BancVue.

February 17, 2011

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue
N.W. Washington, D.C. 20551

Dear Ms. Johnson:

BancVue is a market-research driven product development and marketing company for community financial institutions. We serve around 1,300 institutions nationwide by helping them deliver innovative products that are good for the bank or credit union and good for the consumer.

We strongly oppose both the Durbin amendment and the Fed's proposed implementation of that amendment.

This Letter Won't Cover The Obvious Objections

We won't dwell on the most common objections you've no doubt already received in thousands of letters. Suffice it to say:

- The amendment was not well thought through, added at the eleventh hour and the pace of implementation is dangerously hasty
- The 12-cent cap is dramatically too low
- The $10 billion exclusion is unenforceable due to market competition
- Banks already are implementing service fees to offset expected income losses
- Lost income will decrease financial institution's lending capacity by constraining capital
- Merchants won't pass on the savings to the consumer
- This didn't work in Australia, so why are we trying it here?

What we will cover in this letter are three dramatic, yet seldom-mentioned reasons the Durbin amendment should be delayed until Congress can repeal it.

Guaranteed Paper Checks Cost More than Debit

Proponents of the Durbin amendment frequently site the "low" cost of paper checks as justification for reducing debit interchange. Opponents of the amendment usually counter that argument by citing the obvious paper-based inefficiencies that merchants face when dealing with the hassle and cost of check collection, management, and deposit. And while those points are indeed valid, they miss a bigger point.

We are comparing apples and oranges. A debit payment is guaranteed at the point of sale, and a check is not. A check could be hot or fraudulent. If a merchant chooses to mitigate those risks they can pay for "check guarantee" services. Those services essentially convert the paper check into a guaranteed electronic payment.

Sounds a lot like a debit card right? So you'd expect it to cost the merchant about the same as average debit interchange (1.14 percent), but you'd be wrong. In most cases, it costs more; fees of 0.99 percent to 1.50 percent of the check amount plus $0.15 to $0.35 per check are typical.

Yet despite this fact, supporters of the Durbin amendment say that the reason debit interchange is so "abusively" high is that Visa, MasterCard and the other networks have conspired to artificially inflate fees. But if that is true, why is it that a nearly identical service, guaranteed check depositing, is priced *above* debit interchange?

At the risk of being redundant, I reiterate that debit vs. guaranteed check is a nearly perfect apples and apples comparison. And of these nearly identical services, guaranteed checks usually cost the merchant *more.*

> **Take-a-way: One of the unintended consequences will be small businesses will utilize these guaranteed check services even more and it will cost them more than the current interchange fees for clearing a debit card purchase.**

If we are to believe that the current rate structures for debit card interchange fees are the results of a massive network/issuer conspiracy to collude on pricing to the detriment of the US consumer and merchant, then we should also ask, "Who are the members of the analogous oligopoly in the guaranteed check industry and when can we force them to lower their fees?" This industry is so fragmented that, prior to researching this letter, we couldn't name one noteworthy provider of check guaranteeing services!

Clearly there are no service providers in the guaranteed check space that have the scale to move the market price for that service. So it is clear that the free market is setting the price.

> **Take-Away: Since the price for debit is *not* higher than this nearly identical service of paying for guaranteed checks, it is clear that there is no price-inflating conspiracy at work and that, yes indeed, the free market is working for debit pricing as well.**

History clearly shows us that the economy works best when the government does not interfere with artificial price controls such as those proposed in the Durbin amendment.

Affiliated Networks Encourage Innovation
Our company exists to bring innovative products and services to the smaller community financial institutions that cannot cost-justify funding their own R&D activities directly. This gives us a unique line of site to the challenges and unintended consequences of mandating that issuers must have unaffiliated networks on the debit card.

The Fed has put two options on the table with regard to unaffiliated networks on the card. Alternative one requires one network per authorization method. Alternative two, having at least two unaffiliated networks for both PIN and Sig, is unfathomably more challenging from an innovation perspective. We'll focus on the lesser of these two evils, alternative one.

Much of the exciting and consumer-benefiting innovation currently occurring in the fintech space depends upon intersecting transactional data mid-transaction and applying business rules. For example, a transaction could be intersected and a merchant-funded loyalty reward could be instantaneously applied to the transaction.

Another great example of this type of innovation is MasterCard's, " inControl". (http://www.mastercard.com/us/company/en/whatwedo/incontrol_solutions.html). This system allows consumers to better control the spending on their cards by disabling purchases at certain objectionable merchant categories (for example, you might want to prevent your college-aged child from using his/her debit card at liquor stores or at any point of sale device outside the state in which the school is located). It can also provide better control over budgeting and empower business owners to more easily prevent employee-fraud on the company card. This system's ability to function is greatly reduced when MasterCard (a signature network) is prohibited from working with one of their affiliated networks.

> **Take-Away: Mandating use of unaffiliated networks will reduce consumer access to innovative budget-aids like inControl.**

The Small Financial Institutions Are Being Hurt by the $10B Exclusion

The Durbin amendment would not have passed without the exclusion for smaller financial institutions. Yet congress' intent has backfired. Again, an unintended consequence will occur because of the absence of a viable enforcement mechanism; market forces will prevail and will soon burden smaller institutions with the same cut-rate interchange revenue that was intended only for the large institutions.

But that is not the *really* bad part.

Because of the exclusion, the Fed ignored the debit card costs incurred by smaller institutions and instead focused its analysis only on the nation's largest institutions. Due to their scale, these mega banks obviously have much lower processing and support costs associated with their debit card offerings than the community institutions. So while we'd argue that 12 cents is way to low even for the big banks since many material costs (most notable, fraud) are ignored, the 12-cent cap is absurdly low for the sub $10B institutions.

But since market forces and steering by the merchants will mean that the cap intended for the big banks is, in reality, the cap for all financial institutions, the smaller institutions will in large part end up losing money on every debit purchase made by their consumers. This is the *exact opposite* of what congress wanted.

> **Take-Away: Having a two tiered pricing system may look good on paper, but in the marketplace, it will not be sustainable and will end up hurting community institutions much more than the mega banks.**

Delay, Delay, Delay then Repeal

In the very unfortunate event that implementation of the Durbin amendment cannot be delayed, please ensure that an enforcement mechanism for the $10B exclusion is included in the final implementation.

The better outcome would be that the Fed delay implementation of the Durbin amendment until Congress can repeal it for the following four reasons.

Since the price for debit is not higher than the service of paying for guaranteed checks, it is clear that there is no price-inflating conspiracy at work and that, yes indeed, the free market is working for debit pricing as well.

Unintended consequence: Small businesses will utilize guaranteed check services to receive money from checks, and it will cost them more than the current interchange fees for clearing a debit card purchase.

Unintended consequence: Having a two tiered pricing system looks good on paper, but in the marketplace, it will not be sustainable and will end up hurting community institutions much more than the mega banks, which will lead to higher prices for loans and other banking services to make up for the lost income.

Unintended consequence: Mandating use of unaffiliated networks will reduce consumer access to innovation, which flies in the face of our heritage. Historically, our citizens in these United States have used their freedom to take risks and create new products and services, leading the world in innovation, which has *always* led to creation of new jobs, which is the fuel that drives our economy.

Sincerely,

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