



February 22, 2011

T. Richard Shier | Executive Vice President

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

Re: Notice of Proposed Rulemaking
Debit Card Interchange Fees and Routing
City National Bank Comment Letter
Docket No. R-1404

Dear Ladies and Gentlemen:

City National Bank (“CNB”) appreciates the opportunity to provide the Board of Governors of the Federal Reserve System (the “Board”) with comments regarding the Board’s above referenced Notice of Proposed Rulemaking (“NPR”).

CNB is the largest bank headquartered in Los Angeles, California, with assets in excess of \$21 billion and with more than 75 offices in California, Nevada and New York. CNB is also a member bank of the Midsize Bank Coalition of America (“MBCA”). We are aware that the American Bankers Association, The Clearing House, the Financial Services Roundtable, the Independent Community Bankers of America, the Credit Union National Association, the MBCA, the National Association of Federal Credit Unions and the Consumer Bankers Association among others will file a Comment Letter dated February 22, 2011 (the “Joint Comment Letter”) on this NPR.

CNB participated in the development of the Joint Comment Letter and we endorse, support and agree with the positions taken there. We urge the Board and its staff to carefully consider the points made in the very detailed and thorough Joint Comment Letter when constructing final regulations as they accurately address our grave concerns regarding the NPR. We write this comment letter to emphasize several key points, some of which are also addressed in the Joint Comment Letter.

CNB appreciates the difficulty the staff of the Board has encountered addressing the Durbin Amendment and its timing restrictions. However, we join with virtually all other banks, financial service representatives and trade associations to express our opposition to this NPR. We urge the Board to withdraw the confiscatory price control provisions on the interchange fees in the NPR which we do not believe are called for by the Durbin Amendment. When combined with the other limiting factors being proposed for the determination of our costs, implementation of these provisions will, and must, result in



significant re-pricing and restructuring of our pricing to increase the actual cost to customers using debit cards, or alternatively, to shift the cost to customers on other products.

We know that the NPR, if adopted by the Board, will reduce our income from interchange fees more severely than many others of our peers, in part because our customers' average transaction amounts are higher. As our customers' transaction amounts are high, our losses from these transactions are correspondingly high. While merchants will derive significant economic gain from the NPR as proposed by lowering interchange charges, we will be forced to re-price or reallocate cost to continue to allow us to support providing debit card accessibility for our customers. We believe the NPR is contrary to the requirements of safety and soundness and we respectfully suggest that there are more alternatives permissible under the Durbin Amendment through interpretation by the Board when developing the final rule. We are concerned that the proposed rule will have the unintended consequence of adversely affecting millions of low-and-moderate income consumers, as well as small businesses, using debit cards today.

While we acknowledge that the Board may be constrained by the Durbin Amendment to act swiftly, we urge the Board to eliminate the interchange fee caps proposed in its final regulation and to include a broader definition of "costs incurred by the issuer". We encourage the Board to undertake and engage in a reasoned and careful rulemaking process over a longer period to minimize the adverse impact on issuers and those customers who use debit cards for safety and convenience. We urge the Board to preserve a structure that will provide accessibility to debit cards for those who use them because they are unable to establish the necessary credit history to obtain a credit card. We strongly believe that our nation's payment system as a whole, and the debit card payment system in particular, will be adversely impacted if this NPR is not substantially amended to support continued investment by financial organizations in the debit card payment system. This is especially true because we cannot be certain the Durbin Amendment will be modified or withdrawn by Congress in time.

We would like to emphasize the following additional comments to the NPR.

Respecting Interchange Fees:

1. The Durbin Amendment calls for the Board "to establish standards for assessing whether the amount of any interchange transaction fee... (that an issuer may receive or charge) is reasonable and proportional to the cost incurred by the issuer with respect to the transaction." The law calls for "standards" and does not call for price setting and rate caps, nor does it suggest that debit card issuers should be denied a reasonable return on their products, services and invested capital. The caps proposed in the NPR are substantially below the actual costs incurred by us when providing debit card service and processing transactions.

2. The Durbin Amendment requests the Board to distinguish between "the incremental cost incurred by an issuer for the role of insurer...etc." (which is an "allowed cost") from "other costs incurred by an issuer which are not specific to a particular electronic debit transaction" (which are not "allowed costs"). We encourage the Board to read this provision more broadly than it has done in the NPR. Incremental costs specific to each transaction incurred by a financial institution when providing its payment services



should include an allocation for the total cost of operating the system, including losses resulting from debit card fraud, overhead, and an allowance for reasonable profit on the capital invested to provide the services. We believe it is a reasonable interpretation of the governing law to include these real costs within such incremental costs.

3. Unlike many larger banks, mid-sized and smaller banks, whether below or above the arbitrary \$10 billion asset line described in the Durbin Amendment, use the services of third party providers to operate their "back room" as debit card issuers. The cost of such providers should be included in "allowable costs" even when not attributable to a particular transaction.

4. Similarly, we firmly disagree with the proposition that overhead and other "fixed costs" are not appropriate to include in "allowable costs." For example, the failure to consider an allocation for the cost of the human resources who run the system as an allowable cost because it is not "specific" to a particular transaction we believe to be too narrow an interpretation. This exclusion, like others, is contrary to business economics and will force many issuers out of the market when they cannot make a reasonable return on the expenses incurred and the capital invested in providing the service.

5. We are concerned that Subsection 235.4 of the NPR "reserves" the fraud-prevention adjustment for determination at a later time awaiting responses to this NPR. We believe the full amount of fraud related losses and fraud prevention costs incurred by issuers should be included as allowable costs or as an adjustment to allowable costs. Not knowing how the Board may rule respecting such costs makes planning for compliance more difficult. While we do not anticipate cutting back our fraud prevention costs if the full amount of those costs is not recovered by our fees, if prevented from recovering these costs with interchange fees, we will have to recover these costs from other sources, or limit the service itself. The cost of fraud (losses) and fraud prevention which is borne by the issuers is a very real and significant part of the provision of debit card services, and provides material benefits to merchants accepting debit cards through, among others reduced transaction losses. We must be able to recover these costs.

Respecting the difference between checks and debit card transactions:

As noted by other commentators on the NPR, there are fundamental differences between checks and debit cards which are not considered appropriately. A basic difference is that a check may be returned unpaid, while a debit card transaction, once approved, may not be returned. The merchant has far less risk accepting debit card transactions, far fewer losses and far fewer handling, processing and accounting costs than a comparable transaction paid by a check the payment of which is not guaranteed. From staff processing time alone, merchants benefit from debit card transactions with less staff time involved in processing a transaction for presentment to deposit. In addition to these benefits, nothing in the Durbin Amendment or the NPR addresses the "promise" by merchants that any portion of the "savings" on interchange fees will be passed on to their customers.



Prohibiting network exclusivity:

We believe Alternative A referenced in the NPR to be the preferable approach. We believe Alternative B is largely unworkable and would impose a far greater and unnecessary burden on merchants and processors.

We would like to thank the Board and Board staff for their careful consideration of our views and comments. We urge you to carefully review and consider the views expressed in this letter as well as those contained in the Joint Comment Letter. We trust that following careful consideration of these comments, the Board will make appropriate changes to the NPR in the final rules that will enable the debit card system to continue to grow and flourish, consistent with the intent of the law.

If you have any question, please do not hesitate to contact me.

Very truly,

A handwritten signature in black ink that reads "T. Richard Shier". The signature is written in a cursive style with a large, prominent "T" and "S".

T. Richard Shier
Executive Vice President

cc: Russell Goldsmith, CEO, City National Bank
Michael B. Cahill, EVP & General Counsel, City National Bank