From: Farmers State Bank, Jason Neighbor

Subject: Reg I I - Debit card Interchange

Comments:

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Comments:
This letter is written in response to the call for comments regarding the regulation of debit fee interchange income, Federal Reserve Board Docket NO. R 14 04. The very idea of regulating interchange income is of grave concern to me, and I appreciate the opportunity to comment on the provisions currently under consideration. My employer, Farmers State Bank is a small financial institution in Iowa. We currently offer debit cards to our customers at no cost to them. These cards generate more than 200,000 transactions monthly as our customers do business with a broad range of merchants within our community. Both consumers and merchants depend upon and benefit from these electronic transactions to conduct their business. Consumers rely upon the immediate access to their deposited funds, while merchants benefit from guaranteed payments and reduced labor and processing costs. In support of our debit card program, Farmers State Bank incurs significant expense well beyond the transaction
costs addressed in the legislation. These include, but are certainly not limited to, staffing to support customer inquiries and problem resolution, Visa licensing fees, fraud prevention, intervention and losses as well as card issuing and maintenance. Interchange income covers these expenses and allows us to offer debit services to our customers. Reduction in interchange income will have noticeable impact on our ability to continue to provide such services at no cost to our customers. It also concerns me that the Federal Reserve Board has not taken into consideration costs associated to smaller financial institutions. I understand , in theory, that the under $10 Billion exclusion will protect smaller financial institutions, but most economists are now saying due to market pressures this exclusion will "more than likely not work". With that said, I believe the Federal Reserve's findings were not thorough due to the fact that there was no cost data obtained from smaller financial institutions in their data collection process. I believe it is the duty of the

Federal Reserve Board to inform congress that their findings were based on the data collection of only large financial institutions whose costs may be lower due to economies of scale and the per transaction costs of smaller financial institutions were not taken into consideration. The proposed rules impact two, distinct facets of the debit card process. First is the proposed cap on interchange income. Although issuers under $10 billion in assets, including Farmers State Bank, are exempt from either of the proposed options to cap interchange fees, it is my belief that these protected, smaller issuers cannot help but be negatively impacted by such a cap. My concerns regarding this provision include: The low level cap of no more than 12 cents per transaction (7 cents under the safe harbor) is of concern to me because the cap ultimately may be applied to small issuers in the marketplace in spite of the exemption. It is my opinion that the Federal Reserve Board has taken too narrow of an interpretation of the law. The cap must be set high enough to take into account all costs associated maintaining a card program. Although Visa has indicated its intent to develop a two-tiered system for interchange, they cannot guarantee that the current interchange rate will prevail for the small issuers. In fact, economics seem to dictate that they will have to pass on to the small issuers part of the loss of income they will experience from the cap for large issuers. Therefore, a two-tier system is no guarantee for the small institutions. The lack of any enforcement mechanism for the exemption for small issuers fails to support the intent of the law which is to protect the smaller institutions. The control merchants will now have for routing transactions and offering discounts for certain payment methods could allow them to discourage the use of cards carrying higher interchange rates. In a two-tiered environment, this would unfairly favor the cards issued by the larger institutions. The second provision of the rule calls for issuers to provide access through unaffiliated networks. Although I do have significant concerns about the costs this may incur, I urge adoption of Option A, which simply requires two unaffiliated networks. Our concerns include: Lack of protection from merchants refusing cards that do not access the lowest cost networks jeopardizes the acceptance of our cards at these merchants. Additional loss of interchange income is a potential as networks compete for business by reducing costs to merchants, therefore reducing income to issuers. The complexity of Option B which would require 4 networks per card, 2 for pinned transactions and 2 for signature transactions will result in added expense for all issuers. The cost for maintaining a relationship with one signature based network is huge. Adding a second could, conceivably, double that cost. Again,
this ould endanger the ability of a small institution to continue its debit card program without passing the increase in costs on to the consumers. Not to mention Option B would require all financial institutions to reissue all their debit cards displaying the new networks which would be required. Currently a signature based debit card transaction is routed to the network based on the card number on the card. I don't even want to imagine change to the payment network's infrastructure needed to redefine how a signature based card transaction is routed. Would debit cards now need two card numbers on the card? One for each signature based network? This Option B would cause much more harm than good. The result of the loss of interchange fee income and the costs of belonging to additional payment networks will have detrimental economic impacts on smaller institutions that will ultimately impact their customers by passing the lost revenue to them in the form of increased fees. Any
significant reduction in interchange income will require higher fees paid by our customers and consumers in general. Because debit cards have become an essential tool for consumers, not offering a debit card to our customers is not

an option. As proposed, the current regulation will come at a significant cost to consumers in the marketplace. My comments in this letter have been directed at the rules presented by the Federal Reserve Board. I urge the Board to consider these concerns thoroughly. However, I do want to note that my issues with the law itself are many, and I will inform my representatives in Congress that the best course at the very least is significant revision and at the very best repeal. Thank you for your consideration. Sincerely, Jason Neighbor