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February 22, 2011

Jennifer J. Johnson  
Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Ave. NW  
Washington, DC 20551

Re: **Docket No. R-1404**  
**RIN No. 7100 AD63**  
**Proposed New Regulation II, Debit Card Interchange Fees and Routing**  
**75 Federal Register 81722-81763 (December 28, 2010)**

Dear Ms. Johnson:

Popular, Inc. ("Popular"), a diversified, publicly owned bank holding company with \$38.3 billion in total assets and the largest financial institution based in Puerto Rico, respectfully submits these comments to the Federal Reserve Board (the "Board") in response and opposition to proposed new Regulation II, Debit Card Interchange Fees and Routing published in the Federal Register on December 28, 2010, 75 Fed. Reg. 81722 (December 28, 2010) (the "Proposed Rule"). Popular was founded in 1893 and has two banking subsidiaries, Banco Popular de Puerto Rico ("BPPR") and Banco Popular North America ("BPNA"). BPPR is the largest commercial bank in Puerto Rico and BPNA is a community-banking franchise with branches in New York, New Jersey, Illinois, Florida and California. Popular also holds a forty-nine percent interest in EVERTEC, Inc., a merchant acquiring and processing and technology business that provides services throughout the Caribbean and Latin America.

Popular appreciates the opportunity to provide the Board with comments on the Proposed Rule. Popular opposes the Proposed Rule because it: (i) does not permit our banks to cover the cost of providing debit card transactions; (ii) will force banks to consider new maintenance and other fees on checking accounts; (iii) does not account for fundamental differences between debit transactions and checks; and (iv) establishes government price controls that are inappropriate for debit card transactions.

Popular therefore urges the Board to exercise discretion to the maximum permitted under the statute and change certain aspects of the Proposed Rule as set forth below to mitigate the potential unintended harm that it may cause. For the Board's convenience, we begin our comments with the Scope of Rule, and then address certain sections of the Proposed Rule in the order in which they appear.

**Scope of Rule (Coverage of ATM Transactions and Networks)**

In response to the Board's request for comment, ATM transactions and networks should not be included within the scope of the Proposed Rule. The Dodd-Frank Wall Street Reform and Consumer

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Protection Act's (the "Dodd-Frank Act"), Pub. L. 111-203, 124 Stat. 1376 (2010), amendments to the Electronic Fund Transfer Act, 15 U.S.C. § 1693 et. seq., provide that the Board may prescribe regulations regarding any interchange fee that an issuer may receive or charge with respect to an electronic debit transaction. Since interchange fees for ATM transactions are traditionally paid by, and not received or charged by, the issuer, it seems that the legislative intent was not to delegate to the Board the authority to prescribe regulations regarding ATM transactions and networks.

In addition, the pricing and fee structure of the highly competitive ATM industry is substantially different from the debit interchange fee structure for merchants, which seems to be the focal point of Section 1075 of the Dodd-Frank Act. ATM fees are charged between banks, and merchants are not charged for this service by banks. ATMs provide customers with convenient access to bank accounts at numerous locations, and extending the proposed rule to ATM transactions will pressure banks to require new fees and reduce the number of ATM locations. Therefore, if the Proposed Rule increases the cost of ATM administration, it will have the unintended consequences of reducing ATM availability and forcing consumers to modify their behavior and carry higher amounts of cash.

In response to the Board's request for comment, if ATM networks and ATM transactions are included within the scope of the Proposed Rule, implementation of the network exclusivity provision will be easily achieved as the ATM networks' industry is highly competitive and a majority of issuers has more than one unaffiliated network option available on its cards. If the Board requires two unaffiliated networks for each authorization method, it should not be necessary to require an issuer to ensure that ATM transactions may be routed over at least two unaffiliated networks because the ATM network's business model is generally highly competitive and already offers this feature. Based on the above, there is no need for the Board to state that one point-of-sale debit network and one ATM-only network would not satisfy the exclusivity prohibition under either proposed alternative.

#### **Scope of Rule (*Coverage of three-party systems*)**

Popular requests additional examples of three-party systems.

#### **§235.2(m) Payment card network**

In response to the Board's request for comment on whether other non-traditional or emerging payment systems would be covered by the statutory definition of "payment card network," non-traditional or emerging payment systems should be covered by the statutory definition of "payment card network" in order to avoid a differentiation that promotes unfair competition among service providers. If nontraditional or emerging payments systems are not included within the scope of the Proposed Rule, financial institutions will have a competitive disadvantage.

#### **§ 235.3 Reasonable and proportional Interchange transaction fees (Activity Costs to be Considered)**

In response to the Board's request for comment on whether it should allow recovery through interchange fees of other costs of a particular transaction beyond authorization, clearing, and

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settlement costs, Popular strongly urges the Board to exercise discretion to the maximum permitted under the statute and allow the inclusion of all costs that are specific to a particular transaction such as network fees, cost of inquiries and disputes, fraud losses and fraud prevention costs, fixed costs, including capital investments, and a reasonable profit and return on capital, among others.

Debit transactions are fundamentally different from checks. In calculating the permissible interchange fee, the proposal does not recognize important differences between debit cards and checks, and the fact that there are substantial benefits associated with electronic debit transactions that are not available with standard checking transactions. This includes the fact that in transactions where the card is present, merchants are guaranteed payment and the issuer suffers the loss in the event there are no funds or a valid account. Checks may be returned unpayable and merchants suffer the loss. In contrast, electronic debit transactions offer merchants a guarantee of settlement and faster settlement, features not available in checking transactions.

In response to the Board's request for comment on what other costs of a particular transaction, including network fees paid by issuers for the processing of transactions, should be considered allowable costs, Popular strongly urges the Board to exercise discretion to the maximum permitted under the statute and allow the inclusion of network fees, cost of card plastic issuance, replacement and marketing costs, cost of inquiries and disputes, fraud losses and fraud prevention costs, customer service, fixed costs, including capital investments, debit program research and development, systems maintenance costs, compliance costs, costs related to alleged and actual data breaches, and a reasonable profit. The Board should also consider the risks related to settlement methods (online or offline), card present and card not present transactions, industry category, and country and currency risk.

In response to the Board's request for comment on whether it should limit allowable costs to include only the costs of authorizing a debit card transaction, the Board should exercise discretion to the maximum permitted under the statute and include as allowable costs all possible costs related to a transaction.

### **§ 235.3 Reasonable and proportional interchange transaction fees (Cost Measurement)**

In response to the Board's request for comment on whether it should include fixed costs in the cost measurement, or alternatively, whether costs should be limited to the marginal cost of a transaction, Popular urges the Board to exercise discretion to the maximum permitted under the statute and consider fixed costs that are specific to a particular transaction such as capital investments in technology, including accounting and information systems, customer service support, debit card management, and research and development, among others.

In response to the Board's request for comment on how the marginal cost for a transaction should be measured, Popular is opposed to the proposed marginal cost measurement as it will result in a highly complex measurement that is very difficult to implement and excludes important considerations

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regarding the continuous need for reinvestment in technology and equipment. Popular strongly urges the Board to exercise discretion to the maximum permitted under the statute and include as allowable costs all possible costs related to a transaction.

**§ 235.3 Reasonable and proportional interchange transaction fees (Proposed Interchange Fee Standards)**

In response to the Board's request for comment on Alternative 1 and Alternative 2, as well as on any other alternatives that could be applied, Alternative 2 is preferable over Alternative 1, but the cap of twelve cents needs to be adjusted for costs directly associated to the debit card business in order to avoid unintended consequences.

Low and moderate income customers generally prefer accounts with no or low maintenance and other fees. If the final rule does not permit banks to cover the cost of providing debit card transactions, banks will be forced to implement new maintenance and other fees on checking accounts, and low and moderate income customers will find it more difficult to maintain a bank account and will have to turn to more expensive, less convenient, non-traditional banking services. Therefore, the proposed cap will have the unintended consequence of adversely impacting customers who search for accounts with no or low fees, and neutralize the banks' investment in products and services for the traditionally unbanked market. The Board should also consider the risks related to settlement methods (online or offline), card present and card not present transactions, industry category, and country and currency risk before establishing a cap.

If interchange transactions fees are too low and do not allow issuers to receive a reasonable return on investment, the issuers will need to discontinue their money-losing debit programs or seek subsidizing revenue from other sources to sustain operations. Subsidies could include new or higher fees associated with checking accounts, or reduction of cardholder benefits.

Some markets, like Puerto Rico, are considered "international" by most networks and are subject to a fee structure that is higher than the fee structure for banks located in the "continental" United States. The implementation of a cap that applies equally to all issuers will place an unfair burden on issuers that have a higher fee structure than the sample reviewed by the Board.

In addition, government price controls are inappropriate for debit card transactions and do not work. Price controls will lead to inefficiencies in the payment system and will stifle innovation and improvements.

**§ 235.3 Reasonable and proportional interchange transaction fees (Proposed interchange fee standards – Cap)**

In response to the Board's request for comment on whether it should allow for differences in the cap or safe harbor values for signature and PIN debit transactions, the Board should not distinguish between the cap and safe harbor values for signature and PIN debit transactions as long as the Board

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considers the risks related to settlement methods (online or offline), card present and card not present transactions, industry category, and country and currency risk.

**§ 235.3 Reasonable and proportional interchange transaction fees (Proposed Interchange Fee Standards – Application of the Interchange Fee Standard)**

In response to the Board's request for comment on the two other potential methods for implementing the interchange fee standards, they are operationally complex and difficult to implement as it will be difficult to inform acquirers and merchants their fees ahead of time under the first approach, and it is not clear if all issuer institutions will be responsible for the noncompliance of other institution(s) under the second approach.

**§ 235.4 Adjustment for Fraud-Prevention Costs**

In response to the Board's request for comment on whether the Board should adopt technology-specific standards or non-prescriptive standards that an issuer must meet in order to be eligible to receive an adjustment to its interchange fee, the Board should adopt non-prescriptive standards.

Investment in technology and fraud prevention support for debit cards should be considered as part of the proposed cap per transaction. This type of investment helps protect customers, merchants and financial institutions.

In response to the Board's request for comment on what technology or technologies should be required if the Board adopts technology-specific standards, the establishment of technology standards should not be adopted, as based on the general rate of technological improvements and innovation these standards could become obsolete in a short time period, will not encourage innovation, and will not allow financial institutions an adequate or reasonable time period to recover their investments.

In response to the Board's request for comment on how should the standard differ for signature-and PIN-based debit card programs, standards should not differ for signature or PIN-based debit cards, and the Board should not underestimate the fraud-related risks and losses for PIN-based debit card programs.

In response to the Board's request for comment on whether the Board should consider adopting an adjustment for fraud-prevention costs for only PIN-based debit card transactions, but not signature-based debit card transactions, at least for an initial adjustment, particularly given the lower incidence of fraud and lower chargeback rate for PIN-debit transactions, Popular proposes that the adjustment for fraud-prevention costs should be applicable to PIN-based and signature-based debit card transactions.

In response to the Board's request for comment on whether the Board should adopt the same implementation approach for the adjustment that it adopts for the interchange fee standard, that is, either (1) an issuer-specific adjustment, with a safe harbor and cap, or (2) a cap, the Board should adopt the same implementation approach.

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**§ 235.5(a) Exemption for Small Issuers**

The safe harbor provides no protection to small issuers from market forces. Although the statute attempts to exempt smaller institutions from the price control elements, economic forces will force small issuers to adopt the same price level or risk losing market share to the largest institutions. The price differential between cards will give merchants a strong incentive to steer customers to use cards of the larger institutions and to partner with large institutions to move their accounts to the larger institutions. Small issuers will be subject to the same regulatory cap.

**§ 235.5(b) Exemption for Government-Administered Programs**

In response to the Board's request for comment on whether it should establish a certification process or whether it should permit payment card networks to develop their own processes, the payment card networks should develop their own processes.

In response to the Board's request for comment on how to structure a certification process, including the time periods for reporting and what information may be needed to identify accounts to which the exemption applies, certain cards issued under a government-administered payment program may be distinguished by the BIN or BIN range.

**§ 235.5(c) Exemption for Certain Reloadable Prepaid Cards (Certification)**

In response to the Board's request for comment on whether it should establish a certification process for the reloadable prepaid cards exemption or whether it should permit payment card networks to develop their own processes, the payment card networks should develop their own processes.

Reloadable Prepaid Cards should be included in the scope of the Proposed Rule, otherwise banks would be placed at a competitive disadvantage since customers might migrate to such cards. The debit card market currently offers numerous prepaid card alternatives. In order to understand the scope of the exemption for reloadable prepaid cards, Popular requests additional guidance and examples of electronic debit transactions that will be subject to the exemption.

In response to the Board's request for comment on how it should structure the certification process if it were to establish a process, including the time periods for reporting and what information may be needed to identify accounts to which the exemption applies, the Board should develop a standard report by BIN from issuers or networks.

**§ 235.7(a) Prohibition on Network Exclusivity**

In response to the Board's request for comment on two alternative approaches for implementing the restrictions on debit card network exclusivity, Popular considers that Alternative A is preferable. Alternative B will require card issuance with various network logos that will lead to consumer confusion.

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Popular requests further clarification on the following:

(1) Popular requests guidance on the requirements for PIN only cards. Some banks issue a limited number of PIN only cards that provide little functionality and are directed at a low and moderate income consumer base. The profitability structure for these cards is subject to very thin profit margins. If a signature or second PIN option is required for these cards, the product complexity and costs – processing, brand fees, and fraud, among others – will increase significantly without the existence of the income necessary to support it. The new requirements will likely cause the elimination of these products (mainly savings accounts), reduction of services and probably growth in the unbanked population. Popular would like to know whether PIN only cards will be exempt from the minimum two network requirement.

(2) Popular requests further guidance on what is meant by acceptance “throughout the United States.” In some regions, like Puerto Rico, there is very limited coverage of networks that are “accepted throughout the United States,” and the requirement of having two such unaffiliated networks on which an electronic transaction may be processed will just increase costs and will not provide any significant benefit to merchants and consumers. Therefore, Section 235.7(a)(2) should allow regional networks to satisfy the requirement of having two unaffiliated payment card networks on which an electronic transaction may be processed in markets or regions where networks that are accepted throughout the United States have limited coverage.

In response to the Board’s request for comment on both proposed alternatives for implementing the prohibition on network exclusivity arrangements under EFTA Section 920(b)(1)(A), Alternative A is preferable.

The Board should adopt Alternative A in implementing the routing requirement. Alternative A limits the expense of managing unneeded relationships with additional networks and increases the number of PIN network routes available for merchants. Alternative B would require the banks to have and manage multiple PIN network relationships, creating costs with little benefit. Alternative B would require multiple signature networks be deployed on one card. This is impractical as currently the signature card payment systems do not support such a choice. In addition, Alternative B would require re-issuance of cards in many cases, an unnecessary expense and an inconvenience to customers.

In response to the Board’s request for comment on whether ninety (90) days provides sufficient time for issuers to negotiate new agreements and add connectivity with the additional networks in order to comply with the rule, ninety (90) days is not enough and one (1) year would be more appropriate in order to allow adequate time to address contract revision and amendment and compliance reviews.

In response to the Board’s request for comment on whether adding at least a second unaffiliated signature debit network could inhibit the development of these devices in the future and what steps, if any, the Board should take to avoid any such impediments to innovation, Popular

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proposes that new card-like devices should be exempt from the prohibition on network exclusivity for period of time until they can achieve critical mass and reasonable acceptance.

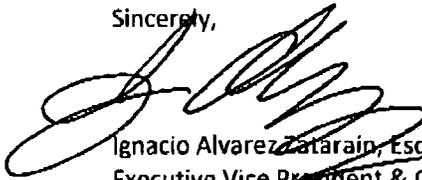
**§235.7 Effective Date**

In response to the Board's request for comment on a potential effective date of October 1, 2011, for the provisions under § 235.7 if the Board were to adopt Alternative A under the network exclusivity provisions, or alternatively, an effective date of January 1, 2013 if Alternative B were adopted in the final rule, Popular understands that the proposed effective dates for Alternative A and Alternative B should be extended for at least one year to allow networks to manage the necessary amendments to the significant amount of agreements with issuers.

For the reasons stated above Popular is opposed to capping interchange fees at 7 or 12 cents. It will have a significant impact on our banks, our customers and our operations. We are also opposed to the adoption of Alternative B for routing debit transactions. Alternative A is a more practical approach.

On behalf of Popular, I thank you for this opportunity to comment on the Board's proposed new Regulation II, Debit Card Interchange Fees and Routing, and hope that you find our comments useful. If you have questions on any aspects of this letter, please call me at (787) 758-7208, Mardi Colón at (787) 751-9800 extension 316983, or Manuel Chinaea at (847) 994-6561.

Sincerely,



Ignacio Alvarez Zatarain, Esq.  
Executive Vice President & Chief Legal Officer  
General Counsel & Corporate Matters Group  
Popular, Inc.