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February 22, 2011

Ms. Jennifer L. 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 AD63

Dear Ms. Johnson:

In response to the notice of proposed rulemaking published in the December 28, 2010 Federal Register, the New York Bankers Association (NYBA) is submitting these comments on the regulation of interchange fees on debit card transactions and routing. NYBA believes that the Board seriously underestimates the direct costs of providing debit card interchange transactions. The Board also chose not to include potential fraud losses in allowable debit card interchange fees and has not established effective rules to permit financial institutions with less than \$10 billion in assets to take advantage of the exemption from fee limits that the Congress provided. We urge that the Board withdraw or materially alter this proposal. NYBA is comprised of the community, regional and money center commercial banks and thrift institutions doing business in New York State. Our members hold in aggregate more than \$9 trillion in assets and employ in excess of 200,000 New Yorkers.

This proposal is intended to implement section 920 of the Electronic Funds Transfer Act (EFTA) as added by section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act). That provision requires the Board to adopt regulations to ensure that the amount of any interchange fee that a debit card issuer charges is reasonable and proportional to the cost incurred by the issuer with respect to the transaction. The Board may, but is not required to, take into account the costs of fraud-prevention in determining allowable interchange fees. In addition, the Act contains an exemption for institutions with total assets under \$10 billion, exempts government-issued debit cards and reloadable pre-paid cards from its restrictions, and requires the Board to impose restrictions on network fees similar to those applicable to issuers. It also

prohibits network exclusivity arrangements and inhibitions on merchant routing of debit card payments, and also restricts the ability of card networks to impose certain restrictions on offering discounts for the use of cash, checks, debit cards or credit cards and on merchants from discriminating against the use of the cards of particular issuers within a network. Finally, the Act prohibits networks from restricting the ability of merchants to set certain minimum limits for the acceptance of credit cards and of colleges and universities to set maximum limits on such cards.

The nation's payments networks are the lifeblood of all business and consumer transactions. Singling out a single element of the payments network – one of the most important – for price controls will harm the nation's economy, with little consumer benefit and stunt the enhancement of research and development into new and existing debit card networks.

NYBA strongly opposes price controls and fee limits of any kind. Controls distort markets, ration the economic good or service to which they apply, remove incentives for innovation, encourage evasion, and discourage competition. We strongly opposed the Durbin amendment that was the source of section 1075 of the Act and we continue to urge that the amendment be repealed. We believe that fee limits on debit card networks are particularly inappropriate because the benefits that can be provided by a healthy and functioning debit card network through ease of payment, security, certainty, convenience and fraud prevention and detection far exceed the costs. In addition, the debit card networks have seen an enormous amount of innovation and development in recent years, providing the average consumer with a comfort level in using his or her debit card that has allowed debit cards to become the most used form of payment in the U.S. economy.

Nevertheless, we recognize that the Board is under a mandate from Congress to implement the provisions of the Durbin amendment in section 920 of the EFTA, and to do so in only nine months after its enactment (by mid-April). Our comments will therefore follow the order of the proposed regulation.

Price Restrictions

In preparing to impose the first set of federal price controls on the banking industry since the demise of regulation Q in the 1980's, the Board conducted three surveys - of card issuers, payment networks and merchant acquirers respectively. These surveys were prepared and executed in an unreasonable time period and provide only a surface glimpse of the actual costs of the payments system. Using the results of these surveys, the Board has made a series of estimates on the costs of providing debit card services. The proposed fee restrictions are based on these estimates. NYBA believes that imposing price controls is a daunting exercise and should be based on data that is thoroughly researched. We therefore urge the Board to withdraw this proposal and engage in further analysis of the entire system of debit card payments.

The Board has proposed two alternatives for possible fee restrictions on debit card transactions. Under alternative 1, an issuer could choose either to charge a flat fee of seven cents per transaction or calculate the proportional costs of each of its transactions, using a formula provided by the Board, but with a cap of twelve cents per transaction. Alternative 2 is a flat cap of twelve cents per transaction. The Board's calculations of the proportional costs of each transaction appear to discount a number of costs that are in fact transactional. The costs of handling inquiries and disputes, as well as network fees imposed on a card issuer specific to each transaction, are directly proportional to the use of individual cards. The Board's own data indicate that the fees imposed by networks are largely transactional and appear clearly contemplated in the Congressional mandate. Because these costs alone appear to aggregate \$2.3 billion charged to issuers and another \$1.9 billion charged to acquirers, they are significant.

Since the statute uses the phrase "reasonable" as well as "proportional," the Board should expand, in so far as possible, the number of allowable costs to be included in the calculation of fees proportional to a transaction.

In addition, Congress specifically contemplated the use of the costs of fraud prevention and avoidance in calculating interchange fees. With the prowess of today's identity thieves and Internet fraudsters, fraud prevention is a major expense factor. We strongly urge that the Board significantly increase allowable transaction fees to provide a robust incentive for networks and issuers to continue to develop fraud resistant systems.

The Small Issuer Exemption

The Board's proposal restates the EFTA's exemption for issuers of debit cards with assets under \$10 billion. However, it contains no language giving force or meaning to this exemption. It also does not apply the restrictions on evasion applicable to the fee restrictions in sections 235.3 and 235.4 to the small issuer exemption. Where a merchant is faced with accepting two cards, one of which will cost it five to twelve cents per transaction and the other of which will bear a transaction fee, at least initially, significantly greater, a merchant may well choose to honor the lower cost card and discourage if not actually refuse to accept the higher cost card despite the prohibitions of current law and contracts.

NYBA urges the Board to strengthen the prohibitions against discrimination against small issuers in the Act by prohibiting evasion and by adopting rules that will make it very difficult for those which choose to accept debit cards to steer customers away from the use of such cards issued by small issuers.

Debit Card Routing

Section 920 of the EFTA also requires that the Board adopt rules prohibiting restrictions on the number of appropriate networks over which a merchant may direct a debit card payment to be routed. In implementing this provision, the

Board proposes two alternatives. Alternative A would require a debit card to have at least two unaffiliated payment card networks available for processing a debit transaction, at least one available for processing signature debit transactions and the other for PIN transactions. Alternative B would require a debit card to have at least two unaffiliated payment networks over which a debit card transaction could be processed for each method of authorization (signature or PIN) available to the cardholder. Both options will require issuers to incur significant additional expense and the limitations on interchange fees in the proposal will prohibit the expenses from being compensated. The very fee limits that prevent compensation for the expense of installing either of the two options make both options unnecessary. It appears that this provision exists in order to allow merchants to direct consumers to use a lower priced network routing option since it seems highly unlikely that consumers would choose either option on their own. We strongly urge the Federal Reserve System to recommend legislation to Congress that would eliminate this and the Durbin amendment entirely.

In summary, the New York Bankers Association urges the Board to withdraw this proposal. The Board should conduct a comprehensive study of all of the costs of providing debit card payments, should develop effective regulatory barriers to discrimination against institutions with assets under \$10 billion in assets, and should thoroughly research all fraud costs and the costs of developing effective fraud prevention and recovery techniques. Preferably, though, the law should be repealed.

As we state at the outset, debit cards have been among the fastest growing and most popular segments of the payments system. Singling out this dynamic, innovative and fast-developing system for price controls will harm the nation's economy with little benefit for consumers, and create a disincentive for further research into, and development of, new payments networks.

We appreciate the opportunity the Board has provided to comment on this proposal.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael P. Smith". The signature is fluid and cursive, with the first name being the most prominent.

Michael P. Smith