



STATE OF DELAWARE  
DEPARTMENT OF STATE

JEFFREY W. BULLOCK  
SECRETARY OF STATE

February 22, 2011

VIA Fed-ex and Electronic Submission

Ms. Jennifer J. Johnson  
Secretary  
Board of Governors of the Federal Reserve  
20<sup>th</sup> Street & Constitution Avenue, NW  
Washington, DC 20551

RE: Debit Card Interchange Fees (Docket No. R-1404)  
RIN 7100-AD63

Dear Ms. Johnson:

The State of Delaware hereby submits comments on the Federal Reserve Board's proposed rules for debit interchange fees ("Proposed Rule"), as required by Section 1075 of the Wall Street Reform and Consumer Financial Protection Act of 2010 (the "Debit Interchange Fee Amendment" or "Amendment"). The State of Delaware urges the Federal Reserve to delay implementation of the Proposed Rule to provide for further study of the impact of the proposed rule on consumers and employment and to amend the Proposed Rule to eliminate price caps.

As state and local governments continue to struggle to recover from the economic impact of the financial crisis and in light of looming debt burdens that such governments face, it is critical that the federal government foster an environment that facilitates job creation and economic growth. In our view, federal entities such as the Federal Reserve have a special responsibility to use their regulatory authority to enhance the ability of financial institutions to borrow and lend money consistent with the principles of our free market economy. Unfortunately, the price control scheme imposed in the Proposed Rule is inconsistent with this responsibility and, if left unchanged, will limit job growth, further restrict lending and threaten the profitability and possibly the survival of many community banks, thereby leading to increased consolidation in the banking sector.

While these effects will be felt nationwide, they will be particularly pronounced in states such as Delaware, where a relatively high percentage of its citizens are employed in the financial sectors. Indeed, in our state, nearly 13 percent of private sector employment is in financial services. Many of the institutions where these individuals work will be negatively impacted by the strict price controls on debit card transactions in the Proposed Rule. Such price controls will limit the ability of these financial institutions to recover the basic operating cost associated with administering the electronic payments system, resulting in lost revenue and higher fees for basic services. This will undoubtedly lead to layoffs and higher unemployment in our state.

While we have had neither the time nor resources to conduct a specific, expert study on the precise financial impact on Delaware of the Proposed Rule, we have heard from large and small institutions alike – both that operate in Delaware and outside our state. In each case, we have heard similar concerns:

- The proposed rule contains an absolute price cap, leaving no room for market fluctuations and variances in transaction costs.
- The costs included in the capped fee are not comprehensive, and will result in losses on current debit products that may render it an **unsustainable business line**.

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Ms. Jennifer J. Johnson, Secretary  
Federal Reserve Board of Governors  
Page 2

- The fraud cost provision in the proposed rule is incomplete, and fraud costs are not included in the proposed price cap. Issuers are forced to incur costs associated with fraud prevention and loss without any adjustment in the interchange fee to cover those costs.
- The proposed rule fails to attribute any value to the payment guarantee that debit cards provide merchants (checks do not provide that level of assurance).
- The proposed rule also requires that debit cards be used on multiple unaffiliated networks, thereby greatly increasing costs and complexity and potentially impacting competition between payment networks.

Because affected institutions **will not be able to break even or recoup the most basic costs** associated with their debit card product line, many will have to consider significant changes to current services that will dramatically reduce consumer choice and satisfaction in the marketplace, including:

- Eliminating debit rewards program.
- Eliminating free checking products or at the very least establishing large minimum deposit levels for free checking.
- Eliminating popular ATM rebates.
- Introducing new fees associated with debit products.
- Encouraging members to use alternative, lower cost payment methods (e.g. cash, prepaid, credit).

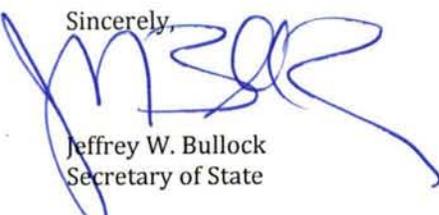
Finally we have heard from an alarming number of small and independent banks that the Proposed Rule is likely to impact them most severely. Despite the fact that the Proposed Rule exempts institutions with less than \$10 billion of assets, practically speaking, such an exemption is not workable. Indeed, there was significant testimony in Congress last week to this very point.

This approach would require the card networks to develop a two-tiered system that could differentiate between small and large issuers. Even if such a system can be developed and deployed, merchants would likely encourage customers to pay with cards from larger institutions as a way to reduce costs, leaving small and independent banks at a competitive disadvantage to larger banks. At a minimum, the potential significant unintended consequences for small independent institutions provide compelling reason in and of itself for further study and for major revisions to the Proposed Rule.

As you develop a Final Rule as required under the Debit Interchange Fee Amendment, I strongly believe that additional time is needed to explore the wide-ranging consequences of the Proposed Rule on employment, lending and consumers, as well as on banks and merchants. At such time that the Federal Reserve does issue a Final Rule, it is essential that the Rule allow issuers to establish interchange rates that are at least adequate to cover the costs associated with operating the system, maximizes the ability of institutions of all sizes to make loans, and minimizes any additional costs to consumers of financial services. In order to accomplish this, at a minimum, it is essential to eliminate the strict price control in the Proposed Rule.

Thank you for your consideration.

Sincerely,



Jeffrey W. Bullock  
Secretary of State

cc: The Honorable Jack A. Markell, Governor  
The Honorable Thomas R. Carper, U.S. Senator  
The Honorable Christopher A. Coons, U.S. Senator  
The Honorable John C. Carney, Jr., U.S. Congressman  
The Honorable Robert A. Glen, Delaware State Bank Commissioner