



February 22, 2011

Jennifer Johnson, Secretary  
Board of Governors  
Federal Reserve System  
20th Street and Constitution Ave NW

RE: Proposed Rule on Debit Card Interchange Fees  
Docket No R-1404

Dear Ms. Johnson;

The Ohio Bankers League [“OBL”] is a non-profit trade association that represents the interests of Ohio’s commercial banks, savings banks, savings associations, their affiliates and their holding companies. The OBL has over 200 members that include the full spectrum of the financial services industry, from small mutual savings associations up to large multistate bank holding companies that have several affiliates and do business from coast to coast. One characteristic that all our members share however is they all offer checking accounts. Over the last few years all or virtually all of our members have gone to great expense to provide their customers access to their accounts via debit cards, giving those customers access to the electronic payment system. As a result of this investment, all of our members have a vital interest in your proposed rule and all depository institutions will be irreparably harmed if the present proposal is not withdrawn and substantially amended prior to adoption in final form.

*The Proposed Rule is Unconstitutional*

The proposed regulation creates a hard cap of between 7 and 12 cents per transaction, regardless of the amount of the funds exchanged. According to the proposal, this is an amount equal to the average variable cost of the cost of authorization, clearance and settlement of debit card transactions. Since this excludes several real costs necessary to develop and maintain the electronic payment network, the Federal Reserve concedes this cap is below the actual cost incurred on each transaction by the debit card issuer. The hard cap proposed in the regulation is far below what it actually costs issuers to provide customers with debit card services and does not permit issuers to make any return on their investment. As a result, the proposed rule confiscates the property of the issuing bank and violates the Takings and Due Process Clauses of the Fifth Amendment of the United States Constitution. In effect, the proposed regulation nationalizes the electronic payments systems and all of the investment and development costs necessary to build the system. \_

*The Proposed Rule will Damage the Safety and Soundness of All Depository Institutions*

As mentioned above, the proposed regulation sets the hard cap well below what it actually costs to deliver debit card services to consumers and will dramatically undercut an important revenue stream for banks, thrifts and credit unions. According to most credible surveys, the proposed rule will remove between \$12 billion and \$14 billion of revenue from depository institutions. This loss represents between 70% and 85% of total interchange fee income to the financial services industry.

Interchange fees represent a much higher percentage of fee revenue for community institutions, so the adverse impact of this loss will fall more dramatically on smaller institutions. This loss will represent a double hit to community banks. First, smaller banks will have a much more difficult time replacing this revenue as they often do not have the expertise to offer other fee-generating financial services such as investment banking or wealth management. Second, smaller depository institutions will have a more difficult time creating economies of scale needed to even approach the costs proposed in this hard cap.

The proposed regulation will also drive more consumers back to cash and check, either because banks will restrict the availability of debit cards or because consumers will not choose to pay the increased costs of debit. Either way, the increased use of cash will also create more opportunities for money laundering and income tax evasion.

The lack of any reimbursement for fraud losses in the cost calculations will also have a detrimental impact on safety and soundness. As discussed in more detail below, even though the rule considers coverage for system upgrades to protect against fraud, apparently when it comes to covering the losses caused by fraud, banks, thrifts and credit unions are on their own. This also has the perverse, unintended consequence of removing any incentives for merchants to take reasonable steps to protect against fraud. As we have learned through data breaches at TJ Maxx and others, retailers are already the weakest link in the fraud prevention chain.

*The Proposed Rule is Even More Narrowly Drafted than the Statute and does not Include Reimbursement for all of the Permissible Costs*

The proposed regulation excludes costs that are permitted under the statute. Most importantly, instead of using incremental costs as prescribed by the statute the Federal Reserve instead substituted the concept of average variable costs. This limited the allowable reimbursement to costs specifically associated with the issuer's authorizing, clearing and settlement of each electronic debit transaction. The proposed rule then unnecessarily eliminated consideration of a broader range of allowable incremental costs attributable to supporting each electronic transaction. For example, other incremental costs that could be reasonably attributed to each transaction include costs of issuing cards, cost of customer service, data processing and the cost of funding.

Second, the law specifically permits the Federal Reserve to include a component to protect against fraud losses. While the rule suggests two alternatives to pay for system

upgrades to protect against fraud losses, there is no assurance that either of those options will be included in the final rule. The proposal should not be finalized until all components permitted by the statute are included in the costs past on to merchants.

*The Proposed Rule will Harm Consumers and Create a Windfall for Merchants*

Even if the proposed rule was not constitutionally defective and did not create safety and soundness concerns for the banking system, it should be withdrawn and rewritten based on the significant public policy concerns. As noted above, under the hard cap in the proposed regulation, banks, thrifts and credit unions will not be able to come close to covering the cost of offering debit cards through interchange fees. Depository institutions will be faced with two choices: Either shift these costs to consumers or lower overall costs by restricting consumer access to debit cards. Neither alternative is an attractive public policy option.

Banks currently use revenue from interchange fees to provide a variety of services to consumers including free and low cost checking accounts as well as free fraud protection. If merchants fail to support the electronic payments system through interchange fees, consumers will have to pick up the cost. Shifting costs of supporting the electronic payments system from merchants to consumers will result in a massive annual subsidy of \$12 billion to \$14 billion to merchants. Since there is no requirement that merchants pass on the benefits of lower interchange fees to consumers, there is no reason to believe they will do so.

Alternatively, issuers may be forced to restrict access to debit cards. Some low income customers may be unable to pick up the additional cost, voluntarily opting out of debit cards and the electronic payments system. This would be a blow to online retailers and other companies that have built their business model around debit cards and the electronic payments system. Additionally, since the fee proposed in the regulation is fixed, some issuers may choose to not accept the additional risk that comes from the potential fraud associated with higher cost big ticket items. All of these unintended consequences will have a detrimental impact on our economy.

For the reasons outlined above, the Ohio Bankers League recommends the Federal Reserve withdraw the proposed rule.

Respectfully Submitted;

A handwritten signature in black ink, appearing to read "Jeffrey D. Quayle". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Jeffrey D Quayle  
Senior Vice President & General Counsel \_\_