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February 22, 2011

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

Re: Proposed Rule on Debit Card Interchange Fees, Docket No. R-1404; RIN No. 7100 AD63

Dear Ms. Johnson:

The Advantage Network is a provider of ATM and Debit card services for 59 financial institutions, all of whom are well under $10 billion in assets. The Durbin Amendment will result in serious unintended ramifications to institutions that are currently noted as exempt from regulation. On behalf of our members, we'd like immediate action to delay the effective date of the Durbin Amendment so proper study can be made of the payments system, the possible effects of implementation to all financial institutions as well as whether consumers will really benefit from the proposed changes. Below I have outlined a number of thoughts on the Federal Reserve's proposal on the Durbin Amendment.

The Amendment, while only regulating large institutions, will affect all financial institutions as merchants can control exclusivity and routing. The merchants could give preferential treatment/incentives to large institution debit cards as the processing costs would be less. Whether regulated or not, market forces will result in a decrease in interchange income for small institutions.

Under the proposed amendment, there is no differentiation between interchange for a signature transaction and a PIN transaction. There are differing benefits and risks to each type of transaction and these should be taken into account when setting interchange rates.

Decreasing the interchange rates dramatically to only cover processing costs leaves financial institutions with only the option of passing on debit card program costs to the customer. Network and Association fees, technology changes, compliance requirements, card reissuance fee for compromised cards due to retailer and/or processor security failings, fraud losses, cost of fraud prevention systems, and system maintenance would all have to be passed on to the customer. The proposed interchange revenue stream would not be enough to support a debit card program for any of our member financial institutions. A "reasonable fee" must include all cost factors in developing and maintaining the program. If interchange is to include only processing costs, institutions will have to implement new fees so DDA programs can be offered at a breakeven point. With the proposed changes, there is no guarantee merchants will decrease their prices so the consumer could be paying the same retail prices and also pay additional fees for banking services.

If the merchants only want to pay the fee for authorizing and settling a POS transaction, then the merchant community also has to bear some of the risks of the program – tighter requirements for reviewing for proper cardholder signature, bearing the cost of card reissuance if their system or business practices results in compromised cards, ensuring proper security for processing the transactions, sharing in the fraud losses.

- As an example in 2009, our Network had to reissue 42,000 cards (1/3 of our outstanding cards) on behalf of our member institutions due to a compromise. While the actual cost of reissuing cards was $135,000, each institution had much more invested in labor due to customer calls, writing letters of explanation, making account changes, etc. The staff time, fraud losses and card reissuance resulting from this compromise were estimated at $20-25 per card which is $840,000- $1 million dollars. Combined, our member institutions only received $13,000 in reimbursement – not even remotely close to the fraud losses or direct cost of card reissuance. Will these preventative measures to mitigate fraud be allowed as part of the regulated interchange fee? There has been discussion that fraud costs as outlined in the Durbin Amendment will only cover actual fraud costs incurred and not the preventive measures taken when there is knowledge that cards have been compromised and are at risk for fraudulent transactions.
- The major Networks have instituted fraud mitigation systems (for example, Verified by Visa and MasterCard SecureCard) which many of the merchant community has not implemented into their online purchasing platform. Also, when a merchant's system has been found to be compromised, they are only assessed a small fine compared to the losses the institutions have to bear.

Part of the argument for merchants to only pay for authorizing and settling a debit transaction is because checks clear at par. There is a presumption there is no cost to the institution to process checks. This is not true. There are equipment, labor, check storage costs and transportation/transmission costs involved in processing checks. Other bank fees have upheld the costs of check clearing for years so there has not been a customer fee for writing checks. With a decreased revenue stream due to not being able to assess overdraft fees on debit card transactions that result in an insufficient funds situation and the proposed drastic reduction in interchange income, institutions will be forced to impose customer fees for checks as well as for using a debit card.

There is a guaranteed payment to the merchant for a debit card transaction, even when insufficient funds are involved. When a check is returned, the merchant must collect from the customer or use a third party service and only get a partial payment for the goods or services sold.

The routing and exclusivity sections of the Durbin Amendment can be very detrimental to a small issuing institution. The merchant will have the right to accept only certain cards and we feel that regulated banks will be given preference due to the lower, mandated interchange costs over small community-based instituions.

The section of the proposal requiring each issuer to have two signature and two PIN debit networks on their cards does not benefit the consumer. The proposal's response to the increase in Network and Association fees is these fees could be passed on to the cardholder. Increasing cardholder costs while not giving them any increase in benefits does not make sense. Even with Alternative A, which requires only one signature and one PIN debit network, there will be detrimental cost effects for issuers who use a regional PIN debit network rather than the mandated national PIN debit network.

The interchange amendment was passed as a last-minute addition to the Dodd-Frank financial restructuring legislation on the Senate Floor. This was done without any Congressional hearings on the amendment.

I urge you to take all necessary action to stop the Federal Reserve from implementing the present Durbin Amendment. Proper time to study the payment system and the consequences to ALL parties involved is imperative.

Sincerely,

Kathy Redinius

Kathy Redinius, VP
Network Director
The Advantage Network