CUNA Interchange Regulation Questions & Issues

TO: Louise Roseman, Director, Reserve Bank Operations and Payment Systems, Board of Governors of the Federal Reserve System

FM: Interchange Working Group of the Credit Union National Association

RE: Implementation of new Section 920 of the Electronic Fund Transfer Act, "Reasonable Fees and Rules for Payment Card Transactions"

DT: July 28, 2010

Following conversations Credit Union National Association staff has had with you, CUNA appreciates this opportunity to raise questions, concerns and other points regarding the implementation of Section 1075 of the Wall Street Reform and Consumer Financial Protection Act, Pub. L. 111-203.

As you know, § 1075 (Electronic Fund Transfer Act § 920) calls for regulation relating to interchange fees in connection with electronic debit card transactions that issuers with assets of $10 billion or more receive. During the development of the legislation, CUNA formed an Interchange Working Group, and it is under the Group's auspices that we are providing these comments. We will also be sharing this document with others, including policymakers on Capitol Hill who have asked for our comments.

Impact of the Board's Rules on Small Issuers

- Under the new law, small issuers as well as certain government-administered payment programs and reloadable debit cards are exempt from the provisions regarding the regulation of debit card interchange fees.
- While small issuers are exempt from such language, they fear they will not be exempt from the impact of these provisions.
- Under Par. 920(a)(1), the Board is empowered to write a rule to implement this subsection and to prevent circumvention or evasion of the provisions on reasonable fees.
- We urge the Board to utilize that authority and develop a regulation that implements the exemption for small issuers, as well as for government programs and reloadable cards.
- In that connection, we are developing proposed regulatory language that we would be pleased to provide if that would be useful.
- We also urge the Board to take into consideration the impact on small issuers when developing rules on interchange fees for large issuers. This should include whether merchants and networks will be willing and able to accommodate interchange fees for small issuers that do not conform to the lower fees expected for large issuers.

- The language in the new law regarding exclusivity and routing restrictions (§ 920(b)) is another area that will likely be problematic for small issuers. (This issue is also addressed below but there is a large concern that these provisions will be interpreted to require issuers of all sizes to participate in at least two independent payment card networks.)
- If that is the outcome, it will be costly to small issuers and the impact of their exemption in § 920(a) will be minimized. We do not believe this was the intent of Congress.
- We urge the Board, in writing its rules under § 920(b), to take into consideration the impact on small issuers and to refrain from including any requirements or provisions that would direct that issuers belong to at least two independent networks.
- Par. 920(b)(4) seeks to codify an "honor all cards" provision to address discrimination between payment cards within a network on the basis of the issuer.
- We urge the Board to consider writing a rule on this section to insure merchants will not reject small issuer cards or encourage, on a discriminatory basis, consumers to use cards issued by large institutions, thereby undermining the exemption for small issuers in § 920(a).

Rulemaking and Effective Dates

- § 920 authorizes the Board to write rules:
    - To implement its authority over interchange transaction fees (Par. 920(a)(1));
    - To prevent circumvention or evasion of provisions in this subsection (Par. 920(a)(1));
    - To establish standards for assessing whether the amount of any interchange fee is "reasonable and proportional" to the cost incurred by the issuer (Subpar. 920(a)(3)(A));
    - To establish standards for making adjustments for fraud prevention costs (Subpar. 920(a)(5)(B)(i));
    - Regarding network fees (Par. 920(a)(8)); and
    - Prohibiting exclusive arrangements and routing restrictions (Par. 920(b)(1)).
- We urge the Board to issue a timetable soon on the development of the rules that would inform stakeholders as to the Board's overall plan for implementation of all of § 920.
- This would include when proposals would be issued under § 920(a) and plans for rulemaking under § 920(b), as it is not clear when rules under that subsection would be effective.
- When the Board develops the final rules, we encourage you to include a schedule under which the Board will over time review and monitor the feasibility of the rules and their impact on all issuers, update costs and other factors, and assess whether the rules are achieving the objectives Congress intended.

Reasonable and Proportional Interchange Fees

- § 920(a) addresses the regulation of interchange fees, and the Board is directed to develop standards for assessing whether an interchange fee is reasonable and proportional to the cost to an issuer with respect to the transaction.
- Does the Board interpret this language as requiring a rule that: (1) actually sets rates or fees; (2) sets standards or parameters for determining whether a fee is reasonable and proportional; or (3) some other approach?
- In our view, the language does not require the Board to set specific fees or rate schedules.
- Also, we believe the language could accommodate a two-tiered system with issuers of $10 billion or more in assets operating under fee limitations that do not apply to small issuers or to government programs and reloadable cards.
- However, due to the uncertainty regarding how merchants and payment networks will react to the interchange fee rules, credit unions are very concerned about the implementation of these provisions for large issuers.
- In writing rules regarding interchange fees, the Board is directed to consider the similarities between debit and check transactions and to distinguish between incremental costs to the issuer and other costs not specific to a particular debit transaction.
- In our view, this language does not require the Board to limit interchange fees to incremental costs but directs it to consider those costs as it writes the rules relating to interchange fees.
- We believe under this language the Board may take into consideration reasonable costs related to an issuer's activities in establishing and maintaining a debit card program. This should include processing costs, including costs for transaction authorization, settlement, and clearance; recordkeeping; staff support costs, including training; other costs to market, offer, open, maintain, and close an account; charge-offs; call center costs; fees paid to networks; and other reasonable costs.
- How the Board determines fraud prevention costs will also be very important in the implementation of the rules regarding interchange fees.
- In our view, the Board should include in fraud prevention costs: debit card reissuance costs for suspected and actual incidences of fraud; costs associated with setting up and maintaining data security programs; costs related to public relations in connection with card fraud or data breaches; and costs for training staff to deal with fraud and data breaches.
- We also encourage the Board to consider the differences in costs for PIN and signature based debit transactions and to allow different fee structures for transactions based on how they are authorized.
- In any event, we believe the Board should consider the cost structures of smaller institutions in determining reasonable fees of larger institutions.

Exclusivity and Routing

- As stated above, these provisions have raised a number of questions and concerns for credit unions that fear they will have to increase the number of networks with which they are connected.
- We think the Board should support a technical, statutory amendment to § 920 that would exempt small issuers from the impact of these provisions.
- At a minimum, we do not think the language should be interpreted to require small issuers to incur new costs as these provisions are implemented.
- For small issuers that already offer PIN and signature based networks, we think it would be sufficient for merchants to choose between these networks. We also think issuers should not have to participate in multiple networks that utilize the same kind of authorization, such as signature only.

Data Collection

- Under § 920(a)(3), the Board may collect information from any issuer or payment network to assist it in its regulation of interchange fees.
- While we do not think the Board should impose burdensome data collection requirements on small issuers, we are concerned that without sufficient data the Board will not be able to assess the impact of its regulations on small issuers.
- CUNA and CUNA Mutual Group, which is represented on our working group, are updating credit union interchange fee and cost data.
- Meanwhile, we would welcome the opportunity to solicit information from credit unions using the surveys the Board is developing for large issuers.

Coordinating with Regulators

- § 920(a)(4) requires the Board to consult with the National Credit Union Administration and other regulators, including the Bureau of Consumer Financial Protection, in the establishment of interchange fee rules.
- We urge the Board to make public its plans for such coordination as well as information that is provided by the other regulators to the Board regarding interchange costs and related issues.

Opportunity to Meet

- We realize you are on a tight time frame to develop the new regulations.
- Nonetheless, as your schedule permits, we would welcome the opportunity to discuss our concerns with you, including via a conference call, regarding the implementation of § 920.
- If you have any questions or comments about the concerns raised in this memo, please contact Mary Dunn, CUNA SVP and Deputy General Counsel, at 202-508-6736.