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February 18, 2011

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

VIA ELECTRONIC SUBMISSION

Re: Regulation II; Docket No. R-1404; December 16, 2010

Dear Ms. Johnson:

This letter is in response to the request for comments on the proposed rules for Debit Card Interchange Fees and Routing issued on December 16, 2010. We recognize the difficult task the Federal Reserve Board has undertaken to develop rules and interchange rates resulting from the Durbin Amendment. The resulting proposed rules reflect the lack of proper debate during the law making process and the lack of time given to the Federal Reserve to properly study the impact of this new legislation. These new rules will increase banking costs to consumers, drive customers out of the traditional banking system, require banks to operate a payment system at a loss, cause banks to close branches and eliminate jobs, reduce innovation in the payments system causing the United States to fall behind other countries, and reduce the overall scope of products and services offered by financial institutions.

Proposed Interchange Rates
First and foremost, we disagree with regulation of interchange rates as it interferes with the free-market system which is what makes the United States an economic leader. The fact all participants of the payment system (banks, consumers, and retailers) have entered into the current system voluntarily should be an indication that government intervention is not needed. The proposed rates take into account a very narrow slice of the actual variable costs associated with the debit card business. In addition, efforts to compare the check to the debit card as similar payment methods are inherently flawed as they are not comparable in the utility afforded to the consumer and the retailer. Listed below are the flaws associated with the proposed rates:

- \$.07 to \$.12 equals roughly 23%-40% of the actual cost to support a debit card program.

- No funding available for infrastructure improvements, card issuance, cardholder support, etc….
- No funding for payment system innovations - mobile payments, near field communication, etc…. Without this funding the Federal Reserve is creating an environment for unregulated non-bank industries to take over the payment system (cell phone providers, retailers, etc…).
- Excluding network fees does not make sense given the tremendous technical infrastructure that has been built over the years and the ongoing funding needed to support these networks. These networks support complex dispute resolution processes giving consumers peace of mind in doing business online or over the telephone, facilitate commerce worldwide in seconds, detect fraud in real time, etc….
- The rate does not account for the fraud and credit risk associated with guaranteeing a payment - the most significant value add to the retail community as demonstrated by the number of merchants that choose to not accept checks (see attached photos of signs at a few retailers close to our facility). To obtain check guarantee services retailers pay a percentage plus a per transaction fee - roughly $.70 per check depending on the type of retail business.
- Flat per transaction rates do not compensate for the risk as transaction amounts increase. In addition the rate should vary based on the risk associated with each retail category code.
- Does not take into account any benefits afforded to the retailers such as self service check out, pay at the pump, card not present commerce over the telephone/Internet, increased spending, and the labor savings when compared to accepting cash and check payments. All of these benefits have been created by the card business, not checks or ACH.
- Covering only variable costs is a flawed concept. No business can survive if it does not cover the fixed costs associated with the business.

While we disagree with the regulation of interchange rates, if required to make a choice of the two proposed methods, we prefer Alternative 2 ($.12 for all transactions) over Alternative 1. Alternative 1 creates additional regulatory burden as each bank builds a business case for a rate greater than the $.07 safe harbor rate. In addition there is more regulatory risk as each exam will involve an interpretation of the rule and a test of the bank's computations. Lastly, this approach will force the acquiring side of the bank to operate with a pass through interchange model when pricing merchants as it will be impossible to know in advance the rate for each card accepted by the retailer.

Fraud Adjustment

The Federal Reserve has not fulfilled the obligation of including a fraud adjustment as allowed for by the Durbin Amendment. This issue cannot be dealt with at a later date as it is a real cost of doing business and must be resolved prior to the new interchange rates taking effect in July. The adjustment should not only take into account the cost of preventing fraud, but also actual fraud losses. Fraud losses are truly variable costs driven by numbers of cards, cardholder transaction volumes, dollar amount of transactions, and the type of retailer. Interchange rates and the related fraud adjustment should account for these variables.

If required to accept one of the two proposed fraud adjustment methods, we prefer the Board's second alternative (non-prescriptive). This approach functions best to facilitate innovation rather than simply meeting the Board's prescribed standards.

Network Exclusivity and Routing

Both proposed alternatives to address network exclusivity will increase issuer's costs significantly. This increased cost combined with the lower interchange rates creates an unacceptable financial burden. The network exclusivity rule assumes retailers do not have a choice as to which card networks they choose to accept at the point of sale. A merchant can simply choose to accept only those network brands that provide the lowest cost payment option. Mandating the issuing bank to provide multiple payment choices on the same card is unnecessary.

Although we disagree with the network exclusivity provision, if forced to choose one of the two proposed alternatives, we prefer Alternative 1. Additionally, we believe ATM transactions and networks should not be covered under the scope of this rule because of the complexity and difficulties the Board addresses in the proposed rule.

Exemptions

The Board includes prepaid cards in the definition of a debit card, and fails to justify the exclusion of these products in the interchange rate regulation. Prepaid cards function substantially similar to debit cards and checking accounts, even providing the ability to access account information online, make bill payments, and earn card rewards. Many retailers partner with prepaid card issuers and will have a competitive advantage over banks if this product is allowed to receive a higher interchange fee. The unintended consequence will be more consumers "banking" with unregulated entities. The only prepaid cards that should be excluded from the rule are government sponsored prepaid card programs as noted in the Durbin Amendment.

The exemption for issuers with less than $10 billion in assets does not protect small institutions as retailers will steer customers away from using debit cards issued by smaller banks. The retailers will accomplish this goal by offering incentives to customers of large banks. If we buy into the argument this will not in fact be the case, we also object to the arbitrary threshold of $10 billion dollars as it will cause an unfair advantage for institutions under $10 billion in assets. While we are over the $10 billion threshold, we are by no means a large bank and in fact more closely resemble a community bank in how we operate. The intent of this exemption is not being met at the $10 billion threshold.

Conclusion

The lack of due process associated with the development of this legislation will lead to several unintended consequences. We strongly oppose the implementation of this new regulation for the reasons listed in this letter. If you have any questions concerning this letter please call me at (303)235-1413.

Sincerely,

David C. Baker
Chief Operating Officer

DCB/jr


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