From: 1st Source Bank, Derek Hayes

Subject: Reg I I - Debit card Interchange

Comments:

Date: Jan 11, 2011

Proposal: Regulation II - Debit Card Interchange Fees and Routing
Document ID: R-1404
Document Version: 1
Release Date: 12/16/2010
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Comments:

Docket No. R-1404 1st Source is the largest locally controlled financial institution headquartered in the northern Indiana-southwestern Michigan area. 1st Source delivers a comprehensive range of consumer and commercial banking services through 75 banking centers and 96 ATMs. 1st Source Bank has a portfolio of approximately 103,000 debit cards. Each month, our clients utilize the convenience of these cards to make over 1 million purchases, instead of using cash, check or credit card. This amendment to the Dodd-Frank reform creates an inequitable situation between acquirer and issuer. The first portion requires an arbitrary cap or control on costs to the merchant for processing debit card transactions, but the latter portion establishes network selection freedom. If the proposed amendment were consistent, it would allow for network selection and a free market for price negotiation between acquirers' and issuers' networks. Instead, the proposal has set up a model by which one business segment may freely choose to set prices on their goods and services and choose the forms of payment for these items, while the other is not allowed to profit in order to offset inherent costs. In relation to those inherent costs, we understand that the Federal Reserve was somewhat limited in the scope under which it was allowed to set the costs of processing a consumer debit card transaction. However, the Fed failed to accurately look at the full extent of costs to issuers. In addition to the basic electronic processing costs involved with a transaction is the cost of fraud protection and remuneration to issuer clients. Many times recently we have seen a merchant acquirer network suffer intrusions, only to have issuers suffer losses as we reimburse consumer clients. Also, the paradigm has long existed under which a merchant accepts a stolen card, does not verify the signature panel and processes a fraudulent transaction; the issuer is left holding the loss because the merchant cannot be "expected to be [a] handwriting expert." These types of costs must be considered in assessing the total costs of processing a card payment. As others have pointed out, if the arbitrary limits of $.07 and $.12

are implemented, the only effect will be to terminate several smaller banks as issuers and remaining issuers will be required to pass costs directly back to U.S. consumers. Will the reductions in merchant costs be offset by lower prices in the marketplace? No. It is our belief that merchants will see this as an opportunity to increase their profit margins instead of passing the savings on to consumers. Lastly, the amendment fails to acknowledge that merchants are not required to accept debit cards. Merchants have long positioned themselves by saying that the cost of accepting cards well outweighs the costs of accepting cash and checks. Ironically, merchants often fail to recognize certain cost savings associated with debit cards but easily overlook the ancillary costs involved with cash and checks. Yet, they choose to accept card payments as more payment avenues equals increased ability to sell products. In an effort to more equitably treat both card issuers and acquirers, we ask the Federal Reserve to re-assess their proposal on interchange fees to ensure these fees incorporate the true costs of providing card services to our consumers. At a minimum, network switch fees must be included in the assessment process, but other issuer costs as described in this letter should be considered as well. Thank you for the opportunity to comment on this proposal. Please contact me if you have questions. 1st Source Bank Derek Hayes AVP - Branch Administration