Electronic Funds Transfer Association

11350 Random Hills Rd., Ste. 800
Fairfax, VA 22030

Ph: (703) 934-6052; Fax: (703) 934-6058
www.efta.org

February 22, 2011

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

Re: Regulation II; Docket No. R-1404

Dear Ms. Johnson:

This comment letter is submitted on behalf of the Electronic Funds Transfer Association (EFTA or the Association) in response to the request for comment recently issued by the Board of Governors of the Federal Reserve System (the Board) on a proposal to adopt rules on debit card interchange and routing, as required by certain amendments to the Electronic Fund Transfer Act made by Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act).

EFTA is the nation's leading non-profit, inter-industry trade association dedicated to the advancement of electronic payment systems and electronic commerce. The Association's nearly 300 members represent a broad spectrum of perspectives that engender accurate and effective analysis of electronic payments and electronic commerce issues. Members include the nation's leading financial institutions, electronic payment networks, card associations, retailers, information processors, equipment, card and software manufactures and vendors, Internet providers, telecommunications companies, state governments and Federal agencies. A list of EFTA Board Members is attached. Please note that none of the governmental members of EFTA were involved in the development of this comment letter.

The Association is adamantly opposed to government price-fixing in any form and therefore believes that the amendments to the Act have set a dangerous precedent of government interference in the free market. We understand, however, that the Board has the difficult task of implementing the Congressional mandate. Accordingly, the Association will limit its comments on the proposal to those solicited by the Board and relating to the operational and other issues raised by the proposal.

Interchange Fee Restrictions

The Board has sought comment on two alternative frameworks for assessing reasonable and proportional interchange fees. Under Alternative 1, each issuer would be permitted to determine the maximum amount of an interchange fee that it may receive with respect to a debit card transaction by calculating its average variable cost for authorization, clearance, and settlement of electronic debit transactions. Issuers could rely on a safe harbor of 7 cents per transaction. Under Alternative 1, issuers with costs in excess of the safe harbor would be permitted to recover their average variable costs for authorization, clearance, and settlement up to a cap. The proposed standard sets a cap of 12 cents per transaction.

Under Alternative 2, the proposed standard would cap the amount of the interchange fee that any issuer could receive. Under this alternative, any interchange fee at or below 12 cents per transaction would be permitted.

The Association supports adoption of Alternative 2, as it presents a less complex challenge to issuers and networks in establishing interchange fees and monitoring compliance with Regulation II and will pose significantly fewer operational hurdles. Establishing costs for authorization, clearance and settlement and monitoring compliance with Alternative 1, even for large institutions, would be difficult and time-consuming, and particularly challenging in the short time available before the effective date of the rule.

EFTA also urges the Board to allow additional variable costs to be included in the calculation of reasonable and proportional interchange fees. Network processing and other transaction-specific fees are clearly variable costs associated with electronic debit transactions and should be included in the calculation of interchange fees. The highly competitive nature of the network processing business will preclude any manipulation of such costs in a manner that would circumvent the rules. There are also other costs related to debit transactions, such as customer service costs and actual fraud losses, that could permissibly be included in the calculation of average variable costs.

Circumvention and Evasion

The Association urges the Board to consider the ramifications of applying the provisions regarding circumvention and evasion of the limits on interchange fees to existing contractual relationships. Any retroactive application of the circumvention rules will necessitate significant revisions to some network branding and processing agreements negotiated before the mandatory effective date. Doing so in the very short time available prior to the effective date of the rule will be virtually impossible; we urge the Board to consider delaying the effective date of any such application for at least six months.

Network Exclusivity and Routing

The Board has requested comment on two alternative approaches to determining whether there are at least two unaffiliated payment card networks available to carry any electronic debit transaction. Under Alternative A, a debit card satisfies the non-exclusivity requirement if it can be used to initiate transactions over two unaffiliated networks, without consideration as to the authorization method chosen by the cardholder. For example, a debit card would have two unaffiliated networks if it enables electronic debit transactions to be carried by one signature-based network and one PIN-based network, provided the networks are not affiliated.

Under Alternative B, the non-exclusivity requirement would be satisfied if the debit card is enabled with more than one unaffiliated network for each method of authorization (currently, signature and PIN). For example, if a card is enabled for signature and PIN debit, Alternative 2 would require that there be two unaffiliated signature networks and two unaffiliated PIN networks available.

The Association urges the Board to adopt Alternative A. Adoption of Alternative B will cause enormous disruption in the debit card market, affecting consumer choice at point of sale, requiring considerable additional merchant, network and financial institution investment, and further restricting the operation of the free market.

If Alternative A is adopted, 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 Association does not believe that 90 days would provide sufficient time for issuers to negotiate new agreements and establish processing connectivity with one or more additional networks after unaffiliated networks have merged. There should be a period of at least 270 days provided in the final rule.

EFTA urges the Board to establish appropriate effective dates for the Act's exclusivity limitations that will permit issuers adequate time to enter into new contractual arrangements with networks, no matter what alternative is adopted by the Board. With respect to Alternative A, October 2, 2011 simply does not provide issuers enough time to conduct appropriate due diligence and negotiate new network contracts. We request that the Board adopt an effective date no later than March 1, 2012.

If Alternative B is adopted in the final rule and multiple signature debit networks are required for each debit card, EFTA urges the Board to give issuers and networks significantly more time to comply with the rule. As proposed by the Board, an effective date of January 1, 2013, will probably not be adequate if Alternative B is adopted in the final rule. We suggest that that Board adopt an effective date of January 1, 2014 if it adopts Alternative B.

Fraud Prevention Measures

The Board has requested comment on whether it should adopt technology-specific standards or non-prescriptive standards that an issuer must meet in order to be eligible to receive an adjustment to its interchange fee.

EFTA urges the Board to adopt non-prescriptive standards for fraud prevention rather than standards that are technology specific. It will be difficult for the Board to identify and promulgate rules regarding specific "paradigm-shifting technology[ies] that would reduce debit card fraud in a cost-effective manner" quickly and efficiently. And having specific technologies "approved" by the Board will stifle innovation and inappropriately favor some technologies over others. Fraud prevention techniques evolve quickly in response to the always rapidly-evolving techniques of criminals, and being permitted to take advantage of only specified technologies would hamper fraud prevention and inappropriately substitute governmental control for market forces.

Additionally, EFTA urges the Board to include activities that are not specific to debit card transactions in the reimbursable fraud-prevention activities. Fraud avoidance has many facets, and limiting reimbursable activities to those specifically related to a type of transaction (signature versus PIN), to electronic debit transactions or to those measures that only benefit merchants would be counter-productive, inefficient and difficult to implement and monitor.

ATM and Emerging Networks and Transactions

The Association respectfully submits that the Board should not include within the scope of Regulation II any ATM or emerging networks or transactions. The legislative history of Section 1075 of the Act indicates that the principal focus of the legislation was point-of-sale electronic debit transactions, not ATM transactions. Additionally, any expansion of the scope of the rule to include emerging networks is unwarranted and unnecessary. There are significant barriers to entry for emerging payment systems and imposing the interchange fee limits and other restrictions of Regulation II on emerging products will stifle innovation and put US companies at a competitive disadvantage compared to global competitors.

EFTA appreciates the opportunity to comment on the proposal and commends the Board on its thorough and thoughtful proposal.

Sincerely,

Kurt Helwig
President & CEO

EFTA Board of Directors

Lynne Barr
Partner
Goodwin, Procter, LLP

James L. Brown

Daniel Cage
President
Linq3 Technologies

Robert Craig
EVP & GM
Online Resources Corporation

Frank D'Angelo
EVP, Payment Solutions
FIS

JB Donaldson
Director, EPC Business Development
ACS State & Local Solutions

Tony Emrick
Senior Vice President
FTPS, LLC

Trevor Fall
EVP, North American Sales
Phoenix Managed Networks, LLC

Paul Finch
President & CEO
Early Warning Services, LLC

Kevin Gregoire
President
Fiserv EFT

James Hanisch
SVP, Corporate Development
CO-OP Financial Services

Keith Harrison
SVP, Product & Alliances
Q2ebanking (Q2 Software, Inc.)
a CBG Holdings, Inc. Company

Alex Hart
Chief Executive Officer
Tier Technologies

Sandra Hartfield
Sandra Hartfield Enterprises

Kurt Helwig
President & CEO
Electronic Funds Transfer Association

Joe Hurley
VP, Network Strategic Development
Discover Financial Services

Wayne Malone
Head of Deposits & Retail Payments,
Citi – International Retail Banking

Patricia O'Donnell
Executive Director
JPMorgan

Christopher Penny
SVP, Corporate Development
Transaction Network Services, Inc.

Patricia Preston
Group Head
MasterCard Worldwide

Ben Psillas
President
Allpoint Network

Joe Samuel
SVP, Global Public Affairs
First Data Corporation

Hamed Shahbazi
Chairman & CEO
TIO Networks Corporation

Steve Taylor
EVP Operations & CFO
PreCash, Inc.

Ronald Wieselberg
VP, Business Development
SafetyPay

EFTA Officers

Jim Hanisch, Chairman
Wayne Malone, Vice-Chairman
Sandra Hartfield, Treasurer
Lynne Barr, Secretary
Kurt Helwig, President & CEO

Council Chairs

Dennis Ambach, *Chairman, Legislative & Regulatory Council*

Charlie Kroll, *Chairman, eFinancial Enablers Council*
CEO
Andera, Inc.

John Pfeuffer, *Chairman, eGovernment Payments Council*
Director of Business Development, EFS
ACS State & Local Solutions, Inc.

Emeritus Board of Directors

Bob Barone
Tom Bennion
Jack Benton
Steve Cole
Ron Congemi
Ray Crosier
Neil Marcous
Rod Reef