



Farmers & Merchants Bank of Central California

KENT A. STEINWERT

President & Chief Executive Officer

February 14, 2011

John F. Moore
First VP & COO/Interim President & CEO
Federal Reserve Bank of San Francisco
101 Market Street
San Francisco, CA 94105

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

Dear Mr. Moore:

Thank you for allowing Farmers & Merchants Bank of Central California (F&M Bank) the opportunity to voice our concerns about the Federal Reserve System's proposed "Debit Card Interchange Fees and Routing Rule." Unfortunately, this legislation will have a detrimental effect on our bank as your proposed ruling does not allow for the recovery of costs, including inherent risk, associated with providing debit card transactions. These proposed government price controls will lead to payment system inefficiencies, stifle innovation and capital investment and negatively affect the financial industry's overall financial health. Furthermore, we suspect the retail industry will not pass along to the consumer the windfall profits gained from this ruling as originally indicated.

F&M Bank has projected that our current debit interchange revenues will be cut by 70-80 percent, leaving this a breakeven product. This significant reduction in revenue can only mean increased fees for consumer and small business clients as we strive to stay financially sound. Farmers & Merchants Bank already operates at a more optimum level of efficiency than our peers. As such, this loss in revenue will have to be offset by higher fees to the customer on other products. Taking into account the demographics of our service area, we suspect that the barriers to the average low-to-moderate income customer for obtaining and maintaining a bank account will most likely be intensified by the changes in interchange fees. Thus, this proposed ruling could place pressure on our objective to broaden the selection and availability of affordable financial products.

The Routing Rule fee structure is of major concern. We would request that the fees you eventually establish take into consideration all cost components including fixed costs, inherent risk, dispute and general inquiry costs, fraud and loss prevention costs, as well as a reasonable return on capital. We believe all of these cost components can be included in your calculation and still fulfill the intent of "reasonable fee" as established in the statute. Importantly, the interchange fee as proposed does not recognize the fundamental differences between debit transactions and checks. Specifically, merchants are guaranteed payment when a card is presented for payment, thus banks absorb losses related to invalid accounts or where no funds are



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available. **And yet, the merchant enjoys the profits earned from the fraudulent sale transaction.** This contrasts to check payments where the merchant suffers the loss on a check returned unpayable.

Alternatives A and B are worrisome and, at best, should be decided with reasonable common sense and incorporate financial fairness in the calculation. Alternative A would limit our bank's expense of managing additional networks and for merchants it would increase the number of PIN network routes. Alternative B has serious impracticality because the network system is currently unable to support such a choice; namely, one card with the capability of multiple signature networks. It also would cause the substantial expense and customer inconvenience related to the re-issuance of cards. We have recently incurred substantial card reissuance expense due to the information security breaches at T-J-Max, and other merchants. We did not receive fair and reasonable compensation from the merchants or card networks for the negative impact to our financial performance.

Farmers & Merchants Bank of Central California is adamantly opposed to the proposed interchange fee caps of 7 or 12 cents, as well as Alternative B. After a very careful and thoughtful review, particularly of the Federal Reserve team's tentatively proposed narrow interpretations of the criteria for setting interchange fees, we believe the Durbin Amendment will have a significant negative impact on our bank's financial performance. Given the current economic environment, the impact from your proposed ruling could possibly affect the quality and affordability of the products and services available to our customers.

Respectfully, we request you to reconsider your proposed ruling and establish interchange fees which fairly and appropriately compensate for our cost of doing business and the need to provide a reasonable return on capital.

Sincerely,

A handwritten signature in black ink, appearing to read "Kent A. Steinwert". The signature is stylized and cursive, with a long horizontal flourish extending to the right.

Kent A. Steinwert
Chairman, President & CEO