

**COMMENTS to the Federal Reserve Board
[Regulation E; Docket No. R-1404]
RIN No. 7100-AD63
12 CFR Part 235**

Proposed Rule on Debit Card Interchange Fees and Routing

**By the National Consumer Law Center
on behalf of its low-income clients**

February 22, 2011

The National Consumer Law Center, on behalf of its low income clients, provides the following comments regarding the proposed rule under the Electronic Funds Transfer Act regarding debit card interchange fees and related issues, as required by Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

NCLC provides legal expertise to attorneys, advocates and policymakers nationwide to protect low income consumers in the financial marketplace.¹ We offer these comments on the impact of the proposed rule on low income consumers.

We did not take a position on Section 1075 and take no position now on the appropriate interchange fee to be permitted under that section. On the one hand, the current situation disadvantages low income consumers, who are more heavily cash or check users and whose debit card volume is lower than other consumers. High interchange fees are likely passed on in the form of high prices, forcing those who do not use debit cards to subsidize the profitability of interchange services and rewards and other services for more affluent consumers. On the other hand, if interchange fees are restricted dramatically, one of the likely outcomes is that banks will make up that revenue by increasing fees on consumers, especially those who do not have the high balances or heavy debit activity necessary to get those fees waived. Banks will have less interest in consumers who cannot pay high monthly fees and whose debit activity does not generate sufficient income, and more low income consumers may be pushed out of the banking system.

¹ The National Consumer Law Center, Inc. (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including Consumer Banking and Payments Law, as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low-income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to address predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of the all federal laws affecting consumer credit since the 1970s, and regularly provide extensive comments to the federal agencies on the regulations under these laws. These comments were written by NCLC attorneys Lauren Saunders and Margot Saunders.

It is also important to observe that the cap on interchange fees is part of a trend toward disaggregation of fees in banking services, as financial service providers and regulators attempt to assign prices for the different costs incurred for individual banking services. It is essential that everyone keep in mind the effect of that process on access for low income consumers to reasonably and fairly priced financial services.

Without taking a position on the calculation of the interchange fee or the technical issues raised by the rulemaking, we wish to make several points.

First, greater consumer protections for prepaid cards are essential. The combination of lower debit interchange fees and an exemption for prepaid cards may accelerate a trend pushing low income consumers out of bank accounts and into prepaid cards. The ban on overdraft and shortage fees and the first in-network ATM fee are important first steps, but prepaid cards also need better disclosures, coverage under Regulation E, access to statements and other forms of transaction information, and a ban on other abusive fees and dangerous credit features. **In addition, in order to be exempt from the interchange fee limits, prepaid cards should be required to offer truly convenient in-network ATMs, not merely one for an enormous metropolitan statistical area.**

Second, the Board and other federal agencies should examine the impact of the interchange rules on access for low income consumers to traditional bank accounts and consider ways to mitigate that impact.

Third, we support measures to encourage chargeback for merchant disputes on debit cards.

1. Greater Protections are Needed for Prepaid Cards if They are To Become the Account of Last Resort for Low Income Consumers

Section 1075 exempts prepaid cards from the proposed interchange fee cap. Beginning July 21, 2012, prepaid cards will be exempt from that cap only if they (1) do not have any overdraft or shortage fees, and (2) do not charge a fee for the first in-network ATM fee each month. Those are important protections, but more are needed for consumers who turn to prepaid card and for prepaid cards to merit an exemption from interchange fees.

Prepaid cards are a promising new form of transactional account for those who have been shut out of the banking system or have found bank accounts too harmful due to overdraft fee manipulations. Prepaid cards are available regardless of credit history and can be significantly cheaper than paying check cashers and other alternative financial service providers. Prepaid cards also open up the world of electronic payments to those who have been reliant on cash, permitting access to internet and telephone purchases. Carrying a prepaid card is safer than carrying large amounts of cash, and prepaid cards generally offer better protection against loss or theft. Prepaid cards even increasingly

come with bill payment features and a form of checks, bringing them closer to the functionality of a traditional bank account.

Nonetheless, most prepaid cards operate in a shadow market without full consumer protections. Some, but not all, prepaid cards also come with inappropriate fees and dangerous credit features. Consequently, if low income consumers are to be pushed even further out of the traditional bank account market, it is essential that protections for prepaid cards be improved in several ways.²

Protection under the Electronic Funds Transfer Act and Regulation E. Most prepaid cards are not currently covered under the EFTA and its accompanying Regulation E. Regulation E provides a variety of protections, including fee disclosures, access to statements and transaction information, protection from loss, unauthorized charges and billing errors, and rules governing overdraft fees. Currently, only payroll cards and non-needs tested government benefit cards, such as unemployment insurance prepaid cards, receive Regulation E protection (and a modified form of protection at that, as discussed below). Regulation E needs to be extended to all prepaid cards.

Better Disclosure of Fees and Other Terms. The fees for prepaid cards are often hidden in fine print and may not even be visible on the outside of the package before purchase. Prepaid cards should be required to come with a clear and conspicuous fee chart (like the credit card “Schumer box”) and a wallet-sized card that consumers can easily reference. Fee information should be prominently available on the issuer’s website. The Consumer Financial Protection Bureau should also consider developing a single typical price tag, comparable to the APR on credit cards that consumers can use to compare cards with different fee structures.

Access to Statements and Other Forms of Transaction Information. For bank accounts, Regulation E requires periodic written statements, unless the consumer opts in to electronic statements following the procedures of the E-Sign Act. For payroll cards and non-needs tested government benefit cards, Regulation E dispenses with the statement requirement as long as transaction information is made available online and upon request by telephone, and as long as balance information is available by telephone and at electronic terminals such as automated transaction machines.³ Most non-Regulation E cards voluntarily follow the payroll card rules. Most prepaid cards do not even offer the option to sign up for paper statements. However, the unbanked consumers who use prepaid cards are less likely to have easy and convenient access to the internet, and even if they do, they may be unlikely to check their transaction activity online as frequently as they would review a paper statement. Forms of transaction information that consumers will actually use are essential to ensure that accounts are monitored for fraud, errors, unwanted fees, and budgeting purposes. All prepaid cards should be required to

² See also National Consumer Law Center, “Features of a Safe Basic Banking or Prepaid Card Account” (Dec. 2010), available at http://www.nclc.org/images/pdf/banking_and_payment_systems/issue-brief-safe-banking.pdf.

³ There are slight differences between the rules that govern payroll cards, 12 C.F.R. sec. 205.18, and those that govern non-needs tested government benefit cards, *id.* sec. 205.15.

offer the option of paper statements for a nominal fee of no more than \$1.00 and should be given incentives to offer other forms of transaction information like cell phone text messages, email or telephone alerts.

No inappropriate fees. The interchange rules take an important first step to making prepaid cards safer by prohibiting overdraft or shortage fees, as well as any the first in-network ATM transaction, for any prepaid card that wishes to be exempt from the interchange caps. However, consumers will not know whether a particular card has chosen to be exempt or not, and these fees should be banned on all prepaid cards. Most prepaid cards currently do not have overdraft or shortage fees, but the few that do make the entire market confusing for consumers and make the name “prepaid” deceptive.

In addition, prepaid cards should not be entitled to higher interchange rates if they have other inappropriate fees. Among these are:

- ***Denied transaction fees,*** which the Board indicated in its overdraft rules could pose “significant fairness issues.”⁴
- ***Fees for ATM balance inquires, automated customer service, or live customer service.*** Consumers should never be charged fees for responsible behavior like checking their balances, understanding their cards, or resolving problems. These fees are especially inappropriate on prepaid cards given that the cards do not come with paper statements.
- ***Inactivity fees or fees for closing an account or requesting a check for the remaining balance.*** Consumers should not be locked into prepaid card accounts that do not work from them, or prevented from reclaiming their remaining funds.

More than one in-network ATM per MSA is necessary. The statute deprives prepaid cards of their exemption from interchange fees next year if the issuer imposes a fee for the first ATM withdrawal per month from an ATM that is part of the issuer’s designated ATM network. The proposed regulation defines the issuer’s designated ATM network to mean either all ATMs identified in the name of the issuer, or any network of ATMs identified by the issuer that provides reasonable and convenient access to the issuer’s customers. Proposed comment 2(g)-1, however, states that an issuer provides “reasonable and convenient access” if it provides one ATM in the metropolitan statistical area (MSA) of the card holder’s last known address. A MSA is a huge area and certainly a prepaid customer who had to travel the distance of an MSA to use an ATM would not have reasonable or convenient access to an ATM. As Consumers Union points out, the Los Angeles-Long Beach-Santa Ana MSA encompasses 4,850 square miles and five counties, and has a population of nearly 11.8 million people. It takes 2.5 hours to drive from Lancaster (North) to San Clemente (South) or 5 hours by public transportation. Other MSAs described in Consumer’s Union’s comments are similar. Under comment 2(g)-1, a single ATM in those MSAs where prepaid card holders could make a no-fee withdrawal would be sufficient to qualify for the prepaid card exemption. That comment should be deleted.

⁴ 74 Fed. Reg. 59,033 59,041 (Nov. 17, 2009).

Dangerous forms of credit. The ban on overdraft fees (beginning in 2012) for prepaid cards that are exempt from the interchange limits is one step in the right direction of banning dangerous forms of credit on prepaid cards. As noted above, that ban should be extended to all prepaid cards to avoid confusion and unfairness. In addition, if prepaid cards are to become the transactional account of last resort for those frozen out of the banking system (and even if they are not), the cards should not be permitted to have other dangerous forms of credit. One such credit line, the iAdvance line of credit on MetaBank prepaid cards, was recently shut down by the Office of Thrift Supervision as unfair or deceptive. In addition to its high cost, 300% to 2,000% APR or higher, that line of credit compelled consumers to repay it automatically from their direct deposit of wages or public benefits and trapped borrowers into a recycling loan trap just like traditional payday loans. Prepaid cards should not come with any credit line or other credit feature that is linked to automatic repayment, that is not based on ability to repay but rather on the ability to seize collateral (the pay or benefit check), that is structured as an unaffordable lump sum payment instead of multiple installment payments over a reasonable period of time, or that is secured by other dangerous forms of security.⁵

2. The Board And Other Federal Agencies Should Consider The Impact Of Interchange Fee Rules On Low Income Consumers' Access To Traditional Bank Accounts And Explore Ways To Mitigate That Impact.

A significant reduction in interchange fees, combined with reduced overdraft income as a result of earlier rules, will inevitably result in an increase in fees on consumers. Many banks are already reimposing monthly fees and increasing other fees. When the tradeoff is overdraft fees for a regular monthly fee, that is a positive development. Consumers are much better off with monthly fees that they can compare and plan for than with hidden back end fees that fall unevenly and are destructive. In the case of interchange fees, the calculus is much more complicated and uncertain, due to issues such as the impact on the prices of goods and services and the multiplicity of ways that banks may restructure their account services and pricing models for different consumer groups.

Regardless whether reduced interchange fees are a net positive or net negative for low income consumers, the Board and other federal agencies need to consider whether the impact on some consumers will be to push them out of the banking system. The current banking system already shows little regard for the needs of low income consumers. Bank accounts are unavailable for some or come with such high overdraft fees that consumers would be better off in a cash economy. But some low income consumers have managed to obtain bank accounts that are safe for them, and excessively high monthly fees could make those accounts unaffordable. Many banks are now imposing fees of \$15 a month or higher and are waiving them only for those who maintain high minimum balances or make a certain number of debit transactions a month.

⁵ For a longer discussion of the features of affordable alternatives to payday loans, see Lauren Saunders, National Consumer Law Center, "Stopping the Payday Loan Trap: Alternatives That Work, Ones That Don't" (June 2010), available at http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf.

Prepaid cards will be an adequate substitute for some consumers (with the added protections discussed above), but not for everyone. Prepaid cards do not typically offer checks or affiliated bank accounts such as savings accounts. They are generally offered by nonbanks that do not have branch locations, and even the banks that offer them tend to do so online and not as part of their branch products. Thus, prepaid cards are a no frills product that encourages anonymity and little human interaction, without the full service banking relationship.

The Board, the Consumer Financial Protection Bureau, the other federal banking agencies, and Congress should examine to what extent lower interchange fees will reduce the number of low income consumers in the banking system and should consider measures to ensure that all Americans have access to a safe and affordable bank account.⁶ Ideas might include Community Reinvestment Act credit or higher interchange fees for fully safe, basic banking accounts, a reinvigoration of the Electronic Transfer Accounts (ETA) mandated by EFT 99,⁷ duties connected with eligibility for direct deposit of Social Security and other federal payments, or other measures.

3. The Board's Rules Should Encourage Chargeback

As explained more fully in the comments of Consumers Union, the Board should adopt rules that encourage issuers to offer chargeback for merchant disputes. Consumers are quite confused over the difference between the merchant dispute rights offered by law on credit cards, the voluntary chargeback that VISA and MasterCard may offer on signature debit purchases, and the general lack of legal chargeback rights on debit cards. Whether through an allowance within the interchange fee rules for fraud prevention measures or other means, the Board's rules should encourage issuers to offer consistent chargeback protection on all debit cards.

Conclusion

Low income consumers do not have the lobbying muscle of either the retail industry or the banking industry. But they often suffer the impacts of the jockeying by other, more powerful groups. The Board, other federal agencies and Congress nonetheless have a duty to consider the impact of new rules on the least powerful consumers and to ensure that all Americans have access to safe and affordable financial services.

Sincerely,
National Consumer Law Center
(on behalf of its low income clients)

⁶ See National Consumer Law Center, "Features of a Safe Basic Banking or Prepaid Card Account" (Dec. 2010), available at http://www.nclc.org/images/pdf/banking_and_payment_systems/issue-brief-safe-banking.pdf.

⁷ 31 U.S.C. § 3332(i) (2).