbin Amendment, which, notably, does not distinguish EDTs by method of authorization. In contrast, Alternative B, which prohibits limiting the number of payment card networks available for processing an EDT to fewer than two unaffiliated networks for each method by which an EDT may be authorized, exceeds the requirements of the Durbin Amendment by categorizing EDTs by method of authorization, a distinction the Board was not authorized to make.

b. Burden on Industry Participants

Alternative A would also be less burdensome to industry participants, including issuers, payment card networks, and merchants. There are substantial technological and financial challenges to enabling multiple signature-based networks on a debit card, which would be required for most debit cards under Alternative B. Enabling multiple signature-based payment card networks on a debit card would require numerous and expensive changes within the industry, including "the replacement or reprogramming of millions of merchant terminals as well as substantial changes to software and hardware for networks, issuers, acquirers, and processors in order to build the necessary systems capability to support multiple signature debit networks

[39] § 920(b)(1)(A).

[40] 75 Fed. Reg. at 81,749.

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for a particular debit card transaction."[41] Alternative B would also create significant challenges for smaller issuers, which the Board recognized by stating that "small debit card issuers could be disproportionately affected by a requirement to have multiple networks for each method of debit card authorization" and "Alternative A would minimize the overall compliance costs for these issuers."[42]

III. Scope of the Durbin Amendment

a. Exemption for Certain Reloadable Prepaid Cards

The Durbin Amendment exempted certain reloadable prepaid cards from the Interchange Fee Limitations. Specifically, the following types of cards were exempted:

> a plastic card, payment code, or device that is—(I) linked to funds, monetary value, or assets which are purchased or loaded on a prepaid basis; (II) not issued or approved for use to access or debit any account held by or for the benefit of the card holder (other than a subaccount or other method of recording or tracking funds purchased or loaded on the card on a prepaid basis); (III) redeemable at multiple, unaffiliated merchants or service providers, or automated teller machines; (IV) used to transfer or debit funds, monetary value, or other assets; and (V) reloadable and not marketed or labeled as a gift card or gift certificate.[43]

The exempt card types are virtually identical in function to regulated card types, yet the issuers of such card types are not subject to the extremely prejudicial Interchange Fee Limitations. This exemption is unjustifiable and unfairly benefits issuers of the exempt card types. The Board should petition Congress to repeal this portion of the Durbin Amendment to avoid form-over-substance manipulations of debit card programs to qualify for the exemption.

b. ACH Exemption

Section 920(c)(2) of the EFTA defined "debit card" to mean "any card, or other payment code or device, issued or approved for use through a payment card network to debit an account (regardless of the purpose for which the account is established), whether authorization is based on signature, PIN, or other means," and includes general-use prepaid cards while exempting paper checks. The definition of "debit card" in the Proposed Rules is nearly identical in all but one respect: without any clear reason for doing so, the Board exempted from the definition account numbers that are used to initiate an ACH transaction to debit a person's account.[44] Interestingly, the definition of "debit cards" in the Proposed Rules is broad enough to include account numbers used to initiate other transactions, so long as they are not ACH transactions. In carving out this extraordinarily specific exception for ACH transactions, the Board arbitrarily

[41] *Id.*
[42] *Id.*
[43] § 920(a)(7)(A)(ii).
[44] 75 Fed. Reg. at 81,729.

favored one type of transaction over others and, in effect, was "picking a winner" among functionally similar types of debit transactions. The Board should revise the definition of "debit card" to remove this exemption.

c. Coverage of Three-Party Systems

Congress clearly intended for the Durbin Amendment and the Proposed Rules to cover three-party systems. The Durbin Amendment explicitly required the Interchange Fee Limitations to regulate all EDTs[45] and broadly defined EDTs as any "transaction in which a person uses a debit card."[46] And, while Congress expressly provided exemptions for small issuers and certain transaction types, Congress made absolutely no mention of an exemption for three-party systems. In response to a clear congressional mandate to regulate all EDTs without regard to the nature of the underlying system, the Board rightfully identified three-party systems as being governed by the Proposed Rules.[47] The Board also aptly acknowledged that, while the Interchange Fee Limitations must apply to three-party systems, the application of the current iteration of the Interchange Fee Limitations to three-party systems would likely be ineffectual.[48] As currently drafted, the term "interchange transaction fee" in the Proposed Rules only refers to the interchange transaction fees paid for the purpose of compensating an *issuer*.[49] Given that the issuer is also the operator of the network and the acquirer in a three-party system, the three-party network could easily offset any mandated reduction in the interchange transaction fees charged in its role as the issuer by increasing the fees charged in its role as the network operator or acquirer, which are currently outside of the scope of the Interchange Fee Limitations.[50] Obviously, the result of this unintended and unauthorized de facto exemption of three-party networks, such as PayPal, from the Interchange Fee Limitations would provide such networks with an artificial competitive advantage over four-party systems and the issuers that participate in four-party systems. Such a result (i) violates both the text and intent of the Durbin Amendment, and (ii) challenges all notions of equity. Importantly, a de facto exemption from the Interchange Fee Limitations also has serious negative ramifications for the safety and soundness of the entire payments system because the unfair advantage it creates for three-party systems will allow them to use the relative windfall revenues to offer incentives to lure customers away from traditional financial institution debit card issuers, which are subject to increasingly strict prudential regulation, and into three-party systems, many of which are not subject to prudential regulation of any kind. For these reasons, it is imperative that the Board revise the Proposed Rules to prevent three-party networks from evading the Interchange Fee Limitations by recharacterizing the interchange transaction fee component of the fees they charge as network or acquirer fees, with no change in the aggregate fees the three-party network charges to merchants.

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[45] § 920(a)(2).
[46] § 920(c)(5).
[47] "The Board's proposed rule also covers both three-party and four-party systems." 75 Fed. Reg. at 81,727.
[48] *Id.*
[49] *Id.* at 81,755.
[50] *Id.* at 81,727.

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Thank you for your consideration and review of our comments and concerns. If you have any questions or wish to discuss any of these matters, please do not hesitate to contact us.

Sincerely,

Jeff Yabuki
President and CEO