EVERTEC℠

February 22, 2011

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

Re: Proposed New Regulation II, Debit Card Interchange Fees and Routing
Docket No. R-1404 & RIN No. 7100-AD63

Dear Ms. Johnson:

Thank you for the opportunity to comment on the Federal Reserve Board's (the "Board") proposed Regulation II, Debit Card Interchange Fees and Routing (the "Proposed Regulation"). EVERTEC, Inc. ("EVERTEC") is a transaction and financial application processing company with headquarters in Puerto Rico. EVERTEC operates the ATH Network, a PIN debit network in Puerto Rico, which consists of 111 member financial institutions in Puerto Rico and the United States Virgin Islands. EVERTEC also provides merchant acquiring solutions including various payment solutions, point-of-sale ("POS") systems and accessories to receive payments efficiently and quickly.

EVERTEC opposes the Proposed Regulation because the interchange cap is too low and does not account for the costs associated with the maintenance of debit card and payment card programs. We are also concerned that the scope is overly broad and should be limited to electronic debit transactions at physical POS merchant locations. As drafted, the Proposed Regulation will require the implementation of processes and administrative structures that will increase costs for the regulating agencies, issuers and cardholders. These additional costs will far outweigh any savings the Board could expect for major retailers and merchants.

Furthermore, we understand that the Proposed Regulations establish government price controls that are inappropriate for debit card transactions. EVERTEC therefore urges the Board to exercise discretion to the maximum permitted under the statute to take into consideration the following points and arguments we present in response to the Board's request for comments on the Proposed Regulation:

I. Coverage of ATM transactions and networks

EVERTEC believes that ATM transactions and networks should not be included within the scope of the Proposed Regulation.

Contrary to POS transactions, in the realm of ATM transactions and networks, interchange fees are traditionally paid by the card issuers. As such, it is our understanding that the authority granted to the Board under the Dodd Frank Act is limited to regulating interchange transaction fees with respect to electronic debit transactions performed at POS terminals.

The ATM model for issued ATM cards already promotes competition among networks because it is a fee charged between banks, and not the merchants, thereby creating a pricing and fee structure substantially different from the debit interchange fee structure for merchants.

Including ATM transactions and ATM networks within the scope of the Proposed Regulation would eliminate this convenience, as banks may be forced to increase fees or reduce the number of ATM locations in order to compensate for lost revenue.

As of today, ATM options are convenient for cardholders, as most issuers provide more than one ATM option with their cards, including access to bank funds at many locations. Including ATM transactions and ATM networks within the scope of the Proposed Regulation would eliminate this convenience, as banks may be forced to increase fees or reduce the number of ATM locations in order to compensate for lost revenue that was used to offset the operating costs to maintain such ATM networks. A logical negative consequence of the above would result in consumers being forced to carry cash due to the decreased availability of ATMs.

II. Coverage of three-party systems

In general, EVERTEC believes that the interchange fee standards for electronic debit transactions should be the same for three-party and four-party systems, if they issue debit cards. However, we are unsure of the scope and definition of these systems as such terms are used in the Proposed Regulation.

EVERTEC requests more clarification or definition on this point.

III. Definitions

EVERTEC believes that the Board should provide a more detailed definition of the scope of the new interchange and routing rules because overly broad guidelines may create confusion among the issuers and other participants in the payment system. This confusion in turn may create an undue burden for such participants to request continual clarifications for new products or situations.

Furthermore, EVERTEC feels that additional guidance is required for many of the defined terms used throughout the Proposed Regulation. In particular, the following terms should be clarified:

Deferred and decoupled debit cards or any similar products – it is unclear which of these products qualify as debit cards for purposes of the Proposed Regulation.

General-use prepaid cards – clarification on the scope of this term is needed. EVERTEC believes that prepaid cards that are accepted at a **limited** number of unaffiliated participating merchants and that do not carry a network brand should not be considered general-use prepaid cards. Furthermore, special attention should be paid to clarify if the concept of gift cards is included under this definition.

Payment card network – EVERTEC understands that non-traditional or emerging payment systems should not be covered by the statutory definition of payment card network at this time. Once such systems achieve critical mass and reasonable acceptance, we suggest the Board reevaluate including them under the definition.

Internet/Web transactions – the proposed interchange is primarily focused on the physical POS payment environment for debit transactions. It is not clear how the Proposed Regulation will affect transactions performed over the Internet or other virtual environments. Particular situations that do not seem to be clearly considered are the following:

a. Interchange – Cards are not swiped for debit purchase transactions performed over the Internet. These transactions are considered "card not present" and carry a higher risk that is not considered in the proposed interchange fee cap. As a result, issuers may be forced to "block" or otherwise not authorize "card not present" transactions. This in turn, could have a negative impact on both consumers and merchants that do business through the Internet.

b. Alternative Routing – For Internet transactions, the consumer determines the card and payment method. The proposed interchange structure does not provide alternative routing options for merchants with respect to signature and PIN debit cards due to the early stages of PIN debit acceptance technology through the Internet. As such, processors are not able to provide merchants the option of alternative routing for these types of transactions.

c. Circumvention – This definition will have a significant impact on the overall payment system environment, but in our opinion it will have much higher impact on payment transactions performed over the Internet and virtual environments due to the fact that the corresponding payment technologies for these transactions are still in development or pilot phases. A logical consequence of this will be that issuers shy away from financial solutions to support payments in this environment due to concerns it may be considered circumvention.

In the end, uncertainty of which products and services are included in the defined terms and therefore covered by the Proposed Regulation, could limit innovation and implementation of more efficient payment technologies.

IV. Activity costs to be considered

EVERTEC believes that the Board should allow recovery through interchange fees of other costs (direct or indirect) of a particular transaction beyond authorization, clearing, and settlement costs.

Limiting an issuer's ability to recover additional costs, such as reward programs, "know-your-customer" due diligence, marketing, cardholder inquiries, card issuance, maintenance costs, fraud prevention, chargeback, compliance programs, and research and development could result in the elimination of many of these features, programs and services that not only benefit the cardholder, but are essential components to a well maintained debit card program.

For example, marketing and reward programs provide incentives for customers to use an electronic mean of payment which is less expensive for merchants when compared to checks or cash. Additionally, cardholder inquiries, card issuance, maintenance, fraud prevention and compliance costs are fixed costs that can be directly allocated to the debit card business. Also, research and development costs are necessary in order to develop new innovative payment systems. Additional costs such as network fees and replacement costs should also be considered allowable costs as part of the transactions.

Furthermore, fraud monitoring is a big factor of the cost of a debit program. Issuing institutions must maintain a robust monitoring infrastructure, hire and train fraud specialists, and constantly sustain fraud losses. As part of the infrastructure, expensive specialized software is required in order to detect fraud. These costs vary greatly by season, by industry and by market and cannot possibly be subject to a revenue cap. In today's industry, the issuers are responsible for a big portion of fraud and merchants have benefited from this fraud prevention and loss structure. Regulating the revenue will force issuers to shift fraud costs to the acquirers and merchants.

The Board should also take into consideration an issuer's ability to segment transactions in order to recover other costs based on the following criteria: 1) method of authorization or settlement; 2) type of industry; 3) transaction amount; 4) card present or not; and 5) chargeback rules.

V. Cost Measurement

EVERTEC believes that fixed costs should be included in the cost measurement. These fixed costs are ever changing and require constant investments in hardware, software, market intelligence tools and the likes needed to adequately administer card programs. These investments are currently paid by the interchange income that the financial institutions receive.

If the Board does not consider the fixed costs as part of the interchange fee, then it will force issuers to increase prices to cardholders or reduce services in order to achieve a less costly operation. If, however, the Board decides to use the marginal cost method, these costs should be calculated using an average of all United States issuing institutions. This cost method will promote efficiencies and scale, as well as provide a vehicle for issuers to lower costs and earn above average returns.

VI. Proposed interchange fee standards

EVERTEC understands that neither of the two interchange fee standard alternatives should be adopted.

However, if these are the only options available, we believe that Alternative 1 is preferable because it is the only alternative that can be monitored and will promote efficiencies and lead issuers to cut costs.

Hence, we understand that the average interchange needs to be much more than $0.12 cents and should be divided by industry and methods of authorization and/or settlement. If all transactions are given equal treatment, this could lead to a reduction in debit card use and an inevitable migration towards increased use of cash or credit.

We believe the income reduction will force many industries to cancel debit card support and switch to credit cards acceptance only. This situation could negatively impact consumers in the long run creating a pattern of overspending and interest charges from increased use of credit lines instead of funds available in their bank accounts.

Furthermore, the Board should allow for different cap values for signature and PIN debit transactions, as well as adopt standards with respect to a permissible amount of variation from the benchmark for any given interchange transaction fee, per industry, payment methods, and chargeback rules, among other criteria.

As drafted, the proposed alternatives for interchange do not offer a differentiation in fees between signature and PIN debit transactions. In addition, since the $0.12 proposed cap is so low, a reasonable difference between the products cannot be achieved. Signature debit cards allow international access and can be used for Internet purchases, but they have a higher fraud risk and cost more to process than PIN debit transactions. On the other hand, PIN debit transactions have experienced a significant growth in the past few years, mostly due to merchant investment in PIN pads to benefit from this lower cost alternative. The absence of any differentiation in the interchange fee for signature versus and PIN debit transactions will limit PIN debit card acceptance growth at merchants, because the economic incentive to invest in PIN pads is eliminated.

The reality is that merchants will not reduce costs to consumers and issuers will need to recover the lost revenue. On the other hand, if interchange payment varies from issuer to issuer, ISO's, acquirers and merchants will not know their costs ahead of time.

VII. Disclosure to payment card network

EVERTEC believes the networks should establish the interchange fee in order to provide ISO's, acquirers and merchants a clear understanding of their interchange costs per network.

If, however, the Board allows different interchange fees per issuer and implements the proposed disclosure rule, then the timelines provided for compliance should be revised to allow more time due to the impact it will have on network settlement programs.

VIII. Request for comment on how to implement an adjustment to interchange fees for fraud prevention costs

EVERTEC believes that adjustments to interchange fees due to technology-specific standards or non-prescriptive standards should not be allowed. Any attempt to establish adjustments will create additional costs due to the ever changing nature of fraud, for which we cannot establish any long term standards which in turn will make measuring the adjustment on an ongoing basis very burdensome. However, fraud-prevention and data-security related costs should be considered within the proposed interchange guidelines by raising the cap appropriately.

The Board should take into consideration that if the proposed interchange fee cap is as low as $0.12, issuers will be greatly limited in their ability to innovate to future technologies related to debit cards which could result in not only increased costs, but a shift in risk to the merchant.

If, however, the Board decides to implement an adjustment to interchange fees for fraud prevention costs, it should adopt the simple cap approach and measure fraud-prevention and data-security costs of debit cards in the United States through an average by issuer.

IX. Exemption for small issuers, government-administered programs, and certain reloadable prepaid cards

EVERTEC believes that the Board should establish a consistent certification process and reporting period for an issuer to notify a payment card network and other parties that the issuer qualifies for the small issuer exemption.

We suggest that the Board establish a yearly review by each supervisory agency and provide a list of the exempted financial institutions to the payment card networks. This yearly review process should allow at least 90 days for the payment card networks to implement the corresponding interchange for those financial institutions whose exemption status has changed.

We also understand that with respect to the proposed exemption for government-administered payment programs and reloadable prepaid cards, the payment card networks are in a better position to establish the appropriate processes needed to identify card accounts that meet the exemptions. If, however, the Board decides to establish the certification process, we believe it should be implemented by BIN in the network settlement systems and a similar reporting process as that for small issuers could be implemented. Furthermore, we understand that the Board provides a clear definition of what is considered a reloadable prepaid card for exemption purposes.

X. Prohibition on circumvention or evasion

EVERTEC is uncertain of the type of acts that an issuer or other participant could perform to circumvent or evade the interchange transaction fee restrictions. As such, we ask that the Board provide additional examples to illustrate this proposed prohibition.

With respect to the network practice of paying signing bonuses to attract new issuers or to retain existing issuers, we believe that such practices should be prohibited under the Proposed Regulation, or in the alternative, be limited to reimbursing issuers the cost to connect / certify to the new network. If the Board were to allow networks to continue paying signing bonuses, we understand that networks could overcharge small issuers to offer bonuses to large ones. In any case, the Board should provide a clear definition of what is considered a bonus and what activities will not be considered a bonus.

XI. Prohibition on network exclusivity

EVERTEC feels that the routing rules, regardless of the alternative selected, will result in additional costs to issuers with no significant impact on merchants. EVERTEC has evaluated the two alternatives presented under the Proposed Regulation and understands that the Board should eliminate both alternatives, especially Alternative B which will create a significant impact on the payment system because it requires significant operational changes by issuers, networks, payment processors, and merchants.

On the other hand, we believe Alternative A is a preferable alternative and more cost effective for issuers. However, if a small issuer elects to issue a PIN only card for a specific program or segment, it should be exempted from having to comply with a signature option. By nature, PIN only cards serve low income consumers and operate on very thin margins. Requiring a secondary option, would result in increased costs for the issuer which could force banks to reduce or otherwise limit services to this group of consumers.

Most of the members of the ATH Network are very small sized credit unions that only issue PIN debit ATM cards. The majority of them have been offered the option to issue signature debit cards, but they do not have the infrastructure to support this product. Signature debit products are usually more targeted for fraud and require additional back office support which represents costs and risks that many of the credit unions consider not cost efficient. Establishing a requirement to have at least two routing options will represent additional risks and costs to most of the credit unions in Puerto Rico. This routing requirement will basically force small credit unions that provide PIN debit only cards to migrate to signature debit cards and incur in additional costs. We understand that the two routing option should not be a requirement if the card issued is a PIN debit only (ATM card), since it will always offer the lowest cost and security to the merchant.

The Board should keep in mind that some US cards are used outside the US and having a card with two signature options may impact not only US processors, but it will have an impact on international networks and processors.

EVERTEC recommends that network exclusivity guidelines of the Proposed Regulation take into consideration the following:

a. If today an issuer only provides a signature debit product, then it must provide a PIN debit network within the card.

b. If an issuer elects to issue PIN only cards, such cards should be subject to the interchange guidelines, but exempt from the routing requirements.

c. The Board should clarify if the merchants will be forced to "honor all cards" because of this prohibition on network exclusivity. EVERTEC is concerned that merchants may decline acceptance of cards issued by exempted small issuers and government administered payment programs.

With respect to the standard that the Board should use for determining whether the regional network provides sufficient coverage for the issuer's cardholders' transactions, we believe that the minimum coverage should be based on the network card acceptance in the region's largest retailers.

The Board requested comment on the potential impact, and particularly the cost impact, on small issuers from adding multiple payment card networks in order to ensure that a debit card is accepted on a nationwide basis on at least two unaffiliated payment card networks. EVERTEC understands that the issuers should select the networks they so desire and that competition will drive them to the best coverage with the lowest fees. If, however, issuers are required to select national networks only, the probable effect will place issuers at the mercy of such national networks' power to increase fees as they see fit.

In other matters, EVERTEC understands that 90 days is not sufficient time for issuers to negotiate new agreements and add connectivity with the additional networks in order to comply with the rule. The parties should be allowed at least a year to negotiate new agreements. Adding a network requires a lot of work, negotiation, testing, pilots, certification, and reviews. There are thousands of issuers and less than 25 networks. That time limit would be unreasonable and an undue burden for the networks.

As mentioned in the Proposed Regulation, the Board understands that some institutions may wish to issue a card, or other payment code or device, that meets the proposed definition of debit card, but that may be capable of being processed using only a single authorization method. Under the Proposed Regulation, the issuer would be required to add at least a second unaffiliated signature debit network to the device to comply with the requirements of § 235.7(a). It is our point of view that if the Board requires adding at least that second unaffiliated signature debit network to the device, this could inhibit the development of these devices in the future. Issuers who develop new card like devices should be exempt from the exclusivity rule for period of time until they can achieve critical mass and reasonable acceptance. The Board can simply state that any issuer with less than a specific amount of transactions per year, is exempt from having two networks. Every issuer strives for more volume and acceptance, so at some point, they will be regulated. Once the volume reaches a certain level, they would a specific amount of months to comply with the regulation. For example, if an issuer creates a new network to run on mobile phones or biometrical thumb prints, it should be exempt until its acceptance volume is above a specific amount of transactions.

XII. Effective Date

The Board should provide significant time for issuers to comply with the final established guidelines. The proposed effective dates for interchange and routing compliance are not reasonable timelines for compliance of such a significant change in the debit card payment system. In addition to system changes, the Board should take into consideration that ISO's, acquirers and merchants must understand how these changes affect their respective business arrangements. Also, ample time will be needed to establish Request for Proposal (RFP) processes, negotiate and sign agreements and re-issue cards, among other tasks.

Assuming that the Alternative A type solution is presented in the final guidelines, the Board should provide at least one year for implementation of interchange fees and at least two years for implementation of a reasonable additional routing compliance alternative. There are many issuers and only a few networks. On the other hand, we believe that Alternative B simply is not viable.

XIII. Additional Considerations

EVERTEC is headquartered in Puerto Rico, a territory of the US. Although the Proposed Regulation offers Puerto Rico treatment as any other state, the card associations, such as VISA and MasterCard, consider card transactions performed in Puerto Rico as **international** transactions with a higher risk factor. As a result, these transactions cost more than their US counterparts.

Also, in some regions, like Puerto Rico, there is limited connectivity to the US which hinders the coverage by national networks. Requiring acceptance "throughout the United States" by two unaffiliated networks will only increase costs more.

Factors such as these, as well as, differences in chargeback procedures and patterns of fraud, should be taken into consideration by the Board in order to ensure that all parties affected by the Proposed Regulation are afforded equal treatment.

XIV. Conclusion

The three final rules on interchange fees regarding a reasonable and proportional debit fee structure, fees for fraud prevention on debit transactions, and debit transaction network fees pose important public policy questions. However, there are important concerns regarding whether the Board has all the necessary input to best address the intent of the statute.

Interchange revenue has been one of the reasons for the growth and success of debit transactions in the US payment system. The revenue generated by these transactions pays for much of the marketing to promote the payment card industry. The Board should incorporate the knowledge and experience of the industry to ensure the Proposed Regulation has the least negative impact on this industry.

The card payment system is a very complex system that has taken many years to get to the current level. It is not a US exclusive system. It is global. By limiting the interchange fee to issuers, these issuers will limit services to debit cards and invest in promoting other payment alternatives that provide a better revenue margin. This limitation will in turn, negatively impact innovation on the debit card payment environment within the US and allow the development and growth of better payment alternatives by foreign issuers and providers.

EVERTEC feels that the Board should delay implementation of the Proposed Regulation in order to ensure that the complex implementation options that have been proposed do not negatively impact the debit card holders, merchants, networks, and other parties in the process.

We are confident that the Board understands the sensitive nature of the Proposed Regulation and will take into consideration industry concerns and their recommendations.

Should you need additional information regarding any of the foregoing, please contact Mr. Jorge Hernández, Senior Vice President and Manager of the ATH Network at (787) 759-9999 ext. 2570 or Mr. Miguel Vizcarrondo, Senior Vice President and Manager of Merchant Acquiring Solutions at (787) 751-9800 ext. 5139.

Sincerely,

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