February 22, 2011

By Electronic Delivery

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

Re: Docket No. R-1404, Debit Card Interchange Fees and Routing

Ladies and Gentlemen:

This letter is submitted on behalf of Barclays Bank of Delaware ("Barclays") in response to the notice of proposed rulemaking issued by the Board of Governors of the Federal Reserve System ("Board") on December 28, 2010. The Board has requested public comment regarding its proposal to implement the debit interchange fee limitations and the exclusivity and routing restrictions of Section 920 of the Electronic Fund Transfer Act ("EFTA"). Barclays appreciates the opportunity to submit comments on the Board's proposal.

Barclays' comments focus on the application of the Board's proposal to prepaid card products. As discussed herein, we believe that the Board's proposal would have a number of harmful consequences for prepaid card programs. For example, we believe that the Board's proposal would greatly limit the availability of the prepaid card exemption from the interchange fee limitations by imposing a number of overly prescriptive conditions for the exemption to apply. In addition, the Board's exclusivity and routing restrictions would stymie new and innovative authentication methods for debit cards, including prepaid cards.

Prepaid cards have seen dramatic growth over the past decade, and the Board's proposal threatens the future growth of this product. Consumers and merchants alike have found prepaid cards to be an efficient and convenient form of payment. We believe this expanded use and acceptance is an express recognition of the value that these cards provide to both consumers and merchants. Similarly, the regulation of debit transactions in Section 920 is premised on the fact that these transactions are important for both consumers and merchants. As a result, we believe that the Board should implement Section 920 in a manner that preserves the economic viability of prepaid card programs.

Prepaid Card Exemption

The Board has proposed several exemptions from the debit interchange fee limitations, similar to the corresponding exemptions in Section 920. Of particular note, the Board's proposal provides that the interchange fee limitations would not apply to any interchange fee received by

an issuer if the transaction is made using a "general-use prepaid card"[1] that is: (1) not issued or approved for use to access or debit any account held by, or for the benefit of, the cardholder (other than a subaccount or other method of recording or tracking funds purchased or loaded on the card on a prepaid basis); and (2) reloadable and not marketed or labeled as a gift card.[2]

The Account/Subaccount Distinction

As proposed, the Board's prepaid card exemption would only be available if a prepaid card is not issued or approved for use to access or debit any account held by, or for the benefit of, the cardholder, other than a subaccount. While the language in the Board's proposal may be consistent with the statute, we believe that, as drafted, the account/subaccount distinction is simply not clear. For example, pass-through deposit insurance is available to participants in omnibus accounts only where the interests of the individual participants are known to the named deposit holder. In this scenario, it is not clear whether the existence of deposit insurance for holders of prepaid cards would be considered to access funds held for the benefit of the cardholder, thereby disqualifying such cards from this essential exemption. In this regard, a federally insured financial institution is not permitted to issue prepaid cards without deposit insurance.

Moreover, the Board's proposal otherwise fails to clarify the distinction between accounts and subaccounts. For example, the Board's proposed Commentary on the prepaid card exemption is silent regarding this distinction. We believe that such lack of clarity in any final rule would greatly impede an issuer's ability to develop prepaid card programs or restructure existing programs in a way that ensures the availability of the exemption. Thus, it is essential for the Board to provide additional clarity on this point in its final rule. In doing so, we believe that the Board should be cautious not to choose form over substance in implementing this provision. Specifically, where there is little, if any, meaningful difference between an "account" and a "subaccount," we believe that the Board should exercise its discretion to ensure that the prepaid card exemption is available to both.

Gift Card Issues

The most significant limitation that the Board's proposal would impose on the availability of the prepaid card exemption is that a prepaid card that is "marketed or labeled as a gift card" cannot receive the benefit of the exemption. In this regard, the proposed Commentary would incorporate the standards established under the Gift Card Act for making the determination of whether or not a prepaid card is marketed or labeled as a gift card. Although the statute includes the phrase "marketed or labeled as a gift card," the statute does not reference the Gift Card Act meaning of "marketed or labeled as a gift card" or otherwise suggest inclusion in the Board's rule of the detailed restrictions that the Board has included in its proposed Commentary.

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[1] The Board's proposal would define the term "general-use prepaid card" as a card, or other payment code or device that is: (1) issued on a prepaid basis in exchange for payment, regardless of whether the card may be reloaded; and (2) redeemable at multiple, unaffiliated merchants or usable at ATMs. Proposed § 235.2(i).

[2] Proposed § 235.5(c).

The proposed Commentary would impose significant obstacles to the availability of the prepaid card exemption. Under the proposed Commentary, an issuer would have to address a number of difficult operational and relationship issues in order to avoid having its prepaid cards considered gift cards, including the fact that the intent of the issuer alone is not sufficient and the exemption can be lost by actions of a partner retailer or its employees. Specifically, the Board's proposed comment 225.5(c)-2 would provide that "[w]hether the exclusion applies generally does not depend on the type of entity that makes the promotional message"; in this regard, a prepaid card "may be marketed or labeled as a gift card . . . if anyone (other than the purchaser of the card), including the issuer, the retailer, the program manager that may distribute the card, or the payment network . . . promotes the use of the card as a gift card." As a result, the Board's proposal would put the availability of the exemption for an issuer at risk by the actions of others, like the employees of a retailer, whom the issuer may have little, if any, meaningful control. We believe that this reading of the statute would impose unnecessary costs on issuers that would provide no meaningful benefit to consumers, while creating constant uncertainty as to the availability of the exemption.

Similarly, proposed comment 235.5(c)-3 includes several examples of scenarios in which a card would be marketed or labeled as a gift card. These examples tend to be overly prescriptive and often impractical. For example, the proposed comment states that a card would be marketed as gift card if it incorporated "gift-giving or celebratory imagery or motifs, such as a bow, ribbon, wrapped present, candle, or a holiday or congratulatory message," on either the card or the promotional materials and documentation that accompanies the card. As a result, issuers likely would have to scrutinize the minutiae of detail on even the most seemingly mundane text or other materials used by merchants in connection with prepaid cards in order to avoid losing the exemption. For an issuer that did not intend for its prepaid card to function as a gift card, a slight misstep with, for example, "celebratory imagery" or a "congratulatory message" on an Internet web page associated with the card could compromise its exemption. We believe that such a result is not required by the statute and would be contrary to Congress' clear intent to exempt reloadable prepaid cards.

Availability of the Prepaid Card Exemption

Under the Board's proposal, it is not clear how an issuer will be able to obtain certainty that the exemption applies, and that the exemption continues to apply. In this regard, based on the Board's detailed description of how a card may be marketed or labeled as a gift card, it would appear that the availability of the exemption could be at stake on a day-to-day basis based on, among other things, the marketing activities of other parties regarding which an issuer may not be aware. As a practical matter, issuers and payment card networks must be able to plan, establish and implement interchange rates for both covered and exempt debit cards, including prepaid cards. It would present significant operational challenges if the "status" of cards was an ongoing question or changed frequently. Thus, we believe that it is important for the Board to clarify that, to the extent that an exemption applies to a debit card product, the exemption, following some form of issuer certification, would remain in effect for a specified time period, of no less than one year, before that product is subject to recertification.

It also is not clear whether and how an issuer could regain an exemption for a prepaid card product that was previously lost. In this regard, if an issuer lost the exemption for a specific prepaid card product because of, for example, inappropriate marketing by a retailer, how would the issuer be able to cure the issue and regain the exemption? Why should an issuer be punished at all for the retailer's mistake in marketing the prepaid cards, let alone punished for the remaining life of the card product, particularly when it is the merchant that would benefit from this "mistake" by lower interchange rates on those cards? Would an issuer have to close that specific prepaid card program and create a new program in order to regain the exemption? The answers to these questions are not clear under the Board's proposal. In addressing these and other questions, it is important for the Board to use its discretion under the statute to preserve the availability of the exemption for prepaid card issuers under such circumstances.

Limitations on the Prepaid Card Exemption

The Board also proposed a limitation on the exemptions for prepaid cards if certain cardholder fees are imposed. Specifically, the Board's proposal provides that the exemptions would not apply after July 21, 2012 if an issuer, among other things, imposes a fee for the first withdrawal per calendar month from an ATM that is identified in the issuer's name or identified by the issuer as providing reasonable and convenient part of its designated ATM network (*i.e.*, the issuer's "designated ATM network").[3] We believe that it is important for the Board to clarify that this limitation does not apply when the issuer itself does not engage in, or even contemplate, the particular activity. For example, if an issuer provides a prepaid card that does not include ATM access, the issuer should not lose the exemption because the card does not provide for free monthly ATM withdrawals.

Limitations on the Exclusivity and Routing of Debit Transactions

Section 920 permits the Board to prescribe regulations that prohibit issuers and payment card networks from restricting the number of payment card networks on which an electronic debit transaction may be processed to: (1) one network; or (2) two or more affiliated networks (the "exclusivity" provision).[4] In addition, under Section 920, the Board may prescribe regulations that prohibit issuers and payment card networks from restricting a merchant that accepts debit cards from "direct[ing] the routing of electronic debit transactions for processing over any payment card network that may process such transactions" (the "routing" provision).[5]

The Board proposed two alternatives to implement the statute's exclusivity limitation. Under the first approach, payment card issuers and networks would be prohibited from limiting the number of payment card networks on which a debit transaction may be processed to less than two unaffiliated networks ("Exclusivity Alternative A").[6] Under the second approach, payment card issuers and networks would be prohibited from limiting the number of payment card networks on which a debit transaction may be processed to less than two unaffiliated networks

[3] Proposed § 235.5(d).
[4] 15 U.S.C. § 1693o-2(b)(1).
[5] 15 U.S.C. § 1693o-2(b)(2).
[6] Proposed § 235.7(a)(1) Alternative A.

for each method of authorization on the card ("Exclusivity Alternative B").[7] The Board's proposal to implement the statute's routing limitations would prohibit issuers from inhibiting the ability of a merchant to route a debit transaction for processing over any payment card network that may route the transaction.[8]

The Board Should Not Impose Requirements that Exceed the Statutory Language

As an initial matter, we note that, unlike the Board's proposal, the statute does not impose a requirement that an issuer add one or more networks to its cards. Instead, the statute states that an issuer may not restrict the number of payment card networks on which an electronic debit transaction may be processed to one network or two or more affiliated networks. As a result, it is not clear that either of the Board's Exclusivity Alternatives would actually implement the language of the statute by requiring the addition of any network, let alone requiring the addition of multiple networks.

Nonetheless, of the two Exclusivity Alternatives, only Alternative A is even remotely responsive to the language of the statute, since this Alternative at least focuses on two unaffiliated networks and does not address authorization methods. Exclusivity Alternative B, on the other hand, would substantially depart from the statute by tying the exclusivity limitation to authorization methods enabled on debit cards. In so doing, Alternative B would substantially increase the cost of compliance for issuers and require substantial changes to existing industry infrastructure. Moreover, it is not clear that issuers and acquirers have the ability to actually implement Alternative B for the foreseeable future. Adding multiple signature networks on the same debit card has never been done and would require systemic changes throughout the industry, including at merchants. The additional cost incurred for this redundant functionality would be enormous and would provide no meaningful benefit to consumers. As a result, we believe that the Board should adhere to the statutory language and not adopt Exclusivity Alternative B. In addition, the Board should do so in a way that first protects consumer choice by only permitting merchant routing where the consumer has not selected the network over which the consumer wants her transactions to be processed.

Exclusivity Alternative B Would Stymie Innovation

We believe that the Board's exclusivity proposal would have a dramatic, limiting impact on innovation in the debit card marketplace. For example, Exclusivity Alternative B is solitarily focused on signature and PIN as forms of authorization for debit cards. While these forms of authorization were relevant 20 years ago, the distinction between them continues to blur, and new authorization methods have been, and continue to be, developed. We believe that the ultimate result of Alternative B would be to set in stone the signature and PIN forms of authorization, and destroy all incentive to innovate with respect to authorization, to the detriment of all participants in debit payments. Specifically, there will be no incentive to develop new authentication methods, such as new contactless forms, biometrics and other technologies, that will allow new transaction types and may provide significant benefits, including, for example, increased competition, as well as the mitigation and reduction of fraud.

[7] Proposed § 235.7(a)(1) Alternative B.
[8] Proposed § 235.7(b).

Under Exclusivity Alternative B, if an issuer or payment card network developed a new authorization method, that form of authorization could not be deployed in the marketplace unless a competitor of the issuer or network also developed and offered a similar authorization method. Because Exclusivity Alternative B would require two unaffiliated networks per authorization method, no authorization method that is not available on two unaffiliated networks could be deployed without violating the Board's rule. In fact, the Board itself noted this very impact. Specifically, the Board stated that, under Alternative B, "an issuer may be unable to implement these new methods of card authorization if the rule requires that such transactions be capable of being processed on multiple unaffiliated networks."[9] It is not clear why the Board would even propose an alternative that would so obviously lead to such a harmful result.

We believe that the Board should encourage competition within the industry. Competition ultimately drives innovation, as companies develop unique and proprietary technologies and approaches to doing business in order to create consumer and market demand. Instead, the Board's proposal would effectively require that a company give away its innovation in order to bring it to the market. This stands in stark contrast to the very premise of Section 920, which appears to be designed to increase competition within the debit card industry. As a result, we believe that the Board should not adopt Exclusivity Alternative B or any other alternative that would stifle innovation within the industry.

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We appreciate the opportunity to comment on this important matter. If you have any questions concerning the issues raised in this letter, do not hesitate to contact me.

Sincerely,

Lawrence Drexler
General Counsel and Chief Privacy Officer

[9] 75 Fed. Reg. at 81,749.