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February 22, 2011

Via Electronic Mail

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

RE: Proposed Rule on Debit Interchange Fees (Docket No. R-1404; RIN No. 7100 AD63)

Dear Ms. Johnson:

The PNC Financial Services Group, Inc. ("PNC") appreciates the opportunity to comment on the proposal by the Board of Governors of the Federal Reserve System ("Board") to adopt new Regulation II and the related Official Staff Commentary. The proposal would implement the provisions of Section 920 of the Electronic Funds Transfer Act ("EFTA"), which was enacted by the so-called "Durbin Amendment" of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

PNC is one of the largest diversified financial services companies in the United States, with approximately $183 billion in deposits and $264 billion in assets, as of December 31, 2010. PNC has businesses engaged in retail banking, corporate and institutional banking, asset management, and residential mortgage banking. PNC provides many of its products and services nationally and others in PNC's primary geographic markets in Pennsylvania, Ohio, New Jersey, Michigan, Maryland, Illinois, Indiana, Kentucky, Florida, Virginia, Missouri, Delaware, Washington, D.C., and Wisconsin.

The debit card payment services that PNC provides its customers are an integral component of our checking account product offerings. In 2010, we had approximately 6.3 million outstanding debit cards relating to our checking accounts. In that year, we processed more than 997 million transactions involving those cards, totaling a volume of approximately $37.5 billion.

PNC adds its voice to the concerns expressed virtually unanimously by the banking industry—large and small banks, savings associations and credit unions alike—that the Board's proposal to impose government price controls is neither authorized by, nor consistent with, the Durbin Amendment. We also echo concerns that the proposal will force issuers to suffer a financial loss on debit card transactions, a result that simply is not compelled by the Durbin Amendment. We expect that these mandated losses will fundamentally alter the provision, convenience and cost of checking account services to consumers. Furthermore, mandating losses on debit payment transactions is likely to result in a migration to alternative payment products. An unintended consequence of this would be forcing a disproportionate number of consumers with lower incomes and lower credit scores out of traditional banking services. We do not believe that the intent of debit interchange legislation was to negatively impact customer access to and adverse pricing of checking and payment products. We strongly believe these changes will result in tangible negative consequences if the Board adopts the implementing regulation and guidance as proposed.

We join the comment letter submitted jointly by the banking industry trade associations, including the view expressed in the letter that the Board's rules must be fundamentally revised in order to meet the requirements of the Durbin Amendment.[1] Below are PNC's comments on particular aspects of the proposal that we believe are important to specifically call to the Board's attention.

No Price Caps

The Durbin Amendment does not authorize the Board to adopt a cap on interchange fees. A cap is fundamentally inconsistent with the statute in that it prevents an issuer from receiving interchange fees that are "reasonable and proportional" to the issuer's allowable costs. In addition, the Durbin Amendment directs the Board to issue "standards for assessing" whether interchange fees charged are reasonable and proportional to an issuer's costs relating to interchange transactions. It is difficult to see how a statutory direction to the Board to adopt "standards for assessing" appropriate fees can be interpreted as a mandate to the Board to set price caps. We note that the U.S. Government and the principal sponsor of the interchange provision, Senator Richard J. Durbin of Illinois, appear to support the conclusion that the Board should not be setting price controls on debit interchange.[2] We urge the Board to adopt a rule that does *not* impose price caps.

Allow Interchange Fees that Reflect Costs and a Reasonable Rate of Return

PNC objects to the Board's proposal to allow issuers to recoup only the costs for authorization, clearance and settlement (ACS) of debit interchange transactions. The Durbin Amendment directs the Board to distinguish between "incremental" ACS costs, which issuers are expressly permitted to recoup, and costs that "are not specific to a particular electronic debit transaction," which issuers are not allowed to recoup. The statute also provides that an issuer may charge fees

[1] Comment Letter signed by representatives of The Clearing House Association, Financial Services Roundtable, Consumer Bankers Association, American Bankers Association, Independent Community Bankers of America, Credit Union National Association, Midsize Bank Coalition of America, National Association of Federal Credit Unions, National Bankers Association, and The Clearing House Payments Company (Combined Industry Trade Assoc. Letter).

[2] In a brief supporting a motion to dismiss a case TCF National Bank has filed against the Board in connection with the Durbin Amendment, the U.S. Government says that the Durbin Amendment's "requirement that the Board 'establish standards' for assessing debit interchange fees does not obligate the Board to set a specific rate for debit interchange fees. Brief filed in support of Motion to Dismiss, *TCF National Bank v. Bernanke, Yellen, Warsh, Duke Tarullo and Bloom Raskin*, at 2, filed on February 18, 2011 (U.S. Government Brief). Senator Durbin also appears to assert that the Board should not be imposing price controls in a Q&A link to a February 14, 2011 press release. *See* Senator Richard J. Durbin Press Release, dated February 14, 2011 at http://durbin.senate.gov/showRelease.cfm?releaseId=331149 ("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.") (Durbin Press Release).

that are reasonable and proportional to the cost incurred by the issuer "with respect to the transaction." The Durbin Amendment imposes no other limitations on the costs that can be recouped and the Board appears to acknowledge that issuers are able to recoup costs beyond ACS costs in setting interchange fees.[3]

There are many other costs issuers incur that are attributable to debit transactions and the Board's rule should allow issuers to charge interchange fees to recoup these costs. At the very least, these include network processing fees, costs of funding transactions, data processing, customer inquiries and disputes, fraud losses (of course, fraud prevention costs also should be included through the Board's separate statutory authority), costs of billing and collection, and card production and issuance costs.

It is not difficult to attribute to particular debit transactions costs ordinarily viewed as fixed. For example, a portion of the salary of an employee who is solely devoted to technical support of an issuer's debit payment system can easily be attributable to individual transactions (simply divide the employee's salary by the number of transactions processed in a year). The cost of this employee's salary would be avoided in the absence of the debit payment service. Given this, we urge the Board to allow a broader range of costs—even those that are ordinarily considered to be fixed costs—into the universe of costs that may be recouped through interchange fees.

Furthermore, we believe that the Board erroneously interpreted the statute when it concluded that interchange fees may be *no greater than* an issuer's costs. The Board ignores the plain meaning of the statute that fees charged can be "reasonable and proportional" to costs relating to interchange transactions. The fees charged do not have to equal allowable costs, just be reasonably related and proportional to them. Oddly, the Board rejects its own recent interpretation of the term when it implemented Section 149 of the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act), which limits credit card penalty fees for violations of cardholder agreements. In that regulation, the Board allowed fees that could surpass the actual cost the bank incurs for the consumer's violation of the agreement. However, even the statute's principal sponsor appears to embrace a meaning of the term in this statute that is the same as the Board's interpretation of the Credit CARD Act.[4] We assert that this interpretation establishes a basis for allowing an issuer to obtain a reasonable rate of return on transactions.

<u>Provide Safe Harbor to Reduce Burden</u>

Although PNC does not agree that the Board is authorized to impose debit interchange price caps, we support the Board's conclusion that safe harbors are permissible. A safe harbor will reduce compliance costs on issuers that choose to take advantage of it and reduce supervision

[3] *See* 75 *Federal Register* 81,722, 734-736 (December 28, 2010) (discussing additional costs the Board considered, but did not include, in allowable costs) (Federal Register Notice). *See also* U.S. Government Brief at 2 ("[T]he Board can consider factors other than the authorization, clearance, and settlement . . . costs that are specific to a particular electronic debit transaction."). PNC agrees with other commenters that the Durbin Amendment's mandate to the Board to consider the functional similarity between debit transactions and check transactions that clear at par does *not* impose a limit on the Board in allowing issuers to recoup costs beyond ACS costs. *See* Combined Industry Trade Assoc. Letter pages 34-39.

[4] Durbin Q&A Release (The standard 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.")

expenses of the agencies. It is important that the safe harbor be administered as a true safe harbor so that an issuer that ventures outside of it can still be in compliance with the statute if the issuer can establish that its interchange fees are reasonable and proportional to its costs incurred with respect to interchange transactions.

PNC urges the Board to adopt a monetary value of the safe harbor that is equal to a percentile of the sum of all issuers'—

- Authorization, clearance and settlement costs;
- Other "per transaction" costs, such as network processing fees, costs of funding transactions, data processing, customer inquiries and disputes, fraud losses, costs of billing and collection, card production and issuance costs, and other fixed-cost components related to delivering the transaction;
- Fraud prevention costs; and
- A reasonable rate of return.

The appropriate monetary value should be set at a level where it is economically feasible for a substantial majority of issuers to invoke it, thus avoiding undue administrative costs on both issuers and their regulators. Moreover, the amount should be high enough to allow issuers to charge fees based on the risk of merchant transactions. The amount of the safe harbor should not deter an issuer from raising interchange fees for processing transactions issuers view as posing higher risk. Issuers may otherwise elect not to continue to accept these higher risk transactions.

We also recommend that the safe harbor be administered on an average basis for all interchange transactions executed by the issuer across all networks over a one-year period. Administering the safe harbor on an average basis for all networks an issuer uses would ease compliance burdens on the industry.[5]

Allow an Adequate Transition

The issuance of the final rules are planned to be released a mere three months before they are to take effect. This unreasonably short period of time will cause significant disruptions in the payments system. It does not give issuers and networks sufficient time to assess the impact of the rules on their business, operations, strategies and compliance infrastructure, much less giving them sufficient time to incorporate those changes. This period of time is particularly onerous if the Board does not make major and fundamental changes to the proposal.

Thus, we strongly urge the Board to delay imposing any requirement through its regulations that requires issuers, by July 21, 2011, to reduce interchange fees to amounts that preclude them from making a profit. We believe a delay is justifiable for the Board and that these requirements should be delayed by at least two years. A delay would afford issuers the time they need to understand the impact of the Durbin Amendment regulations on their businesses, operations and strategies, and to effectively implement necessary changes in a safe and sound manner. A delay

[5] The Board requests comment on a similar proposal whereby an issuer could comply with the rule as long as, on average over a specified period of time, the issuer is in compliance with the rule. Federal Register Notice at 81,738. We agree with the Board's proposal, but urge the Board to adopt the approach in a safe harbor.

would also give the Board time to adopt rules to allow adjustments to interchange fees that reflect fraud prevention costs, rules the Board said in the proposal that it plans to pursue.

Since the Durbin Amendment's mandate on reasonable and proportional fees becomes effective on July 21, 2011, we also ask the Board to provide the industry with as much clarity as possible about compliance with the statutory mandate during this interim period. We discuss above that the statute's mandate that fees that are "reasonable and proportional" to costs clearly allows issuers to charge fees that exceed those costs. This reasonable and proportional standard allows fees not only to exceed costs, but it also allows the spread by which those fees exceed costs to vary over time. What is a "reasonable" level on July 21, 2011, when the industry is facing dramatic changes to its debit payment systems and how checking accounts are provided to consumers, certainly could be different from what is "reasonable" on July 21, 2013, when the industry has had time to incorporate those changes. Accordingly, PNC urges the Board to clarify that issuers may continue to charge interchange fees at pre-July 21, 2011 levels during this period.

Adopt Alternative A for Network Exclusivity Options

With regard to network exclusivity, PNC strongly supports the Board's proposed Alternative A, which would require debit cards to have at least two unaffiliated payment card networks available for processing, regardless of whether those networks are exclusively PIN, signature or dual networks. The Durbin Amendment does not require anything more; nothing in Section 920 requires (or even suggests) that there must be multiple networks for each authorization method as would be required by Alternative B. The Durbin Amendment does not distinguish, or direct the Board to distinguish, electronic debit transactions by method of transaction authorization. Finally, we believe the adoption of Alternative B will present issuers and networks with significant operational challenges and financial burdens. Thus, we strongly urge the Board to adopt the exclusivity and routing requirements specified in Alternative A.

Exclude ATMs

The Board requests comment on whether ATM transactions and networks should be subject to interchange fee limits and network exclusivity requirements. PNC urges the Board to exclude ATM transactions and networks from the scope of the rule. The term "interchange transaction fee" is defined in Section 920(c)(8) as a fee charged "for the purpose of compensating an issuer." In ATM transactions, however, transaction fees are paid *by* the issuer and flow to the ATM operator. Therefore, the proposed interchange transaction fee standards should not apply to ATM transaction fees. We also believe that it was not the intent of Congress for ATM networks to be within the scope of the Durbin Amendment. We accordingly recommend that the Board exclude both ATM transactions and networks in its final rule.

Ease Burden on Prepaid Cards

In the proposal, the Board identifies potential negative effects of applying the network exclusivity requirements to reloadable prepaid cards and health savings account cards. PNC urges the Board to exclude these cards from the exclusivity requirements because of the disproportionate burden and costs those requirements would impose on these card programs. Imposing those requirements will stifle innovation, as the Board points out in the proposal, and could dissuade issuers from providing consumers with these useful programs.

Finally, we also urge the Board to apply different interchange limits, including through safe harbors, for gift cards and other nonexempt prepaid cards. These payment systems are not as developed as debit card payment systems and often impose higher costs than traditional debit payment systems. We urge the Board to take these additional and unique costs for these payment systems into account when setting interchange limits.

Thank you for your consideration of these comments. If you would like to discuss any aspect of this letter, please do not hesitate to call me.

Sincerely,

James S. Keller

cc: Michael D. Coldwell
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