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COMMITTEE ON APPROPRIATIONS

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September 30, 2011

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

RE: Docket No. R-1404 and RIN No. 7100 AD 63 – Debit Card Interchange Fees and Routing

Dear Ms. Johnson:

As primary author of Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (commonly known as the "Durbin Amendment"), I submit the following comments in response to the July 20, 2011, interim final rule published by the Board of Governors of the Federal Reserve System ("Board") in the Federal Register (76 Fed. Reg. 43478 et seq.) on adjustments to debit interchange transaction fees for fraud prevention costs.

Comments on the Interim Final Rule on Fraud Prevention

The Board's interim final rule in several respects fails to follow the text of Section 920(a)(5) of the Electronic Fund Transfer Act ("EFTA"). Rather than proposing a rule to meet the statute's intended goal of effectively preventing fraud in the debit system, the Board's interim final rule appears instead to make it easy for large banks to preserve more of their current interchange revenue stream regardless of the effectiveness of their fraud prevention efforts. The Board must do more to respect the text and intent of Section 1075 and must address the shortcomings of the interim final rule by implementing a final rule that requires actual compliance with effective fraud prevention steps in order for a fee adjustment to be allowed. I will discuss several specific shortcomings below.

1. Effectiveness

The Board's interim final rule fails to follow the directive in EFTA Section 920(a)(5)(A)(ii)(II) that the Board must establish standards that "shall…require issuers to take effective steps to reduce the occurrence of, and costs from, fraud" if the Board is to allow issuers to receive fee adjustments.

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The standards put forth by the Board in the interim final rule do not require issuers to take steps that are effective. The Board's interim final rule states that an issuer is eligible to receive a fraud-prevention adjustment if the issuer "develop[s] and implement[s] policies and procedures reasonably designed" to identify, prevent, monitor, and respond to fraudulent transactions and if the issuer reviews and updates its policies periodically. There is no requirement anywhere in the Board's interim final rule that the policies and procedures developed and implemented by an issuer actually result in the taking of steps that prove to be effective in reducing the cost or occurrence of fraudulent transactions. Under the interim final rule, it appears an issuer would be allowed to receive a fee adjustment if the issuer does not adhere to its written policies and procedures or if the issuer does not take any steps at all pursuant to those policies and procedures. Further, under the interim final rule it appears an issuer would be allowed to receive an adjustment even if steps taken by the issuer pursuant to the issuer's policies and procedures prove disastrously ineffective and result in industry-worst levels of fraud. These outcomes are incompatible with both the plain text and intent of Section 1075.

Simply allowing Visa and MasterCard to increase the interchange fees that they fix on behalf of large issuers if those issuers have policies and procedures in place creates no incentive for those issuers to ensure that their policies and procedures work effectively to prevent fraud. The Board's standards must provide for accountability to ensure effectiveness. Under Section 1075, it is clear that issuers cannot be permitted to receive an interchange fee adjustment if the Board's standards do not require issuers to take effective steps to reduce the occurrence of, and costs from, fraud.

The Board can promptly address this shortcoming by identifying target metrics with respect to the occurrence of fraud and fraud losses that issuers will be expected to satisfy in order to receive a fee adjustment. As I explained in my comments submitted on February 22, 2011, the Board can set achievable target metrics and deem those individual issuers who meet the metrics through the use of cost-effective technologies to satisfy the effectiveness requirement and thus be eligible to receive a fee adjustment. By applying this metrics-based approach, the Board will incentivize the market to implement fraud prevention technologies that achieve the effective results that the statute demands. By failing to apply this approach and instead simply giving its blessing to issuers' policies and procedures regardless of their effectiveness, the Board's interim final rule will further entrench the problem of fraud in the debit system.

2. Compliance

EFTA Section 920(a)(5)(A)(ii) provides that the Board may allow an issuer to receive a fee adjustment if and only if "the issuer complies with the fraud-related standards established by the Board." The text of the law is clear that an issuer that does not comply with the Board's standards cannot receive a fee adjustment. However, the Board's interim final rule states that an issuer will be eligible to receive an adjustment if the issuer merely "certif.[ies] such compliance to its payment card networks on an annual basis."

There is a fundamental distinction between an issuer making a certification to a network and an issuer actually and verifiably complying with the Board's standards. The mere act of an issuer submitting a certification of compliance to a network does not constitute actual, verifiable

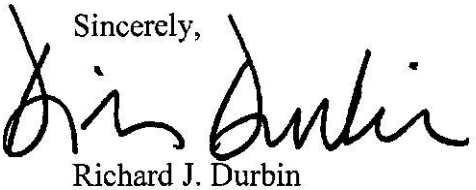
compliance such that an issuer would be permitted under 920(a)(5) to receive an adjustment. Under the Board's interim final rule an issuer could easily submit a certification of compliance to a network even if the issuer was in no way actually compliant with the Board's standards. Indeed, under the Board's interim final rule such an outcome is to be expected since the Board provides no explicit mechanism for monitoring and validating the certification process and no penalty for issuers or for networks if false certifications are made. The payment card networks cannot simply be trusted to ensure the compliance of their issuer clients. Verification of actual compliance is essential.

Because there is no mechanism for issuer compliance to be verified under the Board's interim final rule, it appears that the Board's interim final rule contravenes Section 1075 in that it may enable a non-compliant issuer to unlawfully receive a fee adjustment. However, with cooperation between the Board and the Federal Trade Commission ("FTC") this outcome can be avoided. Under the text of Section 1075, the last word with respect to ensuring the requirement of issuer compliance would not belong to the payment card networks. EFTA Section 920(d) provides that "[c]ompliance with the requirements imposed under this section shall be enforced under Section 918." EFTA Section 918(c) provides that the requirements imposed under Section 920 shall be enforced by the FTC with respect to all requirements whose enforcement is not specifically committed to another government agency. Thus, it is within the jurisdiction of the FTC to oversee the payment card networks to ensure that issuer compliance with the Board's standards is met.

It is incumbent upon the Board to support FTC in its statutorily directed responsibility of enforcing the compliance role that payment card networks are directed to play under the Board's rulemaking. The FTC is adequately resourced and equipped to monitor the payment card networks and to gather the information it needs to ensure that no network is improperly deeming an issuer to be compliant with the Board's standards. The FTC also has a vested interest in ensuring compliance, as that agency recognizes the importance of reducing the occurrence and cost of fraud in the debit system for the sake of consumers, businesses and other stakeholders who are impacted by fraud. Effective FTC enforcement will satisfactorily ensure the issuer compliance that is required under Section 920(a)(5)(A)(ii) for a fee adjustment to be allowed. The Board must not take steps to undermine the effectiveness of such FTC enforcement, for in the absence of effective verification of actual compliance, the granting of a fee adjustment under the Board's interim final rule would contravene the text of Section 1075.

Thank you for the opportunity to submit these comments. Should you need any clarification or further information please feel free to contact my office.

Sincerely,



Richard J. Durbin
United States Senator