December 17, 2013

Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Proposed Agency Information Collection Activities; Comment Request: Proposed 2013 Regulation II Debit Card Issuer Survey (**FR 3064a**) and Payment Card Network Survey (**FR 3064b**)

Dear Mr. Frierson:

As a part of the ongoing administration of Section 920(a) of the Electronic Fund Transfer Act ("Section 920(a)"),[1] the Board of Governors of the Federal Reserve System (the "Board") recently issued for public comment proposed 2013 revised debit card issuer and payment card network surveys to facilitate its ongoing regulatory and reporting obligations under Section 920(a) and related Federal Reserve Board Regulation II ("Regulation II").[2] The American Bankers Association, The Clearing House Association L.L.C., the Consumer Bankers Association, the Credit Union National Association, The Financial Services Roundtable, the Independent Community Bankers of America, the Mid-Size Bank Coalition of America, and the National Association of Federal Credit Unions (collectively, the "Associations") respectfully submit this letter in response to the Board's request for comment on the proposed 2013 revised Regulation II surveys, including the Debit Card Issuer Survey, FR 3064a (the "Issuer Survey"), and the Payment Card Network Survey, FR 3064b (the "Network Survey"; together, the "2013 Surveys"), published in the Federal Register on October 17, 2013.[3] The Associations appreciate the opportunity to comment on the 2013 Surveys.[4]

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[1] 15 U.S.C. § 1693o-2(a).
[2] 12 C.F.R. pt. 235.
[3] 78 Fed. Reg. 62352 (October 18, 2013).
[4] Although the Associations principally represent issuers of debit cards, the relationship between these issuers and the payment card networks positions the Associations to comment on both the Issuer Survey and certain aspects of the Network Survey insofar as the Network Survey is likely to impact debit card issuers.

The Associations acknowledge the significance of the 2013 Surveys as tools in the Board's ongoing implementation of Section 920(a). The information gathered from the 2013 Surveys and the Board's use of that information may impact significantly the debit card marketplace. Consequently, the Associations and the debit card issuers they represent have an interest in ensuring that the Board collects comprehensive, accurate debit card cost information, and that any Board action influenced by the 2013 Surveys is grounded in an understanding of the existing debit card marketplace and the true costs associated with operating a debit card issuing program.

EXECUTIVE SUMMARY

The Associations believe that the Board should develop final 2013 Surveys that completely and accurately capture issuer cost data related to electronic debit transactions without placing an undue burden on those required to complete the 2013 Surveys. To achieve this objective, the Associations strongly encourage the Board to:

- Allow at least ninety (90) days for respondents to complete the 2013 Surveys;
- Revise the 2013 Surveys to omit misleading differentiation of payment card networks based on authentication methods supported;
- Revise the 2013 Surveys to promote complete and consistent responses from respondents while maintaining the successful individualized issuer follow-up protocols from the 2011 surveys; and
- Revise the Issuer Survey to ensure that full debit card cost data are captured accurately and completely, particularly with respect to costs of authorization, clearing, and settlement, and to avoid insufficiencies and imprecision that may hinder the Board's ability to conduct a comprehensive analysis.

We urge the Board to revise the 2013 Surveys to address the concerns raised in this comment letter and discussed in detail below. As the 2011 surveys demonstrated, the 2013 Surveys are an important resource for the Board in fulfilling its ongoing obligations under Section 920(a). We believe that there would be substantial benefit to the Board, debit card issuers, payment card networks, and the debit card marketplace if the Surveys were revised as recommended in this letter.

DETAILED COMMENTARY

I. The Board's data collection function under Section 920(a)

Section 920(a) provides that the Board shall, at least every two years, disclose aggregate or summary information concerning the costs incurred, and interchange transaction fees charged or received, by issuers in connection with debit card transactions.[5] Section 920(a) provides the

[5] 15 U.S.C. § 1693o-2(a)(3)(B).

Board with the authority to require issuers and payment card networks to provide information to enable the Board to carry out this task.[6]

In furtherance of the Section 920(a) data collection mandate, the Board has issued revised drafts of two surveys related to Regulation II: one for debit card issuers (the Issuer Survey) and one for payment card networks (the Network Survey). The 2013 Surveys will collect information on costs, debit card usage, and interchange fees. Each of the 2013 Surveys is mandatory for issuers and payment card networks, as applicable, that the Board has determined are within the scope of Section 920(a). The Board has also indicated that information collected in response to the 2013 Surveys may be used to respond to possible outcomes of ongoing litigation regarding Regulation II (the "Regulation II Litigation").[7]

II. Description of the 2013 Surveys

A. Issuer Survey (FR 3064a).

The Issuer Survey would collect data from issuers of debit cards (including general-use prepaid cards) that, together with affiliates, have assets of $10 billion or more. The Board has indicated that it anticipates approximately 558 responses to the Issuer Survey.[8] The Issuer Survey would collect information (i) relating to all debit card transactions (including general-use prepaid card transactions) on an aggregate basis (Section II), (ii) relating to debit card transactions broken out by network type (single-message transactions (which the Board equates to PIN-authenticated transactions) (Section III) and dual-message transactions (which the Board equates to signature-authenticated transactions) (Section IV)), and (iii) relating to general use prepaid card transactions (Section V). The Issuer Survey would request information on accounts and cards associated with accounts domiciled in the States, the District of Columbia, and U.S. territories regarding transactions involving a merchant located in the United States.

Broadly speaking, the Issuer Survey in 2013 follows the same format as the 2011 version, soliciting the following categories of information:

> **Respondent Information**: Includes the name of the debit card issuer covered in the response and relevant contact information.
>
> **All Debit Card Transactions**: Includes summary information for debit card (including general-use prepaid card) transaction volume and value; chargebacks to acquirers; costs

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[6] *Id.*

[7] 78 Fed. Reg. 62352, 62353 (October 18, 2013).

[8] As in 2011, the Board's stated number of anticipated respondents (558), suggests that each chartered financial institution that issues debit cards and has, together with its affiliates, at least $10 billion in consolidated worldwide assets, will complete a separate survey. *See* 78 Fed. Reg. 62352, 62352 (October 18, 2013). As we indicated in 2011, the pool of potential respondents with actual debit transaction data likely will be much lower. While there may be 558 financial institutions that meet the participation criteria (i.e., are part of an affiliated group that has at least $10 billion in assets), many of them are individual affiliates of a larger group, but do not issue debit cards. Accordingly, we anticipate that many of the 558 potential respondents will provide "zero" answers. As in 2011, the Associations believe the Board should consider allowing completion of the Surveys on a consolidated basis at the holding company level rather than at the individual affiliate level. Requiring individual issuer responses, as opposed to holding company-level responses, will be burdensome with little apparent benefit.

of authorization, clearance, and settlement; costs for cardholder inquiries, cardholder rewards, and non-sufficient funds handling; costs for fraud prevention and data security; interchange fee revenue; fraudulent transactions; and fraud losses.

Single-Message (PIN) Debit Card Transactions: Requests data for the same set of questions asked in the aggregate section above, but specifically about single-message (PIN) debit card transactions, excluding general-use prepaid card transactions.

Dual-Message (Signature) Debit Card Transactions: Requests data for the same set of questions asked in the aggregate section above, but specifically about dual-message (signature) debit card transactions, excluding general-use prepaid card transactions.

General Use Prepaid Card Transactions: Requests data for the same set of questions asked in the aggregate section above, but only with respect to general use prepaid card transactions.

In drafting Section III and Section IV of the Issuer Survey, the Board has carried forward from 2011 the notion that PIN-authenticated transactions are routed over single-message networks (and that single-message networks *only* process PIN-authenticated transactions) and that signature-authenticated transactions are routed over dual-message networks (and that dual-message networks *only* process signature-authenticated transactions).[9]

The Issuer Survey contains several significant revisions from the 2011 version. Most importantly, the Issuer Survey has been revised in several instances to reflect a potentially increased focus on costs that the Board would classify as variable authorization, clearing, and settlement costs. This category of revisions includes, among other items, (1) the elimination of transaction monitoring costs from the defined term "costs of authorization, clearing, and settlement"; (2) the creation of a new cost breakdown between "fixed costs" and "variable costs," and (3) general revisions in the instructions and questions apparently designed to clarify further the nature of costs that the Board considers to be included in authorization, clearing, and settlement functions of a debit card issuer. The Board's increased focus on authorization, clearing and settlement costs and its new focus on distinguishing variable and fixed costs, ostensibly, are driven by the Board's preparation for all potential outcomes of the ongoing Regulation II Litigation.

Of the above, the focus on, and methodology for, differentiating between "fixed costs" and "variable costs" is of particular note and concern, with those terms defined as follows:

> *Fixed Costs*: Costs that do not vary with changes in the number or value of transactions over the course of the reporting period. For in-house fixed costs, these include all capital expenditures that were depreciated or amortized. For third-party processing fees, these include fees that are not assessed on a per-transaction or ad valorem basis. For example, fees associated with minimum volume commitments to third-party processors should be reported as fixed costs.

[9] As discussed in Section III(C) below, we believe that this approach is erroneous given the evolving nature of authentication methods for debit card transactions.

Variable Costs: Costs that directly vary with the number or value of transactions over the course of the reporting period. In-house variable costs, for example, may include certain labor costs. Variable costs related to third-party processing fees are those fees assessed on a per-transaction or ad valorem basis.

As discussed in Section IV below, these definitions are potentially unduly limiting, and the method of categorizing and differentiating between fixed and variable cost elements may adversely impact the quality and usability of cost data the Board collects.

In addition to the revisions relating to authorization, clearing, and settlement costs, the Issuer Survey has been revised to require issuers that have affiliated processors (i.e., processors that are under common control with the issuer) to report processing services provided by the affiliate processor at the cost of service to the affiliate rather than an arms' length value. This approach is a departure from prior iterations of the survey and, as discussed in Section IV below, unduly prejudices issuers that insource, rather than outsource, debit card program service components.

B. Network Survey

Similar to 2011, the Network Survey would collect information from payment card networks. Importantly, payment card networks that operate both single-message and dual-message networks would be required to complete surveys and report data separately for each type of network. As with the Issuer Survey, the Board continues to equate PIN authentication with single-message networks and signature authentication with dual-message networks in the Network Survey. [10]

The Network Survey would collect information in two areas:

Respondent Information: Includes the name of the network covered in the response and relevant contact information. Also includes whether the payment card network is a single-message (PIN) or dual-message (signature) network, and whether the payment card network offers a tiered interchange fee rate schedule that differentiates between exempt issuers and non-exempt issuers, and the number of merchant locations at which debit cards issued on the network are accepted for payment.

Debit Card Transactions: Includes the volume and value of settled purchase transactions, as well as information across a variety of card and transaction types, including card-present and card-not-present transactions; chargebacks and returns; small-issuer exempt and issuer non-exempt transactions; and exempt and non-exempt general-use prepaid card transactions. The Network Survey also requests information on interchange fees paid by acquirers and received by issuers, broken down across the card and transaction types elicited above; the network fees received from acquirers and issuers; and payments and incentives paid by networks to acquirers, merchants, and issuers.

[10] As discussed in Section III(C) below, we believe that this approach is erroneous given the evolving nature of authentication methods for debit card transactions.

As with the Issuer Survey, the Network Survey includes several revisions from the 2011 version. Most of the revisions contained in the Network Survey, however, are intended to eliminate the multi-period reporting obligations that were contained in the 2011 version.

III. Comments on the 2013 Surveys generally

The 2013 Surveys present several overarching concerns. If these concerns are not addressed, the 2013 Surveys may suffer from insufficiencies that lead to incomplete, inaccurate, or statistically unusable responses. Incomplete, inaccurate, or unusable responses inevitably will hinder the utility of the 2013 Surveys for the Board's analysis, aggregation and reporting under Section 920(a), and potentially will harm debit card issuers and payment card networks if the Board modifies Regulation II based on the results the 2013 Surveys yield in their current form.

A. Notwithstanding the Board's desire to use the 2013 Survey responses in conjunction with the ongoing Regulation II Litigation, the proposed response period should not begin before February 15 and should extend for at least ninety (90) days.

To provide comprehensive and accurate data, respondents will need a reasonable amount of time to collect relevant information following the end of calendar year 2013 and will require sufficient time to fully complete the 2013 Surveys. Debit card issuers faced significant challenges in completing the 2011 surveys during the slightly more than 60-day response window (the 2011 issuer surveys were issued in early February 2012 – prior to February 15 – with responses due on April 16, 2012). Accordingly, shortening the response time may impair the quality of reported data, particularly given the Board's revisions requiring new data categorizations. For example, some of the new proposed cost allocations (e.g., fixed versus variable) will require additional, careful consideration and analysis by debit card issuers.

While proposing to shorten the response period to accommodate potential timing and outcomes regarding the Regulation II Litigation may seem logical, the undesirable ramifications of inaccurate or incomplete data that may result from a condensed response period outweigh any potential benefits from accelerated reporting timelines. If the 2011 survey response process may be used as a reasonable guidepost, then issuers will need all of the originally contemplated sixty (60) days to respond to the Issuer Survey, plus additional time. Indeed, in the Issuer Survey, the Board itself has recognized that it underestimated in the 2011 survey the burden of complex data collection and associated timing requirements, resulting in an increase in the estimated time to complete the Issuer Survey by a full work week (40 hours, to a total of 200 hours) in 2013.

Based on the 2011 survey experience and changes to the 2013 Surveys, we believe that respondents should be given not less than ninety (90) days to complete the 2013 Surveys to improve respondents' ability to collect and provide complete and accurate information. In addition, the 2013 Surveys should not be issued until February 15th or later to allow time for year-end closing and preliminary audit and review of debit card program data from the previous calendar year. For example, many issuers will not receive invoices from third parties (e.g., processors or networks) for year-end 2013 activity until mid-January 2014 or later. Additionally, many issuers have launched new debit programs in 2013, such as prepaid card programs, and will require additional time to gather data related to these new programs. Issuing the 2013

Surveys on or after February 15th and allowing at least ninety (90) days to complete them will increase the availability of accurate, complete data in response to the 2013 Surveys.

B. The Board conflates single-message network transactions with PIN-authenticated transactions and conflates dual-message network transactions with signature-authenticated transactions.

In the 2013 Surveys, the Board has carried forward its notion from the 2011 surveys (and from Regulation II itself) that PIN-authenticated transactions are routed over single-message networks (and that single-message networks *only* process PIN-authenticated transactions) and that signature-authenticated transactions are routed over dual-message networks (and that dual-message networks *only* process signature-authenticated transactions). This notion, which was incorrect in 2011, is even more untrue in the current marketplace, both because PIN and signature methods of authentication are not the exclusive methods of authentication used in the marketplace and because single-message networks increasingly process transactions that are not, in fact, authenticated using a PIN, and dual-message networks increasingly process transactions that are not authenticated using a signature (including PIN-authenticated transactions).

For example, many debit card transactions today are neither PIN nor signature authenticated, meaning that the consumer is not required to enter a PIN or provide a signature at the point of merchant interaction (e.g., for nearly all card-not-present transactions and most card present transactions).[11] These transaction types currently are processed on both single-message and dual-message networks. Additionally, dual-message networks can and do process PIN-authenticated transactions, and single-message networks can and do currently process transactions that are not PIN-authenticated. Given the evolving authentication methods supported by payment card networks with respect to electronic debit transactions (including transactions authenticated by neither PIN nor signature) regardless of the network's messaging format (single message or dual message), identifying and differentiating networks by the type(s) of transaction authentication methods they support is increasingly complex and burdensome, and is likely to lead to confusion and error by issuers and networks responding to the 2013 Surveys.

We encourage the Board to remove references to "signature" and "PIN" authentication methods in the both the Issuer Survey and the Network Survey, and to collect information based solely on the messaging system of the network (single message or dual message) without regard to the methods by which transactions processed or routed on that network may be authenticated. For purposes of the 2013 Surveys, and for interchange and transaction routing policy-making, focusing on transaction authentication methods is increasingly irrelevant and misleading.

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[11] For example, "PIN-less debit" is gaining popularity in response to the increased routing competition under Regulation II. *See* Karen Epper Hoffman, Networks: No PIN, No Problem, Digital Transactions 26 (July 2013), *available at* www.digitaltransactions.net/issues/viewer/4155; *see also* Press Release, "Acculynk Announces Alaska Option Issuers Enabled with PaySecure Internet Debit" (May 14, 2012) (noting that more than 7,000 card issuers and 3,200 internet merchants take advantage of PaySecure's "graphical PIN pad" technology to securely process debit transactions online using the customer's PIN), *available at* www.reuters.com/article/2012/05/14/idUS145583+14-May-2012+BW20120514.

C. Despite proposed revisions, experience from the 2011 surveys indicates that the 2013 Surveys continue to lack the precision required to elicit complete, consistent and accurate responses from debit card issuers and payment card networks.

While revisions the Board made before releasing the final 2011 surveys and certain revisions reflected in the proposed 2013 Surveys are helpful, industry feedback from our members on the 2011 survey completion process indicates that without additional modifications, debit card issuers and payment card networks are unlikely to complete the 2013 Surveys consistently.[12]

For example, as part of the 2011 survey response process, the Associations raised multiple questions to the Board regarding a varied set of issues, ranging from the Board's unduly restrictive approaches to fraud losses and interchange accounting to the Board's treatment of health savings accounts, chargebacks and transaction reversals. Similarly, debit card issuers were forced in the 2011 surveys (and will be again under the proposed 2013 Surveys) to make decisions regarding allocation between U.S. and non-U.S. program costs and revenues, determinations regarding application of the Board's overly-narrow definition of authorization, clearing, and settlement costs, and accounting for costs from third parties. The Board will continue to face limiting constraints in implementing Section 920(a) via the surveys unless the Board promotes greater consistency among the survey responses and minimizes the number of responses that are not utilized for analysis and reporting.

Regardless of whether the Board enhances the clarity of information requests and categorization in the 2013 Surveys, the Board should continue the process it adopted in 2011 of a formal, individualized approach to answering respondent questions about the surveys and should continue conducting follow-up interviews once the initial 2013 Survey responses have been reviewed. This follow-up process should continue to rely on individual discussions with respondents rather than group meetings or multilateral forums wherever possible. As the Board learned in 2011, one-on-one interviews and correspondence with respondents, particularly those that the Board considers to have provided concerning responses (e.g., statistical outliers), will facilitate more consistent and complete survey responses and data collection. This approach will promote a more meaningful sample set of responses as it allows the Board to avoid discarding a significant number of responses. Better guidance in the 2013 Surveys will result in more accurate and useful data, and a dedicated follow up process will enhance the precision in, and usability of, responses.

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[12] In a 2006 publication setting forth federal agency survey standards, the Office of Management and Budget noted that "[a]gencies must design [a] survey to achieve the highest practical rates of response, commensurate with the importance of survey uses [and] . . . to ensure that survey results are representative of the target population so that they can be used with confidence to inform decisions." Office of Management and Budget, Standards and Guidelines for Statistical Surveys, Standard 1.3 (2006). Although the mandatory nature of the 2013 Surveys makes establishment of a sample set of responses straightforward, the general nature of the questions and lack of detailed instructions regarding requested data makes it highly likely that the data collected will be less than "representative of the target population" and will not support the type of meaningful analysis that "can be used with confidence to inform decisions."

IV. Specific Comments on the Issuer Survey

A. Consistent with the requirements of Section 920(a), the Board should revise the Issuer Survey to capture authorization, clearance, and settlement costs more completely and accurately.

Section 920(a) instructs the Board to "establish standards for assessing" whether the amount of an interchange transaction fee is reasonable and proportional to "costs incurred by the issuer with respect to the transaction."[13] To support this statutory mandate, the Issuer Survey must collect information across multiple categories of cost data, including costs broadly related to the authorization, clearance, or settlement of debit card transactions. The Issuer Survey, as currently drafted, both fails to capture the full scope of costs that are properly included as authorization, clearance, or settlement costs related to debit card transactions and fails to elicit other cost data that rightly should be included by the Board in establishing standards for assessing recoverable interchange transaction fees under Section 920(a).

1. The Board's "variable cost"/"fixed cost" dichotomy is an inappropriate proxy for identifying incremental authorization, clearance, and settlement costs.

The Issuer Survey's fixed cost/variable cost dichotomy should not be used as a method for determining debit card issuer costs that are "incremental" to the issuer's authorization, clearance, or settlement of debit card transactions. The concept of "incremental costs" encompasses costs beyond the "variable costs" of a debit card transaction and certainly beyond those costs that "vary directly with the number or value of transactions." The revisions to the Issuer Survey suggest that the Board is considering – among possible responses to potential outcomes of the Regulation II Litigation – to limit "incremental costs" to the separately calculable per-transaction costs that vary directly with transaction counts or values and that result from authorization, clearing, and settlement activities of the debit card issuer or its third party processor. These so-called "variable" costs, while certainly part of a debit card issuer's incremental costs of authorization, clearance, and settlement, exclude a number of cost elements that are incremental to an issuer's role in authorizing, clearing, and settling debit card transactions and that should be included.

As an example, the use of "variable cost," as defined by the Board in the Issuer Survey, fails to account for the incremental costs that debit card issuers incur as part of their constant investments in debit card authorization, clearing, and settlement systems to facilitate anticipated peak transaction volumes (*e.g.*, Black Friday transaction volumes), and fails to recognize as incremental those debit card costs "fixed" by debit card issuers that could easily be negotiated to vary with transaction count or volume (*e.g.*, through the payment of greater fixed fees to a third party transaction processor in exchange for lower, per transaction fees). In that regard, the fixed cost versus variable cost approach incentivizes issuers to seek high per transaction fees to the exclusion of fixed fee arrangements, which potentially limits the

[13] 15 U.S.C. § 1693o-2(a)(3)(A). In directing the Board's rulemaking under Section 920(a), Congress only limited the Board's consideration of "costs. . . which are not specific to a particular electronic debit transaction." 15 U.S.C. § 1693o-2(a)(4)(B)(ii).

competitive environment among networks and service providers by eliminating pricing flexibility and compelling issuers to assume increased price risk by forgoing the economic certainty that accompanies fixed fee cost structures. Further, by creating an unreasonable dichotomy between fixed and variable costs, the Issuer Survey forces issuers to categorize cost data in an artificial manner that will not allow meaningful calculation of incremental costs unless the individual cost components constituting each category are reported on a line-item basis. In other words, the proposed approach in the Issuer Survey to dividing authorization, clearance, and settlement costs into "fixed cost" and "variable cost" categories does not properly identify the full scope of "incremental" authorization, clearance, and settlement costs that the Board must consider under Section 920(a).

We urge the Board to abandon the unreasonable "fixed cost"/"variable cost" dichotomy. Instead, we encourage the Board to collect data related to authorization, clearance, and settlement activities at the component, line-item level, using, for example, the cost categories set forth in Section IV.A.3 below.[14] If the Board is later compelled to categorize costs as either "incremental" or "non-incremental," having full line-item cost detail will permit more accurate evaluation of the Issuer Survey information.

2. The Board's definition of "costs of authorization, clearance, and settlement" in the Issuer Survey, like its 2011 predecessor, fails to include *all* costs related to a debit card issuer's authorizing, clearance, and settlement activities.

The Board's definition of authorization, clearance, and settlement costs in the Issuer Survey is overly narrow and omits a number of costs incurred by debit card issuers in performing activities related to authorizing, clearing and settling debit card transactions. For example, transaction

[14] In the event that the Board is unwilling to forgo the fixed versus variable cost approach currently proposed, then we encourage the Board to make the following modifications to the Issuer Survey to clarify and improve these categorizations. First, "transactions monitoring costs tied to authorization" should be (A) removed from question 5, (B) added to question 3, and (C) reinserted in the defined term "cost of authorization, clearance, and settlement." As the item description itself indicates, and as the Board properly concluded in the 2011 survey and other Board-issued documents, transaction monitoring costs are a cost related to authorization of transactions and should be included as a variable cost and a cost of authorization, clearance, and settlement in question 3. *See, e.g.,* Reply Brief for Defendant-Appellant Board of Governors of the Federal Reserve System at 27, NACS, et al. v. Bd. of Governors of the Fed. Reserve Sys., --- F. Supp. 2d ----, No. 11-02075 (RJL) (D.D.C. July 31, 2013), appeal docketed, No. 13-5270 (D.C. Cir. Dec. 04, 2013) (concluding that "[t]ransaction monitoring is an integral part of the authorization of specific electronic debit transactions, and inclusion of these costs is thus entirely appropriate"). Second, the Board should clarify in question 3 that all network processing fees are variable costs, and the Board should revise the definition of "network processing fees" to include all fees paid by an issuer to a network in connection with or related to the network's processing of debit card transactions, including membership, participation, license and other fixed fees. The Board's current approach of excluding membership, participation and license fees from the definition of "network processing fees" (1) artificially limits issuer flexibility in structuring financial arrangements with networks by inducing issuers and networks to maximize per transaction fees and minimize membership, participation, license or other fixed fee arrangements, which limits potential competition in the debit card marketplace, and (2) potentially penalizes issuers for structuring network fee relationships in a manner that includes large fixed payments with lower per transaction fees even where doing so may increase economic certainty and decrease risk.

monitoring costs; receiving, responding to, and resolving customer inquiries with respect to debit card transactions; debit card transaction compliance costs (such as transaction reporting and dispute resolution); debit card transaction non-sufficient funds handling costs; card production and delivery; a portion of costs related to establishing and maintaining debit account relationships; and other cost elements all relate to an issuer's authorizing, clearing and settling of debit card transactions, yet the Board does not include these items as "costs of authorization, clearance, and settlement costs" in the Issuer Survey and, in many cases, does not separately collect these cost elements through the Issuer Survey. We urge the Board to re-evaluate the definition of "costs of authorization, clearance, and settlement" in the Issuer Survey and to include additional cost elements within that definition, including the cost elements identified above and in Section IV.A.3 below. To the extent the Board elects not to do so, we urge the Board to separately collect all of these debit card cost elements to ensure the collection of comprehensive debit card transaction and debit card cost information to assist the Board in developing a full understanding of the landscape of debit card costs.

3. The Board should enhance the Issuer Survey to more accurately capture line-item debit card costs.

We believe that the cost categories in the Issuer Survey should be enhanced to more fully and accurately capture issuer costs associated with debit card transactions. As a general principle, we believe that aggregate lump sum data requests, while helpful, are not as useful to the Board as collecting total cost data that is broken down into various specific cost line items. While this approach is a departure from the one taken in 2011, it is necessary, particularly if the Board insists on collecting data in fixed cost and variable cost categories, or if the Board retains its current, narrow definition of authorization, clearance, and settlement costs.

Detailed cost breakdowns will place the Board in a better position to analyze debit-related costs, to respond to potential outcomes in the Regulation II Litigation, and to set interchange policy in the future. Collecting more detailed cost information will also allow Congress, the courts, and the Board to evaluate the impacts of Section 920(a) and the Board's approach to implementing it through Regulation II in a manner that is not possible using data collected under the currently-proposed groupings. For example, instead of grouping all potentially allowable costs into general "costs of authorization, clearing, and settlement" or "fixed costs" or "variable costs" categories with no specific cost line-items and no opportunity for issuers to explain their cost allocations, we encourage the Board to define individual subcategories of data that constitute potential incremental costs of authorization, clearing, and settlement. These subcategories should be supplemented with additional open-ended opportunities for issuers to provide reporting according to their own cost categories, including narrative explanation of the makeup of and justification for such categories. Adopting this more detailed data collection approach, while requiring issuers to report cost data at a more granular level, will put the Board in the best position to refine interchange policy and respond to Regulation II Litigation in a manner that accounts for all relevant costs.

Specifically, we recommend that the Board revise the Issuer Survey to include the following categories of cost data in Question 3 on "costs of authorization, clearing, and settlement" (which would appear in Sections II, III and IV), expanded to include all costs related to debit transactions, irrespective of whether currently defined by the Board as allowable costs under Regulation II or categorized as a "fixed cost" or a "variable cost":

- In-house Costs
  - Authorizations
  - Transaction Monitoring
  - Clearing and Settlement
  - Chargeback and other Billing Error Processing
  - Transaction Posting
  - Statement Production
  - Card Production and Deployment (ordinary course)
  - Card Production and Deployment (fraud replacement)
  - Cardholder Interactions and Customer Service (ordinary course)
  - Cardholder Interactions and Customer Service (alleged fraud)
  - Rewards and Incentive Programs, including program administration, rewards and affinity partner revenue sharing
  - Research and Development Costs

- Third-Party Fees
  - Authorizations
  - Transaction Monitoring
  - Clearing and Settlement
  - Chargeback and other Billing Error Processing
  - Transaction Posting
  - Statement Production
  - Card Production and Deployment (ordinary course)
  - Card Production and Deployment (fraud replacement)
  - Cardholder Interactions and Customer Service (ordinary course)
  - Cardholder Interactions and Customer Service (alleged fraud)
  - Rewards and Incentive Programs, including program administration, rewards and affinity partner revenue sharing
  - Research and Development Costs

- Network Fees
  - Per Transaction Processing
  - Other Transaction Processing Fees (membership, licensing, etc.)

- Other Costs

In each case, these line-item costs should include all costs of equipment, hardware, software, and labor associated with the defined task or function. Additionally, as noted in the list above, we strongly recommend including a narrative "Other Costs" category to give debit card issuers the discretion to disclose other debit card costs not contemplated by the fixed survey categories, which is critical to the success of the Issuer Survey as a tool for collecting complete cost information. Such a category allows issuers to disclose relevant costs to the Board and simultaneously affords the Board the ability to review potential emerging (and, at a minimum, potentially not contemplated) issuance costs. As part of the "Other Costs" category, the Board should ensure that the Issuer Survey allows for explanation from issuers for each included cost, including both a description of the cost and the rationale for inclusion.

B. To facilitate collection of a broad sample of debit card cost structures, the Board should allow for, but not mandate, the Issuer Survey to be completed by Exempt Issuers.

As previously requested, we recommend that the Board expand the Issuer Survey to allow exempt issuers (those with assets below $10 billion) to participate voluntarily in the Issuer Survey. Doing so will provide the Board with additional cost information from exempt issuers that will assist the Board in evaluating whether the small issuer exemption continues to have its intended effect both on exempt issuers and the debit card marketplace generally. In addition, exempt issuer responses to the Issuer Survey may give the Board additional, useful data in formulating responses to the Regulation II Litigation.

Participation should be at the exempt issuer's option; it should not be mandatory. Cost data provided by exempt issuers will assist the Board in developing a more comprehensive understanding of the debit card marketplace and of the impacts of Regulation II on a broader cross-section of the industry. Such an understanding will be critical for the Board when responding to the Regulation II Litigation, evaluating Regulation II generally, and considering potential future adjustments to the interchange fee standards.

C. The new treatment for affiliated processors at cost does not account for the actual costs charged to the P&L of a debit card issuer's debit card program.

As a result of the proposed revisions from the Board, the Issuer Survey now requires issuers to account for affiliate processors at the cost of service to the affiliate processor rather than the cost to the issuer. Taking this approach ignores the commonly accepted principles of cost accounting that govern inter-affiliate services within a controlled group of companies.[15] Under these generally accepted principles, a debit card issuer typically would be required to pay an imputed mark-up for the services provided by an affiliate processor.

Accordingly, requiring a debit card issuer that relies on an affiliate processor to include affiliate processing costs at the cost of service to the affiliate as part of the Issuer Survey is likely to result in a debit card issuer underreporting the true cost of the debit card issuing program. This approach unduly prejudices issuers that use affiliates for transaction processing services by including reported cost data that is artificially low relative to arms' length, third party costs. As a result, issuers with affiliate processors will be unable to report a true debit card issuer program cost.

D. The Issuer Survey should be revised to facilitate the inclusion of certain international fraud losses in the issuer responses.

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[15] In managerial accounting, when different affiliates or divisions of a multi-entity company maintain their own profit and loss statements, they typically are also responsible for returns on investment. Accordingly, when divisions or affiliates are required to transact with each other, a transfer price is used to determine costs. *See, e.g.,* Dennis Caplan, MANAGEMENT ACCOUNTING: CONCEPTS AND TECHNIQUES, *available at* http://classes.bus.oregonstate.edu/spring-07/ba422/management%20accounting%20chapter%2023.htm (noting that "[w]hen product is transferred between profit centers or investment centers within a decentralized firm, transfer prices are necessary to calculate divisional profits, which then affect divisional performance evaluation").

The need to capture and evaluate accurately the full costs associated with U.S. debit card transactions and, specifically, the fraud costs associated with U.S. debit card transactions is important to the proper application of Section 920(a). Fraud on U.S. accounts from the use of debit card information at international merchant locations, in many instances, is responsible for a material portion of an issuer's total fraud losses to U.S.-domiciled accounts. In these scenarios (as with most cross-border fraud losses), the critical data compromise step leading to the fraudulent debit card activity on the account frequently occurs in the country in which the debit card is issued (*i.e.*, *inside* the United States for U.S.-issued debit cards) even though the second step, the fraudulent transaction, is perpetrated at a merchant location outside the country where the account is held (*i.e.*, *outside* of the United States for debit cards issued on U.S.-domiciled accounts).[16] For example, a U.S. debit cardholder who never has traveled outside the United States may have debit card information compromised in the United States and then have that information used to perpetrate fraud at a merchant location in another country, where retail practices and law enforcement may be less effective at preventing such fraudulent activity. For the reasons that follow, we respectfully request the Board to consider the inclusion of fraud losses on a U.S.-domiciled debit card account that are realized by issuers upon the unauthorized use of a debit card or debit card account at a merchant location outside the United States ("International Fraud Losses") as part of the data collected in the Issuer Survey.

1. Issuers incur material costs as a result of International Fraud Losses, even if an international merchant location is involved.

As with fraud losses occurring in the United States, issuers must account for International Fraud Losses as a cost of their U.S. debit card issuing business, and International Fraud Losses may account for a material portion of an issuer's total fraud losses on U.S.-domiciled debit card accounts. While International Fraud Losses, by definition, are attributable to fraudulent debit card transactions perpetrated at merchant locations outside the United States, their nexus to U.S.-domiciled debit card accounts and transactions, including accounts that may never have been accessed for legitimate debit card transactions outside the United States, justifies inclusion of associated cost data in the Issuer Survey.

Further, excluding International Fraud Losses also is at odds with the Board's approach to other cost data incurred outside of the United States that the Board collects via the Issuer Survey. For example, many issuers maintain back-up or co-located transaction processing systems (or pay their third party processors to maintain these systems) that include infrastructure located outside of the United States. Although these costs are incurred outside of the United States,

[16] A recent Federal Reserve Bank of Atlanta study indicates that a significant driver of this International Fraud Loss paradigm is the ability of a fraudster to engage in technological arbitrage to facilitate the fraud and take advantage of the differing fraud prevention approaches in different jurisdictions. *See* Douglas King, *Chip and PIN: Success and Challenges in Reducing Fraud*, RETAIL PAYMENTS RISK FORUM, FEDERAL RESERVE BANK OF ATLANTA 1 (January 2012) (noting that technological differences have shifted fraud "to different products (from credit to debit), other channels (from card-present to card-not present, or CNP), or other geographies (cross-border fraud)"), *available at* www.frbatlanta.org/documents/rprf/rprf_pubs/120111_wp.pdf. The study also notes the significant increase in cross-border fraud, particularly due to differences between EMV and mag stripe technology and related counterfeit cards. *Id.* at 22. Accordingly, Issuers expect International Fraud Losses and associated costs only to increase as fraudsters and cross-border information flows become more sophisticated.

they are an integral component of an issuer's cost of authorization, clearance, and settlement under domestic debit card programs. Similarly, call centers used to facilitate fraud prevention and customer service may be located outside of the United States, but these costs also are collected in the Issuer Survey because they relate to U.S. debit card transactions. We submit that International Fraud Losses should be included in Issuer Survey because they represent a real, often significant cost to Issuers related to their U.S.-domiciled debit card accounts and transactions. Moreover, for reasons discussed below, consideration of these International Fraud Losses is consistent with the jurisdictional approach of Section 920(a).

2. The Board's authority to regulate electronic debit transactions does not preclude the Board from considering elements that contribute to issuers' U.S. debit card costs, such as International Fraud Losses connected to U.S. debit cards, even where components of those cost elements arise outside the United States.

In issuing Regulation II, the Board construed the scope of its regulatory authority under Section 920(a) as being limited to the United States. Consequently, Regulation II limits both the definition of "account" to accounts "located in the United States"[17] and the definition of "electronic debit transaction" to "use of a debit card by a person as a form of payment in the United States."[18] We agree that the Board's authority *to regulate debit card interchange fees and routing* is limited to debit card activity in the United States. However, we do not believe that this limitation on the Board's authority to *regulate* activity outside the U.S. precludes the Board's consideration of Issuer debit card costs associated with U.S.-domiciled accounts and collection of associated data in the Issuer Survey.

Indeed, the Board's own discussion in releasing Regulation II confirms that the Board's geographic considerations were focused entirely on the scope of the Board's authority to regulate, and not the costs the Board could collect and consider in establishing those regulations: "Accordingly, limiting the scope of this part to transactions initiated at United States merchants to debit accounts in the United States avoids both extraterritorial application of this part as well as conflicts of laws."[19] As the Board indicated, the geographic concern centered on the Board's ability to promulgate a regulation that purported to have extraterritorial applicability and that potentially would create conflicts of law without any mechanism for resolving them.[20] It does not follow, however, that because the Board limited the scope of its authority to regulate, the Board also is precluded from considering costs simply because an element of those costs, which neither could have arisen nor been incurred by an Issuer but for the issuance of a U.S.-domiciled debit card, occurs outside of the United States.

The Board's rulemaking to implement the small issuer exemption in Section 920(a) underscores that the Board recognizes its ability to consider non-U.S. factors under Section 920(a) and Regulation II notwithstanding the limitations on the scope of the Board's authority to regulate. Section 920(a)(6)(A) provides that the interchange transaction fee limitations do not apply to

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[17] 12 C.F.R. § 235.2(a) (2011).

[18] 12 C.F.R. § 235.2(h) (2011).

[19] Regulation II—Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43394, 43406 (July 20, 2011).

[20] As the Board noted, Section 920 of the Electronic Fund Transfer Act does not contain a conflicts of laws provision. *See id.* (indicating that "the EFTA provides no indication (such as a conflicts of law provision) that Congress intended for Section 920 to apply to international transactions").

"any issuer that, together with its affiliates, has assets less than $10,000,000,000."[21] In determining the scope of affiliates that should be considered when evaluating issuer asset size, the Board concluded that foreign affiliates of issuers should be included because "the Board believes it is appropriate to consider the total resources available to an issuer when determining whether it is 'small.'"[22] Just as the Board determined that consideration of assets of affiliates located outside of the United States is both permissible and important to determining whether an Issuer of debit cards associated with U.S. domiciled accounts should qualify for the small issuer exemption, we request that the Board consider the costs of International Fraud Losses when evaluating issuers' U.S. debit card costs.

* * *

Thank you for considering the views expressed in this letter. We appreciate the opportunity to share our views and would be pleased to discuss any of them further at your convenience. Please feel free to contact Paul Saltzman, President and General Counsel of The Clearing House Association (Paul.Saltzman@theclearinghouse.org, (212) 613-0138), or Rob Hunter, Deputy General Counsel of The Clearing House Association (Rob.Hunter@theclearinghouse.org, (336) 769-5314), who have been coordinating the participation in this letter of all the Associations listed below.

Sincerely,

/s/
Nessa Feddis
Senior Vice President and Deputy Chief Counsel for Consumer Protection and Payments,
American Bankers Association

/s/
Paul Saltzman
President,
The Clearing House Association L.L.C.

/s/
James D. Aramanda
CEO,
The Clearing House Payments Company L.L.C.

/s/
Steve Zeisel
Executive Vice President and General Counsel,
Consumer Bankers Association

[21] 15 U.S.C. § 1693o-2(a)(6) (2011).
[22] Regulation II—Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43394, 43420 (July 20, 2011).

/s/

Bill Cheney
CEO,
Credit Union National Association

/s/

Rich Whiting
General Counsel and Executive Director,
Financial Services Roundtable

/s/

Viveca Ware
Executive Vice President, Regulatory Affairs,
Independent Community Bankers of America

/s/

Brent Tjarks
Executive Director,
Midsize Bank Coalition of America

/s/

B. Dan Berger
President/CEO,
National Association of Federal Credit Unions

APPENDIX A

The American Bankers Association

The American Bankers Association ("ABA") represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its 2 million employees. ABA's extensive resources enhance the success of the nation's banks and strengthen America's economy and communities. Learn more at www.aba.com.

The Clearing House

Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world's largest commercial banks, which employ over 2 million people and hold more than half of all U.S. deposits. The Clearing House Association L.L.C. is a nonpartisan advocacy organization representing—through regulatory comment letters, amicus briefs and white papers—the interests of its owner banks on a variety of systemically important banking issues. The Clearing House Payments Company L.L.C. provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily and representing nearly half of the automated clearing-house, funds-transfer, and check image payments made in the U.S. See The Clearing House's web page at www.theclearinghouse.org.

The Consumer Bankers Association

The Consumer Bankers Association ("CBA") is the only national financial trade group focused exclusively on retail banking and personal financial services—banking services geared toward consumers and small businesses. As the recognized voice on retail banking issues, CBA provides leadership, education, research, and federal representation on retail banking issues. CBA members include most of the nation's largest bank holding companies as well as regional and super-community banks that collectively hold two-thirds of the industry's total assets.

The Credit Union National Association

The Credit Union National Association ("CUNA") is the largest credit union advocacy organization in the country, representing state and federal credit unions, which serve about 97 million members. CUNA benefits its members by partnering with state credit union leagues to provide proactive legislative, regulatory, and legal representation, the latest information on credit union issues, economic reports, regulatory analyses and advocacy, compliance assistance, grassroots and political advocacy efforts, and education. Visit www.cuna.org for more information about CUNA.

The Financial Services Roundtable

The Financial Services Roundtable ("FSR") represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.1 trillion in revenue, and 2.4 million jobs.

The Independent Community Bankers of America

The Independent Community Bankers of America® (ICBA), the nation's voice for nearly 7,000 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services. ICBA members operate approximately 23,600 locations nationwide, employ almost 300,000 Americans and hold more than $1.2 trillion in assets, $1 trillion in deposits and $750 billion in loans to consumers, small businesses and the agricultural community. For more information, visit www.icba.org.

Midsize Bank Coalition of America

The Midsize Bank Coalition of America ("MBCA") is a group of 22 US banks formed for the purpose of providing the perspectives of midsize banks on financial regulatory reform to regulators and legislators. The 22 institutions that comprise the MBCA operate more than 3,300 branches in 41 states, Washington, D.C., and three U.S. territories. Our combined assets exceed $322 billion (ranging in size from $7 to $25 billion) and, together, we employ approximately 60,000 people. Member institutions hold nearly $241 billion in deposits and total loans of more than $195 billion.

The National Association of Federal Credit Unions

Founded in 1967, the National Association of Federal Credit Unions ("NAFCU") exclusively represents the interests of federal credit unions before the federal government. Membership in NAFCU is direct; no state or local leagues, chapters or affiliations stand between NAFCU members and its headquarters in Arlington, VA. NAFCU provides its members with representation, information, education, and assistance to meet the constant challenges that cooperative financial institutions face in today's economic environment. NAFCU represents nearly 800 federal credit unions, accounting for 63.9 percent of total FCU assets and 58 percent of all FCU member owners. NAFCU represents many smaller credit unions with limited operations as well as many of the largest and most sophisticated credit unions in the nation, including 82 out of the 100 largest FCUs. Learn more at www.nafcu.org.