NAVY FEDERAL Credit Union

Office of the President

February 22, 2011

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

Re: Docket No. R-1404; RIN No 7100 AD63; Debit Card Interchange Fees and Routing

Dear Ms. Johnson:

This comment is in response to the proposed rules promulgated by the Board of Governors of the Federal Reserve System ("Board") on December 16, 2010 to implement Section 920 of the Electronic Fund Transfer Act, as updated by Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

As the nation's largest natural person credit union with $44 Billion in assets and 3.6 million members, we are committed to serving the needs and improving the financial conditions of our members, including the Soldiers, Sailors, Marines and Airmen who defend our country. Debit cards are an important product offering for our members, especially junior enlisted personnel and others in lower income categories. Navy Federal believes strongly that the proposed rule does not address the reasonable costs associated with providing a safe, secure debit card program to our members. If enacted as proposed, the results will be extremely damaging to U.S. consumers, including many military service men and women. A reduction of interchange by 75% to 85% will lead to unintended consequences such as consumers paying for financial services that were previously offered to them for free. This could lead many, especially the less affluent, to become "unbanked" or to turn to payday lenders to receive the services they desire.

We agree with Senator Dodd and Representative Frank who have stated that this rule overreaches. If this overly severe approach to interpreting the law is implemented, debit card interchange will be neither "reasonable" nor "proportional" as required by the Act. Navy Federal and many other credit unions will lose money on every debit card transaction.

We urge the Board to reconsider its overly narrow interpretation of Section 1075 and issue a final rule that fully considers the real costs associated with operating a consumer debit card program.

PO Box 3000 Merrifield VA 22119-3000

Navy Federal Credit Union provides the following comments in response to the Federal Reserve Board's (the Board) debit card interchange proposal. If you have any questions, please contact Charla Tompkins, Senior Policy Analyst & Compliance Officer, at (703) 206-2672.

Sincerely,

Cutler Dawson

Cutler Dawson
President/CEO

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Enclosure

Response to the Federal Reserve Board's Proposed Rule on Debit Card Interchange Fees and Routing

Prepared by Navy Federal Credit Union

February 22, 2011

Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") calls for the Federal Reserve Board of Governors "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."

Under the Board's severe approach to interpreting the statute, debit card interchange will be neither "reasonable" nor "proportional" as mandated by the law. The proposed alternatives of 7 to 12 cents per transaction will force the majority of financial institutions to lose money on every debit card transaction. We believe the Board was given the flexibility within the statute to include both incremental and fixed costs associated with debit card transactions in determining allowable interchange rates. Unfortunately, the Board's interpretation of allowable costs considers only a very narrow set of incremental costs, completely ignoring all other incremental and fixed costs necessary to authorize, clear and settle a debit transaction. Additionally, the Board's pricing alternatives fail to recognize the very real differences between signature and PIN debit transactions. These differences include, but are not limited to, different cost structures and risks associated with each type of transaction.

The routing and exclusivity provisions of the proposal, which were never discussed in conference, or voted on by the House when the statute was initially passed, have the effect over time, of reducing even further the income available to offset costs of debit card transactions. It may also reduce consumer choice at the point of sale, eliminating benefits such as zero liability for fraud and chargeback rights available with signature debit, but not with PIN. Finally, we believe it makes the small issuer exemption moot. We urge the Board to consider the harmful consequences, outlined herein, of replacing the current market-based system with a government controlled system. The proposed system will ultimately be to the detriment of consumers and financial institutions of all sizes.

The Board has not satisfied statutory mandates since it has failed to sufficiently identify the consequences prior to issuing its rule

From consumer harm, to the safety and soundness of small financial institutions, the Board has continuously commented that it does not know what effect its proposal will have on various aspects of the complex debit card market.[1]

[1] Staff members have acknowledged that it has not studied the effects this proposal would have on consumers by commenting that it is "hard to anticipate" and would be "difficult to predict." In addition, staff members have also acknowledged that they "really don't know" what the effect of the proposal would be on small Financial insitutions. Meeting of the Board of Governors of the Federal Reserve System Transcript, page 25, 27 and 29 (Dec. 16, 2010).

Enclosure

Additionally, Section 904 of the Electronic Fund Transfer Act (the "EFTA") dictates that the Board "prepare an analysis of the economic impact which considers the costs and benefits to financial insitutions, consumers, and other users of electronic fund transfers, including the extent to which additional documentation, reports, records, or other paper work would be required, and the effects upon competition in the provision of electronic banking services among large and small financial institutions."[2] We believe the Board has not performed its due diligence as required by Section 904 of the EFTA.

The card issuer survey that the Board distributed to only 131 financial institutions, with only 89 responses, did not provide sufficient data to determine how this proposal will affect the entire financial industry. This is an inherently flawed approach and therefore should not be the basis for rule-making. The survey data only covered costs of a small number of the largest financial institutions over a short and static one year time period. It does not fully capture the costs of implementing, managing and maintaining a debit card program since both past and future investments are ignored. We believe the impact this proposal will have on small financial insitutions, consumers and the competitive market will be very harmful. At best, by the Board's own admission, the consequences are unknown. Therefore, we urge the Board to determine this impact as a whole before a final rule is issued.

The Board has ignored the fact that consumers may not receive any benefit and may even be harmed as a result of the proposed rule.

Section 902 of the EFTA states that the primary objective of this title is the "provision of individual consumer rights" as it relates to the electronic fund transfer system. However, no actual studies have been conducted to determine if consumers will see any type of benefit from this proposal. In her testimony on Febuary 17,2011 Governor Raskin admitted as much stating that past studies have been inconclusive. In fact, we believe consumers will be harmed as a result of this regulation.

As consumers, Navy Federal members currently benefit from the convenience and revenues generated by debit cards. These revenues offset both the costs and risks to issuers of offering debit cards, as well as recognize the value of the significant benefit that accrue to merchants who accept debit cards. Consumer benefits of debit cards include convenient access to free checking accounts, dividends (interest) and in most cases ATM fee rebates. The Board has acknowledged that the implementation of this proposal will result in issuers no longer being able to provide such services to consumers and will result in the implementation of consumer fees such as "cardholder fees, to help recover costs." Unfortunately, this is already happening as many financial institutions have been forced to raise or implement new fees as a result of other recent regulatory mandates and in anticipation of the loss of revenue stemming from this rule. It will be almost impossible for issuers to provide identical services while simultaneously experiencing a 75% to 85% reduction in income.

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[2] 15 U.S.C. 1693b(a)(2).

There is no evidence that consumers will benefit from the rule in general. Without a comprehensive and balanced study to determine the true impact, any statement suggesting that consumers will benefit by reduced prices is speculative at best. In the words of the Board's staff *"any savings that consumers might realize at point of sale could be offset by fee increases at their banks."*[3] This paradox will force consumers to reevaluate their current relationships with their financial institutions. As a result, consumers, especially the less affluent who can least afford it, may become unbanked: increasing their usage of payday lenders' inferior and costly prepaid products like those offered by Wal-Mart and 7-11, and turning away from regulated financial institutions to meet their financial service needs.

The Board has effectively negated the small issuer exemption through the routing and exclusivity provisions of the proposed rule

While the interchange provision of the proposed rule recognizes the importance of interchange to small financial institutions by exempting them, ironically, the routing rule severely compromises that exemption. Merchants will have the power to route transactions to networks that effectively lower small financial institutions' revenue. This will render the exemption moot.

Card networks are free to set a single, uniform interchange rate for all institutions, regardless of size. Even if some networks do support a two-tier interchange system, market forces due to the routing requirements will force the rate the Board approves to become the de facto rate for all institutions. In addition there is nothing to prevent merchants from incenting cardholders to use the lower cost cards of large issuers vice the more expensive small issuer cards. This became even more evident when the Board's staff itself stated "it is possible that merchants would discriminate against those [small] issuers by declining to accept their cards because there are higher fees..."[4] The small issuer exemption is essentially a distinction without a meaning. As the largest single contributor to the National Credit Union Share Insurance Fund, Navy Federal is greatly concerned about the adverse impact of the proposed rule on all credit unions, regardless of size.

The Board has taken an extraordinarily narrow interpretation of allowable costs in determining the interchange fee standards

We strongly urge the Board to expand its definition of allowable costs that can be recovered through an interchange fee so that it is at a reasonable level that is proportional to the cost incurred by the issuer with respect to a debit card transaction. The statute specifically requires the consideration of the "incremental" cost of authorization, clearance, and settlement of a particular transaction. The Board however has ignored this requirement and only included the least expensive components of authorization, clearing and settlement costs, resulting in the two unreasonable alternatives set before us. The statute does not direct the Board to ignore all costs of doing business, or costs which are a component of debit card services.

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[3] Meeting of the Board of Governors of the Federal Reserve System Transcript, page 26 (Dec. 16 2010).

[4] Meeting of the Board of Governors of the Federal Reserve System Transcript, page 35 (Dec. 16 2010).

It is important to note that incremental costs of debit transactions occur over time, not just during the one year reporting period measured by the Board's survey. A longer-term view would make clear the argument that investments in computers, telecommunications, call center and facilities are incremental and have allowed for the significant growth in debit card transaction volume that has occurred over the years.

This measure of per transaction costs also does not consider fixed costs which are essential for a program to exist. The Board has acknowledged that excluding such fixed costs may prevent issuers from recovering expenses associated with debit card transactions.[5] In addition, the Board noted, but curiously discarded, a "commonly-used economic definition of incremental costs" that included fixed costs that could not be avoided if a good were not produced at all.

Network Fees

Network fees must be included in the definition of allowable costs to be recovered through interchange fees. Unlike with checks, debit card issuers are obligated to join networks that require payment of network fees to process transactions. The proposed rule specifically excludes network fees even though these are a significant cost that varies based on the number of transactions within a reporting period. These costs must be incurred as a necessary precondition for the transactions to occur. The Board itself notes that transactions cannot be authorized, cleared, or settled without an issuer paying costs such as network fees.[6] It must also be noted that the routing and exclusivity provisions of the proposed rule will require this particular cost component, as well as others associated with joining additional networks, to significantly increase in the coming years; yet there is no compensation to the issuers for this newly mandated cost.

Cardholder Inquiries

One of the most important costs that the Board considers fixed, but which in fact is incremental, is cardholder inquiries. Regulation E mandates that debit card holders be able to make inquiries to call centers and branches regarding error resolution of debit card transactions. Cardholder inquires are therefore incremental to settlement since a transaction cannot truly be considered settled if it can still be disputed under regulation. In addition, call centers are designed to service specific ranges of transaction volumes, most importantly anticipated peak volumes. Debit card transactions increase over time; therefore, call center resources are resized to accommodate this. The costs incurred in upgrading these resources are both incremental and variable with respect to debit card transactions as they were not accommodated by the prior level of resources. Thus these costs are specific to a particular group of transactions.

Debit Card Plastics and Personalization

Yet another cost that should be included in interchange is the cost of producing and maintaining cards. A transaction cannot be made unless a card is issued to a consumer. This is

[5] Debit Card Interchange Fees and Routing: Proposed Rule, 75 FR 81736 (Dec. 28, 2010).
[6] Debit Card Interchange Fees and Routing: Proposed Rule, 75 FR 81735 (Dec. 28, 2010).

even true whether or not the card is actually present to make a transaction. This is not a fixed cost, as it varies based on the size of the debit card program. Moreover, cards must be replaced if damaged, lost, stolen or expired. This includes situations where financial institutions reissue cards due to data breaches caused by the negligence of merchants. Cards themselves are integral to preventing fraud and include security features. These costs should be included in the interchange rate established by the Board.

Fraud Losses

The proposed rule fails to account for the significant costs associated with fraud losses absorbed by debit card issuers. Financial institutions suffer fraud losses as part of authorizing and settling transactions. As a top ten debit issuer, Navy Federal's fraud losses run into millions of dollars per year. As a matter of regulatory requirement and effective member service, we must be staffed to address fraud issues and prevention. Currently, interchange fees help to subsidize the cost of fraudulent transactions after fraud occurs. Fraud occurs as a result of merchants not properly obtaining authorization at the time of purchase and data breaches such as the one that occurred at TJX, Inc., in 2007. This single breach compromised over 45 million credit and debit card numbers. Information was stolen from one of TJX's systems, through no fault of the issuing financial institutions. As a result of the breach, banks and credit unions around the country had to block transactions and reissue millions of debit cards, at the issuer's, not the merchant's, expense. Moreover, financial institutions absorbed millions of dollars in fraud losses as a result of this one merchant's negligence.

Ironically, the day after the December 16, 2010 presentation of the proposed rule by the staff to the Board, Navy Federal, along with other debit card issuers, was faced with yet another merchant data breach. In this new merchant data breach alone, we suffered fraud losses in the hundreds of thousands of dollars and chose to reissue tens of thousands of debit cards -- at our expense, not the merchant's. We were confounded with the reality that under the Board's proposal, we would receive zero compensation from the merchant for their negligence in failing to protect consumer data. This is unfair and unreasonable. Today, we have cost recovery recourse for data breaches via the networks (albeit limited, not full cost recovery) but it is unclear whether or not this will be permissible in the future. By excluding fraud loss recovery in the permissible interchange fee, the Board will set up the situation where financial institutions may have little recourse but to sue merchants when breaches occur. That seldom happens today since interchange offsets such losses.

Merchant's claim that PIN transactions are inherently more secure and that issuers could reduce fraud losses and operating costs if all transactions were conducted by PIN. However, this assertion flies in the face of reality. The majority of debit transactions cannot be conducted using a PIN because merchants have chosen not to install PIN capable terminals. There are approximately eight million merchants in the U.S. who accept debit cards; however, only two million merchants accept PIN debit. For example, PIN is not generally used for restaurant, hotel, car rental, internet or telephone transactions. The Board recognized this in its comments, saying that 75% of all merchants in the United States are unable to accept PIN transactions at the point of sale.[7]

[7] Debit Card Interchange Fees and Routing: Proposed Rule, 75 FR 81723 (Dec. 28, 2010).

The Board did not accurately consider the functional differences between electronic debit transactions and checks when setting the interchange fee standard

Section 920 of the Act requires the Board to consider the functional similarity between electronic debit transactions and checks. However, we believe the Board should also consider the differences. The only commonality between the two instruments is that the source of funds of a completed transaction is the same transaction account. Debit card transactions are processed though multiple closed systems where both parties are contractually bound by a set of network rules. In addition, debit card transactions provide for dynamic authorizations and guarantees that provide merchants with comfort in accepting transactions from persons from whom they might not accept checks. It is impractical, if not impossible, to use checks for many transactions for which debit cards are routinely used, including places where the speed of transaction is important or when checks or cash are not practical for tender.

Checks are not a form of guaranteed payment. The board has taken an overly restrictive and incorrect view in comparing checks to debit cards by only considering a narrow range of costs incurred within the Federal Reserve System for clearing checks. This ignores the reality of other merchant costs associated with accepting checks such as non-sufficient funds losses, collection and handling expenses. The Board's commentary discusses how payment authorization is not an inherent part of the check acceptance process, and how merchants can purchase check guarantee services from third party vendors.[8] However, the Board fails to mention that the cost for these check guarantee services averages $1.16 per transaction.[9] In addition, once a debit card transaction is authorized, debit issuers are responsible for paying the merchant, even if after authorization funds are not available to cover the debit. Finally, merchants often assert that debit is not a guaranteed form of payment. This is simply not true. We believe that when making this assertion, merchants are confusing consumer chargeback rights available on some, but not all debit card networks, with fraud. A chargeback for merchandise not as promised by the merchant or for fraud is different than guaranteed payment of a transaction once authorized. We believe the Board did not consider any of these differences in its pricing comparison of debit cards to checks.

The network routing and exclusivity provisions will only serve to further reduce interchange below the Board standards, while simultaneously eliminating consumer protections

As stated within the proposed rule, networks will most likely price below any cap or safe harbor in order to obtain the merchant's routing preference.[10] This is the core result of a competitive marketplace. The merchant routing provisions would tend to put downward pressure on interchange fees in general, resulting in merchants steering transactions towards

[8] Debit Card Interchange Fees and Routing: Proposed Rule, 75 FR 81734 (Dec. 28, 2010).
[9] Average check written in 2009 is $1,167 per the Federal Reserve Payment Study. Check guarantee services in the industry on average is 100bps.
[10] Debit Card Interchange Fees and Routing: Proposed Rule, 75 FR 81738 (Dec. 28, 2010).

lower costs networks.[11] In addition, if the Board caps interchange at the low rate of $0.12 as proposed, the Board claims that 80% of the large non-exempt Financial insitutions will recover their costs. Conversely, this means that 20% of large non-exempt issuers won't even recover this narrow band of permissible costs. Moreover, other incremental and fixed costs for running a debit card program are not covered by the $0.12. The routing provision will result in even more financial institutions losing money on every debit transaction. The routing and exclusivity provision is also one of several reasons why the small issuer exemption will not work, as market forces will drive any two-tier interchange structure to converge to the lowest rate.

The language of the network routing provisions in the proposed rule also puts retailer profits ahead of consumer protection at the point of sale. The consumer no longer has a choice in which network their transactions will be routed. The merchant makes that decision for the consumer, a decision that results in higher profits for the retailer. As a result, consumers may lose the benefits and consumer protection available from a particular network, such as chargeback rights on a bad purchase or the zero fraud liability benefit in case of fraud as mandated by some networks, but not others. The current market actually mandates consumer benefits greater than does Regulation E. If the proposed rule is implemented, the zero liability benefit in the present market may disappear, resulting in potential consumer harm.

Impact on Gift Cards

One of the many unintended consequences resulting from this proposed rule is the end of gift card programs offered by many financial institutions. At Navy Federal, gift cards were never a money-making product. Interchange helps this marginal product breakeven. If the rule is implemented as written, many financial institutions will no longer be able to afford to issue these types of prepaid cards. Very likely, only closed-loop gift cards issued by merchants will remain as an option for consumers.

In addition, with the routing and exclusivity provisions, open loop network branded gift cards, like the ones we offer, will be required to have a PIN network option added. Such an option does not exist today. The result will be that consumers will be able to obtain cash via either the ATM and/or the cash-back at the point of sale feature available on all PIN-only debit networks. Accordingly requiring prepaid gift cards to add a PIN network option flies in the face of FINCEN's "Know Your Customer" (KYC) requirements. It is burdensome for the Board to expect financial institutions to obtain the identity of a gift card <u>recipient</u> so that it may know who has access to funds via an ATM or cash-back at the point-of-sale. The recipient does not buy the card, the gift card giver does. It is specifically for this reason -- potential money laundering concerns -- that we don't allow access to cash on gift cards through PIN networks. In addition to KYC requirements, we would have to build the capability for PIN generation; yet more complexity and expense. This is an extremely complex issue which should be fully researched and understood before including prepaid cards in the routing and exclusivity provision,

[11] Meeting of the Board of Governors of the Federal Reserve System Transcript, page 36 (Dec. 16 2010).

Specific Comments

We recognize that the Board has requested comments on several specific areas of the proposal. In response, we have included our comments below. However, we would like to reiterate that we do not support many of the underlying arguments at the foundation of the proposal. Even if our comments are ultimately incorporated into the final rule, we believe the Board went far beyond the intent of Congress in interpreting the statute. The current proposal is fundamentally flawed.

Definition of Account

Section 903 of the EFTA defines the term "account" to mean "a demand deposit, savings deposit, or other asset account...established primarily for *personal, family or household purposes...*"[12] However, the Board is proposing that business accounts, and therefore business debit card transactions, be included under the purview of EFTA Section 920. We do not believe that these transactions should be included, and thus be governed only under certain portions of a regulation. The purpose of this regulation is consumer protection, not small business protection, and the accounts and transactions covered should reflect this intent. Business debit card transactions are usually for larger dollar amounts and issuers need to be compensated for that risk.

Interchange Fee Standard Alternatives

The Board is forcing Navy Federal into the unfortunate dilemma of choosing between two interchange rate alternatives, neither of which meet the statutory intent of being "reasonable and proportional" to the costs we incur on debit card transactions. The first alternative would employ issuer specific standards, a safe harbor fee of seven cents per transaction and a total cap of a maximum of 12 cents per transaction. The second alternative would create a cap, permitting any fee up to 12 cents per transaction. If no other alternatives were available, we would favor proposed alternative two. This alternative reduces the compliance burden of both the Board and debit issuers. However, we must reiterate, that the cap does not come anywhere close to allowing for a reasonable and proportional cost recovery.

Within the calculation of allowable costs the Board used to determine the cap, they only reflected the cost data of a small subset of large and efficient debit card issuers. The Board did not survey financial institutions with assets less than $10 billion, resulting in only 60% of all debit card and prepaid card transactions being captured in the survey cost data.[13] The smaller issuers that were not surveyed most likely have higher costs associated with less efficient debit card operations due to smaller economies of scale.

While merchants will argue that these smaller institutions are "exempt," small community banks and credit unions will inevitably become caught up in controls imposed by this proposal. Accordingly, their costs should be reflected in this data. The Board acknowledges

[12] 15 U.S.C. 1693a(2).
[13] Debit Card Interchange Fees and Routing: Proposed Rule, 75 FR 81725 (Dec. 28, 2010).

this when it states that merchants would discriminate against small issuers by declining to accept their cards because there are "higher fees associated with accepting those cards." In order to become competitive, these small issuers will need to have interchange fees more in line with those charged by larger issuers under this regulation. The Board has also acknowledged within the proposal that only 80% of issuers would recover costs at 12 cents.[14] They are referring to large, non-exempt issuers. Therefore, if the Board approved this proposal as written, it will knowingly be forcing 20% of large, non-exempt issuers, and an unknown number of smaller, exempt issuers, to either operate at a loss, charge new fees or eliminate debit programs altogether.

Fraud Adjustment

The Board has proposed two potential options for determining a potential fraud adjustment. Under the first alternative, the Board would select the most useful anti-fraud technologies, determine the issuer's cost for implementing those technologies and permit some sort of upward adjustment to offset those costs. The second option would establish more general standards, requiring issuers to take reasonable steps to maintain an effective anti-fraud program. Issuers should be compensated for fraud prevention activities ***and*** fraud losses, including those that result from merchant data breaches.

If the Board refuses to accept this argument, we believe the only way fraud adjustments for specific technologies would work is if all stakeholders are required to participate. PIN debit, with or without a chip (EMV capable), is not a panacea for stopping fraud. In addition, chip and PIN would require a considerable investment on the part of merchants to buy and install the terminals. Requiring a fraud adjustment for an innovative new technology such as issuing chip and PIN enabled cards would be useless if there was not a place to use the cards. Moreover, not providing a fraud prevention adjustment for existing fraud prevention technology and systems ignores the effectiveness of existing systems that stop fraud and protect consumers today. Therefore, we support the second option which would establish more general standards.

Network Routing and Exclusivity Alternatives

The Board has proposed two options to implement the network routing and exclusivity provision of the proposal. Again, we recognize the constraint the statute places on the Board. Neither choice benefits consumers or financial institutions, only merchants. Under Alternative A, a debit card issuer would be required to provide two unaffiliated networks for routing PIN and signature transactions. Under Alternative B, debit cards would be required to be enabled to route PIN transactions over at least two unaffiliated networks and signature transactions over at least two unaffiliated networks. If provided with no other options, we believe Alternative A is the only realistic option. In order for Alternative B to even be technologically possible, it would first require massive changes to the existing debit card system for issuers, networks and merchants alike. Of course, this would come with additional expenses that issuers would not be compensated for.

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[14] Debit Card Interchange Fees and Routing: Proposed Rule, 75 FR 81737 (Dec. 28, 2010).

Alternative B would complicate how transactions would be identified, making back office operations nearly unworkable. The Board acknowledges that a requirement for multiple networks "could reduce the likelihood that the cardholder would be able to obtain benefits that are specific to a particular card network."[15] This would include zero liability, enhanced chargeback rights and text alerts for potential fraud. Some merchants have argued that Alternative A will not provide them any choice in routing decision; however, the Board's staff has stated that merchants will have the ability "to steer and to discount" and that there will be "some pressure on signature debit networks just due to the fact that merchants will have a little more flexibility."[16] Under Alternative A, Navy Federal will be forced to join an unaffiliated PIN network, adding additional expense and complexity to our operations. It will require us to select an appropriate network and make system, operational and procedural changes necessary to transact business on a new network. This is not trivial and cannot be done in the short time-frame between April and July 2011. With alternative A, we believe a more appropriate effective date would be April 2012 at the very earliest. This would help ensure all affected issuers and networks have sufficient time to support changes necessary to select and connect to a new network.

We implore the Board to do the right thing and not overreach by selecting Alternative B. Alternative A more than meets the ill-conceived statutory requirement for routing and exclusivity.

ATM Transactions

ATM transactions/networks should not be included in the scope of this rule. The entire focus of the Durbin Amendment is on merchant POS transactions, not on ATM transactions.

The interchange flow of ATM transactions is the reverse of debit POS transactions. The ATM owner (often a merchant) receives the interchange income from the transaction, and the financial institution (card issuer) pays it. This income reimburses the ATM owner for the cost of cash, the ATM and its maintenance, and the software that runs on the ATM. In short, including ATM transactions in the rules and reducing the interchange to the cost of the transaction will make owning an ATM too expensive for many retail outlets.

To compensate for the loss of interchange, the result could be additional harm to consumers in the form of an increase in surcharges and even a decrease in the number of ATMs available to the consumer. Another consideration is that there are no goods being purchased: the debit card is being used to access the cardholder's own funds, so there are no purchase costs for goods, no inventory carrying costs, no spoilage, none of the expenses associated with providing merchandise to a consumer.

There are multiple concerns with routing ATM transactions. Interchange income is only one reason that a particular network is chosen by a card issuer for routing. There are currently

[15] Debit Card Interchange Fees and Routing: Proposed Rule, 75 FR 81749 (Dec. 28, 2010).
[16] Meeting of the Board of Governors of the Federal Reserve System Transcript, page 40 (Dec. 16 2010).

several no-surcharge networks that pay ***higher*** interchange than other networks to the ATM owner. However, the card issuer chooses these networks for routing to save their members the cost of the surcharge. This is also beneficial to the card issuer who rebates surcharge fees. It is less expensive to pay the higher interchange than to reimburse a consumer for the cost of the surcharge. This is one of the reasons that it is imperative that the card issuer retains the ability to choose the network over which the transaction is routed. Since the issuer provides the card and pays the interchange, the routing choice needs to remain the issuer's decision. Issuers have the burden of the expense, so there is no need for expanded choice of routing to be applied to ATM networks. Issuers choose to join the networks that provide them and their customers with the pricing and service that is required. There also are expenses associated with joining additional ATM networks. There are IT costs, multiple systems to be maintained for processing returns and chargebacks, training costs associated with maintaining multiple networks, and employee time to settle multiple networks daily.

Conclusion

In conclusion, we urge the Board to:

- Determine the impact of the rule on consumers, financial institutions and the payments industry as a whole prior to implementation as required under EFTA;

- Expand its definition of allowable costs that can be recovered through an interchange fee to include all costs specific to operating a debit card program, including essential incremental costs such as network fees, cardholder inquiries, debit card plastics and personalization, and fraud losses;

- Consider the differences between checks and debit card transactions, such as guaranteed payment, when determining a reasonable and proportional rate of interchange;

- Exclude prepaid cards from the network exclusivity and routing provisions of the final rule;

- Exclude business accounts, and therefore business debit card transactions, from the definition of account in the final rule; and

- Exclude ATM transactions from the definition of covered transactions within the final rule.

If the aforementioned considerations cannot be made in the final rule, we therefore urge the Board to:

- Select the second interchange fee standard of a 12 cent cap per debit card transaction;

- Select the second option of general fraud prevention standards for the fraud adjustment; and

- Select alternative A, requiring two unaffiliated networks for routing PIN and signature transactions on each debit card.

We believe the Board has discretion to delay implementation of the rule, affording time to conduct a thorough study of its impact, since the statute merely requires the Board to establish standards for determining whether interchange is reasonable and proportional. There is regulatory precedent for such a delay. In addition, there is an argument that interchange rates are reasonable and proportional today in light of the time that would be needed by the industry to make the significant and structural changes necessary to comply with all aspects of the rule. We believe that the Board could establish a time table to "ratchet-down" interchange rates over time.