Community Depository Institutions Advisory Council

On April 1, 2011, the Community Depository Institutions Advisory Council met with the Board of Governors to discuss the Board's proposed rule on debit card interchange fees and routing (Docket R-1404). The council provided written views, which are provided below.

Reasons banks are losing market share of the payment system:

Big banks, which are pioneers, will not have the resources or incentive to invest in new ideas and innovate because of loss of revenue (through interchange, for example), the uncertainty that the government will interfere in a product after the fact, as they have with debit cards, and because of the uncertainty related to federal preemption. One bank recently withdrew its prepaid card from six states because of the DFA provision which imposed state laws on prepaid cards.

Interchange price restrictions:

Unintended consequences:

- Will harm consumers who will pay higher checking account and debit card fees to replace the lost interchange that supports the cost of providing checking accounts.
- Will harm banks through lost revenue and drive community banks out of business: One bank reported net income will decrease 17% under the proposal.
- Community banks will be covered under any rule. It is not possible to fix the regulation or statute.

The Federal Reserve should use whatever statutory authority it has to ensure banks are compensated for the cost of debit cards:

- Fraud losses: One bank suffered $1 million in debit card losses last year. Another $300 million bank would have earned $64,000 in interchange under the regulation, but suffered $117,000 in losses.
- Card replacement for breaches: Breaches are often unreported, but cards must be replaced. Costs to the bank include not only the $7 to replace the card, but the reputational loss and potential loss of the exasperated customer who loses confidence in the bank
- Fraud prevention costs
- Payment network fees
- Customer service costs, including inquiries related to debit card transactions
- Capital costs
- 100% of the authorization, settlement, and clearance, not just 80% as proposed.

Future of Banking

- Interchange:
    - The likely results of the Interchange regulation is increased fees for savings and checking accounts, as well as NSF and other banking fees.
    - The industry should be aware of the changes in consumer behavior and evolution of technology that makes checking accounts and traditional forms of payment less important to the consumer
    - The bankers expect an increase in use of prepaid debit cards. Prepaid debit cards are exempt from the interchange rule and most cost less than a checking account while providing a similar service.