

**Meeting Between Federal Reserve Staff  
and K. Craig Wildfang and Paul Snyder  
September 15, 2010**

**Participants:** K. Craig Wildfang (Robins, Kaplan, Miller & Ciresi LLP) and Paul Snyder (Public Strategies Washington)

Louise Roseman, Robin Prager, Stephanie Martin, David Mills, Mark Manuszak, Edith Collis, Vivian Wong, Jeffrey Yeganeh, Jennifer Davidson, and Dena Milligan (Board); Julia Cheney (Federal Reserve Bank of Philadelphia)

**Summary:** Staff from the Federal Reserve Board and the Federal Reserve Bank of Philadelphia met with Craig Wildfang and Paul Snyder to discuss the interchange fee provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Act”). Mr. Wildfang informed Federal Reserve staff that he is the lead counsel for the merchant-plaintiffs in a pending class-action lawsuit against certain payment card networks. Using prepared materials, Messrs. Wildfang and Snyder highlighted certain challenges they expected the Federal Reserve Board to face during the rulemaking process, including: debit card transaction routing; the comparison to checks, which clear at par through the Federal Reserve System; network fees; fraud and fraud prevention. A copy of the material distributed at the meeting is attached below.

# Federal Reserve Board Adoption of Rules on Debit Cards

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# AGENDA

- Introductions
- Process Issues for Rules' Adoption
- How Merchants and Their Representatives can be of Assistance to the Board
- Discussion of Major Issues the Board Will Have to Consider
- Comments on Board Survey Forms and Data Gathering
- Comments on Presentations of Visa and JP MorganChase

# Introductions

- K. Craig Wildfang
- Paul Snyder

# Caveats and Limitations

- Protective Order in MDL 1720
  - Limits counsel for the merchants
    - Absent consent from banks and networks, or an order from the Court, we cannot disclose materials produced in discovery
    - We have asked banks and networks to give their consent, but they have not yet agreed
    - If they do not consent, we intend to file a motion seeking permission to disclose information to the Board

# Process Issues

- The Board's schedule for
  - Data and Information Gathering
  - Preparing Draft Rules
  - Obtaining Input from Interested Parties
  - Revising and Issuing Final Rules
  - Post-Adoption Activities

# Merchants' Desire to Assist the Board

- Merchants' Recognition of the Difficulties the Board Faces
  - New Tasks & Responsibilities on Board
  - Tight Time Frame
  - Opposition from Issuers and Networks
  - Important Policy Objectives

# Merchants' Desire to Assist the Board

- Merchants and their Representatives Have Important Expertise and Resources
  - We are prepared to deploy resources to assist the Board
  - The discovery record in MDL 1720 has 60+ million pages of materials
    - Including data on issues relevant to the Board's task
  - Merchants' Counsel and Consultants Together Have Dozens of Years of Experience on Important Issues Facing the Board

# Merchants' Interests Are Aligned

- Although Merchants' Opinions On Some Payment Card Issues Are Not Always Identical
- .... In the Case of the Debit Card Issues That Are the Subjects of the Board's Rule-Making All Merchants' Opinions and Interests Are Aligned

# Merchants' Interests Are Aligned

- **All Merchants Will Be Positively Impacted By the Board's Rules, as Congress Intended**
- **There Is No Economic, Policy or Logical Basis for Differentiation in the Board's Rules and Their Application to Merchants**
  - Merchant Category
  - Merchant's Debit Card Transaction Volume
  - Card Present vs. Card Not Present

# Important Issues for the Board Under § 1075

- §920 (a)(2) Statutory Limit on Debit Interchange Fees
  - Mandatory Limit » “The amount of any interchange fee that an issuer may receive or charge with respect to an electronic debit transaction shall be reasonable and proportional to the cost incurred by the issuer with respect to the transaction.”

# Important Issues for the Board Under § 1075

- §920 (a)(3) Mandatory Requirement for Board to Adopt Rules
  - “... to establish standards for assessing whether the amount of any interchange transaction fee...” complies with the statutory limit

# Important Issues for the Board Under § 1075

- §920 (a)(4) Mandatory Factors the Board Must Consider in Prescribing Regulations
  - (A) “consider the functional similarity between ... (i) electronic debit transactions; and (ii) checking transactions that are required within the Federal Reserve System to clear at par;”
  - (B) “distinguish between” “incremental costs” which “shall be considered” and “other costs” which “shall not be considered”

# Important Issues for the Board Under § 1075

- Policy Goals
  - Incentivize / Reward Efficiency
    - Efficient Products
    - Efficient Networks
    - Efficient Issuers
  - Dis-incentivize / Deter Inefficiency
    - Inefficient Products
    - Inefficient Networks
    - Inefficient Issuers

# Important Issues for the Board Under § 1075

- Policy Goals
  - Incentivize / Reward Innovation
    - Innovative Products
    - Innovative Networks
    - Innovative Issuers
  - Dis-incentivize / Deter Barriers to Innovation & Entry
    - Outdated Products
    - Networks With Outdated Rules, Policies, Etc.
    - Issuers With Consumer-Unfriendly Policies

# Fraud and Fraud Prevention

- §920 (a)(5)(A) The Board “*May*” Allow For An Adjustment to the Interchange Fee Limit “*If*”
  - “(i) such adjustment is *reasonably necessary* to make allowance for costs incurred by the issuer in *preventing* fraud in relation to electronic debit transactions involving that issuer; *and*
  - (ii) the issuer complies with the fraud-related standards established by the Board under subparagraph B ...”

# Fraud and Fraud Prevention

- Merchants Agree That Fraud Prevention Is Important, *But*
  - The incidence and magnitude of fraud in debit transactions is already *tiny* by any measure
  - *Merchants*, not issuers or networks, bear the vast majority of costs of preventing fraud and fraud losses
    - Javelin Strategy & Research Study, reported at November 2009 K.C. Federal Reserve Bank Conference, found merchants bear *90%* of such costs
- So compensating issuers for *their* fraud costs by shifting those costs to merchants via a higher interchange fee would be unfair, especially when network “no surcharge” rules prevent merchants from recovering those costs from the cardholders

# Fraud and Fraud Prevention

- In this context, the costs of administering a “fraud cost adjustment” to debit interchange fee limits may actually exceed the savings that might be achieved by incentivizing fraud prevention efforts by issuers
- Fraud prevention efforts by *networks* are the vast majority of fraud prevention costs, and are likely the more efficient method of preventing fraud

# Network Fees

- Historically Network Fees for Debit Transactions Have Been Small
- More Recently Both Visa and MasterCard Have Raised Network Fees More Aggressively
- The Board Will Need To Be Vigilant To Guard Against Efforts By Issuers and Networks To Circumvent Other Limitations

# Prohibitions On Exclusivity Arrangements

- Networks Have Been Aggressive In The use of Exclusive Arrangements With Issuers
  - This has lead to ever-higher debit interchange fees
- Elimination of Exclusivity Arrangements Will Enable Merchants To Use Steering To Reduce Acceptance Costs By Promoting Competition Among Issuers for Acceptance

# Discussion of Board Survey Forms and Data Gathering

# Comments on Presentations By Visa and JPMorganChase