

February 8, 2011

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, CD 20551

Re: Docket No. R-1404 and RIN No. 7100 AD63

Dear Ms. Johnson:

Thank you for the opportunity to comment on the Federal Reserve System's proposed "Debit Card Interchange Fees and Routing" rule.

As Chairman of the Board of First Security Bancorp, a bank holding company in Searcy, Arkansas with \$3.6 billion in total assets, I am writing to express my opposition to the proposed rule. First Security Bank is a wholly owned subsidiary of First Security Bancorp that has more than 900 employees, 70 banking locations and offers all types of deposit, loan, and trust services to both consumer and commercial customers throughout the state of Arkansas.

First Security Bank is opposed to the proposed rule for the following reasons:

Although the statute attempts to exempt smaller, community bank institutions, such as First Security Bank, from the price control elements, economic forces will require our institution to adopt the same price level for debit card interchange fees or risk losing market share to the largest institutions. Therefore, although not intended, we will be subject to the same regulatory cap.

The price differential between cards will give merchants a strong incentive to steer customers to use the rate controlled cards of the larger institutions and to partner with those institutions to move their accounts to the larger institutions.

As a result, the passage of this law could result in an annual loss of debit card interchange revenues of approximately 75% for First Security Bank and all other smaller community bank institutions. It has been estimated that in order to simply break even each month where debit card revenue and expense is concerned, First Security Bank would have to charge all personal non-interest bearing deposit accounts \$8 per month in service fees for accounts which are currently free or not service charged. This will have a negative impact on low income customers and will negate the purpose of all other legislation and guidance that is being developed to



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protect consumers, including the FDIC's newly issued guidance on automated overdraft payment programs.

In order to preserve the intent of the small issuer interchange rate exemption included in the law, we ask that the Federal Reserve Board (the Board) issue additional rules to guarantee the small issuer exemption in the marketplace and protect the interchange revenue of all small issuers.

Below are our specific comments regarding the proposed interchange fee and transaction processing restrictions and fraud prevention as proposed:

Proposed Interchange Fee

- As dictated in the law, we request that the Board fully consider the "role" and cost of the issuer in the authorization, clearing, and settlement of an electronic debit transaction. For example: In order to have a transaction processed on our current network, we must be a network participant. Participation requires the payment of various fees, including but not limited to network fees, participation fees, and debit card residency fees.
- We also request that the Board expand its view of settlement and consider all related costs. The primary objective of the Electronic Funds Transfer Act is to protect individual consumers engaging in electronic funds transfers (EFTs). Network operating rules, which also provide consumer protections, require an issuer to maintain responsibility and liability for settlement until a cardholder's dispute rights have fully expired. Any costs incurred by an issuer throughout this settlement process should be considered allowable costs, including the cost of inquiries and disputes; fraud losses and fraud-prevention costs; and fixed costs, including capital investments, used to support settlement. The annual estimated fraud loss to First Security Bank is approximately \$150,000.
- The law specifies that the interchange fee shall be "reasonable and proportional" to the costs (not the exact costs) to authorize, clear, and settle a debit transaction. An allowance should also be made for institutions to recognize a reasonable profit. If all aspects of the factors discussed above are not considered, the proposed interchange cap is not considered a "reasonable" fee as expense would exceed revenue.
- Additionally, in calculating the permissible interchange fee, the proposed rule does not recognize important value-added differentiators between debit cards and checks. For example: When a merchant obtains a proper authorization for a debit transaction, payment is guaranteed and the issuer suffers the loss in the event there are insufficient funds. Checks may be returned non-payable, and merchants suffer the loss. The cost of such losses should be considered.



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- When comparing Alternative 1 (safe harbor and fee cap) under the regulation to Alternative 2 (fee cap only), Alternative 2 is the better alternative. Alternative 1 would require the creation of a separate interchange rate for each covered issuer, as each such issuer would have different costs. This would require payment card networks to create a new interchange system for each covered issuer. Alternative 1 would be more expensive to all issuers, including small issuers, as the network implementation costs would be passed on to issuers.

Transaction Processing Restrictions

- When comparing Alternative A (minimum of two unaffiliated networks for PIN and signature transactions) to Alternative B (minimum of two unaffiliated networks for PIN transactions and two for signature transactions), Alternative A would be the most cost-effective alternative because community financial institutions would not have to join additional payment card networks. Additionally, if ATM transaction routing is included within the final rule's scope, Alternative A would be the most cost-effective alternative. First Security Bank is already in compliance with Alternative A for both ATM and point-of-sale routing.
- Alternative B (two unaffiliated networks per authorization type) may require reissuance of cards in order to comply with network branding requirements. This is an unnecessary expense and an inconvenience to our cardholders due to such things as recurring payments. If the Board mandates Alternative B, it should require that an interchange adjustment be made to cover the increased cost to issuers for participation in multiple networks. The current annual cost to First Security Bank to issue debit cards is approximately \$100,000.
- Additionally, the law states that merchants are not authorized to discriminate between debit cards within a payment card network on the basis of the institution that issued the debit card. The Board should specifically address the discrimination aspect of the law in the final rules to provide protections for all issuers within a payment card network.

Fraud-Prevention Costs

- In discussing fraud-prevention costs, the Board should organize and oversee a fraud consortium comprised of representatives of all stakeholders in the electronic payments industry. Its purpose would be to develop a holistic approach to fraud-prevention and liability allocation issues. Primarily, the consortium should come up with fraud-prevention alternatives that not only reduce fraud but also provide a positive return on investment for all stakeholders.



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- The consortium should develop non-prescriptive, fraud-prevention standards for merchants. Implementation of these standards could be monitored through an enhanced review of regulated merchant-sponsoring financial institutions. The consortium should also ensure that all parties have an equal opportunity to implement new technologies, and that small issuers are not denied such implementation opportunities due to excessive cost.
- Finally, when comparing Alternative 1 (the technology specific approach required to recover costs incurred as the result of fraud) to Alternative 2 (the non-prescriptive approach to maintain an effective fraud-prevention program), Alternative 2 is the better alternative due to costs associated with implementing such technology for smaller institutions and due to the fact that it is not practical for the Board to mandate specific technologies.

Because of the many issues related to consumer harm and basic fairness to smaller institutions, such as First Security Bank, I urge you to strongly consider each of the points addressed in this letter.

Respectfully Submitted,

A handwritten signature in cursive script, appearing to read "Reynie Rutledge".

Reynie Rutledge, Chairman of the Board
First Security Bancorp

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