American Bankers Association
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The Honorable Ben Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Chairman Bernanke:

On behalf of the ABA and our thousands of member banks, I wanted to once again reiterate our concerns over aspects of the proposed Federal Reserve Board (Board) rule on debit card interchange that will do great harm to banks throughout the country, and particularly to community banks. I strongly urge you to make revisions to the rule to mitigate those harms. The ABA, various commentators, and the Board itself have all indicated that the statutory provisions underlying the proposed rule provide the Board with greater authority on cost calculations and other matters than the Board has to date chosen to exercise. We respectfully request that the Board act to mitigate the harms of the proposed rule.

As you are aware, the Tester-Corker amendment received 54 votes in the Senate last week. While short of the 60-vote procedural threshold reserved for many controversial issues, it is clear that a majority of the world's greatest deliberative body has sent a very strong message of concern over the approach taken by the Board in this rule. These concerns have been echoed by House Financial Services Chairman Spencer Bachus, Ranking Member Barney Frank, a diverse group of House Members, federal and state regulators, commentators, and consumer groups. We urge you to address those concerns.

Specifically, we ask the Board to consider the following:

- Consideration of Costs

  In its proposal in December, the Board limited the costs that it considered in setting interchange fees to "the per-transaction value of costs that vary with the number of transactions (*i.e.*, average variable cost) within the reporting period..." This is a very narrow interpretation of the statutory language, as it fails to consider a broad range of costs necessary to carry out individual transactions. For example, such an interpretation excludes, among other elements, an appropriate allocation of fixed and overhead costs, as well as such elements as fraud losses (discussed below), network fees applicable to individual transactions, and an appropriate allocation of customer services costs. We strongly believe that such costs need to be included in any cost calculation under existing law.

  Importantly, nothing in the statute compels the Board to adopt this "average variable cost" framework. For example, various terms such as "reasonable and proportional", "incremental", and "authorization, clearance and settlement" are not defined in statute, leaving to the Board to determine allowable costs associated with individual debit card

transactions. Moreover, the Board clearly has the authority under new section 920(a)(4)(B) of the Electronic Funds Transfer Act to include costs specific to a particular electronic debit transaction. Banks must invest significant capital and incur substantial infrastructure costs that allow that particular electronic debit transaction to be processed; some portion of those costs should be included in cost calculations. Network fees incurred with every transaction are clearly specific to a particular electronic debit transaction and should likewise be included. Customer services inquiries and dispute resolution on individual transactions are also specific to a particular electronic debit transaction. All of these are "real" costs incurred by financial institutions to process individual debit card transactions and thus should be factored in under any "reasonable and proportional" standard set forth under the statute.

- Fraud Losses and Prevention Costs

Actual fraud losses and costs associated with those losses (e.g., card reissuance costs) are costs specifically tied back to a particular electronic debit transaction and clearly within the Board's authority to be included under the statutory standard. These costs should be included in any permissible cost calculation. Moreover, and as the Board has acknowledged, fraud prevention costs are specifically permitted under the statute to be included in any debit card interchange pricing scheme. The proposal did not include any such adjustments. These costs are sizeable and, in fact, are the reason actual losses have been limited to the extent they have been in the marketplace. It is imperative that adequate allowances for fraud prevention costs be included in any determination of allowable debit costs under the rule – to both compensate institutions for such costs and incentivize investments in efforts that protect consumers, enhance security, and maintain market confidence in the payments system.

- Community Bank Exemption

We strongly encourage you to take whatever action necessary and permissible under the law to mitigate the harm incurred by community banks, which is clearly the intent of the new statutory provision. This includes taking actions with respect to the routing and exclusivity provisions to minimize regulatory burdens and compliance costs incurred by such institutions. We also would note that a primary driver for harm to community banks under the statutory scheme has been the Board's narrow reading of allowable costs, which will create market incentives for retailers to drive business away from community banks to lower-cost debit card providers. Reducing such incentives through the expansion of allowable industry costs as outlined above would greatly mitigate the potential harm to community banks and is clearly consistent with the statutory intent of the provisions.

- Timing

We strongly encourage the Board to recognize the hardships of implementation and compliance associated with this complex rule, and to extend any compliance deadlines accordingly. Despite the ease and efficiency that consumers and businesses experience in using our nation's electronic payments system, it involves a highly complicated process with many moving parts. The rule proposed by the Board will have enormous impact on the existing payments system infrastructure, which, if done in haste, could have sizeable negative impacts for individuals, consumers, and our broader economy. We urge the Board to use its existing authority to deem institutions in compliance with any new rule for some appropriate period in order to provide banks and payment networks with a reasonable chance to meet

their obligations under the law. That period should be no less than the three-month window envisioned by the statute as enacted.

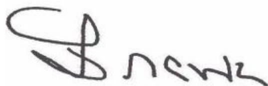
The ABA and our member banks have filed numerous and extensive comment letters with the Board that outline our concerns with the proposed rule. This letter merely highlights some, but not all, of those major issues. (An example of another important issue not highlighted here but discussed in great depth in prior letters involves the elimination of any regulatory cap on interchange fees, which we believe the Board lacks statutory authority to impose.)

In sum, the ABA and our members remain seriously concerned over the approach the Board has taken in the proposed rule. We believe the Board can exercise much greater authority under the existing statutory language, and we note that in court documents in the TCF litigation the Board has itself recognized that it is not limited to this narrow set of costs that vary with the number of transactions. Rather, the Board also can consider other costs that are specific to a particular electronic debit transaction.

We strongly urge the Board to exercise its authority to minimize the harm posed to consumers, communities, community lenders, and the overall U.S. payments system. As we have stated repeatedly, failure to do so will have dire consequences – higher costs to consumers on banking products, low- and moderate-income consumers being driven out of the banking system due to the elimination of low-cost products that banks can no longer afford to offer, reductions in bank capital leading to commensurate reductions in lending capacity, and, as you have noted, increased failures of community banks. This will result in irreversible harm to local communities and the banks that serve them.

Thank you in advance for consideration of our views.

Sincerely,



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