

**Correspondence Received from the
Merchants Payment Coalition
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Note: The attached document replaces an earlier version of the document submitted by the Merchants Payment Coalition to Federal Reserve staff. The replacement has been made at the request of the Merchants Payment Coalition.

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BY EMAIL

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Board of Governors of the Federal Reserve System
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Dear Ms. Roseman:

We are submitting this letter on behalf of the Merchants Payments Coalition (“MPC”) in response to certain recent network and issuer submissions.¹ While not wanting to take your team’s time merely to respond to differences in our proposals, we do believe it is crucial to point out where Visa and Bank of America mischaracterize and ignore Section 920 of the Electronic Fund Transfer Act (“Act”) in their recent submissions. Such attempts to rewrite the Act should be rejected. At the same time, Visa and Bank of America make several factual concessions that support key points made by the MPC. With respect to both the law and facts, therefore, these recent network and issuer submissions highlight the propriety, administerability, and procompetitive nature of the MPC’s proposed regulatory framework.

A. The Board Should Reject Attempts by Networks and Issuers to Rewrite Section 920 of the Electronic Fund Transfer Act.

Networks like Visa and issuers like Bank of America are entitled to their opinions, but they are not entitled to rewrite the statutory mandates governing this proceeding.

¹ Letter from Visa General Counsel Joshua R. Floum to Director Louise L. Roseman dated Nov. 8, 2010 (“Visa Letter”); Letter from Oliver Ireland (Morrison & Foerster LLP) to Director Louise L. Roseman dated Nov. 5, 2010 (submitted on behalf of an unnamed “number of institutions” and containing text that is largely identical to that in the Visa Letter); Letter from Bank of America Deputy General Counsel Stacie E. McGinn to Director Louise L. Roseman dated Nov. 12, 2010 (“BofA Letter”).

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1. The Act prohibits consideration of issuer costs that are “not specific to a particular electronic debit transaction.”

Section 920(a)(4)(B) of the Act clearly directs the Board to consider certain costs and not to consider other costs in establishing standards to assess debit interchange fees. Specifically, this provision requires the Board to consider incremental authorization, clearance and settlement (“ACS”) costs incurred by an issuer in a particular debit transaction. As detailed in the MPC’s earlier submission, these incremental ACS costs are well-defined in the industry. Section 920(a)(4)(B) also prohibits the Board from considering any issuer costs that are “not specific to a particular electronic debit transaction.”²

The legislative history is also clear. As stated by the provision’s author, Senator Durbin, on the Senate floor during debate on this legislation:

[T]he cost to be considered by the Board in conducting its reasonable and proportional analysis is the incremental cost incurred by the issuer for its role in the authorization, clearance, or settlement of a particular electronic debit transaction, as opposed to other costs incurred by an issuer which are not specific to the authorization, clearance, or settlement of a particular electronic debit transaction.

Cong Rec. S. 5925 (July 15, 2010). In short, the Board should not consider any costs other than incremental ACS costs incurred by the issuer for a particular debit transaction.

Ignoring both the plain meaning of this statutory provision and its clear legislative history, Visa and Bank of America argue that the Board should consider issuer costs that are “not specific to a particular electronic debit transaction.” Visa claims that the Act is ambiguous because it fails to explain whether the Board should consider a category of costs “specific to debit card transactions” that are not ACS costs, and then fails to offer a single credible example of such a cost. Bank of America is more direct in its invitation to the Board to ignore the Act. At the end of the day the result is the same: Visa and Bank of America declare that the Board must consider all of the following issuer costs even though every single one of them is “not specific to a particular electronic debit transaction”:

- Costs of providing cardholders their periodic statements and other customer notices (Visa Letter at 14; BofA Letter at 8).
- “Product development costs” (BofA Letter at 8).

² Bank of America unwittingly highlights the strict limitation that Section 920 places on the types of costs the Board is permitted to consider by juxtaposing an unrelated statutory provision in which Congress explicitly directs the Board to consider “all direct and indirect costs . . . including interest[,], overhead, . . . taxes[, and] return on capital.” BofA Letter at 6 (quoting 12 U.S.C. § 248a(c)(3)). The absence of such cost categories in Section 920 is telling.

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- “[C]ard production and delivery” costs (BofA Letter at 7).
- “Costs associated with selling and distributing debit cards” (BofA Letter at 8).
- Costs of staff and other infrastructure for customer service (BofA Letter at 7-8).
- “[E]xpenses associated with call center personnel” (BofA Letter at 8).
- Costs of “[r]ewards and incentives” (BofA Letter at 8).
- “Data and systems security” costs (BofA Letter at 8).
- All network fees, including for “assessments” and “chargebacks” (BofA Letter at 7).³
- Fraud costs (which the Act addresses in a different statutory provision) (Visa Letter at 13; BofA Letter at 8).
- “[N]onvariable costs” (*i.e.*, fixed costs) (Visa Letter at 16).

The Act is not ambiguous; none of these costs can be considered. As a result, the Board does not have the discretion to entertain these attempts to rewrite the Act out of thin air. These arguments must be rejected.⁴

³ Should the Board accept this argument, it would excise the Act’s prohibition against the use of network fees as a device to circumvent the Act’s regulation of debit interchange. *See* Section 920(a)(8)(B)(ii). If network fees were a cost that could be considered to set interchange, networks could simply raise them to justify higher interchange to issuers. That Bank of America would suggest this outcome as a reasonable interpretation of the Act typifies its wholesale assault on the Act and its plain meaning.

⁴ Even an issuer of debit cards — TCF National Bank — rejected Visa’s and Bank of America’s arguments in a brief it filed in federal court earlier this month:

[Section 920] restricts regulated debit issuing banks to recover only three discrete costs of debit transactions from merchants: the authorization, clearance and settlement of individual electronic debit transactions. The statute explicitly forbids regulated banks from charging retailers for “any cost” of a debit transaction other than those three electronic steps: in other words, it excludes variable costs that are needed to service the customer’s account, and all fixed costs that are incurred in order to establish, maintain and operate the system.

Plaintiff’s Memorandum of Law in Support of its Motion for a Preliminary Injunction at 2, *TCF Nat’l Bank v. Bernanke*, No. 10-cv-4149(LLP) (D.S.D. Nov. 4, 2010); *see also* Complaint at ¶ 2, *TCF Nat’l Bank v. Bernanke*, No. 10-cv-4149(LLP) (D.S.D. Oct. 12, 2010).

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2. The Act does not permit the Board to adopt an approach in which networks set different interchange rates based on factors unrelated to issuers' costs.

Section 920(a)'s mandate to consider only the issuer's incremental ACS costs for each transaction not only prohibits consideration of other issuer costs — as discussed above — but also prohibits consideration of factors that are unrelated to the issuer's costs. The proposal Visa argues that the Board should adopt flouts this latter prohibition.

Different interchange rates based solely upon issuer-specific incremental ACS costs for each transaction are permissible under the Act. Also, since incremental ACS costs do not vary significantly (if at all) across issuers, the use of a single interchange rate for all issuers that reflects those costs could be permissible under the Act. The Act, however, prohibits networks and issuers from maintaining the status quo in which a network can set different interchange rates for any transaction it pleases based upon factors unrelated to the statutorily-mandated incremental ACS costs. In other words, attempting to inflate certain interchange rates by taking into account factors with no relationship to incremental ACS costs is inconsistent with Section 920(a), yet that is Visa's proposal.

Specifically, Visa argues that the Board adopt an approach pursuant to which networks can ignore incremental ACS costs and set whatever interchange fee they want for any given debit transaction, based upon factors such as the merchant's size, the merchant segment (*e.g.*, grocery stores), and/or the acceptance channel (*e.g.*, card-not-present). Visa Letter at 11-20 (labeling this naked price discrimination the "Average Effective Debit Interchange Rate"). Because these factors are wholly unrelated to the issuer's costs, let alone the issuer's ACS costs for the transaction that the Board can consider, Visa's proposal that the Board adopt the Average Effective Debit Interchange Rate approach must be rejected.⁵

Visa's proposal also should be rejected since it is based on price discrimination. Price discrimination is classic evidence of market power, and Visa's argument is a thinly-veiled attempt to perpetuate the status quo where it (and other networks) can exercise market power by price discriminating against merchant categories, such as card-not-present merchants, where they face little competition. As Congress clearly intended that the Act restrain such attempts to wield market power over merchants, Visa's attempt to extend its ability to do just that must be rejected.

⁵ Additionally, Visa's argument that an *ad valorem* interchange fee (*i.e.*, not a flat amount, but rather calculated in terms of the "basis points of [the] transaction amount") would be appropriate under this approach also must be rejected because the only costs that the Board is supposed to consider are incremental ACS costs that are flat, per-transaction costs. Visa Letter at 18. It would be inappropriate under the Act to allow networks and issuers to charge increasingly larger interchange fees as the transaction size grows, even though the incremental ACS costs stay the same regardless of transaction size.

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3. Bank of America's misquotation of the Act's fraud prevention cost adjustment provision is deceptive.

Under Section 920(a)(5) of the Act, the Board may allow an adjustment to the debit interchange fee for fraud prevention costs. The Act specifies that one condition of such an adjustment is that it must be "reasonably necessary to make allowances for costs incurred by the issuer in preventing fraud." Section 920(a)(5)(A)(i) (emphasis added).

Bank of America argues in Section IV of its letter, however, that this adjustment should allow issuers to recoup "All Debit Related Fraud Costs," including "fraud losses." BofA Letter at 12 (emphasis in original). To support its fraud adjustment argument, Bank of America misquotes Section 920(a)(5) as stating that the adjustment must be "reasonably necessary to make allowances for [fraud] costs incurred by the issuer." *Id.* at 13. Bank of America's misleading use of a bracketed word and failure to quote the end of the sentence leaves the reader with the impression that the permitted adjustment is not just for fraud prevention costs but is also for fraud losses. That is not true, and Bank of America's attempt to deceive the Board by misquoting the Act should be recognized for what it is.

4. The Act does not exempt business debit transactions.

Visa's claim that business debit transactions should be exempted from the Board's regulations is merely another attempt to improperly rewrite the Act to limit its reach. Nothing in Section 920 indicates that it is inapplicable to business debit transactions, and there is no justification for it to be. Moreover, in contrast to the definition of "account" in Section 903 (which is limited to accounts "established primarily for personal, family, or household purposes"), Section 920 explicitly applies to all debit transactions accessing an account "regardless of the purpose for which the account is established." *See* Section 904(c)(2) and (5). Again, Visa's attempt to rewrite the Act should be rejected.

5. The Act does not exempt any products from its non-exclusivity mandate.

In addition to not exempting any business debit transactions, Section 920 contains no exemptions from its non-exclusivity provision. Visa, however, argues that the Board should simply ignore the statute and invent such an exemption for certain prepaid products, including the increasingly-common cards that access Flexible Spending Accounts ("FSAs"), Health Spending Accounts ("HSAs"), and Health Reimbursement Arrangements ("HRAs").⁶ Visa Letter at 6.

⁶ Merchants that accept FSA/HRA cards must invest in expensive technology to substantiate transactions that qualify for the benefits associated with these cards. As such, the costs associated with these cards are a serious concern to merchants. While Evolution Benefits emphasizes in its letter to the Board that "the costs of building and maintaining the necessary technology, data exchanges, and operating support infrastructure ... are many orders of magnitude greater than typical debit cards," it ignores that much of these costs fall on merchants. Letter from

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While Congress clearly set forth exemptions to Section 920(a), it just as clearly elected not to do so with respect to the non-exclusivity provision in Section 920(b)(1). Visa is asking the Board, once again, to rewrite the Act to include exemptions that Congress deliberately chose not to include in Section 920(b)(1). Moreover, Visa's argument unwittingly shows why Section 920(b)(1) should require at least two network routing options for each transaction, a subject we discuss below. As Visa acknowledges, FSA and HRA cards currently provide only signature-functionality through either the Visa or MasterCard networks. Visa also emphasizes that gift cards and other non-reloadable prepaid cards (neither of which is even exempt from Section 920(a)) typically do not have PIN functionality.⁷ Visa, however, ignores the fact that if Section 920(b)(1) does not reach signature-only cards, there will continue to be a lack of competition with these transactions in the face of Visa's and MasterCard's monopoly position on these cards.⁸ That result simply cannot be reconciled with Section 920(b)(1)'s objective of introducing network competition for transactions to the benefit of consumers and merchants. Visa's argument that the Board should exempt certain health care cards, as well as gift cards and other non-reloadable prepaid products (which, pursuant to Section 920(a)(7)(A)(ii)(V), are explicitly not exempt from Section 920(a)), from the Act's non-exclusivity mandate must be rejected. Visa Letter at 6.

Evolution Benefits to Associate General Counsel Keiran J. Fallon dated Nov. 10, 2010 at 2. In fact, merchant investments in this infrastructure have enabled employers and the employees that receive qualifying health care coverage to save substantial costs.

⁷ Visa claims that "operational challenges" limit the PIN debit networks' ability to handle FSA/HRA and gift card transactions. Visa Letter at 5-6. To the extent that is true, that is all the more reason to ensure that merchants have routing options for these transactions via an alternative signature debit network. This also casts a spotlight on the need to allow PIN debit networks to handle these and other signature transactions, via, among other options, the "PIN-less" debit services offered by the PIN debit networks that are currently available in the marketplace. Doing so would allow these networks to overcome any operational challenges that might exist and increase network competition.

⁸ FSA, HSA and HRA cards have become increasingly common as consumers' out-of-pocket health care expenses continue to go up. For example, the U.S. Department of Health and Human Services estimates that there was \$269 billion in direct consumer payments made to healthcare providers in the U.S. in 2007, a figure expected to grow to \$314 billion in 2010 and \$414 billion in 2015. See Ann Kjos, "New Prospects for Payment Card Application in Health Care," at 4-5, 13 (Nov. 2008), available at <http://www.philadelphiafed.org/payment-cards-center/publications/discussion-papers/2008/D2008NovemberHealthCareCardApplication.pdf>. Notably, of this \$269 billion, health care payment cards were used only for \$8 billion, or 3 percent, in 2007. *Id.* at 4-5. Thus, the untapped market for health care payment cards is tremendous. For perspective, the expected \$414 billion in direct consumer payments in 2015 is approximately one-third of the total debit market in 2008. Moreover, the number and volume of transactions on these cards is set to increase dramatically as the Patient Protection and Affordable Care Act (Pub. L. No. 111-148, 124 Stat. 119 (2010)) goes into effect. Lastly, the use of prepaid cards to provide benefits to consumers — examples include cards issued by FEMA to individuals who suffer injuries in an emergency — is expected to increase in the coming years. A general exemption for such cards will create a new category of cards that Visa and MasterCard can monopolize to the detriment of merchants and consumers.

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Moreover, these health care cards are subject to Section 920(a) regulation because they, likewise, do not qualify for the exemptions that are set forth in Section 920(a)(7). For starters, FSA, HSA and HRA cards are not “government-administered” programs under Section 920(a)(7)(A)(i) because, unlike EBT or WIC cards, they are cards issued to consumers as part of benefits packages that they receive from programs administered by their employer, benefits manager (such as Evolution Benefits), or insurance company. Further, these cards access accounts that are typically held by the employer for the benefit of the cardholder (the employee) or are held by the cardholder himself, which disqualifies them from the Section 920(a)(7) exemption. *See* Section 920(a)(7)(A)(ii)(II). In addition, these cards are often not “reloadable,” as the cardholder designates his/her contribution prior to the year and cannot reload the card if the account is depleted during that year, creating another reason why they do not qualify for the prepaid card exemption. *See* Section 920(a)(7)(A)(ii)(V). For all of these reasons, these health care cards should be subject to Section 920(a) regulation.

6. The non-exclusivity mandate is for at least two network routing options for each transaction.

With respect to the actual substance of Section 920(b)(1), it prohibits issuers and networks from restricting routing either to a single network or to multiple networks that are all affiliated with each other — in other words, they need to permit routing over at least two unaffiliated networks. The provision’s author, Senator Durbin, confirmed on the Senate floor during debate on this legislation that “[t]his paragraph is intended to enable each and every debit card transaction — no matter whether that transaction is authorized by a signature, PIN, or otherwise — to be run over at least two unaffiliated networks.” Cong Rec. S. 5926 (July 15, 2010) (emphasis added).

Visa argues, however, that the “plain language” of this provision should be read to require issuers to enable transactions to run over “no more than two” unaffiliated networks. Visa Letter at 4 (emphasis added). This attempted sleight of hand by Visa misrepresents the non-exclusivity provision, and should be disregarded.

7. The Act mandates that merchants are free to direct the routing of debit transactions.

Section 920(b)(2) prohibits issuers and networks from directly or indirectly inhibiting the ability of any merchant to choose the network (from among those available) over which to route its debit transactions. As detailed in the MPC’s previous submissions, issuers and networks have used a wide range of tactics over the years to control routing indirectly by manipulating cardholders’ incentives and enacting mandatory routing rules. Indeed, these tactics have resulted in the suppression of PIN debit transactions despite the fact they have lower costs and lower fraud rates than signature debit transactions.

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Ignoring the Act's clear direction to give merchants the ability to route to at least two unaffiliated networks, Visa argues that the routing "decision should remain with the consumer" and that the Board should permit networks to "continue to require" merchants to allow consumers to choose a PIN transaction. Visa Letter at 7-8. These arguments are inconsistent with the mandates of Section 920(b)(2) that clearly prohibit issuers and networks from inhibiting merchants' routing choices, including indirectly by manipulating cardholders' incentives.

Tellingly, even consumer groups do not think consumers ought to direct the routing of these transactions and reject Visa's argument that its routing proposal is required under the consumer protection provisions of Section 904(a). *See, e.g.*, Letter from David A. Balto to Director Louise L. Roseman dated Nov. 19, 2010 at 5-6. Giving merchants the ability to choose routing is in the best interests of consumers because it will increase network competition and, in turn, lower consumer prices. *Id.*

8. The Act directs the Board only to "establish standards for assessing" whether debit interchange fees are reasonable and proportional.

Bank of America argues that "the Board should – indeed, must – include a fair profit margin to the issuers," suggesting that law regarding federal ratemaking applies to Section 920. BofA Letter at 6 (emphasis added); *see also* Visa letter at 16-17. This argument is wrong because (i) Section 920 does not give the Board authority to engage in a ratemaking; (ii) there is no required rate of return or profit margin even in the main example discussed by Bank of America; and (iii) the fact that banks can earn profits on the real product at issue — the underlying demand deposit account — without interchange belies the need for a rate of return, in any event.

First, the Act directs the Board only to "establish standards for assessing" whether debit interchange fees are reasonable and proportional. Section 920(a)(3)(A). Nowhere in Section 920 is the Board given ratemaking authority. This stands in stark contrast to the authority given the agencies cited primarily by Bank of America and Visa in making their ratemaking argument — the FERC and the FCC. *See, e.g.*, 42 U.S.C. § 7172(a)(1) (FERC explicitly granted power for the "establishment, review, and enforcement of rates" charged by sellers of electricity and natural gas); 16 U.S.C. § 824e (FERC "shall determine" and "fix ... by order" rates and charges of electricity utility companies); 15 U.S.C. 717d (same with respect to gas distribution companies); 49 U.S.C. § 60502 (FERC "has the duties and powers related to the establishment of a rate or charge for the transportation of oil by pipeline"); 47 U.S.C. § 205(a) (FCC "is authorized and empowered to determine and prescribe" charges of common carriers).⁹ There is

⁹ It makes sense that Congress granted the FERC and the FCC explicit ratemaking authority because the rate being regulated applies to the companies' primary product, is their primary source of profits, and is paid by their customers. None of these is true here. The bank's primary product and source of profits is the checking account (a debit card is just a "feature" of or "access device" to these accounts). In addition, merchants pay interchange, not the cardholders who are the issuers' customers.

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no grant of such ratemaking authority to the Board in Section 920.¹⁰ Accordingly, Bank of America's and Visa's ratemaking analogies are invalid.

Second, even the statutory ratemaking provision underlying the case at the heart of Bank of America's ratemaking argument does not require a rate of return or profit margin. *See* BofA Letter at 5-6 (extensively quoting *Verizon Commc'ns, Inc. v. FCC*, 535 U.S. 467 (2002)). Specifically, the opinion relied upon by Bank of America addresses an agency's ratemaking authority that "shall be – based on the cost (determined without reference to a rate-of-return or other rate-based proceeding)." 47 USC § 252(d)(1) (emphasis added). Further proving the point, the statutory provision makes clear that separately the agency has discretion to exclude or include a profit margin; such a consideration is optional, not mandatory. *Id.* (the agency "may" include a reasonable profit). Thus, the very example relied upon by Bank of America to argue that the Board "must" include a profit margin or rate of return actually undermines their argument. BofA Letter at 5-6.

Finally, issuers should be able to maintain positive rates of return and profits after Section 920 is implemented, even if the Board adopts the proposal that is most faithful to the Act — that interchange be set at par subject to a rebuttable presumption. That is readily apparent from the fact that per capita usage of debit is highest around the world when debit interchange is set at par.¹¹ This conclusion is reinforced by the fact that banks have profitably issued checks to consumers for decades without interchange. Banks profitably offer these access devices to funds held on deposit because of the profits they earn on the core product at issue — the demand deposit account. Tellingly, TCF Chairman and CEO William Cooper admitted that, "[a] debit card is actually just part of a checking account ... not a product in and of itself. It's a delivery system for the checking account in a similar way that the checks are [A] checking account is the core business ..." Transcript to TCF Financial Corp.'s Conference Call, *TCF Discusses Lawsuit Challenging Durbin Amendment*, Oct. 12, 2010, at 2, 9 (emphasis added).¹² Moreover, the law does not prohibit banks from charging their depositors a competitive price for any DDA services they provide. These realities belie Bank of America's claim that debit issuers should get a guaranteed rate of return.

¹⁰ This fact is further highlighted by Bank of America's reference to an unrelated statutory provision that explicitly grants the Board ratemaking authority. 12 U.S.C. § 248a(a) (directing the Board to "put into effect a schedule of fees"). The contrasting absence of such a grant of ratemaking authority in Section 920 is telling.

¹¹ *See, e.g.*, Submission of the MPC of Oct. 27, 2010 ("MPC White Paper") at 3; Submission of Steven C. Salop dated Oct. 27, 2010 ("Salop Report") at ¶¶ 48, 64-68; Submission of Kenneth J. Morrison dated Oct. 27, 2010 ("Morrison Report") at ¶¶ 2, 13-14, 42-43.

¹² CEO Cooper explains that talking specifically about the profit on debit cards: "would be like saying, what's the profit on the bun at Burger Chef. We don't sell a bun. We sell a hamburger which is a checking account and we've got all the costs associated with that checking account and all of the revenues associated with that. Now if you take all of our revenues and our expenses into consideration, our retail banking system makes a profit. We'll obviously still be profitable [even if the Board promulgates debit card regulations pursuant to Section 920]." *Id.* at 7.

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For all of these reasons, the arguments by Bank of America and Visa regarding ratemaking and mandatory profit margins and rates of return should be rejected.

B. Factual Concessions by Networks and Issuers in Their Recent Submissions Support Several Key Points Made by the MPC in This Proceeding.

In addition to highlighting the networks' and issuers' strained interpretation of Section 920, their recent submissions confirm that there remain many more factual and policy disagreements between them and merchants than would be appropriate to catalog in this letter.¹³ Visa and Bank of America did make several concessions, however, that are particularly notable because they support key points made by the MPC in this proceeding. For example:

- “Consumer interests are paramount.” BofA Letter at 1. This conclusion is central to Professor Salop's analysis and is the basis for the rebuttable presumption standard in the MPC's proposed framework for the Board's regulations. Salop Report at ¶¶ 2, 5, 6, 7(a) and (b), 9, 16-17, 52, 58, 72-86, 99, 102-103, 118-119, 171(b), 172; MPC White Paper at 1, 5-7.
- At-par clearance of check transactions was intended to make them more efficient. Visa Letter at 21. The conclusion that the same is true for debit cards is another major focus of Professor Salop's analysis and is the basis, together with the plain text of Section 920(a), for the “at-par” default in the MPC's proposed framework for the Board's debit interchange regulations. *See, e.g.*, Salop Report at ¶¶ 11, 60, 72, 80, 83, 87, 90, 96, 100, 130-131, 143(c); MPC White Paper at 6.
- Interchange fees currently are fixed by networks rather than independently determined by each individual issuer. Visa Letter at 13, 17. This concession confirms that networks like Visa facilitate and manage collusion among rival issuers to fix their interchange rates. This type of anticompetitive behavior creates market inefficiencies. Salop Report at ¶¶ 51-52; MPC White Paper at 6-7, 15.
- “The proper role of regulation is to correct market inefficiencies.” BofA Letter at 10. As observed previously by the MPC, this is a primary reason that regulations promulgated under Section 920 should address the anticompetitive market power and collusion of networks and issuers that currently produce substantial market

¹³ The MPC stands ready to address all such differences if the Board wishes, but recognizes the limited time available to the Board's staff. The networks' and issuers' mischaracterizations of law (some of which were highlighted in the previous section of this letter) and fact do raise concerns, however, that other mischaracterizations of law and/or fact by the networks and issuers have gone uncorrected in their many meetings with the Board. Merchants also remain willing to review (even subject to the confidentiality provisions of a protective order) the networks'/issuers' representations regarding their actual costs — information that is particularly susceptible to subtle manipulation and that could influence the Board's deliberations.

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inefficiencies. *See, e.g.*, Salop Report at ¶¶ 2, 6, 9-11, 16, 172; MPC White Paper at 6.

- Costs other than incremental ACS costs vary widely by issuer and are hard to allocate. Visa Letter at 2, 9-10. In addition to the statutory prohibition against considering costs other than incremental ACS costs, this is a practical reason that consideration of other costs would be inappropriate. Submission of Stephen Craig Mott dated Oct. 29, 2010 (“Mott Report”) at ¶¶ 33-45; MPC White Paper at 1, 7-8.
- Individual issuers are able to offer cardholders additional services and fraud protection not offered by certain networks. Visa Letter at 7. There is no legal or business reason preventing an individual issuer from offering its cardholders additional services or fraud protection features that are not offered by certain networks. Indeed, issuers are best positioned to police fraud regardless of the network over which a debit transaction is routed.¹⁴ Mott Report at ¶¶ 64-66; MPC White Paper at 2, 11.

C. These Recent Submissions Highlight the Propriety, Administerability, and Procompetitive Nature of the MPC’s Proposed Regulatory Framework.

As detailed in a previous submission to the Board, the MPC has recommended a practical, easy-to-administer approach that increases competition and is faithful to the Act. In summary:

- There should be a rebuttable presumption that debit interchange shall be at par, as it is in seven of the eight countries with the highest debit usage. Networks and issuers should be able to rebut the at-par presumption only by showing that a positive interchange fee would advance consumer welfare.
- If the at-par presumption can be rebutted, any positive interchange must be limited to the incremental ACS costs of the transaction. These costs are well-defined and do not vary materially by issuer. Additionally, any such interchange fees should be capped,

¹⁴ Visa, as part of its argument to limit the scope and reach of Section 920(b)(1), vastly overstates the extent to which networks offer critical fraud prevention measures that benefit consumers. As detailed in the Mott Report, the role of the network regarding fraud prevention pales in comparison to the critical role played by the issuer — the entity best positioned to police fraud. Mott Report at ¶¶ 64-66. Visa also misleads the Board when it suggests that certain unnamed networks may not provide basic data security, a deficiency that could expose cardholders to risk should their transactions be routed over these (unnamed) networks. Visa Letter at 4 (“Certain networks may simply not provide the risk/fraud controls”). In truth, as part of the basic services they provide to their customers, debit networks provide the features that Visa suggests may vary by network. In this regard, it is worth noting that all debit networks are audited by the FFIEC and are required to provide a standard set of features, including security protocols (*e.g.*, 128-bit triple-DES), risk management, fraud controls and tools, transaction processing requirements, data security and network brand value and marketing support.

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initially, at the incremental ACS costs for signature debit of approximately 1.36 cents and phased down over time to the incremental ACS costs for PIN debit which currently are approximately 0.33 cents. Mott Report at ¶¶ 1, 35.

- Any fraud adjustment (positive or negative) to interchange should be limited to spurring investments in paradigm-shifting fraud prevention measures that are demonstrably superior to the low fraud experienced with PIN debit. Any such offset should take into account merchant and consumer investments to implement that technology, as well as any lingering fraud prevention or fraud loss costs that are borne by merchants under that technology.¹⁵
- Merchants must be able to choose between at least two unaffiliated networks to route any debit transaction. That means that all debit cards on which an issuer has chosen to include both signature and PIN debit functionality should have at least two signature and two PIN networks over which merchants can route. Cards with only signature (or only PIN) debit functionality must have at least two signature (or PIN) networks available for routing. These requirements must be supplemented with standards that prevent networks and issuers from inhibiting merchants — through rules, penalty fees, or programs that encourage processors or consumers to frustrate merchants' ability to control routing — from directing the routing of debit transactions.
- Vigorous oversight and penalties are needed to protect against evasion of the regulations. Networks have imposed numerous network fees on merchants in recent years, and such fees can be used in a host of ways to reward issuers and incent them to issue debit cards that utilize a particular network. In that way, network fees could prove to be a substitute for interchange as networks compete for issuers. Anti-circumvention standards should be crafted to prevent that and other ways of evading the regulations from occurring.

Before concluding, we must address the arguments the Board has received that the Act should be phased in over time. The suggestion that networks and issuers will need up to two years to comply with the Act cannot withstand scrutiny. Visa and MasterCard typically change their interchange fees and structures (including such items as security rating category requirements and involving hundreds of tiers that vary by transaction, product, card type and/or merchant category) twice each year in April and October — with mere weeks' notice to industry participants. As the changes mandated by the Act should be much simpler to accomplish than overhauling the credit and debit card rates as the networks regularly do, one cannot conclude that

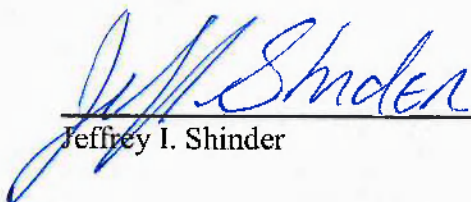
¹⁵ A fraud offset that rewards issuers for investments regarding the current magnetic stripe system, including most egregiously for investments related to signature debit, would merely perpetuate the skewed incentives of the current system in which merchants currently bear a majority of the fraud costs associated with debit transactions.

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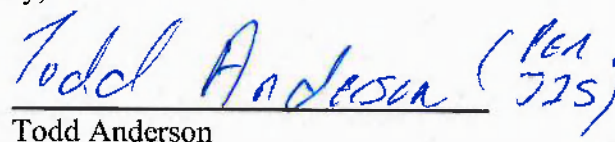
additional time will be necessary. Arguments about the costs of compliance to issuers are similarly misplaced. Issuers (including small issuers) will not face onerous costs to connect to multiple networks as they can add network functionality without reissuing debit cards, and the costs of connecting to additional debit networks are not extensive and likely will be mitigated by competition for volume that should intensify post-regulation.¹⁶ Accordingly, there is no reason that the Board's rules and regulations under the Act cannot be prescribed and take effect by July 21, 2011 as mandated by Congress.

We appreciate your consideration of this letter. Please do not hesitate to contact us if you or your colleagues have any questions.

Sincerely,



Jeffrey I. Shinder



Todd Anderson

¹⁶ Contrary to arguments that have been made previously to the Board, smaller issuers will not face onerous costs if they are required by the Act to connect to multiple networks. Such issuers typically outsource the connectivity function to "gateway" providers, which greatly ease the operational burden and expense associated with establishing connections to multiple networks. These gateway providers — including Fiserv, FIS/Metavante, and Jack Henry — already have connections with all of the debit networks, which smaller issuers can utilize to link up with the various networks. Moreover, the additional expense associated with setting up these linkages would be limited to the fees charged by the gateway processors and the nominal fees levied by the PIN debit networks for connecting to their systems. Gateway processing is a competitive market where competition already limits pricing. As for the costs of connecting to additional debit networks, the PIN debit networks impose nominal connection and/or membership fees (which range from zero to a one-time/annual fee of several thousand dollars) that they might even waive, as some have done in the past for competitive reasons, to attract more volume. Lastly, banks can add networks without reissuing cards by simply providing updates to the weekly BIN files, which further minimizes the costs associated with linking to multiple networks.