First National of Nebraska

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

Via Facsimile 202-452-3819
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Ms. Johnson:

RE: Docket No. R-1404 and RIN No. 7100 AD63

Thank you for the opportunity to comment on the proposed changes to debit card interchange fees and routing rules as proposed in Section 920 of the Electronic Funds Transfer Act (EFTA Section 920), added by Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. We appreciate the opportunity to participate in this important activity and have the following limited comments for consideration:

Background:
First National of Nebraska ("FNN") is a closely held, non-listed financial services holding company with total assets of approximately $14 billion based in Omaha, Nebraska with community banking operations in Nebraska, Colorado, Illinois, Kansas, South Dakota, Iowa and Texas. It has credit card issuing operations on a nationwide basis with outstanding balances of $3.5 billion and is an active issuer of signature based debit cards to its consumer and small business customer base with an outstanding signature debit card base of 330,000 customers. First National's primary operating unit is the First National Bank of Omaha, a nationally chartered bank also based in Omaha, Nebraska a nationally chartered bank. It has five other banking charters as wholly owned subsidiaries based in Nebraska and South Dakota, four national charters and one Nebraska State Chartered institution.

General Comments:
We believe that the timeframes included in the statutory directions to the Federal Reserve for the creation of the enabling rules are far too short for both commentary and implementation given the complexity of the issues involved. This will most probably lead to extensive unforeseen consequences that will negatively impact consumers as well as the banking industry. This contention is supported by the content and language of the Proposed Rule, which is itself incomplete and seeks comment on core structural concepts, which should themselves be subsequently published for comment prior to approval. The technical complexity of many of the items under consideration is such that proper implementation to meet the full intent of the statute appears unfeasible given the timeframes set out in the statute. In the normal course of business, changes to the card system infrastructure are scheduled many months ahead and implemented

subject to a previously determined release schedule, this critical process appears to have been ignored in the Proposed Rule and its authorizing statute.

We are generally very concerned with the tone and timbre of the Proposed Regulation; it follows a strict interpretation of the enabling statute; however, precedent has shown that the Reserve Bank has been willing to take a more pragmatic approach to rule making where their assessment of the environment deems it necessary. Given the circumstances under which the Durbin Amendment was both drafted and then passed through Congress, this situation would appear well suited for the Reserve Bank to act in a pragmatic fashion. It could propose regulations that meet the general intent of the statute, without creating significant changes that generate no benefit for consumers.

Given that the Proposed Rule attempts already to omit issues associated with the treatment of costs related to fraud, it is our belief that the Reserve Bank should take a consistent approach in respect of all of the components of the Rule and seek to implement a schedule that is more appropriate for the complexity of the issues at hand. Such a delay would have no negative consumer impact, as it is apparent from the content of documentation published with the Proposed Rule that little to no consumer benefit is expected from its implementation.

Comments on Specific Questions:

The Notice contains requests for comments on numerous items in the Proposed Rule, we have commented on those that we believe are most relevant to our business:

Establishment of a process to ensure that interchange fees associated with debit card transactions are reasonable and proportionate to the issuer's costs effective as of July 21st, 2011.

It is our belief that the Statute raises significant constitutional issues, which are currently being litigated. However, in response to the specific components of the Reserve Bank's proposed solution to the legislation, we have comments in relation to the "cap".

Implementation of a Cap:

The Proposed Rule outlines two approaches, we believe that the use of Option B, namely the institution of a simple single cap would be the most reasonable given the restricted timeframe for implementation. However, we would like to point out that the concept of an interchange fee per bank issuer is very different from the existing status quo and is a concept that would require significant implementation time and costs ~ the costs of which would not be recoverable from within the interchange fee given the current definitions in the Rule and statute. We believe that the concept outlined in Option A while well-meaning in its structure would be administratively unworkable and would materially disadvantage smaller participants in the industry (both those that fall above and below the $10 million threshold).

Calculation of a Cap:

The definition of what components of cost should be taken into consideration when determining the cap, while clearly attempting to follow the guidance of the legislation, is unnecessarily restrictive and moves past the exclusion of just the "sunk cost" capital outlay into an area where too literal an interpretation appears to have been made on the "transaction based" concept. It is apparent that the Reserve Bank believes that the exclusion of a cost component designed to update fixed infrastructure, or provide a return on already invested capital, is prohibited by the statute. However by excluding account management costs, it appears to have stretched its interpretation

too far; at a minimum, the costs associated with the management of active accounts should be considered in computing the cap. The proposed cap, posits a reduction from the current norm of some 80% from the current market position and assumes the most restrictive view of "transactional costs" possible. The reality of the situation is that transactions cannot be processed without customers, and the support of customers and their accounts are a variable cost that cannot be separated from the cost of processing each transaction that is tied to that customer or account. While we do not agree that the approach taken by the Statute on this topic is correct, given the directions, we believe that the Reserve Bank should take a pragmatic approach to the cap proposal and include all variable costs associated with customers, accounts and transactions in arriving at the required numbers. While we fully believe that this approach will have a chilling effect on innovation and further development of the payment infrastructure, it is a more realistic and pragmatic approach to the statutory language than the current proposal. This would then leave the industry as a whole to seek legislative solutions to the overarching issue.

Fraud Losses and Expenses:
The treatment of fraud losses and fraud related expenses is a major weakness within the Proposed Rule. We do not believe that a rule can be formulated without a fraud component, and the current "catch-up" model is unrealistic. As currently drafted, the request for additional comment asks for commentary on how to treat costs related to fraud mitigation; it appears to definitively exclude as a component of cost the fraud losses themselves. This is an extraordinary diversion from historic precedent, where fraud losses have been seen as an acceptable component of interchange fees. This decision is likely to have a material impact on consumer costing, once again to the benefit of the merchant. We would request that the Reserve Bank reconsider its approach to fraud losses and expenses to: (a) include it in the initial final rulemaking; (b) include as an authorized component fraud losses themselves and (c) when it comes to dealing with fraud reduction expenses, treat them as a component of cost, rather than as a way of developing new technologies.

Blended Rates:
The restriction on creating a blended rate also appears unrealistic given the need to recognize comparable costs and risks associated with each transaction. We believe that should Option B be chosen, it should be done on a network by network basis with a requirement that the blended rate from various rates combined not exceed the stated single cap.

Issuer restriction of the number of networks over which a debit transaction may be routed and restrictions on merchant routing of such transactions.
The proposed rule requests comment on the concept of increasing merchant choice as to which network a given transaction should be processed in order to get to the relevant Issuing Bank. While clearly designed to promote competition between pin and signature debit, it is doubtful as to whether there is any long term benefit to the proposal, given the market's propensity to level prices over time. The rule proposes that each debit card issued by a bank shall offer any accepting merchant a choice of processing networks, and goes on to provide two alternative approaches: (a) one signature network and one unaffiliated pin network; or (b) two signature networks and two debit networks, all unaffiliated with each other. The merchant would then have the option to decide how the transaction would be processed when presented. The proposal does not take into account the impact on the cardholder of the discretion being provided to the merchant, and no guidance is given as to the consumers ability to request or require an override (for example in the event of a signature debit card holder who does not know his or her pin attached to the card). The

long term efficacy of the proposals seems doubtful if signature and pin interchange rates were to move together, but the consumer confusion would appear significant.

If a mandate has to be issued, the technical viability at the Point of Sale of the second (dual pin and debit marks) is very limited, and as such, by default the option for balanced pin and signature marks on each debit product would appear to be the only viable option.

Is it necessary for issuers to report interchange fee revenue to networks in order to set issuer-specific interchange fees? Does the FRB need to include a rule to specify the data reporting that is required? The FRB has defined March 31 as the date for issuers to report their data to the networks, is this a good date for that reporting to occur?

The networks already have the interchange fee revenue for each issuer from within their systems, as it is their systems that handle the accounting that remits interchange revenue from the acquiring side to the issuing side of the business. This request would seem to duplicate an existing system.

What is the definition of a payment network and which, if any of these networks should be included? Three party networks; alternative payment networks, ATM networks?
For market compatibility all should be covered, especially given the movement of the three party network operators to solicit banks to acquire and issue, which makes them look more like four party networks.

What are the circumstances where an agent of issuers should be considered the issuer?
The agent of the issuer should only be considered the issuer when it has such a level of control that the role of the issuer is totally subordinated to that of its agent. However, we believe that this topic has ramifications far greater than those presented in this proposal and should be further studied.

What are allowable costs? Which costs other than authorization, clearing and settlement? Network Fees" Should they allow only authorization costs since this is the only cost element unique to debit cards as compared to checks? Any fixed costs? Costs limited to marginal costs and if so, how should marginal costs be measured? What are the correct criteria for determining what constitutes an allowable cost? Does the FRB need to better clarify allowable costs?
We have responded to this request in a prior answer, however from a general perspective, we believe that the definition of allowable costs is far too restrictive and should include at a minimum account management costs and fraud costs, as well as some form of allowance related to product innovation and infrastructure maintenance. We note that this is a topic that has been responded to in depth by many parties, including the Card Associations and we are in agreement with their proposals on this topic.

We thank the Reserve Bank for the opportunity to comment on the Proposed Rule and look forward to the next steps in this process.

Sincerely,

Nicholas W. Baxter
Senior Vice President