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1700 NORTH MOORE STREET
SUITE 2250
ARLINGTON, VA 22209
T (703) 841-2300 F (703) 841-1184
WWW.RILA.ORG

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BY EMAIL – Interchange.Survey@frb.gov

Ms. Louise L. Roseman
Director, Division of Reserve Bank Operations
and Payment Systems
Board of Governors of the Federal Reserve System
Washington, DC 20551

Re: Comments on Draft Card Issuer Survey

Dear Ms. Roseman:

On behalf of the Retail Industry Leaders Association (RILA), I am pleased to provide comments on the Federal Reserve Board's draft survey of card issuers. The following comments reflect input from a number of RILA members on various aspects of the survey. They are generally organized along the six sections of the survey and its instructions.

Before we address the specifics of the survey, however, we offer some general comments about the process. On the issue of historical data, we believe that requesting information for only one year is not enough. We believe that data over a number of years, and in some limited instances going back as much 20 years, would give the Federal Reserve a clearer perspective of key issues, such as the importance of network routing options for merchants. One solution to any burden concerns raised by the issuers would be to ask them for data from every five-year interval for requests that date back to 1990.

We also think the Federal Reserve, in assessing issuer costs, should be cognizant of the fact that most of the fixed costs associated with issuing debit cards actually predated the issuance of debit cards since they were incurred as part of the ATM system. At the very least, such costs should be allocated appropriately between a bank's ATM and debit programs. Moreover, many of the costs that banks may attempt to include in their responses, such as the costs of account statements, go back to the days when checks were the predominant way to access the demand deposit account. Such costs should be disregarded, and the survey instructions should clarify that these types of costs should not be included in survey responses.

RILA and its members are also concerned about fraud costs and the allocation of costs associated with chargebacks. With respect to fraud, the survey and instructions should make clear that fraud means only transactions initiated by someone other than the authorized user of the card. Costs associated with bad debt – which issuers often attempt to shift to merchants through chargebacks – are a reflection of underwriting and have nothing to do with fraud. Similarly, chargebacks relating to contests over defective merchandise or which relate to customer satisfaction also have nothing to do with fraud. To eliminate such costs from the equation, the Federal Reserve should clearly exclude these types of costs from the definition of fraud. As for chargebacks, the banks should allocate the portion of those costs that is truly attributable to fraud as opposed to other chargebacks.

From the calls that the Federal Reserve held with industry participants regarding this survey, it became readily apparent that issuers are urging the Federal Reserve to consider costs unrelated to settlement, clearing and authorization when developing rules and regulations that concern the appropriate level of debit interchange. RILA submits that should the Federal Reserve analyze such costs, it must also take into account the substantial economic benefits beyond line-item revenues that inure to issuers' broader demand-deposit relationship with consumers through their issuance of debit cards. These include the massive savings that issuers achieve by having transactions routed through a debit network rather than via costly paper checks. Indeed, the primary purposes of introducing debit in this country and in others, such as Canada, was to avoid the costs of handling paper checks as well as to mitigate and manage fraud costs. In this regard, we set forth below several suggested data requests that relate to the means by which the issuance of debit cards achieve economic benefits for banks over and above the interchange revenues that they have exacted from merchants through their collective exercise of market power.

As a general concern, we also note the importance of verifying the accuracy of the responses and the need to ensure that respondents are not loading in extra costs.

Lastly, the Federal Reserve should survey acquirers and processors regarding certain costs. In particular, the Federal Reserve should request cost information that would disclose how inexpensive it would be for banks to link up to existing networks in order to comply with a rule that requires numerous routing options on debit cards.

New Categories

We recommend that the Federal Reserve add the following new categories to the issuer survey:

- Information, dating back three years, regarding the benefits that banks receive from the debit card's connection to the demand deposit account relationship, including greater balances with which to extend loans, and the ability to cross sell other financial services, such as credit cards, mortgages and home-equity lines to debit card holders.
- Any contemplated changes in branding, network affiliations or routing on debit cards that may go into effect in the next 12 months.
- Any existing or proposed hybrid cards that combine credit and debit functionality on the same card or device, or any card or device that would allow the consumer to make a credit card transaction at the point of sale and have that transaction paid within a specified time frame via their demand deposit account, effectively converting it into a debit transaction.
- The issuer's ownership interests in entities that own networks, and the issuer's board or committee representation within Visa and/or MasterCard. This request should include any mechanism whereby the issuers control Visa's or MasterCard's ability to take positions regarding interchange in litigation or regulatory contexts, including the Visa Retrospective Responsibility Fund.

- Information, dating back three years, detailing the processing costs for the issuer's paper check programs.
- Information on whether the issuer has ever participated in a functional cost study performed by a card network or other external party, and if so, details of the issuer's participation.

Section I – Card Program Information

- The instructions to Section I should define "debit card program" to include consumer AND business debit cards.
- This data should cover the past 10 years, with banks perhaps providing data for 2000, then 2005-2010 and then 2007-2010, to minimize the reporting burden.
- Section I.B.3.a should be clarified with respect to compromised cards since lost/stolen cards are not necessarily compromised, but rather a normal cost of doing business. One option would be to separate card reissues into separate lines to record reissues due to expired card replacement, lost/stolen cards, or reissues due to data breaches. Normal expired-card replacement may vary considerably by issuer, depending on the length of the expiration period.
- The reported number of compromised cards in Section I.B.3.a should indicate any reimbursement received from merchants or from networks as a result of having collected fines and fees from merchants.
- Section I.B.3 needs a grid line to separate the entries for debit and prepaid programs and clarify that separate responses for both are sought.
- The survey should request volume data, broken out by network, for cards bearing one network affiliated, one PIN debit unaffiliated, two or more PIN networks, etc., to give the Federal Reserve the ability to see the correlation between network routing options and interchange. This data should date back 20 years, based on five-year intervals to mitigate the reporting burden. The instructions to Section I should make clear that the requests regarding the number of cards by PIN-only network access refers to point-of-sale (POS) PIN-debit functionality and not ATM-only functionality. The survey, however, should also request data on the number of debit cards with ATM-only functionality.

Section II – Card Program Activity

- Section II.A should be clarified with respect to the manner in which "value" is to be determined. Is it the net of purchases and returns, or a gross amount of purchases plus return volume? Should purchases and returns be noted on both line II.A and lines II.A.5 and II.A.6?
- In Section II.B and C, the survey should request more detail under "fraud related chargebacks" and "non-fraud related chargebacks," such as the chargeback reason code. These are standard reason codes that all issuers use and that are provided back to merchants. Including this type of information will validate that the issuers are not including chargebacks that are not fraud related. It will also allow for a comparison of

the chargeback and fraud data on an issuer-by-issuer basis, while permitting confirmation against the data to be provided by the merchants.

- The "number and value of transactions" data requested in Section II of card issuers should also be requested separately of acquirers, which will allow for validation of the data.
- Section II should reflect fees paid to banks and other owners of ATMs for providing cash to cardholders, as well as fees collected from merchants for providing cash to the bank's cardholders.
- Section II should include the total fees charged to cardholders for using their cards for purchases as well as for using ATMs owned by merchants or other parties.
- The survey should also request that issuers report any changes in the manner in which fees are paid to third-party processors for debit card services over the last 2 years.
- In the Revenues segment of Section II, the survey should collect information on revenue collected from cardholders for providing identity theft insurance and on money collected from merchants for fines related to breaches.
- The survey should solicit information about the difference in interchange revenues for cards with rewards programs vs. cards with no rewards. The higher interchange on rewards cards suggests that it goes to fund the cost of the rewards and is not related to the authorization, settlement, or clearing of the transaction. In addition, it should request information about the actual cost of rewards programs, including rates of redemption.

<u>Section III – Card Program Costs</u>

- The detail requested in Section III may prevent some issuers from attempting to complete the data. One option would be to remove line D (which appears to be a subtotal of A-C) and add a Total Costs line at the bottom. The Total Costs would not necessarily need to equal the lines above, but it would allow a place to record costs that cannot easily be placed in a bucket, such as all-in processing costs for third-party services.
- To permit validation of the "Third Party Costs" in Section III, the survey should ask issuers to identify the third parties (possibly subject to a threshold for materiality).
- For further validation of card program costs – the survey should ask issuers to provide results from any functional cost study that the organization has participated in whether performed by a card network or other external party.
- Section III.C would challenge infrastructure costs that would be required anyway to handle ATM transactions. The survey should ask that issuers provide trends in costs related to handling ATM transactions (number of transactions at ATMs) as debit cards have gained further acceptance. This could also be validated against the percentage of transactions handled in cash by merchants over similar time period.
- Data and systems security costs requested in Section III could be easily duplicated in Section IV (Fraud prevention). The survey should specifically indicate that any costs listed in Section III should not be included in Section IV.

- Costs from issuers with Canadian operations could be very instructive for comparative purposes, particularly given the viability of at-par pricing in Canada.
- Fixed costs and variable costs should be defined to ensure consistency across issuers. Without such a definition, we are concerned that the data will be hard to work with as issuers will come in with costs classified in different ways.
- In addition, costs should be broken out by those that vary with the value of the transaction and those that do not vary in that fashion.

Section IV – Fraud Prevention Activities and Costs

- Overall, it may be difficult to separate the cost of fraud monitoring, versus all security costs, or versus all-in processing costs for third-party services. The survey needs to clarify whether the fraud prevention costs for card production requested under Section IV.A are also to be included in Section III.I.
- The survey should clarify that fraud expenses include only expenditures that issuers undertake incrementally, not costs of compliance with industry/regulatory requirements.
- The survey should request any evaluation by the issuers of the costs and/or benefits of reissuing credit or debit cards with Chip and PIN functionality.

Section V – Fraud Activity and Losses

- Section V and its instructions need a clear definition of "fraud," that distinguishes unauthorized use from other non-fraud chargebacks (e.g., bad debt) as noted above.
- The survey should request costs for the following fraud activity categories:
    - Fraud Application
    - Lost/Stolen
    - Not Received (NRI)
    - Counterfeit/Skimming
    - Account Take-Over (ATO)
    - Mail Order/Telephone Order (MO/TO) and Internet
- The survey should ask issuers to submit any fraud benchmarking studies (e.g., Auriemma Fraud benchmarking), which utilize the fraud types listed in the preceding bullet.

Section VI – Exclusivity Arrangements and Routing Procedures

- In order to reflect the trends in the various data requested under the survey, it should cover more than just 2009. One option is for the survey to look back either 10 years or at least to 2003. Going back only five years gives the banks that dropped all marks except Interlink the opportunity to say they have not dropped any marks since they dropped them more than five years ago. Another approach would be to ask the banks how many network marks were on their card on a specified date in each year going back to 2000.

- We recommend changing the timeframe in Section VI.F to cover the past ten years (or one of the other options in the preceding bullet) since this activity began more than five years ago. In addition, we suggest modifying the follow-up "if yes" question to read: "If yes, briefly describe the extent or scope of the reduction and the rationale for it in the space below, as well as, whether your organization reissued cards due to dropping a network."

- Section VI should include a question asking whether the issuer has taken any steps over the past ten years to promote signature debit use vs. PIN debit use, along with an explanation and the rationale for such steps. Such steps could include issuing debit cards that are not PIN-enabled, differences in transaction fees between PIN and signature debit transactions, and/or rewards or other benefits (e.g., zero liability) that apply to signature but not to PIN debit.

- The survey should request details on contractual arrangements with Visa or MasterCard where the issuer receives incentives, including lump sums and discounted network services (including reduced ATM charges), in return for issuer commitments to dedicate all or a substantial portion of their debit card volumes, PIN or signature, over networks owned by Visa and MasterCard. The survey should also request any contracts between the issuer and Visa and MasterCard that include a penalty or liquidated damages provision, including provisions that require the repayment of past benefits or discounts, in the event that the issuer does not meet certain volume commitments to Visa's or MasterCard's signature or PIN debit networks.

- The survey should request any agreements between an issuer and Visa or MasterCard that include a most-favored-nations clause requiring Visa or MasterCard to match any interchange increase offered by a competing signature or PIN debit network.

RILA appreciates the opportunity to comment on the card-issuer survey, and we would be pleased to discuss RILA's views with you further at your convenience.

Respectfully submitted,

John Emling
Senior Vice President, Government Affairs