First Citizens

February 11, 2011

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

RE: Docket No. R-1404 – Proposed Rule, Debit Card Interchange Fees and Routing

Dear Ms. Johnson,

On behalf of First Citizens Bank, I appreciate the opportunity to provide our feedback on the Federal Reserve's proposed regulations to implement the debit card interchange fee and routing provisions of the "Durbin Amendment."

I have serious concerns that the approach taken in the proposal to address interchange fees will have an unintended negative result. Specifically, the proposed maximum allowable interchange fee of 12 cents per transaction will have negative consequences for two groups the proposal purports to protect: consumers and small banks.

The Federal Reserve faces a challenging task to implement the Durbin Amendment requirement that allowable interchange fees include only the incremental costs of authorization, clearance, and settlement of debit card transactions. I appreciate your efforts to craft a regulation that fairly and reasonably implements this requirement. I also appreciate the Federal Reserve's efforts to recognize the disproportionate impact this could have on smaller banks by including an exemption for issuers under $10 billion in assets.

However, the two alternatives offered in the proposal fall short of determining a "reasonable and proportional" fee. Moreover, the exemption for small issuers will simply not be meaningful or effective. As merchants become familiar with the pricing restrictions for larger banks, market forces will drive smaller banks to the same pricing levels in order to compete. Effectively, every card issuer will be subject to the regulatory pricing standard.

Debit card interchange fees accounted for approximately 10 percent of our pre-tax income for 2010. If we lose 80 to 90 percent of our interchange fee revenues as industry sources predict, then we will lose roughly 9 percent of our total pre-tax income. This represents a significant deficit in our financial position, at a time when increased deposit insurance premiums, loss of fee income from debit card overdrafts, and a general lack of borrowing already have put tremendous pressure on the balance sheets of smaller banks.

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More than likely, the big banks can absorb the reduction in interchange revenue and move forward. Many small banks, some of which are already struggling, may have to close their doors unless they take very aggressive action to create new revenue sources. Ultimately, this means increased fees and services charges, a reduction in product offerings and services, and lower interest rates paid on deposit products, among other things. Consumers will pay more for their basic banking needs. In the meantime, it remains to be seen whether merchants and retailers will actually pass on any savings to consumers as a result of the interchange fee cap.

As you consider additional alternatives for the final rule, I urge you to use your full authority to adopt the broadest possible interpretation of the definition of allowable fees. The final rule should allow for all the costs and expenses that a bank incurs as a result of offering a debit card program, which is necessary to provide for the authorization, clearance and settlement of transactions. By limiting the allowable fees to just those fees that are unique and attributable to each individual debit card transaction, the proposal prohibits banks from recovering many direct and indirect operating costs that are necessary to offer a debit card program.

At a minimum, the interchange fee cap should take the following into consideration:

<u>Fraud losses</u>

While there is a provision in the proposal for a "fraud adjustment," this will not be in place when the rule initially goes into effect. Moreover, this provision only allows for the recovery of costs for fraud prevention efforts. It does not address the fraud losses that we incur despite our prevention efforts. The actual fraud losses we bear on debit card transactions already significantly detract from the overall profitability of the product. The proposal would compound this issue by prohibiting us from offsetting any portion of our fraud losses through interchange fees, which are paid by the merchants who already enjoy protection from the vast majority of fraud losses under Regulation E and card network rules.

<u>Fixed Costs</u>

The proposal suggests that fixed costs for debit card operations are recoverable "through other means." Generally, the "other means" available to us are increased account fees and service charges to our customers, the consumers making the purchases. Shifting the expenses related to debit card operations from the retailers and merchants, who gain significant benefit from the ability to accept debit card payments rather than checks, to consumers seems inappropriate.

<u>Reasonable Profit</u>

In virtually any business arrangement in which Business A provides a service to Business B, and B uses the service to sell its goods and services to the end consumer, Business A receives some reasonable compensation above and beyond the straight pass through of the cost of each transaction. To be viable and sustainable, debit card programs must be profitable to the bank. Rather than passing additional costs to our consumer customers, we should be able to recognize a reasonable profit from the merchant, who is also profiting from the transaction. It has to be assumed in the final rule that reasonable profit is a component of the incremental costs associated with the bank's provision of a debit card program that allows for the authorization, clearance and settlement of debit card transactions.

Thank you for your consideration. I realize that the Federal Reserve has limited options under the Durbin Amendment. Like many of my colleagues, I simply ask that you carefully consider all available options and arrive at a solution for interchange fees that allows banks to offset fraud losses, recover fixed operating costs, and earn a reasonable profit.

Respectfully,

Jim Apple

Jim Apple, CEO