February 15, 2011

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

Re: Debit Card Interchange Fees and Routing Restrictions, Docket No. R-1404

Dear Ms. Johnson:

Thank you for the opportunity to comment on the Federal Reserve Board's proposed changes to interchange rules. I write on behalf of Fullerton Community Bank, which is headquartered in Fullerton, California and serves Orange County area. My bank has $688 million in assets and we have approximately 6600 debit card customers.

While my bank is not covered by the Durbin Amendment debit card interchange fee regulation, I believe that the Board's use of rigid price caps that do not allow issuers to recover their costs would artificially drive fees down for all issuers and threaten a product that is important to consumers, my bank, and the economy generally. I also believe that the Board's restrictions, which if adopted would apply to all institutions, would be costly for our bank to implement, as discussed in more detail below.

The Durbin Amendment does not require the Board to set price caps as the means to regulate debit card interchange fees. It merely requires the Board to establish standards for ensuring that the debit card interchange fee is reasonable and proportional. A fee that is reasonable and proportional must allow banks, like mine, to earn a reasonable rate of return. The Board's rigid approach would artificially drive down interchange fees for all issuers, covered or not.

The fee caps proposed are nearly 80% lower than the current, market-based fees. The safe harbor rate is even lower. Even assuming that our bank is allowed to charge the maximum 12 cents per transaction, to support this product, we would have to consider charging account fees, limiting customer card benefits, and discontinuing other consumer programs. Even public and semi-public utilities that are subject to price regulation are allowed to recover costs and earn a reasonable return. A rule that flatly prohibits an issuer from recovering all of its costs compels the issuer to subsidize operations, shift costs, or reduce services, and thus puts a private sector bank in a worse position than a utility.

Debit card fraud losses continue to grow. In addition to the direct losses, the cost of maintaining systems, card reissue costs, and customer assistance costs continues to grow as well. Issuers bear most of the risk of fraudulent transactions because they are the account holding institution from which funds are debited. Issuers' assumption of fraud risks is a significant component of the interchange fee.

The Board's comparison of debit card transactions with check transactions is faulty because it does not adequately account for the advantages of debit card transactions over check transactions from the merchant's perspective. The Board's simplistic emphasis on the lack of comparable network fees in check transactions is illusory. For example, if I deny a check payable to a merchant, the merchant could be charged a bad check fee from its own bank and might not be able to collect from its customer for the cost of the sold goods. But if a card that the merchant accepts turns out to be fraudulent, it is my bank and not the merchant that is likely to suffer the loss. The Board does not adequately account for this risk-shifting benefit to the merchant.

Thank you for your consideration of these comments.

Sincerely,

Maria Franco