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

Re: Proposed Regulation II; Docket No. R-1404

Dear Ms. Johnson:

This letter is submitted on behalf of Wells Fargo & Company and its affiliates ("Wells Fargo") in response to the Proposed Rule implementing provisions of Section 1075 of the Dodd Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), which amends the Electronic Fund Transfer Act ("EFTA"), published in the Federal Register on December 28, 2010, at 12 CFR Part 235 (the "Proposed Rule"). Wells Fargo appreciates the opportunity to comment and respectfully requests the members of the Board of Governors of the Federal Reserve System ("Board") to consider adopting the suggestions set forth herein.

The Wells Fargo vision to satisfy all of our customers' financial needs and to help them succeed financially is a driving force in the way we do business. Engaging in responsible lending practices, encouraging consumers to make responsible and successful financial choices and conducting business with honesty and integrity, are already at the heart of our vision. It is our practice to build our business processes and strategies in compliance with all applicable laws and regulations.

This letter provides Wells Fargo's comments to the Proposed Rule as well as further requests for additional clarification based upon the Proposed Rule.

Summary of Key Comments:

<u>The Proposed Rule is Inconsistent with the Statute's Requirements</u>

- **Price Caps Not Required**: The statute does not require proposing price caps on interchange transaction fees. It requires the Board to establish standards for assessing whether the amount of any interchange transaction fee is reasonable and proportional to the cost incurred by the issuer.
- **Reasonable and Proportional Standard Applies to Fees, Not Costs**: The statutory "reasonable and proportional" test applies to interchange transaction *fees* and their relation to actual costs incurred by the issuer. The Proposed Rule incorrectly applies the "reasonable and proportional" standards to *costs* incurred by issuers and in doing so improperly excludes actual costs incurred by issuers which should be considered.
- **Costs Not Properly Considered**: The only type of costs specifically excluded by the statute when establishing standards is for "other costs which are not specific to a particular electronic debit transaction." The statute does not otherwise limit the types of allowable costs the Board should consider when establishing these standards. Accordingly, the Board must consider *all* costs actually incurred by an issuer, including incremental costs for the issuer's role in authorization, clearance, or settlement, and all fraud-prevention costs.
- **Section 904 of the Electronic Fund Transfer Act**: In prescribing the Proposed Rule, the Board is required to follow the requirements of Section 904 of the EFTA. Namely, it appears the Board did not: (1) consult with the other agencies referred to in Section 917 and take into account, and allow for, the continuing evolution of electronic banking services and the technology utilized in such services, (2) prepare an analysis of economic impact which considers the costs and benefits to financial institutions, 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 and the availability of such services to different classes of consumers, particularly low income consumers, or (3) to the extent practicable, demonstrate that the consumer protections of the Proposed Rule outweigh the compliance costs imposed upon consumers and financial institutions.

<u>Non-Prescriptive Adjustments for Fraud-Prevention Costs are Imperative and Should be Established Concurrently with Proposed Rule</u>

- Issuers incur considerable fraud-prevention costs from which all parties in an electronic debit transaction benefit. Accordingly, it is reasonable and necessary for the Board to exercise its authority to make adjustments to the interchange transaction fee for these costs.
- Any adjustment to the interchange transaction fee for fraud-prevention should be non-prescriptive to ensure flexibility in responding to emerging and changing fraud risks. By contrast, a technology-specific approach is inflexible, could cause issuers to under-invest in other innovative new technologies, and would provide

fraudsters with valuable information to adapt to and circumvent fraud prevention efforts.
- Fraud prevention costs are equally relevant as other costs permitted by the statute. Wells Fargo applauds the Board's recognition that allowing an adjustment for fraud prevention costs is reasonable and necessary and urges the Board to establish such standards concurrently with the rest of the Proposed Rule.

The Statute Only Requires Two Unaffiliated Networks

- As the Board notes in the preamble to the Proposed Rule, "nothing in EFTA Section 920(b)(1)(A) specifically requires that there must be two unaffiliated payment card networks available to the merchant once the method of debit card authorization has been determined."
- Compared to Alternative B, Alternative A reduces consumer confusion with fewer networks on each debit card, will be less costly to implement, and will be less costly to operate.
- EFTA Section 920(b)(1) does not require networks to have national coverage, but only requires the networks to be unaffiliated.
- If the Board were to adopt Alternative A, the effective date should be no sooner than one year after the date final rules are published by the Board.

Circumvention or Evasion Should be Reviewed on a Case-by-Case Basis

- Wells Fargo agrees that circumvention or evasion should be reviewed on a case-by-case basis. However, circumvention or evasion does not necessarily occur in every situation where an issuer receives net compensation from a payment card network with respect to electronic debit transactions. There may be situations where parties participate in optional value-added services facilitated by a payment card network and agreed to by a merchant that result in net compensation to the issuer. This should not be considered circumvention or evasion.
- Signing bonuses should not be a factor in determining whether circumvention or evasion has occurred as they are not specific to an electronic debit transaction.

The Statute Does Not Regulate the Amount of Network Fees

- Wells Fargo agrees with the Board that the statute does not directly regulate the amount of network fees that a network may charge for its services, and that the Proposed Rule also should not set or establish the level of such network fees.
- Payments or incentives should not include settlements of fraud transactions negotiated or received by payment card networks on behalf of issuers.

Scope of Rule Should be Limited to "Accounts" as Defined in EFTA Section 903(2) and Should Not Include ATM Systems

- Congress' legislative intent indicates that the definition of "account" should include only accounts established primarily for personal, family, or household purposes, and specifically exclude business accounts and accounts held by financial institutions pursuant to bona fide trust agreements, in accordance with the EFTA.

- The usual and customary use of ATMs for access to, and deposit of, cash should not be included in the scope of the Proposed Rule.

Scope of Rule Should Consider Three-Party Systems and Emerging Payment Systems

- Wells Fargo believes the Board needs to define regulations that apply to all payment card networks. However, the Board needs to consider emerging payment systems and three-party systems where some elements of the Proposed Rule, such as multiple network routing, may not be practical. The Board needs to ensure while they are trying to establish a fair competitive environment, they do not stifle innovation.

Stated Congressional Intent Supports an Exemption for HSAs and Other Employee Benefit Program Accounts

- Statements made by senior House and Senate Members demonstrate the clear intent by Congress to exempt electronic debit transactions made using debit cards associated with HSAs and other employee benefit program accounts, including FSAs, HRAs and qualified transportation accounts, from the interchange transaction fee restrictions and network exclusivity provisions of the statute.

The Proposed Rule May be Inconsistent with the President's January 18, 2011 Executive Order

- In contrast to the President's January 18, 2011 Executive Order, the Proposed Rule does not appear to result from a reasoned determination that its benefits justify its costs. The costs to consumers, in the form of higher fees (which the Board acknowledges) and loss of existing benefits, will be substantial. In addition, the industry will incur enormous costs to comply with the exclusivity and routing requirements, and suffer an unreasonable loss of interchange revenue. None of these costs have been shown to justify any purported benefits. Moreover, the Proposed Rule does not guarantee any direct benefit for consumers and any such benefits will actually flow directly to merchants.
- The Board did not tailor its Proposed Rule to ensure the least burden is imposed on society. To the contrary, the Board's proposed price caps and narrow approach to allowable costs (including its deferment of any consideration of fraud-prevention costs) will impose a tremendous burden on consumers who use debit cards as well as the entire debit card industry.
- The Board, in proposing these rules, did not seek to identify a means to achieve regulatory goals that are designed to promote innovation. By contrast, the Proposed Rule will likely stifle innovation and result in increased costs to consumers and a reduction or possible elimination of debit card services and benefits they currently enjoy today.

Discussion:

I. Section 235.3: Reasonable and Proportional Interchange Transaction Fees

A. Board Required to Establish Standards for Assessing Whether Interchange Transaction Fee is Reasonable and Proportional to Issuer's Cost

No Requirement to Establish a Cap

In proposing a price cap on interchange transaction fees, the Board has exceeded the mandate of the statute.

EFTA Section 920(a)(3) directs the Board to "establish standards for assessing whether the amount of any interchange transaction fee . . . is reasonable and proportional to the cost incurred by the issuer with respect to the transaction." Rather than establishing "*standards* for assessing" whether interchange transaction fees are reasonable and proportional, the Board has already made a determination, by setting specific price caps, of what it deems is a reasonable and proportional interchange transaction fee, which is contrary to the requirements of the statute. Had Congress intended for the Board to have such authority, it could have directed the Board to "establish what a reasonable and proportional interchange transaction fee is" but clearly chose not to. By requiring the Board to establish "*standards* for assessing," Congress clearly intended for the Board to establish guidelines or a framework of rules for determining whether an interchange transaction fee was reasonable and proportional.

Safe Harbor Alternative to Price Caps

The Board's proposed cap on interchange transaction fees is not required by the statute, but it also infers that the Board believes there is no difference in the cost of an electronic debit transaction based on the dollar amount of the transaction. Based on Wells Fargo's actual experience, that is not a valid assumption. The Board's conclusion may be a result of not having enough time to capture, and issuers not having enough time to collect, more robust transaction information during the survey process. Wells Fargo's experience has been that while some costs are based on the transaction, there are cost components that are directly attributable to the dollar value of the transaction.

As an alternative for the Board to comply with the statute, Wells Fargo proposes a safe harbor approach without a cap. The Board's proposed safe harbor of $.07 significantly understates the actual costs of a debit card transaction that are to be considered under the statute. The proposed cap of $.12 is also significantly below actual costs and crowds out a significant number of higher dollar transactions performed by consumers and small businesses. Wells Fargo recommends setting a safe harbor that is an average effective rate that approximates current interchange levels. With the question looming as to whether all costs were properly included, this would set a standard from which the Board could anchor and adjust without injecting significant risk into the payment system. This methodology would also be consistent with EFTA Section 920 and preserve the flexibility of the current system that has evolved over the years from market forces in response to cost and risk.

Wells Fargo further recommends that the Board implement Alternative A, which would require a debit card to have at least two unaffiliated payment card networks available for processing an electronic debit transaction, no sooner than one year after the date final rules are published by the Board. In order to allow sufficient time for the Board to review and analyze the impact of Alternative A on competition and interchange transaction fees, gather additional cost data, and conduct further study of interchange transaction fees and issuer costs, we recommend the Board review the safe harbor no sooner than July, 2013, to determine whether an adjustment is warranted.

The safe harbor alternative would put a standard in place and prevent increases in interchange transaction fees while the Board conducts its study and analysis.

Board Takes an Improperly Narrow View of the Types of Allowable Costs

The Board appears to be engaging in an unnecessary analysis of whether issuers' *costs* are reasonable and proportional, which is not sanctioned by the statute. The statutory "reasonable and proportional" test applies to interchange transaction *fees* and their relation to actual costs incurred by the issuer. The statute first requires the Board to determine actual costs incurred by the issuer, and once actual costs are determined, the statute requires the Board to establish standards for assessing whether the interchange transaction fee is reasonable and proportional in relation to those costs. The Board is only required to specifically exclude "other costs which are not specific to a particular electronic debit transaction," as required by EFTA Section 920(a)(4)(B)(ii). All other actual costs incurred by issuers, which are not specifically excluded by the statute, must be considered. Moreover, a fee cannot be "reasonable" if it does not include any reasonable profit to the issuer or cover all of the issuer's costs associated with the transaction. It's notable that Congress did not use the terms "equivalent to" or "limited to" when describing the interchange transaction fee and its relation to an issuer's costs. Clearly, Congress contemplated issuers charging an interchange transaction fee that covered their actual allowable costs and earned a profit that was reasonable and proportional to those costs.

B. Considerations for Standards

1. Similarities to Check

Board Improperly "Considers" Functional Similarity Between Electronic Debit Transactions and Checking Transactions

The Board correctly acknowledges that EFTA Section 920 only requires the Board to "consider" the functional similarity between electronic debit transactions and checking transactions. However, the Board's reliance on this mandate to "consider," as a basis for unilaterally excluding core components of issuers' costs, is misplaced. The statute's requirement in Section 920(a)(4)(A) to "consider the functional similarity between (i) electronic debit transactions; and (ii) checking transactions that are required . . . to clear at par" does not compel the Board to ensure these payment systems are priced equally or even similarly. More importantly, it does not require or even permit the Board to ignore actual costs incurred by issuers. Rather, it simply requires the Board to conduct a comparison between the two payment systems as part of prescribing regulations to establish standards for assessing whether any interchange transaction fee is reasonable and proportional to the cost incurred by the issuer. In fact, in considering the functional similarities, it also necessarily includes comparing the differences between these payment systems, which the Board acknowledged. The considerable differences in these payment systems, in particular, the benefits bestowed on merchants when accepting debit payments (such as faster payments and guaranteed payment), do not justify ignoring real and actual costs incurred by issuers, such as network processing fees and customer service costs.

In short, the requirement to consider the functional similarities does not require or allow the exclusion of actual costs incurred by issuers. Section 920(a)(4)(B)(ii) is the *only* section that specifically requires the exclusion of certain types of costs from consideration, and it limits that exclusion *only* to "other costs which are not specific to a particular electronic debit transaction." Likewise, that section does not provide the Board license to ignore the costs of any one type of authorization method, such as signature debit.

2. Statute Requires All Costs to be Considered, Except Those Specifically Excluded

<u>Statute Does Not Direct the Board to Limit Allowable Costs Only to Incremental Costs Associated with Authorization, Clearance and Settlement</u>

The Board takes an unnecessarily limited and unduly restrictive approach to costs it proposes should be permitted for consideration when establishing standards for assessing whether a fee is reasonable and proportional to the cost incurred by the issuer.

By directing the Board to establish standards for assessing whether the amount of any interchange transaction fee is reasonable and proportional to "the *cost* incurred by the issuer," section 920(a)(3)(A) requires the Board to consider all of an issuer's costs, except those described in Section 920(a)(4)(B)(ii) which are not specific to any particular electronic debit transaction. While section 920(a)(4)(B)(i) contains a specific directive to the Board to *include* incremental costs of authorization, clearance, or settlement, it does not direct the Board to do so *to the exclusion of any other types of costs*. Other types of costs that should be considered include, but are not limited to, the costs of issuing debit cards, providing customer service and communications with respect to electronic debit transactions, customer alerts, money management tools, instant card issuance, rewards programs, and network fees.

EFTA Section 920(a)(4) only requires the Board to "distinguish" between those incremental costs and "other costs" which are *not specific* to a particular electronic debit transaction and does not provide a comprehensive list of the only types of costs the Board shall consider when prescribing regulations to establish standards for assessing whether an interchange transaction fee is reasonable and proportional. Rather, the direction given to the Board by Section 920(a)(4) is merely *in addition to* all other issuer costs the Board must and reasonably should consider.

The only limiting language regarding costs is in Section 920(a)(4)(B)(ii). That section provides that "other costs," which are not specific to a particular electronic debit transaction, shall not be considered when prescribing regulations to establish "standards for assessing," and notably, it does not mandate that other costs be excluded. Beyond that language, there is no support for the Board's interpretation that Section 920(a)(4) limits its consideration of costs only to the "incremental costs" described in 920(a)(4)(B)(i). Had Congress intended the Board's very narrow interpretation of this section, it would have indicated that incremental costs of authorization, clearance, or settlement "shall be the *only* costs considered" by the Board. Even as the Board correctly points out, the statute does not prohibit consideration of "other costs" which are *specific* to a particular transaction and are not incremental costs incurred by the issuer for its role in authorization, clearance or settlement. To the contrary, section 920(a)(3)(A) directs the Board to consider these, and all other costs incurred by the issuer with respect to an electronic debit transaction. Other types of costs that should be considered include, but are not limited to, costs of issuing debit cards, providing transaction authorization and settlement status to customers as a convenience, providing transaction settlement information as required by law, handling reactive customer inquiries related to the authorization and settlement of a transaction, generating proactive queries to the customer in response to a particular electronic debit authorization query, customer alerts, money management tools, instant card issuance, and rewards programs.

In addition, issuers pay network fees to payment card networks for each transaction processed over those networks. As noted by the Board, "although these network fees typically are not associated with one specific component of authorization, clearance, or settlement of the transaction, a particular transaction cannot be authorized, cleared, and settled through a network unless the issuer pays its network processing fees." EFTA Section 920(a)(4)(B)(i) requires the Board to consider "the incremental cost incurred by an issuer *for the role of the issuer in the authorization, clearance, or settlement of a particular debit transaction*." (*Emphasis added*). Since network fees paid by the issuer are integral to the authorization, clearance, and settlement of a particular electronic debit transaction, such fees should be considered by the Board when establishing standards for assessing whether an interchange transaction fee is reasonable and proportional to the *cost* incurred by the issuer.

Finally, in establishing standards for assessing whether an interchange transaction fee is reasonable and proportional to the cost incurred by the issuer, we urge the Board to consider the risk associated with high-dollar transactions. In other words, there is a direct "cost," in the form of increased risk, to the issuer in authorizing, clearing, and settling transactions for goods or services with a high dollar value.

In light of the foregoing, Wells Fargo respectfully requests the Board to reconsider the provisions regarding reasonable and proportional interchange transaction fees, including establishing "standards for assessing" rather than a cap and considering all issuer costs other than "other costs which are not specific to a particular electronic debit transaction."

C. Effective Date

Because the statute requires the Board to prescribe interchange transaction fee regulations in final form by April 21, 2011, Wells Fargo recommends setting a safe harbor that is an average effective rate that approximates current interchange levels. Wells Fargo further recommends that the Board implement Alternative A no sooner than one year after the date final rules are published by the Board. In order to allow sufficient time for the Board to review and analyze the impact of Alternative A on competition and interchange transaction fees, gather additional cost data, and conduct further study of interchange transaction fees and issuer costs, we recommend the Board review the safe harbor no sooner than July, 2013, to determine whether an adjustment is warranted. In addition, this interim period would allow issuers, merchants and payment card networks time to implement the necessary changes to contracts, systems and operations that will result from a change in interchange transaction fees.

II. Section 235.4: Adjustment for Fraud-Prevention Costs

Section 920(a)(5) permits the Board to allow for an adjustment to the amount of an interchange transaction fee if such adjustment is reasonably necessary to make allowance for costs incurred by the issuer in preventing fraud and if the issuer complies with fraud-related standards established by the Board. Wells Fargo strongly believes it is imperative the Board exercise its power to allow for an adjustment for fraud costs as these are very real and critical costs incurred by issuers with respect to electronic debit transactions. The bifurcation of the analysis of fraud costs from other costs associated with electronic debit transactions prevents a true and accurate analysis of whether the amount of any interchange transaction fee is reasonable and proportional to the cost incurred by the issuer. To rush forward with a final rule before a full, complete analysis of such costs, which are integral to authentication and electronic debit transactions in general, would be an unfair and unwarranted disservice to both the mandate of the statute, the industry and users of debit card services.

Wells Fargo encourages the Board to ensure that its review of this type of cost is not improperly diluted. In addition, we urge the Board to consider all fraud-prevention costs, including the costs incurred in debit card account fulfillment, deposit loss mitigation directly impacting the debit card, card issuance, secure delivery of the debit card, card activation, debit card security, cardholder authentication, information sharing and investigation support, data management, debit card authorization processing, high risk account review, customer service and support, skimming compromise and data breach inference and response, fraud claims processing, and developing and distributing consumer and merchant educational materials.

Non-Prescriptive Standards Would Allow Individual Issuers to Quickly Respond to Changing Conditions

Wells Fargo recommends any fraud-related standards established by the Board be non-prescriptive to allow the industry to continue to establish its own best practices, such as through PCI-DSS, and should allow for continued innovation in fraud-prevention. To apply a one-size-fits-all analysis will result, at best, in sub-optimal fraud performance for some issuers and will effectively commoditize the customer experience in this area, which has traditionally been an area in which issuers compete. Also, it is very difficult to maintain fraud-prevention practices for any length of time in the very dynamic state of the industry and financial services in general, and to attempt to set effective standards at the pace required to meet those dynamics would most likely not be successful. The ongoing attempt to set such standards would also be very time consuming for the Board. An example of the difficulty and dynamic nature of this area is the Card Verification Value ("CVV") procedures. Before CVV practices were introduced, the Board would have been expected to develop the ability, and gain financial institution consensus, to stop millions of dollars of fraud on a daily basis. The industry itself, including networks, issuers, processors and merchants, acted decisively and partnered together in a cost-effective manner in implementing this program in the early 1990s. In fact, the industry has a history of taking prompt action in the fraud area to protect consumer interests and to maintain confidence in the payment system.

We also urge the Board to be mindful, during its forthcoming analysis of this section, that the statute permits it to consider fraud-prevention technology in a broad sense, and not limit its review to fraud practices that are rooted in traditional technology, such as magnetic stripes and chips for smart cards. Utilizing a variety of practices and processes in different situations has proven effective and cost-worthy.

Finally, publishing technology-specific standards would provide fraudsters with valuable information, which would allow them to adapt to and overcome the standards and increase the rate of fraud.

Non-Prescriptive Standards Should Include a Common Means to Measure and Report Fraud Management Expenses and Should Not Differ Between PIN and Signature Debit Networks

Wells Fargo believes the Board should establish non-prescriptive standards that establish a common means to measure and report fraud management expenses for the industry. Wells Fargo recognizes the difficulties the Board may encounter in attempting to set standards for cost effectiveness of fraud management. This is compounded by the uncertainties of those fraud losses actually prevented after fraud intervention on an account, as well as the limited degree of certainty in attributing customer attrition to a particular fraud-related event. An all-inclusive standard would need to consider: (a) fraud-prevention process expenses, (b) actual fraud losses, and (c) revenue lost by the issuer as a result of fraud intervention measures. An initial measure that the Board might adopt is a simple comparison of the cost of the fraud-prevention procedure against the lost dollars avoided by implementation of the procedure. Wells Fargo believes all major debit card issuers currently use such metrics; therefore, a review of the range of these metrics across issuers would appear to be a logical first step by the Board. In subsequent iterations, Wells Fargo requests that the Board be receptive to additional metrics that capture: (a) the true cost of retaining customers through a fraud experience, and (b) the true fraud loss prevented by intervention, inclusive of the loss prevented via issuer intervention but which would have been expected in the absence of such intervention.

To the extent activities that are not specific to electronic debit transactions (or to card transactions more broadly) are effective in reducing or preventing debit card fraud, such activities should be subject to reimbursement in the adjustment. For example, know-your-customer due diligence must be included as an appropriate fraud prevention expense as it is certainly a mandated, and therefore proper, business expense in this industry. Such due diligence at account opening is rightfully included in this cost assessment as it is the cornerstone for many additional fraud prevention processes after account opening, including additional know-your-customer-based mandates, such as periodic Office of Foreign Assets Control ("OFAC") verifications. Furthermore, these types of expenses are appropriate because they are not dependent on the method of access to electronic debit transactions (e.g., cards versus mobile device) and are not based on a distinction between PIN or signature platforms.

The standards the Board implements should not differ between PIN and signature debit networks and should be sufficiently flexible to accommodate both types of processing. Any technology-specific or other prescriptive standards would stifle innovation in fraud prevention and detection practices.

<u>The Adjustment Should Include Fraud-Prevention Costs for PIN-Based and Signature-Based Electronic Debit Transactions</u>

Wells Fargo does not recommend the Board adopt an adjustment for fraud-prevention costs for only one type of transaction, such as PIN-based only. Creating artificial incentives to prevent one specific type of fraud will cause fraudsters to naturally migrate to an alternative method. In addition, some transactions are neither PIN nor signature and therefore would not fit into any specific category. However, these transactions are still subject to fraud-prevention measures at a cost, which should be considered in the adjustment.

<u>The Interchange Transaction Fee Adjustment Should Not be Limited Only to Those Fraud Types Directly Benefitting the Merchant</u>

Wells Fargo strongly recommends against any proposal which would limit adjustments for costs of fraud-prevention methods only to those that directly benefit merchants. Detecting and preventing fraud is an expense borne largely by the issuers, yet it inherently benefits all participants in the payment system. Therefore, limiting the interchange transaction fee adjustment only to those fraud types directly benefiting the merchant would create an incentive to limit investment only to those fraud prevention methods for which an adjustment is permitted, which would not always be the most effective methods. Wells Fargo urges the Board to avoid establishing any standards which could have the unintended consequence of incenting fraud prevention methods which may not necessarily be the most effective. Any fraud prevention techniques which are proven effective should be entitled to an appropriate adjustment.

Moreover, we urge the Board to consider and assess fraud risk that could be caused at the merchant, which has a broader impact for issuers. For example, a data compromise at the merchant leads not only to direct fraud losses but also to higher fraud risk for impacted debit cards, which would require the issuer to take additional steps and incur additional costs including, but not limited to, costs of reissuing debit cards, notifying impacted cardholders, investigating transactions, and engaging in fraud mitigation efforts.

A Thorough Understanding of the Different Types of Fraud Mitigation Systems and Procedures, and Associated Costs, is Necessary to a Measurement of Allowable Costs

Most issuers have fairly robust cost accounting systems to track fraud expenditures. However, to determine allowable costs, Wells Fargo urges the Board to take the time to develop a thorough understanding of (a) the different types of fraud mitigation systems and procedures in the industry, (b) the full range of expected expenses per account associated with fraud detection, prevention, mitigation and associated customer service, (c) the wide range of issuer-reported expenses for these functions, and (d) the alternatives and consequences of not utilizing such functions.

Wells Fargo Supports an Adjustment with a Safe Harbor that Takes into Account all Fraud-Prevention Costs

Wells Fargo supports an adjustment with a safe harbor, but strongly recommends against any cap, as that is not supported by the statute. The statute creates a standard that, among other requirements, any adjustment must be "reasonably necessary to make allowance for costs incurred by the issuer in preventing fraud in relation to electronic debit transactions involving the issuer." Any cap would artificially limit the ability of an issuer to demonstrate that a fraud-prevention cost reasonably necessitated an adjustment. We also encourage the Board to recognize that fraud expenses necessarily include both fixed investments as well as per-transaction expenses.

An Adjustment Standard with a Safe Harbor Could be Updated on an Annual Basis

If the standards are set in a reasonable and flexible manner that captures all significant changes in issuers' fraud environment, we believe an annual update should be sufficient for the safe harbor.

A Survey of a Large Random Sample of Merchants in Each Volume Tier and Category Would Allow the Board to Measure Merchants' Fraud-Prevention and Data-Security Costs

We applaud the Board's attempt to seek a manageable methodology of obtaining additional data and suggest implementation of a large random sample of merchants in each volume tier and category (far fewer than 8 million). Questions utilized in such a survey could be similar to those posed to issuers, and inquire regarding fraud-prevention and data security costs directly attributable and reportable by merchants. In addition, numerous networks compile merchant fraud rates (both fraud absorbed and not absorbed by the merchant), and that information may also prove beneficial to the Board's review.

III. Section 235.7: Limitations on Payment Card Restrictions

EFTA Section 920(b) requires the Board to prescribe regulations prohibiting an issuer or payment card network from restricting the number of payment card networks on which an electronic debit transaction may be processed to one such network, or two or more such networks that are owned, controlled or otherwise operated by affiliated persons or networks affiliated with such issuer. In addition, the Board must prescribe regulations that prohibit an issuer or payment card network from inhibiting the ability of any person who accepts debit cards for payments to direct the routing of electronic debit transactions for processing over any payment card network that may process such transactions.

A. Section 235.7(a): Prohibition on Network Exclusivity

The Board has proposed two alternative approaches for implementing the restrictions on debit card network exclusivity. The first alternative (Alternative A) would require a debit card to have at least two unaffiliated payment card networks available for processing an electronic debit transaction. The second alternative (Alternative B) would require a debit card to have at least two unaffiliated payment card networks available for processing an electronic debit transaction for each method of authorization available to the cardholder. Wells Fargo urges the Board to adopt Alternative A.

<u>Statute Does Not Require Two Unaffiliated Networks for Each Method of Authorization</u>

As the Board notes in the preamble to the Proposed Rule, "nothing in EFTA Section 920(b)(1)(A) specifically requires that there must be two unaffiliated payment card networks available to the merchant once the method of debit card authorization has been determined." Wells Fargo urges the Board not to go beyond what is required in the statute. Requiring payment card network options for each method of authorization is cost inefficient and will be confusing to consumers.

<u>The Two Signature-based Network Proposal is Unworkable and Unnecessary</u>

Wells Fargo agrees with the Board that enabling the ability to process an electronic debit transaction over multiple signature debit networks would require the replacement or reprogramming of millions of merchant terminals, and substantial changes to software and hardware for networks, issuers, acquirers and processors. Implementation of the required infrastructure, compliance, and reporting would be very expensive and extremely time-consuming. Such reprogramming would be impossible within six months of finalizing a regulation implementing such a requirement. In fact, given that such a requirement would fundamentally change the structure of the entire payment system, we expect it would take years to implement.

While the Board notes that only about 2 million of the 8 million merchant locations in the United States that accept debit cards have the ability to accept PIN debit, the fact is that this is the result of merchant choice. With the installation of PIN pads, and perhaps terminal upgrades in some cases, additional merchants would have the ability to accept PIN debit.

The Proposed Rule Should Provide Disclosure Safe Harbor and Maintain Consumer Choice at the Point of Sale

Wells Fargo agrees with the Board that, from the cardholder perspective, requiring multiple payment card networks on each card could have adverse effects. For example, each network provides various cardholder benefits, such as enhanced chargeback rights, the ability to receive text alerts regarding possible fraudulent activity, and merchant discount offers. As the Board notes, it may be challenging for issuers or networks to explain to cardholders that they will receive certain benefits only if a merchant chooses to route their transaction over a particular network. Wells Fargo agrees and requests that the Board include a safe harbor for those issuers and networks that provide a general disclosure to cardholders, to the effect that card benefits, services and protections are available only if the card transaction is processed on a specified network. We also encourage the Board in its rulemaking to ensure consumers have the opportunity to exercise their choice at the point of sale.

Requiring Additional Networks Will Increase Card Issuer Cost Which Was Not Captured in the Board's Cost Survey

As noted by the Board, some issuers enter into exclusivity arrangements with payment card networks to reduce core processing and other administrative costs through economies of scale and to eliminate or reduce the membership and compliance costs associated with connecting to multiple networks. In fact, the Board's data collection and analysis in connection with the Proposed Rule is based on the current environment, wherein there exists economies of scale and cost efficiencies (based on negotiated pricing with volume incentives and discounts). While Alternative A would be less onerous to implement than Alternative B, it would still result in a loss of cost efficiency. Alternative B's requirement of two unaffiliated payment card networks on each card for each method of authorization would increase costs well beyond Alternative A and the current environment. Moreover, issuers would incur additional costs to comply with various network rules and to process transactions through multiple networks, including developing, programming and maintaining additional systems and software, adding employees to address differences in chargeback procedures and exception settlements, and building out metrics. Finally, in the case of Alternative B, issuers may have to reissue cards on a more frequent basis in order for consumers and merchants to know which networks are available on the specific card, and at great expense, to remove or add network brands, marks or logos. This would also be a poor customer experience, may cause customer confusion as cards are reissued more often, and could create the potential for increased fraud each time those reissued cards are mailed.

Final Rule Should Allow Regional Networks

EFTA Section 920(b)(1) does not require networks to have national coverage, but only requires the networks to be unaffiliated.

A national requirement is too broad and effectively puts smaller networks at a considerable disadvantage when trying to compete with other networks, and creates a high threshold for new networks trying to enter the market. This is particularly true in those states in which a network must be certified by state government authorities to operate in such state.

Congressional Intent Supports an Exemption from the Network Exclusivity Provisions for HSAs, FSAs, HRAs, and Qualified Transportation Accounts

Wells Fargo urges the Board to consider the following statement read into the Congressional Record (at pages S5927-8) by Senator Chris Dodd, who was Chair of the Senate Banking Committee, on July 15, 2010:

> Mr. Dodd. Mr. President, I would also like to clarify the intent behind another of the provisions in the conference report to accompany the financial reform bill, H.R. 4173, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Section 1075 of the bill amends the Electronic Fund Transfer Act to create a new section 920 regarding interchange fees.... Since interchange revenues are a major source of paying for the administrative costs of prepaid cards used in connection with health care and employee benefits programs such as FSAs, HSAs, HRAs, and qualified transportation accounts—programs which are widely used by both public and private sector employers and which are more expensive to operate given substantiation and other regulatory requirements—we do not wish to interfere with those arrangements in a way that could lead to higher fees being imposed by administrators to make up for lost revenue....Hence, we intend that prepaid cards associated with these types of programs would be exempted within the language of section 920(a)(7)(A)(ii)(ll) *as well as from the prohibition on use of exclusive networks under section 920(b)(1)(A).* (*Emphasis added*).

In light of the stated Congressional intent, Wells Fargo requests that the Board exempt electronic debit transactions made using a card that accesses HSAs, FSAs, HRAs, and qualified transportation accounts from the Proposed Rule's network exclusivity provisions.

Wells Fargo Requests Clarification that Non-Reloadable Gift Cards are Exempt from the Network Exclusivity Provisions

EFTA Section 920(b)(1) contains prohibitions on network exclusivity arrangements with respect to electronic debit transactions. Section 920(c)(5) defines electronic debit transaction as "a transaction in which a person uses a debit card." Section 920(c)(2) defines debit card as "any card, or other payment code or device, issued or approved for use through a payment card network to debit an *asset account* (regardless of the purpose for which the account is established), whether authorization is based on signature, PIN, or other means." (*Emphasis added*). In the case of a non-reloadable gift card, an asset account is not established because the card is a disposable limited-use product. Therefore, a non-reloadable gift card is not a "debit card" within the plain meaning of the statute. Moreover, requiring additional networks on the card will eliminate cost efficiencies which are integral to continuing to offer this product. Wells Fargo therefore requests clarification that non-reloadable gift cards are exempt from the network exclusivity provisions.

Public Policy Supports an Exemption from the Network Exclusivity Provisions for Government Card Programs

EFTA Section 904(c) allows the Board, in prescribing regulations, to make "adjustments and exceptions for any class of electronic fund transfers, as in the judgment of the Board are necessary or proper to effectuate the purposes of this title." According to Section 902(b), the primary objective of the EFTA "is the provision of individual consumer rights." Requiring multiple networks on a card issued in connection with a government-administered payment program will result in additional costs to the program manager, which will likely result in higher cardholder fees. Such a result is inconsistent with the general purpose of government benefit programs and with the recent efforts of local, state and federal government agencies to reduce program costs by paying government benefits with debit cards instead of checks. Accordingly, Wells Fargo requests that the Board exempt government card programs from the Proposed Rule's network exclusivity provisions.

B. Section 235.7(b): Prohibition on Merchant Routing Restrictions

According to comment 2(h)-1 of the Proposed Rule, the definition of "electronic debit transaction" includes transactions in which a person uses a debit card for the initial purchase of goods or services, as well as subsequent transactions in connection with the initial purchase of the goods or services. Wells Fargo requests that the Board specify that the payment card network used for the initial purchase of the goods or services must also be used for subsequent transactions in connection with the initial purchase of the goods or services. Allowing merchants to change the routing for transactions beyond the initial purchase could create a negative customer experience because different networks offer different functionality and protections to the customer, such as chargeback rights, return procedures, and rewards programs. Allowing the merchant to route the initial purchase through a payment card network with a more developed chargeback policy, and route the return through a payment card network with an inferior chargeback policy would be detrimental to customers. Moreover, issuers may not know how the transaction is being routed or by which network rules the transaction is being governed.

C. Effective Date

Since the statute does not specify an effective date for the provisions on network exclusivity and merchant routing restrictions, Wells Fargo urges the Board to allow sufficient time to ensure a successful implementation.

If the Board were to adopt Alternative A, the effective date should be no sooner than one year after the date final rules are published by the Board. Given the vast amount of administrative and technical work needed to implement such a radical change for all of the participants in the payment system, such a time-frame is warranted and perhaps even optimistic. To add additional networks, the issuer and payment card networks must engage in a Request for Proposal ("RFP") process, and draft and negotiate contracts. Moreover, the issuer must certify the networks, and processes and procedures would have to be established in compliance with each network's rules.

Alternative B would have broad impacts on the entire payment system, requiring each participant in the system to revise systems, processes and procedures. Wells Fargo urges the Board to gather additional information regarding implementation requirements for all members of the payment system prior to adopting any effective date for Alternative B. If the Board were to adopt Alternative B, the effective date should be no sooner than October 1, 2015.

IV. Section 235.6: Prohibition on Circumvention or Evasion

EFTA Section 920(a)(8) authorizes the Board to prescribe regulations regarding any network fee, but *only* to ensure that: (1) a network fee is not used to directly or indirectly compensate an issuer with respect to an electronic debit transaction; and (2) a network fee is not used to circumvent or evade the restrictions of Section 920(a) and regulations prescribed thereunder (i.e., provisions requiring that the interchange transaction fee with respect to an electronic debit transaction be reasonable and proportional to the issuer's costs with respect to the transaction). Section 920(c)(10) of the EFTA defines "network fee" as "any fee charged and received by a payment card network with respect to an electronic debit transaction, other than an interchange transaction fee." Wells Fargo agrees with the Board that the statute does not directly regulate the amount of network fees that a network may charge for its services, and that the Proposed Rule also should not set or establish the level of such network fees.

Section 235.6(a) of the Proposed Rule states that "no person shall circumvent or evade the interchange transaction fee restrictions in sections 235.3 and 235.4." In addition, the Board specifies that such circumvention or evasion occurs if an issuer receives net compensation from a payment card network *with respect to electronic debit transactions*. (*Emphasis added.*) Proposed comment 6-1 states that a finding of circumvention or evasion "will depend on all relevant facts and circumstances." Wells Fargo agrees that circumvention or evasion should be reviewed on a case-by-case basis. However, circumvention or evasion does not necessarily occur in every situation where an issuer receives net compensation from a payment card network with respect to electronic debit transactions. Issuers and payment card networks may enter into a variety of contractual arrangements, including joint ventures and investment arrangements, for the development of new products and services, changes to existing products and services, and business development opportunities. Compensation paid to issuers by payment card networks pursuant to such arrangements, whether as a return on investment, dividend, or other form of payment, is not tied to volume incentives or commitments, is not specific to any electronic debit transaction, and should not be a factor in determining whether circumvention or evasion has occurred. Limiting compensation on such arrangements is not authorized by the statute and would stifle innovation. Wells Fargo requests that the Board clarify that section 235.6 does not apply to contractual arrangements between issuers and payment card networks that are not specific to electronic debit transactions. This will allow parties the necessary flexibility to negotiate such agreements based on the business needs and desired outcomes for the particular arrangement.

The Board should also consider circumstances where optional value-added services offered through a payment card network and agreed to by the card issuer and the merchant, could result in net compensation to the card issuer for their role in the electronic debit transaction. Since all parties agree to the service, clearly this is not circumvention or evasion and should be allowed for by the Board in its rulemaking.

Similarly, signing bonuses are not tied to volume incentives or commitments, are not specific to any electronic debit transaction, and should not be a factor in determining whether circumvention or evasion has occurred. Signing bonuses are used by payment card networks as a means to attract new issuers to the network, and to incent issuers to utilize the network for new card programs, and are not meant to compensate issuers for electronic debit transactions processed over the network. In fact, since the statute and the Proposed Rule prohibit issuers and payment card networks from inhibiting the ability of merchants to direct the routing of electronic debit transactions, signing bonuses can only be attributed to overall network participation and not to any particular electronic debit transaction. In addition, signing bonuses, marketing incentives, and other similar payments are paid by payment card networks to issuers as a means to increase the network's brand awareness and brand value. Wells Fargo agrees with the Board that "if such payments were considered in assessing whether network-provided incentives during a calendar year impermissibly exceeded the fees paid by an issuer during that year, it could constrain a network's ability to grow the network and achieve greater network efficiencies by potentially removing a significant tool for attracting new issuers."

Proposed comment 6-1(i) sets forth an example of circumvention or evasion wherein the total amount of payments or incentives received by an issuer from a payment card network during a calendar year in connection with electronic debit transactions, other than interchange transaction fees, exceeds the total amount of all fees paid by the issuer for electronic debit transactions during the calendar year. According to proposed comment 6-1(ii), payments or incentives paid by a payment card network could include, but are not limited to, marketing incentives, payments or rebates for meeting or exceeding a specific transaction volume, percentage share or dollar amount of transactions processed, or other fixed payments for debit card related activities. However, the proposed comment specifies that payments or incentives do not include interchange transaction fees passed through to the issuer by the network, or funds received by an issuer from a payment card network as a result of chargebacks or violations of network rules or requirements by a third party. While Wells Fargo agrees that payments or incentives do not include interchange transaction fees and funds received as a result of chargebacks or violations of network rules or requirements by a third party, Wells Fargo requests the Board to clarify that payments or incentives also do not include settlements of fraud transactions negotiated or received by payment card networks on behalf of issuers.

V. Section 235.2: Definitions

Account. The definition of "account" set forth in section 235.2(a) of the Proposed Rule impermissibly expands the scope of the EFTA to include accounts established for business purposes and bona fide trust arrangements. Wells Fargo respectfully requests that the Board follow Congress' legislative intent and limit the scope of "account" to include only accounts established primarily for personal, family, or household purposes, and to specifically exclude business accounts and accounts held by financial institutions pursuant to bona fide trust agreements, in accordance with the EFTA.

EFTA Section 903(2) defines "account" in pertinent part as "a demand deposit, savings deposit, or other asset account ... established *primarily for personal, family, or household purposes.*" (*Emphasis added.*) EFTA Section 903(2) further states that "such term does not include an account held by a financial institution pursuant to a bona fide trust agreement." While Congress defines "debit card" in EFTA Section 920(c)(2) to include cards that "debit an asset account (*regardless of the purpose for which the account is established*)", one cannot extrapolate this to infer that Congress intended to refer to accounts that are not otherwise included in the EFTA definition of "account." In fact, Congress did not amend or alter the definition of "account" when drafting EFTA Section 920(c), nor did it alter the definition elsewhere in Section 920. Rather, Congress incorporated the established definition of "account" set forth in EFTA Section 903(2) when defining "debit card" in Section 920(c)(2). If Congress intended to expand the definition of "account" to include accounts established for business purposes or pursuant to a bona fide trust agreement, it could have expressly made the change in Section 920(c).

Moreover, EFTA Section 902(b) provides that "[t]he primary objective of [EFTA] ... is the provision of individual consumer rights." Congress did not change this objective when drafting Section 1075 of the Dodd-Frank Act and EFTA Section 920, and thereby implicitly limited the definition of "account" to consumer accounts that are not held by a financial institution pursuant to a bona fide trust agreement. The definition of "account" set forth in section 235.2(a) of the Proposed Rule should accordingly be limited to such accounts and should not be deemed to include business accounts or bona fide trust arrangements.

Debit Card. According to section 235.2(f)(1) of the Proposed Rule, the definition of "debit card" includes "any card, or other payment code or device, issued or approved for use through a payment card network to debit an account." Wells Fargo requests that the Board clarify that "payment code" does not include one-time passwords or random number generators used to help identify customers engaging in online transactions so long as the one-time password or random number generator is not also being used in place of the debit card number as a means to charge the transaction to the underlying account. Wells Fargo further requests that the Board clarify that "payment code" does not include sequence or transaction codes used to help the issuer match the authorization of a transaction with the posting of the transaction. For example, for signature-based debit card purchases, issuers will usually authorize a transaction, but not settle the transaction and post it to a customer's account until the merchant sends an "authorization code" to indicate the transaction should be completed.

Section 235.2(f)(3)(iii) of the Proposed Rule excludes "account number[s], when used to initiate an ACH transaction to debit a person's account" from the definition of "debit card." Wells Fargo requests that the Board broaden the scope of this exclusion to apply to account numbers when used to initiate transfers between accounts held at the same financial institution. For example, if a consumer provides his or her account number to initiate an electronic fund transfer, the institution may route the transfer through the ACH network or, if the payment recipient is at the same institution as the payor, the institution may create an internal transfer between accounts within the institution. Because such intra-institutional transfers are similar to the ACH process, Wells Fargo believes these transactions should be afforded the same exclusion as ACH transactions.

Issuer. The Board specifically requests comment on whether the appropriate entity is deemed to be the issuer in relation to the proposed examples set forth in proposed comment 2(k), including four-party systems, three-party systems, BIN-sponsor arrangements (sponsored debit card model and prepaid card model), and decoupled debit cards. Wells Fargo agrees with the Board's designations for the issuing entity in each of the proposed examples.

Payment Card Network. The Board requests comment on whether non-traditional and emerging payment systems would be covered by the statutory definition of "payment card network." Wells Fargo urges the Board to level set the playing field for all entities (including financial institutions of all sizes and non-financial institutions) in the alternative payment system arena. Carving out an exception for non-traditional and emerging payment systems—yet applying the interchange transaction fee restrictions and network exclusivity requirements to all transactions cleared through financial institutions simply because they also offer traditional debit card payment systems—would place financial institutions at an unfair competitive disadvantage. Setting forth standards that apply equally to all entities engaging in alternative payment systems would foster competition and would likely improve innovation.

VI. Scope of Rule

The Regulation Should Not Apply to Automated Teller Machine ("ATM") Transactions

The Board requested comment on the application of the Proposed Rule to ATM transactions and ATM networks and on whether ATM transactions and ATM networks should be included within the scope of the Proposed Rule. Wells Fargo does not believe the usual and customary use of ATMs for access to, and deposit of, cash should be included in the scope of the Proposed Rule. The opinion is based partly in the reasoning used by the Board itself: the implementing statute does not support the inclusion of ATMs in the scope of the regulation. This is shown clearly by the title of EFTA Section 920: "Reasonable Fees and Rules for Payment Card Transactions" since an ATM withdrawal is not a "payment." In addition, Congress' intent is showcased by its explicit reference to acceptance of a debit card, credit card or other access device *as a form of payment* in the definition of "payment card network" in EFTA Section 920(c)(11). (*Emphasis* *added*). The term "debit card" is further defined in EFTA Section 920(c)(2) as "any card, or other payment code or device, issued or approved for use through a payment card network to debit an account…" Finally, EFTA Section 920(c)(5) provides that an "electronic debit transaction" is "a transaction in which a person uses a debit card." Using a device to access one's own money is qualitatively different than using a device "as a form of payment."

Similarly, the flow of fees in a traditional ATM transaction does not fit the stated process inherent in the Proposed Rule's definition of "interchange transaction fee," which states:

> "Interchange transaction fee" means any fee established, charged, or received by a payment card network *and paid by a merchant or acquirer for the purpose of compensating an issuer* for its involvement in an electronic debit transaction. (*Emphasis added.*)

The term is *limited to those fees that a payment card network establishes, charges or receives to compensate the issuer* for its role in the transaction. The economics of an "interchange transaction fee," as defined in the statute and the Proposed Rule, is reversed in an ATM transaction. In such a transaction, unlike in a payment for a good or service, the *card issuer pays* the owner or operator of the ATM for the transaction. Therefore, inclusion of traditional ATM transactions within the scope of the Proposed Rule defies its stated intent, the statute's clear language, and the intent of the statute.

Inclusion of ATM transactions in the scope of the Proposed Rule would be contrary to public interest and could encourage ATM owners to route transactions in the most expensive manner leading to higher charges from issuers to customers to cover the increased cost. Moreover, many networks are regional, and requiring national access would effectively severely limit the number of networks that could be utilized. Therefore, if ATMs are included in the Proposed Rule, Wells Fargo requests that the Board take the position that one point-of-sale and one ATM network is sufficient to meet the network exclusivity requirements of the Proposed Rule.

Scope of Rule Should Consider Three-Party Systems and Emerging Payment Systems

Wells Fargo believes the Board needs to define regulations that apply to all payment card networks to ensure a level playing field for all payment system participants. To do otherwise would result in an unfair advantage to some participants at the expense of others. Excluding three-party systems from all provisions of the Proposed Rule could create an unfair market advantage, which would harm four-party systems.

However, in defining such regulations, Wells Fargo urges the Board to consider emerging payment systems and three-party systems where certain provisions of the Proposed Rule, such as network exclusivity provisions and merchant routing restrictions, may not be practical and would actually stifle innovation.

VII. Section 235.5: Exemptions

A. Request for Additional Exemption, or Clarification of Exemption for Reloadable Prepaid Cards, under Section 235.5 for Electronic Debit Transactions Made Using a Debit Card Associated with Health Savings Accounts (HSAs) and Other Employee Benefit Program Accounts

Described in Section 223 of the Internal Revenue Code (Code), a Health Savings Account ("HSA") is a funded trust account and is designed to help individuals pay for current and future medical expenses on a tax-free basis. Contributions may be made within specified limits by individuals who meet certain eligibility rules and by employers or others on behalf of such individuals. A debit card may be issued to allow individuals to access funds in the HSA.

The Board has proposed to implement exemptions from the applicability of the interchange transaction fee restrictions for small issuers as well as government-administered payment programs and certain reloadable prepaid cards. One requirement for the reloadable prepaid card exemption is that the card must not be "issued or approved for use to access any debit account held by or for the benefit of the cardholder (other than a subaccount or other method of recording or tracking funds purchased or loaded on the card on a prepaid basis)." However, for a variety of reasons, it may be beneficial to establish HSAs and other employee benefit program accounts (including Flexible Spending Accounts ("FSAs"), Healthcare Reimbursement Arrangements ("HRAs"), and qualified transportation accounts) as individual accounts. Wells Fargo requests that the Board issue an additional exemption from the applicability of the interchange transaction fee restrictions for electronic debit transactions that are made using a debit card that is linked to such accounts. In the alternative, Wells Fargo requests that the Board clarify that HSAs and other employee benefit program accounts qualify for the exemption in Section 235.5(c) even if the account is established as an individual account. We believe such an exemption is appropriate because of the intent expressed on the House and Senate floors to exempt HSAs and other employee benefit programs from the interchange transaction fee restrictions, as well as the unique costs and public policy goals associated with such accounts.

<u>Congressional Intent Supports an Exemption for HSAs and Other Employee Benefit Program Accounts</u>

Wells Fargo urges the Board to consider statements made during the debate over the interchange legislation by senior House and Senate Members. The statements call for an exemption from the interchange transaction fee restrictions for debit cards associated with employee benefit programs, including HSAs, FSAs. HRAs and qualified transportation accounts.

On June 28, 2010, in the House, Rep. John Larson of Connecticut and Rep. Barney Frank of Massachusetts, who was Chair of the House Financial Services Committee at that time, engaged in a colloquy on the floor as follows (see the Congressional Record, pages H5225-6):

> Mr. Larson of Connecticut. Madam Speaker, I rise for the purpose of engaging in a colloquy with Chairman Frank to clarify the intent behind section [1076] in this bill. The section amends the Electronic Fund Transfer Act to create a new section 920 regarding interchange fees. Interchange revenues are a major source of funding for the administrative costs of prepaid cards used in connection with health care and employee benefits programs like FSAs, HSAs, HRAs and qualified transportation accounts.
>
> These programs are [lightly[1]] used by both the public and private sector employers and employees and are more expensive to operate because of substantiation than other regulatory requirements. Because of this, *I would like to clarify that Congress does not wish to interfere with those arrangements in a way that could lead to higher fees being imposed by administrators to make up for lost revenue, which would directly raise health care costs and hurt consumers.* This is clearly not something that was the intent that we'd like to do. *Therefore, I ask Chairman Frank to join me in clarifying that Congress intends that prepaid cards associated with these types of programs should be exempted within the language of section 920(a)(7)(A)(ii)(ll).*
>
> Mr. Frank of Massachusetts. If the gentleman would yield, he's completely correct. The Federal Reserve has the mandate under this, which originated in the Senate, to write those rules. We intend to make sure those rules protect a number of things: smaller financial institutions from being discriminated against since they're exempt from the regulation, State benefit programs, and these.
>
> So the gentleman is absolutely correct, and I can assure him that I expect the Federal Reserve to honor that. And if there is any question about it, I am sure we will be able to make sure that it happens.
>
> Mr. Larson of Connecticut. I thank the chairman. (*Emphasis added.*)

On July 15, 2010, Senator Chris Dodd of Connecticut, who was Chair of the Senate Banking Committee at that time, read the following statement into the Congressional Record (at pages S5927-8):

> Mr. Dodd. Mr. President, I would also like to clarify the intent behind another of the provisions in the conference report to accompany the financial reform bill,

[1] The transcript appears to be in error with respect to this particular word; the C-SPAN captions for the colloquy, available at http://www.c-spanvideo.org/videoLibrary/clip.php?appid=598395052, indicate the word "widely" was used rather than "lightly."

> H.R. 4173, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Section 1075 of the bill amends the Electronic Fund Transfer Act to create a new section 920 regarding interchange fees. This is a very complicated subject involving many different stakeholders, including payment networks, issuing banks, acquiring banks, merchants, and, of course, consumers. Section 1075 therefore is also complicated, and I would like to make clarification with regard to that section.
>
> *Since interchange revenues are a major source of paying for the administrative costs of prepaid cards used in connection with health care and employee benefits programs such as FSAs, HSAs, HRAs, and qualified transportation accounts*—programs which are widely used by both public and private sector employers and which are more expensive to operate given substantiation and other regulatory requirements—*we do not wish to interfere with those arrangements in a way that could lead to higher fees being imposed by administrators to make up for lost revenue*. That could directly raise health care costs, which would hurt consumers and which, of course, is not at all what we wish to do. *Hence, we intend that prepaid cards associated with these types of programs would be exempted within the language of section 920(a)(7)(A)(ii)(II) as well as from the prohibition on use of exclusive networks under section 920(b)(1)(A).* (*Emphasis added.*)

The above statements demonstrate the clear intent by Congress to exempt electronic debit transactions made using debit cards associated with HSAs and other employee benefit programs from the interchange transaction fee restriction provisions. Congress expected the Board to honor its intent. Congress clearly recognized that there are unique costs associated with HSAs and other employee benefit programs and that public policy demands keeping such costs down.

<u>The Unique Costs Faced in Administering HSAs and Other Employee Benefit Program Accounts Favor Granting an Exemption</u>

The above statements by senior Members of Congress acknowledge that interchange revenue helps offset the administrative costs of HSAs and other employee benefit programs. For HSAs, such costs include tax reporting obligations, monitoring contribution limits, administering rollovers and trustee-to-trustee transfers, producing and distributing educational materials, and implementing specialized customer support services. The costs associated with administering an HSA program are greater than those associated with administering standard deposit account products. For FSAs and HRAs, such costs include substantiating purchases to ensure that funds are used for qualified medical expenses.

The above statements also recognize that interfering with interchange revenue could lead to higher administrative fees, which, in turn, could directly raise health care costs and hurt consumers. Interchange revenue helps offset the unique costs associated with these products. If interchange revenue is limited, fees charged to HSA accountholders and other employee benefit programs will likely increase.

Public Policy Supports Controlling Health Care Costs for Consumers and Creating an Additional Exemption or Clarifying the Existing Exemption for Reloadable Prepaid Cards

In 2010, Congress passed the Patient Protection and Affordable Care Act of 2010 (PPACA) [Pub. L. No. 111-148]. The passage of PPACA aims to support the strong public policies of improving access to health care and decreasing the overall costs of health care. HSAs further these policies by introducing market forces to the health care system. HSAs drive down health care costs by placing financial incentive in the hands of health care consumers. With an HSA, consumers are encouraged to compare costs when considering their medical care. By comparing costs, consumers introduce competition into the health care market, which ultimately drives down prices and makes health care more affordable and accessible.

As explained above, Wells Fargo and other HSA providers face unique costs with administering HSAs, and interchange revenue helps offset these costs. Interchange transaction fees are currently paid by medical providers (e.g., doctors, hospitals, and pharmacies), who presumably price their services accordingly. Restricting interchange transaction fees will result in HSA providers increasing the fees they charge directly to HSA accountholders – and almost certainly will not lead to medical providers lowering their prices. Essentially, the increased fees will shift costs from medical providers to HSA accountholders and ultimately discourage the use of HSAs and undermine the public policy goals of controlling medical costs by introducing market forces to the health care system.

B. Section 235.5(b): Exemption for Government-Administered Programs

Wells Fargo requests that the Board clarify the meaning of "government-administered programs." For example, do such programs include programs administered by tribal systems and other programs in which funds are paid to consumers by government agencies, such as jury-duty fees that are funded to a prepaid card?

VIII. Section 235.8: Reporting Requirements

For the years an entity is required to report, the Board proposes that such entity must submit the report to the Board by March 31 of that year. The Board is requesting comment on whether the three-month time frame is appropriate. While Section 235.8 of the Proposed Rule sets forth examples of data that issuers may be required to report, it is difficult to determine whether the three-month time frame is appropriate without additional clarification as to the complexity of the information required and the specific reporting forms to be utilized.

IX. Additional Comments

ATMs Should Not be Included in the Scope of the Proposed Rule

The Board requested comment on how to implement the network exclusivity provision if ATM networks and ATM transactions are included within the scope of the rule. For the reasons stated in Section VI of this letter (Scope of Rule – Automated Teller Machines ("ATMs")), Wells Fargo does not believe the usual and customary use of ATMs for access to, and deposit of, cash should be included in the scope of the Proposed Rule.

Deferred Debit Cards

According to comment 2(f)-2 of the Proposed Rule, the term "debit card" includes "a card, or other payment code or device, that is used in connection with deferred debit card arrangements in which transactions are not immediately posted to and funds are not debited from the underlying transaction, savings, or other asset account upon settlement of the transaction. Instead, the funds in the account are held and made unavailable for other transactions for a specified period of time. After the expiration of the applicable time period, the cardholder's account is debited for the value of all transactions made using the card that have been submitted to the issuer for settlement during that time period."

This language suggests that funds in the account are held and made unavailable for other transactions for a specified period of time. After the expiration of the applicable time period, the cardholder's account is debited. However, we are unclear whether the "applicable time period" is the same as the "specified period of time." In other words, we are unclear whether the debiting of the card account occurs immediately after the running of the hold period or whether these sentences contemplate a period of time between the hold and the debit. Because of this uncertainty, it is unclear whether a deferred debit card with a window period between the hold against the card account and the debit against the card account is covered within this description or falls outside of this description.

A fair reading of the above two quoted sentences would suggest that a deferred debit card within the coverage of this commentary does not have a window period. To make that point clear, we suggest that the reference to "applicable time period" be changed to "specified period of time."

Amending the commentary as suggested above would make it abundantly clear that a deferred debit card falling within this commentary does not have a window period between the expiration of the hold and the debit against the card account.

General-Use Prepaid Card Includes Prepaid Cards Accepted at a Limited Number of Unaffiliated Participating Merchants

The Board requested comment on whether a prepaid card that is accepted at a limited number of unaffiliated participating merchants and does not carry a network brand should also be considered a "general-use prepaid card" under the rule. EFTA Section 920(a)(7)(A)(ii) simply requires the card to be "redeemable at *multiple*, unaffiliated merchants or service providers, or automated teller machines," in order to qualify for the reloadable prepaid card exemption. (*Emphasis added*). A prepaid card that is accepted at a limited number of unaffiliated participating merchants is "redeemable at multiple, unaffiliated merchants" so long as it is accepted at two or more unaffiliated merchants. Section 920(a)(7)(A)(ii) does not require the prepaid card to carry a network brand in order to qualify for the exemption. Therefore, a prepaid card that is accepted at a limited number of unaffiliated participating merchants and does not carry a network brand should also be considered a "general-use prepaid card" under the Proposed Rule.

Reasonable and Convenient Access to ATMs

The Board requested comment on whether additional clarification or guidance is needed for how an issuer may identify a network of ATMs that provides reasonable and convenient access to the issuer's cardholders. For the reasons stated in Section VI of this letter (Scope of Rule – Automated Teller Machines ("ATMs")), Wells Fargo does not believe the usual and customary use of ATMs for access to, and deposit of, cash should be included in the scope of the Proposed Rule.

An Agent of an Issuer Should Not be Considered an "Issuer"

The Board requested comment on whether there are circumstances in which an agent of an issuer also should be considered to be an issuer within the rule's definition. Wells Fargo agrees with the Board that "an issuer that outsources certain issuing functions retains the underlying relationship with the cardholder and should retain responsibility for complying with the rule's requirements as they pertain to issuers." An agent of an issuer should not be considered an issuer within the Proposed Rule's definition.

Reporting Not Required if a Network Does Not Establish Individualized Interchange Transaction Fees above the Safe Harbor Amount

If a network does not establish individualized interchange transaction fees above the safe harbor amount, the Board believes it is not necessary to require an issuer to report its maximum allowable interchange transaction fee to networks through which it receives electronic debit transactions. The Board requests comment on whether this reporting requirement is necessary to enable networks to set issuer-specific interchange transaction fees. Wells Fargo agrees with the Board that it is not necessary to require an issuer to report its maximum allowable interchange transaction fee to a network if the network does not establish individualized interchange transaction fees above a safe harbor amount.

Section 235.5(b): Exemption for Government-Administered Programs – Networks Should Develop Their Own Certification Process

The Board requests comment on whether it should establish a certification process or whether it should permit payment card networks to develop their own processes. Wells Fargo urges the Board to permit payment card networks to develop their own processes. The payment card networks best understand how each program is set up and can properly identify such products.

If the Board is to establish a certification process, the Board requests comment on how to structure this process, including the time periods for reporting and what information may be needed to identify accounts to which the exemption applies. For example, the Board understands that certain cards issued under a government-administered payment program may be distinguished by the BIN or BIN range. Wells Fargo believes such reporting should be conducted in the normal course of issuer reporting to networks and that the payment card networks are in the best position to determine how such products should be identified.

<u>Section 235.5(c): Exemption for Certain Reloadable Prepaid Cards – Networks Should Develop Their Own Certification Process</u>

The Board seeks 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. Wells Fargo believes such reporting should be conducted in the normal course of issuer reporting to networks and that the payment card networks are in the best position to determine how such products should be identified.

<u>Section 235.5(d): Exception</u>

The exemption for government-administered programs and the exemption for certain reloadable prepaid cards will not apply if on or after July 21, 2012, any of the following fees may be charged to a cardholder with respect to the card: (1) a fee or charge for an overdraft, including a shortage of funds or a transaction processed for an amount exceeding the account balance, <u>unless the fee or charge is charged for transferring funds from another asset account to cover a shortfall in the account accessed by the card</u>; or (2) a fee charged by the issuer for the first withdrawal per calendar month from an ATM that is part of the issuer's designated ATM network. Wells Fargo agrees with the Board's clarification regarding overdraft fees (as shown in the underlined text).

<u>Certain Devices Capable of Being Processed Using Only a Single Authorization Method Should be Exempt from Network Exclusivity Provisions</u>

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 rule (under either alternative), 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). The Board requests comment on whether this 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. Requiring such devices to add at least a second unaffiliated signature debit network would inhibit the development of these devices and stifle innovation. Wells Fargo requests that the Board not require a second unaffiliated network on such devices.

The Board understands that in many cases, issuers do not permit PIN functionality on prepaid cards to prevent cash access in response to potential money laundering or other regulatory concerns. In addition, in the case of debit cards issued in connection with health flexible spending accounts and health reimbursement accounts, Internal Revenue Service (IRS) rules require the use of certain sophisticated technology at the point-of-sale to ensure that the eligibility of a medical expense claim can be substantiated at the time of the transaction. However, PIN-debit networks may not currently offer the functionality or capability to support the required technology. Thus, applying the network exclusivity prohibition to these health benefit cards in particular could require an issuer or plan administrator to add a second signature debit network to comply with IRS regulations if PIN networks do not add the necessary functionality to comply with those regulations. The Board requests comment on any alternatives, consistent with EFTA Section 920, that could minimize the impact of the proposed requirements on these prepaid products. Based on stated Congressional intent, as explained in Section III (Limitations on Payment Card Restrictions) of this letter, Wells Fargo requests that the Board exempt prepaid cards that access HRAs, other employee benefit program accounts, and qualified transportation accounts from the Proposed Rule's network exclusivity provisions.

Not Necessary to Address Volume, Percentage Share, Dollar Amount Requirements, or Other Types of Arrangements in the Exclusivity Provisions

The Board requests comment on whether it is necessary to address volume, percentage share, or dollar amount requirements in the exclusivity provisions, and whether other types of arrangements should be addressed under the rule. Wells Fargo agrees with the Board that it is not necessary to address volume, percentage share, or dollar amount commitments since such commitments could only be given effect through issuer or payment card network priorities that direct how a particular electronic debit transaction should be routed by a merchant, and such routing priorities would be prohibited by the proposed limitations on merchant routing restrictions.

Issuers Require at Least One Year to Add an Additional Unaffiliated Network in the Event Previously Unaffiliated Networks Subsequently Become Affiliated

Proposed Section 235.7(a)(3) addresses circumstances where previously unaffiliated payment card networks subsequently become affiliated as a result of a merger or acquisition. The proposed rule requires issuers in these circumstances to add an additional unaffiliated debit card network no later than 90 days after the date on which the prior unaffiliated payment card networks become affiliated. The Board requests comment on whether 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. Wells Fargo requests that the Board allow issuers at least one year to add an additional unaffiliated debit card network. To add a new network, the issuer and payment card network must engage in a RFP process, draft and negotiate contracts, the issuer must certify the network, and processing would have to be transferred from the prior network to the new network.

Conclusion

Wells Fargo strives to provide our customers with flexible, wide-ranging and competitive financial products, superior service and education while fully complying with all applicable laws and regulations. We believe the regulations, as proposed, will have unintended adverse consequences and are not in the best interests of our customers. We respectfully urge the Board to consider all of the comments and suggestions herein.

If you have any questions or would like to discuss any of the issues herein, please do not hesitate to contact me at (612) 667-4025 or dawn.m.mandt@wellsfargo.com.

Sincerely,

/s/ DAWN M. MANDT

Dawn M. Mandt
Senior Counsel