Meeting Between the Board of Governors
and the Federal Advisory Council
December 3, 2010

Participants: Chairman Ben Bernanke, Governor Warsh, Governor Duke, Governor Tarullo, and Governor Raskin

Jim Annabel, Ellen Alemany, Robert Kelly, Henry Meyer, Richard Hickson, David Nelms, Bryan Jordan, Richard Davis, Bruce Lauritzen, Russell Goldsmith, Phillip Green (alternate for Federal Reserve Bank of Dallas), Phillip Wenger (alternate for Federal Reserve Bank of Philadelphia)

Summary: The Federal Reserve Board met with the Federal Advisory Council ("the Council"), a statutorily created advisory group that is composed of twelve representatives of the banking industry (one member from each Federal Reserve District). The Council ordinarily meets four times a year to provide the Board with information from the banking industry's perspective.

During the meeting, the Council discussed the implementation of the interchange-fee provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, and the Council presented its views on payment-network exclusivity and interchange fees. The information collected from the Council at the meeting is summarized in the attachment. The viewpoints expressed in the attachment are solely those of the Council.

Attachment

Payment network exclusivity and interchange fees:

- The Council is appreciative of the Fed's open process and the fact that significant resources have been expended to collect data, understand a very complex industry, and evaluate potential impacts. The industry is anxious to have sufficient time and ability to comment following issuance of the draft rules.
- The Council is concerned that Debit Interchange Price Controls have the potential to harm small retailers and businesses, small and large banks, and consumers (especially low to moderate income households who would lose access to free checking accounts).
  - $14-15B in annual debit interchange revenue enables no-fee checking accounts and debit rewards. Debit Cards are the single most used consumer financial product, supporting $1.5T of consumer spending.
  - Small "exempt" banks are expected to be impacted along with large institutions.
  - Inefficiency could be rewarded given cost plus structure.
  - Typical bundled pricing for small merchants and businesses suggests they are not likely to benefit from lower interchange.
  - Experience of other countries (such as Australia) suggests consumers will not experience lower costs from retailers if interchange is reduced. At best this is an economic transfer from banks (and ultimately from consumers) to large retailers.
  - Broad and growing acceptance of debit cards at current pricing levels confirms retailers see value of sales and efficiencies that more than offset their current debit costs.
- The Fed is given the mandate to establish interchange on a "reasonable and proportionate" basis relative to certain incremental costs. Consistent with this responsibility (and with established rate setting precedents in other regulated industries), the council urges the Fed to permit banks to recover all costs associated with debit card transactions, including relevant fixed costs, along with a reasonable profit.
  - Maintain viability of the business and encourage continuing innovation.
  - Avoid significant harm to consumers, businesses, and the overall economy.
  - Debit Cards are not independent products, but are core features of checking accounts which have significant cost structures.
- The council also urges the Fed not to over-engineer routing rules. A simple requirement of two unaffiliated networks meets the law and avoids many unintended consequences.
  - Encourages competition.
  - Practical to implement.

- Simple for consumers.
- Other considerations:
  - Sufficient transition time.
  - Reward efficiency (such as pin vs signature).
  - Minimize impact on "exempt" banks.
  - Minimize potential litigation and complexity (safe harbor?).
  - Small details in the rules may have great significance to the outcomes.