U.S. PIRG
Federation of State PIRGs

218 D Street, SE
Washington, DC 20003
www.uspirg.org • info@uspirg.org
Phone: (202) 546-9707
Fax: (202) 546-2461

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: **Comments on the Interim Final Rule on Debit Card Interchange Fees and Routing, Docket No. R-1404 and RIN No. 7100 AD 63**

Dear Ms. Johnson,

On behalf of U.S. PIRG, please find our comments on the Interim Final Rule on Debit Card Interchange Fees and Routing, Docket No. R-1404 and RIN No. 7100 AD 63 ("interim final rule"). U.S. PIRG serves as the non-profit, non-partisan Federation of State Public Interest Groups, which are public interest advocacy groups with over one-half million members nationwide. On behalf of our members and other consumers, U.S. PIRG has testified in the past three Congressional sessions in favor of swipe fee reform. Our comments below specifically refer to the circumstances under which an issuer may receive or charge a fraud-prevention adjustment of one cent under §235.4 of the interim final rule.

Card fraud is a pervasive problem for consumers. Thirty-two percent of consumers reported card fraud in the past 5 years (up from 27% in 2009).[1] To date, issuers have been unwilling to invest in fully effective fraud-prevention measures in the U.S. because it has not been in their economic interest to do so. Historically, issuers have been able to push many of the costs of fraud onto consumers and retailers. The Durbin Amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act is meant to change that dynamic and give issuers an incentive to reduce fraud rather than simply shifting costs onto others.

Debit card issuers have a duty to protect and prevent against fraudulent debit card transactions as strenuously as possible. The interim final rule prescribes a set of standards with which an issuer must comply to receive a fraud-prevention adjustment on top of the interchange fee. We believe that several aspects of the interim final rule should be strengthened to encourage issuers to invest in effective fraud prevention activities and better protect cardholders and their financial accounts.

Specifically, we discuss below the following topics:

- **The Board's standards for development of issuer policies and procedures are lacking quantifiable measurements of fraud reduction.** There is nothing in the interim final rule requiring that fraud be prevented or reduced. Issuers can receive a fraud-prevention adjustment based on generalized standards, which do not require them to show that fraud rates have actually decreased.

[1] "House of Cards: Why Your Accounts are Vulnerable to Thieves," Consumer Reports (June 2011).

- **Issuer certification to the card networks is not sufficient.** Visa and MasterCard, and other card networks, are not regulators and have profit-driven motives to "certify" all issuers regardless of their fraud prevention practices.

- **The Board should require assessments of issuers' programs that encourage more fraud-prone debit products.** Current debit-reward programs by some issuers encourage the use of signature debit, which has a significantly higher fraud rate than PIN debit.

- **The Board should ensure that consumers are not required to "foot the bill" for issuers implementing more secure card authorization methods or other fraud-prevention activities.** The fraud-prevention adjustment is designed to compensate issuers appropriately for costs incurred in preventing fraud, including implementation of new and effective fraud-prevention technology. Those costs cannot then be passed on to the consumer.

We are pleased to offer the below comments to the interim final rule.

I. The Board's standards for development of issuer policies and procedures are lacking quantifiable measurements of fraud reduction.

The Durbin Amendment authorizes a fraud-prevention adjustment for issuers that take effective steps to reduce fraud. Specifically, the statute requires that the adjustment be reasonably necessary to make allowances for costs incurred by the issuer in preventing debit card fraud.[2] The law requires issuers to take effective steps to reduce the occurrence of, and costs from, fraud before they can receive the adjustment. The interim final rule does not hold issuers to that standard. Instead, the interim final rule establishes standards that do not require issuers to take any steps to reduce fraud.

Requiring issuers to monitor the incidence of fraud, track fraud reimbursements and losses, secure cardholder data and conduct an annual assessment of fraud-prevention policies are helpful activities, but they are not the actions required by the law to receive the fraud-prevention adjustment. The standards lack any measurement of an issuer's success in reducing fraud. The law requires measureable reductions in fraud by an issuer prior to allowing that issuer to collect any fraud-prevention adjustment.

II. Issuer certification to the card networks is not sufficient.

Under the interim final rule, to receive a fraud-prevention adjustment, issuers certify their compliance with the Board's standards to the payment card networks.[3] Visa, MasterCard and other payment card networks get to decide whether issuers in their own network can receive a fraud-prevention adjustment. Visa and MasterCard have been appointed under the interim final rule to direct a potentially substantial amount of revenue for card issuers. However, these networks are not regulators as the interim final rule makes them out to be, and they have not been given that power under the law.

Visa and MasterCard have been the subject of numerous private and government lawsuits alleging anticompetitive and other disconcerting behavior, including price discrimination. For example,

[2] 75 Federal Register 248, at 81735.
[3] 76 Federal Register 139, at 43487.

the district court for the Southern District of New York held that both Visa and MasterCard possess market power and engaged in price discrimination.[4] Moreover, the payment card networks have profit motives in certifying issuers -- by allowing issuers to receive an additional one-cent adjustment, issuers will be more inclined to include that payment card network's branding on the debit cards they issue. It is not sufficient for the Board to delegate its regulatory and oversight authority to the card networks. Issuers should certify to the Board, not the card networks, to be sure that the Board's standards are properly interpreted and met before adjustments are granted.

The interim final rule provides no defined requirements or specified certification processes payment card networks must follow in certifying issuer compliance. The Board should implement a unified certification process requiring issuers to demonstrate, on an issuer-by-issuer basis, that they are in fact reducing fraud. Further, the Board's certification processes should be open and transparent. Providing cardholders and consumers access to compliance filings will provide transparency in the issuer marketplace and help cardholders make informed decisions about the debit products they are using.

III. The Board should require assessments of issuers' programs that encourage more fraud-prone debit products.

The interim final rule specifically requests comment on "whether an issuer's policies and procedures should require an issuer to assess whether its consumer rewards or similar programs provide inappropriate incentives to use an authentication method that is demonstrably less effective in preventing fraud."[5]

The Durbin Amendment was enacted to address the debit interchange system that was built on an anticompetitive market with perverse fraud-prevention incentives. Historically, through the imposition of fees as well as through rewards programs and other incentives, the card networks and issuers have encouraged the use of more fraud-prone signature debit transactions rather than safer and more efficient PIN debit transactions. Under the current system, issuing banks either provide debit-card rewards, or assess surcharges on PIN debit transactions to encourage signature debit usage. According to a recent bankrate.com study, 65% of debit rewards programs offer rewards only on signature debit purchases; the range for rewards on PIN purchases is significantly lower, between 0.1 and 0.5 percent.[6] This behavior by issuers cannot be justified from a fraud-prevention standpoint.

Signature-based debit cards have, according to the Board, four times the rate of fraud as PIN-based cards.[7] A recent study found that in 2009, 95% of issuers suffered from a signature debit data breach, with 31% of their cards potentially compromised.[8] The result was an increase in issuers' net debit fraud losses. The study documents that fraud was far more significant for signature debit than PIN

---

[4] *US v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 341 (S.D.N.Y. 2001) (holding that Visa and MasterCard have market power evidenced by their ability to successfully engage in price discrimination. "The reality is that Visa and MasterCard are able to charge substantially different prices for those hundreds of thousands of merchants who must take credit cards at any price"), *aff'd*, 344 F.3d 229 (2nd Cir. 2003). *See also US v. American Express, MasterCard and Visa*, Case No. 10-cv-4496 (E.D.N.Y. 2010); *In Re Payment Card Interchange Fee and Merchant-Discount Antitrust Litigation*, Case No. 05-md-1720 (E.D.N.Y. 2005).

[5] 76 Federal Register 139, at 43485.

[6] Bankrate.com 2010 Debit Card Rewards Study, available at http://www.bankrate.com/finance/checking/free-money-for-debit-card-users-1.aspx.

[7] 76 Fed. Registry 139, at 43480 (based on a dollar-per-dollar basis).

[8] *See* Pulse, 2010 Debit Issuer Study (June 2010).

debit, and was increasing more rapidly for signature debit. Signature fraud losses increased by 43%, to 7.5 basis points from 5.2 basis points, while PIN fraud losses rose by only 24%, to 1.0 basis points from 0.8 basis points.[9] In addition, of the 64 financial institutions that collectively represent more than 78 million debit cards that participated in this study, 46% expect signature debit fraud loss rates to increase over the next two years.[10]

A system that promotes the less secure and more costly product for consumers makes no economic sense and is a sign of a broken market. Banks should not be rewarded for promoting products that have a higher rate of fraud and end up costing consumers more. Issuers are only entitled to the fraud-prevention adjustment under the law if they *reduce* fraud, not if they encourage it. At the very least, U.S. PIRG believes that the Board should require issuers to assess their debit fees and rewards programs and promote the least fraud-prone debit products and the best fraud-protection for cardholders.

IV. The Board should ensure that consumers are not required to "foot the bill" for issuers implementing more secure card authorization methods.

The Board recognizes that a significant amount of fraud-prevention and fraud loss costs are borne by merchants and consumers. Additionally, merchants have substantial costs to comply with PCI-DSS fraud prevention and they absorb a lot of fraud losses through chargebacks. These costs make it more expensive for merchants to do business. As a result, prices go up and consumers end up paying more.

The fraud-prevention adjustment is meant to compensate issuers for taking effective steps to reduce fraud, *but* the adjustment is to be offset by the fraud costs absorbed by consumers and merchants. The law is designed to ensure that issuers cannot push the fraud-prevention burden onto merchants and consumers and also receive a fee from them. The cost of implementing new authorization technology and other fraud-prevention strategies should not fall on merchants and consumers. The adjustment must take into account what merchants and consumers are paying; they cannot continue to shoulder the burden of fraud-prevention and fraud losses and also be required to subsidize the activities of issuers.

We thank you for your time and consideration of our comments. Please let us know if we can answer any questions or provide any further information.

Sincerely,

Edmund Mierzwinski

Edmund Mierzwinski
Consumer Program Director

---

[9] Id.
[10] Id. at 18.