OREGON BANKERS ASSOCIATION

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February 21, 2011

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

Attn: Comments - **Sent Via Electronic Delivery**

RE: Docket No. R-1404 and RIN No. 7100 AD63 – Debit Card Interchange Fees and Routing

Dear Board of Governors:

On behalf of the Oregon Bankers Association and its membership of Oregon's state and national banks doing business in Oregon, we appreciate the opportunity to comment on the above-referenced rule concerning debit card interchange fees. This rulemaking and the Durbin Amendment itself are of grave concern to Oregon banks.

In our view, the Durbin Amendment was incorporated into the Dodd Frank Act (DFA) without proper vetting, particularly since there were neither hearings on the amendment nor any real analysis of its impact on businesses, consumers and small banks. Consequently, we believe the Durbin Amendment was a poorly understood addition to DFA that did nothing to reduce risk in our overall financial system and instead amounted to a government mandated transfer of revenue from banks to merchants. The fact is that an interchange fee is a fee paid by retailers and businesses in exchange for access to a card payment system that is more efficient and cost effective than cash or checks. It is a transaction between two businesses and is a fair cost of doing business.

That said, the Durbin Amendment mandated that the Federal Reserve determine what constitutes a "reasonable and proportional" fee to a merchant for the use of a debit card payment network. Our concern is that this mandate and the ensuing proposed rule do not properly take into consideration the overall costs associated with maintaining and improving the U.S. payment system, the cost of fraud, and the need for some return to the bank. For the reasons set forth below, we do not believe that the proposed rule addresses these concerns or the overall impact that implementation of this rule will have on the banking industry and the customers we serve.

I. The proposed rule does not permit banks to cover the true cost of providing debit card transactions and other free or low cost banking services. As a result, the rule will result in new maintenance and other fees on checking accounts.

Ultimately, the consumer will bear the brunt of the Durbin Amendment and the proposed rule on interchange fees. Debit card interchange provides revenue that supports free checking, fraud protection, and the efficient operation of the nation's payment system. Under the current rule, debit card revenue is likely to be slashed by 70 to 85%. Even Oregon's small community banks are estimating such an impact on their interchange income. Banks are telling us that they will be forced to charge fees for checking accounts or other banking services in order to make up for the revenue that previously supported these services.

This reduction in revenue is also likely to impact a bank's ability to make loans, hire employees and to otherwise support an economy that is still struggling to emerge from a severe recession. Further, low and moderate income customers, in particular, will find it more difficult to maintain a bank account as costs rise and will have to turn to more expensive, less convenient, and more risky non-traditional banking services.

Proponents of the Durbin Amendment suggested that merchants will pass their savings on to consumers. There is absolutely no guarantee that consumers will realize any savings due to reduced prices.

II. The safe harbor provision of the proposed rule does not afford real protection to smaller issuers of debit cards.

Although the DFA purports to exempt smaller institutions from the price control elements imposed on larger institutions, economic and market forces will likely force smaller institutions into the same price level as larger institutions or they risk losing market share. This could also result from networks that may refuse to bear the cost of a two-tier system. Moreover, any dual-tiered price differential gives merchants a strong incentive to steer customers toward cards with lower interchange fee, or even refuse to accept small bank debit cards.

III. The Federal Reserve should exercise its discretion to the maximum extent permitted under the statute to improve upon a deeply flawed law.

The Federal Reserve has the opportunity to address some of the shortcomings in the Durbin Amendment by maximizing the discretion it is afforded by the statute. In calculating interchange fee, the Federal Reserve should consider the following:

- network fees;
- the cost of inquiries and disputes;
- fraud losses and fraud prevention costs;
- fixed costs, including capital investments; and
- a reasonable profit.

A fee that does not take into account these factors is not a "reasonable" fee. In addition, the caps outlined in the Federal Reserve's proposal are based on a "median" expense figure of signature and PIN transactions, which is particularly unfair to an issuer whose signature transactions outweigh their PIN transactions. The Durbin Amendment does not call for a single interchange, and the Federal Reserve should separate the transaction processing modes when establishing any caps.

IV. Debit transactions are fundamentally different from checks.

In calculating the permissible interchange fee, the proposal does not recognize important differences between debit cards and checks. This includes the fact that in transactions where the card is present, merchants are guaranteed payment and the issuing bank suffers the loss in the event that there are insufficient funds in the account. In contrast, checks may be returned as unpayable, and merchants suffer the loss.

VI. Government price controls are inappropriate for debit card transactions.

Government price controls generally do not work. Price controls on debit card transactions will lead to inefficiencies in the payment system and will stifle innovation and improvements.

Let's not forget that in Australia, interchange regulations were enacted and, as a result, consumers ended up paying more, losing rewards and didn't see any difference in prices of products and services. Retailers in Australia, however, increased their profits.

Conclusion

For the reasons stated above, the Oregon Bankers Association is strongly opposed to the Federal Reserve's rule to cap interchange fees at 7 or 12 cents. As articulated above, this cap represents only some of the expenses associated with issuing cards and maintaining the payments system. It would have a significant adverse impact on our member banks and will ultimately result in greater cost to the consumer as banks are forced to offset their expenses through other charges for banking services.

The Oregon Bankers Association urges the Federal Reserve to consider the above concerns and those of Oregon's banks as it pursues implementation of the Durbin Amendment. We stand ready to work with the Federal Reserve to devise a plan that would best serve the interests of the customers and communities served every day by America's banks. If you have any questions, please feel free to contact me.

Very best regards,

Linda W Navarro

Linda W. Navarro
President & CEO
Oregon Bankers Association & Independent Community Banks of Oregon