

**Meeting Between the Board of Governors
and the Community Depository Institutions Advisory Council
April 1, 2011**

Board members: Chairman Ben Bernanke, Vice Chair Janet Yellen,
Governor Elizabeth Duke, Governor Daniel Tarullo, and
Governor Sarah Raskin

Council members: Howard T. Boyle, Barrie G. Christman, Richard J. Green,
Peter G. Humphrey, Kay M. Hoveland, Peter J. Johnson,
Charles H. Majors, Randy M. Smith, William T. Stapleton,
Dennis M. Terry, and Claire W. Tucker

Summary: The Federal Reserve Board met with the Community Depository Institutions Advisory Council (“the Council”), an advisory group established by the Board in 2010 to provide input on the economy, lending conditions, and other issues of interest to community depository institutions. One representative from each of the newly created local advisory councils at the twelve Federal Reserve Banks is selected to serve on the Council, which meets twice a year.

During the meeting, the Council discussed the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act, and the Council presented its views on the Board’s proposed regulation on debit card interchange fees and routing and on proposed amendments to Regulation Z. The information collected from the Council is summarized in the attachment. The viewpoints expressed in the attachment are solely those of the Council.

Attachment

Payment systems: What have been community depository institutions' recent experiences with respect to access to payment and settlement systems? Looking forward, is the trend towards direct access to the Federal Reserve or access through intermediaries (correspondent banks, bankers' banks, corporate credit unions)? (Dodd-Frank-related comments are below.)

Reasons banks are losing market share of the payment system:

Big banks, which are pioneers, will not have the resources or incentive to invest in new ideas and innovate because of loss of revenue (through interchange, for example), the uncertainty that the government will interfere in a product after the fact, as they have with debit cards, and because of the uncertainty related to federal preemption. One bank recently withdrew its prepaid card from six states because of the DFA provision which imposed state laws on prepaid cards.

Interchange price restrictions:

Unintended consequences:

- Will harm consumers who will pay higher checking account and debit card fees to replace the lost interchange that supports the cost of providing checking accounts.
- Will harm banks through lost revenue and drive community banks out of business: One bank reported net income will decrease 17% under the proposal.
- Community banks will be covered under any rule. It is not possible to fix the regulation or statute.

The Federal Reserve should use whatever statutory authority it has to ensure banks are compensated for the cost of debit cards:

- Fraud losses: One bank suffered \$1 million in debit card losses last year. Another \$300 million bank would have earned \$64,000 in interchange under the regulation, but suffered \$117,000 in losses.
- Card replacement for breaches: Breaches are often unreported, but cards must be replaced. Costs to the bank include not only the \$7 to replace the card, but the reputational loss and potential loss of the exasperated customer who loses confidence in the bank
- Fraud prevention costs
- Payment network fees
- Customer service costs, including inquiries related to debit card transactions
- Capital costs
- 100% of the authorization, settlement, and clearance, not just 80% as proposed.

Regulatory matters and the future of banking: How will recent changes in the regulatory landscape affect community depository institutions' ability to continue to provide services to their customers? What will be the effect on the industry generally? (Dodd-Frank-related comments are below.)

- **Lack of Implementation Time**
 - With Dodd-Frank estimated to produce more than 250 new regulations, the breadth and pace of Dodd-Frank implementation is overwhelming for most banks and their compliance staff.
 - The fast pace of rulemaking allows insufficient time to understand new rules, train staff, and to implement the requisite policies and procedures. Rulemaking and implementation should be slower and more deliberate to allow banks adequate time to prepare and properly implement the new regulations.
- **Cost of Compliance**
 - Generally, 5% -7% of noninterest expenses arise from regulatory compliance. These compliance costs will increase as Dodd-Frank implementation is rolled out.
 - Sources of compliance costs:
 - Hiring staff;
 - Training;
 - Increased transaction time.
 - Despite certain exemptions for small institutions, Dodd-Frank will increase burden in the creation of policies, auditing, and monitoring.
 - Banks are facing challenges in the hiring and development of their compliance staff.
 - Finding experienced staff, particularly in the compliance area, is difficult and becoming more costly.
 - Rural banks are particularly challenged to attract and retain qualified candidates.
 - In response to Dodd-Frank, consultants predict each typical community bank will need 2 FTE dedicated to compliance issues. This will prove difficult for small banks that traditionally operate with several employees sharing compliance duties.
- **Impact on consumers and small communities**
 - Due to new regulations and the increased compliance burden, banks are exiting profitable lines of business leaving the consumer with fewer choices and a fewer number of reputable lenders in the market.
 - E.g., a member bank chose to exit manufactured home lending citing a lack of compliance resources, despite being one of a few remaining such lenders. The borrowers affected are generally low-income and often underserved.
 - E.g., a small bank chose to stop offering home loans because they lacked the capacity to do escrows as required under the new regulations.

- **Future of Banking**

- Interchange:

- The likely results of the Interchange regulation is increased fees for savings and checking accounts, as well as NSF and other banking fees.
 - The industry should be aware of the changes in consumer behavior and evolution of technology that makes checking accounts and traditional forms of payment less important to the consumer
 - The bankers expect an increase in use of prepaid debit cards. Prepaid debit cards are exempt from the interchange rule and most cost less than a checking account while providing a similar service.