FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

March 10, 2011

Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave, N.W.
Washington, D.C. 20551

Re: Comment on Proposed Rulemaking on Debit Card Interchange Fees and Routing (Docket No. R-1404 and RIN No. 7100 AD63)[1]

Dear Mr. Chairman:

The Federal Deposit Insurance Corporation (FDIC) appreciates the opportunity to comment on the proposed rule by the Board of Governors of the Federal Reserve System that would implement the debit card interchange and transaction processing provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[2] The FDIC commends the Board for its work on the difficult task of implementing this very complex and important section of the statute. We offer comments on how the proposed rules could be modified to better implement all of the intended protections of Dodd-Frank.

As the federal regulator of most community banks in the United States, the FDIC is concerned about the potential impact of the Board's proposed rule on small bank issuers of debit cards and their customers in contravention of Congressional intent. Specifically, we are concerned that these institutions may not actually receive the benefit of the interchange fee limit exemption explicitly provided by Congress, resulting in a loss of income for community banks and ultimately higher banking costs for their customers.

Although small banks are statutorily exempt from the fee caps set by the Dodd-Frank Act, the exemption may be unavailable in practice because of market-driven factors not addressed by the Board's proposal. First, small banks may be unable to receive any tangible benefits from the statutory exemption if card networks do not implement a two tier fee schedule that will enable small banks to receive fees above the proposed cap. If the statutory exemption for small issuers is not protected and becomes unavailable in practice to community bank issuers, this could create a bias toward large bank issuers that have lower marginal costs and greater opportunities to substitute income from non-core banking operations or alternative products.

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[1] 75 Fed. Reg. 81722 (Dec. 28, 2010).
[2] *See* Pub. L. No. 111-203 § 1075 (codified at 15 U.S.C. § 1693o-2).

Second, the Board's proposal to implement the network exclusivity and routing restrictions could result in additional costs and operational challenges for community banks, which would place significant pressure on community bank bottom lines, as well as on their competitive positions. Moreover, there is a possibility that merchants may discriminate against community bank issued cards at the point-of-sale by explicitly or ambiguously encouraging the use of large bank cards with lower fees.

The combined potential impact of small bank issuers' inability to benefit from the fee cap exemption and increased operational costs and challenges would undermine Congress's intent to protect community bank issuers. If market forces reduce interchange fees overall, such costs and loss of revenue will heavily impact those community banks that significantly depend on revenue from debit card transactions. This, in turn, may affect a community bank issuer's ability to provide its customers with free or lower cost products and services. We are especially concerned about the potential impact the proposed rule could have on the ability of low- and moderate-income consumers to gain access to affordable small bank products and services. Our specific concerns include:

I. The Board should ensure against evasion of the protections Congress intended to provide community banks and minimize the potential negative impact on consumers.

Community banks may be forced to reduce their debit card interchange fees if card payment networks do not implement a two-tier fee schedule. The proposed rule assumes the creation of a two-tiered interchange rate structure, yet there is no requirement for card payment networks to provide a two-tier fee schedule to preserve the exemption for community banks that Congress created. Without such a requirement, it will be up to the networks to decide on adjustments to their fee structure. A potential outcome is that if the networks decide that it is not in their best economic interest to offer a two-tier fee structure, they will not do so. This could result in forcing community banks to compensate for their loss of fee income by imposing higher fees on their customers, including transaction and other bank related product and service fees. Consumers who are financially vulnerable, especially low- and moderate- income individuals and families, may feel the hardest impacts as they are least able to handle additional expenses. In addition, an increase in fees for basic banking services could easily drive such consumers to non-bank financial service providers. Such developments would be a financial step backwards for consumers, as non-bank service providers do not provide the security and consumer protections offered by more traditional accounts at insured financial institutions and do not help consumers build a credit history.

- **Recommendation.** The Board should use its authority, including its anti-evasion authority, under the Electronic Fund Transfer Act to protect the statutory exemption created by Congress and to address the practical implications of the proposal, such as whether the payment card networks will have the discretion and ability to prevent community bank issuers from receiving an exemption to the fee cap by failing to maintain two-tiered fee schedules, making the small bank exemption irrelevant.

II. More information is needed on what lower interchange fees would mean for small issuers.

Regardless of the proposal's fee cap, small issuers will likely face market pressure regarding their fees. The FDIC is concerned that in practice small issuers may not receive fees above the Board's proposed fee cap of 12 cents, which would have an undetermined financial impact on community banks.[3] The FDIC has been unable to identify any research that shows the incremental costs for small bank issuers. Consequently, we are concerned that the proposed 12 cent fee cap may not fully consider the incremental costs for small issuers and encourage the FRB to conduct more work in this area.

- **Recommendation.** Absent an effective exemption for community banks from the interchange fee cap, the Board should expand its survey methodology to gain information on the costs incurred by issuers of all asset sizes and revise its fee cap proposal as appropriate.

III. Network exclusivity requirements could fundamentally alter card processing framework.

The requirement to establish nonaffiliated signature/PIN-based networks should be implemented in a manner that is least disruptive to the marketplace and creates the least burden for community banks. As the Board is aware, many debit cards today satisfy Alternative A, which would require that a debit card could access at least one signature-based payment processing network and one unaffiliated PIN-based payment processing network. By contrast, the second, more expansive proposed routing alternative (Alternative B) would likely require wholesale re-issuance of debit cards and extensive changes in payment network processes and agreements. Such costs would impose a tremendous burden on community banks.

- **Recommendation.** The FDIC strongly urges the Board to adopt Alternative A as the least burdensome method of providing merchants with more choice in selecting a payment processing network.

IV. Fraud prevention costs are not included in the fee cap.

The Dodd-Frank Act gives the Board authority to make an adjustment to the fee standard for fraud prevention. The Board has deferred decision on allowance of a fraud adjustment, a key component affecting the fee standards. A fraud prevention adjustment not only could provide incentives to reduce fraud but directly affects the calculation of the fee standard.

- **Recommendation.** Given the significant increase in debit card use, we encourage the Board to establish a fraud related fee policy that promotes and encourages innovations and improvements in fraud prevention throughout the industry. At a minimum, the Board should conduct research to identify fraud prevention costs faced by issuers of all sizes and specify a

[3] According to the proposed rule, the Board only surveyed the costs of issuers with assets in excess of $10 billion in assets. *See* 75 Fed. Reg. at 81724-25.

placeholder amount to be allowed for the adjustments to interchange fees to enable issuers and others to fully evaluate the proposed fee standard.

The FDIC encourages the Board to consider our concerns and recommendations as it proceeds with implementation of the debit card interchange fee and routing provisions of the Dodd-Frank Act. We are extremely concerned about the proposed rule's impact on community banks and consumers in contravention of Congressional intent. We urge the Board to use its authority to make the small bank fee cap exemption real, as Congress intended, to avoid unnecessary adverse consequences for consumers and small bank issuers, and to implement alternatives that would present the least operational challenges for community banks.

Sincerely,

Sheila C. Bair

cc: Jennifer J. Johnson, Secretary