

From: James Barta  
Subject: Reg II - Debit card Interchange

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Comments:

February 23, 2011

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

Dear Ms. Johnson

I am writing to express my concern for how the incentives and risk allocation created by the proposed regulation will impact consumers.

The twelve-cent interchange fee cap is a drastic departure from current fee averages. The cap moreover excludes some costs associated with debit cards, such as issuers' liability for fraudulent use of debit cards. Faced with uncompensated expenses, issuers must either shoulder these burdens without compensation or attempt to recoup their loss through alternative means.

For instance, issuers currently shoulder a larger proportion expenses associated with the fraudulent use of debit cards. Since the regulation does not allow interchange fees to account for this expense, issuers are incentivized to renegotiate contracts to shift more of the risk to merchants. Merchant prices would subsequently reflect their new risk burden, tending to negate consumer savings from lower interchange fees. This risk allocation would also tend to burden small merchants more than larger businesses, which can spread the risk over more transactions thereby creating a larger risk pool.

Alternatively, issuers may attempt to recoup uncompensated expenses through instituting or raising fees for checking accounts or debit cards. Comments from major bank and credit union trade associations mention this possibility. Fees on bank accounts or debit cards, however, would tend to shift costs of debit card use from regular users to occasional users, thus over-incentivizing debit-card use even if there are less costly alternatives to society.

Granted, interchange fees may not force debit card users to internalize all costs, since merchants recoup the fees through prices and not fees for debit card use. Interchange fees, nevertheless, allocates the cost in proportion to a consumer's purchases. Frequent debit card users are thus more likely to bear the costs of their activity than infrequent ones.

Additionally, this arrangement may avoid disproportionately burdening low-income brackets. College students, for instances, often maintain multiple checking accounts in different states to have access to funds from home and while at school. If banks charge for checking accounts, then many students will realize the cost of debit cards multiple times even if they are infrequent users or spend very little. The same logic applies to other low-income populations.

Sincerely,

James Barta