CITIZENS
NATIONAL BANK

December 22, 2010

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

RE: Docket No. R-1404; RIN No. 7100 AD63 (Proposed Interchange Regulation)

Dear Ms. Johnson,

The Citizens National Bank of Somerset appreciates this opportunity to comment on the proposed interchange fee regulations put forth by the Fed. First of all, we recognize that the Fed has been put in an unfortunate situation in being required to regulate interchange by the Dodd-Frank legislation. While we understand the Fed must create a regulation, we do not believe the severity of the proposed regulation is necessary or prudent.

Over the last few decades, electronic payment technologies have steadily gained in security, convenience, functionality and, concomitantly, popularity. Debit cards now make up more payments than checks, credit cards, ACH or prepaid cards. As the acceptance of paper checks continues to decline, debit cards will increasingly be a favored choice among consumers and merchants alike. Consumers generally pay nothing or very little in account fees for having a debit card.

Interchange revenue has been the driving force behind the growth of debit cards as well as the advances in security and fraud prevention technology. Without interchange revenue, issuing banks will have to find new ways to recoup the costs (and necessary profit) to continue issuing cards. This will have to occur in one of two ways. Either card or account fees will be levied or the amount of money invested in fraud prevention, processing and other technology will be reduced, or both.

One example of how this may affect technology investment is in the speed of debit card processing. A large number of community financial institutions still do not process debit card transactions in real-time. Many institutions are still processing on a delay such that when a customer swipes their card it may be up to two or three days before it appears in their account. Such delays hurt the efficiency of the system and undermine many of the benefits to consumers and merchants. The main reason such upgrades are not taken on by banks is simply the cost of the technology. It adds tens of thousands of dollars to the cost of processing debit payments besides large upgrade fees. Such technology is even less likely to be taken up without interchange revenue to fund it.

The general response to any concerns from the Community Financial Institutions is that banks under $10 Billion in assets are exempt from the new rules. While this sounds great on the surface, no one genuinely believes that there will be an interchange rate for big banks and a separate, much higher rate for small banks. More likely is that merchants, now having greater power to route transactions, will negotiate similar or equal rates.

Whatever form fees take to replace the interchange income, whether they be account fees, card fees or transaction fees, these fees will lead to increasing numbers of low income consumers dropping out of the traditional banking spectrum and further into check-cashing services, payday loan services and other predatory financial products. The FDIC and legislators have consistently shown a desire to make it easier for low-income consumers to get into traditional banking relationships and this proposal will harm those efforts.

If history has taught us anything in economics, it is that government price-fixing is just as bad as any other sort of price fixing. While we recognize that the Fed is not to blame for the mandate, it does have discretion as to the severity of the regulations put forth. Financial Institutions, processors, and networks will not sit idly by and lose money. Government forced de-funding of payment technology will only serve to slow the pace of technological investment and innovation while shifting costs to consumers in different ways.

The Fed has an opportunity here to show its support for payment technology, consumers, and the banking industry as a whole by not allowing this needless regulation cripple an important part of our economy. We urge the Board of Governors to resist the political pressure to reduce interchange fees to unsustainable levels. Such Draconian action as has been proposed will not help anyone but rather stifle progress. Once again, we appreciate the Board taking our comments into consideration on this important issue.

Sincerely,

Jonathan D. Absher
Operations Analyst