



California
CREDIT UNION LEAGUE

NEVADA
CREDIT UNION LEAGUE

September 29, 2011

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

Re: Interim Final Rule Regulation II, Debit Card Interchange Fees and Routing
Docket No R- 1404, RIN 7100-AD63

Dear Ms. Johnson:

On behalf of the California and Nevada Credit Union Leagues, I appreciate the opportunity to comment on the Board's interim final rule and request for comment on provisions allowing an issuer to receive an adjustment of 1 cent to its interchange transaction fee, subject to certain provisions. By way of background, the California and Nevada Credit Union Leagues (Leagues) are the largest state trade associations for credit unions in the United States, representing the interests of more than 400 credit unions and their 10 million members. While our states do not currently have any credit unions that meet the non-exempt status, we expect they will grow into that asset group in the near future

The Leagues recognize and appreciate the difficult task given to Board staff to develop regulations to implement the interchange amendment, especially given the scope and complexity of this issue, the need to address a statutory exemption for small issuers, and the short implementation timeframe mandated by the Dodd-Frank Act. While we do not agree with all aspects of the final rule—especially the cap on debit card fees for non-exempt large issuers—we thank the Board for including provisions in the final rule intended to reinforce the small issuer exemption from the fee setting and circumvention and evasion aspects of the final rule. These include annual publication by the Federal Reserve of 1) a list of institutions that fall above and below the \$10 billion small issuer asset threshold exemption; and 2) a list of the average interchange transaction fee that each network provides to small issuers as well as to non-exempt large issuers. In addition, we look forward to results of the reports required from Federal Reserve staff—within 6 months and 18 months of the effective date of the rule, respectively—regarding the effectiveness and impact of the two-tiered system on small issuers' interchange fee income.

Under the interim rule, an issuer may receive an upward adjustment for fraud prevention of no more than 1 cent above the amount of interchange fees it receives for each debit card transaction, provided that the issuer previously has certified to the network on which the transaction is carried that the issuer complies with certain non-prescriptive fraud prevention standards. The Leagues agree with the use of non-prescriptive standards instead of the more restrictive technology-specific approach outlined in the proposed rule.

We believe the non-prescriptive approach is much more flexible, efficient, responsive, and fair than the technology-specific approach.

However, in our opinion, the 1 cent amount is insufficient to cover the true costs that issuers bear for fraud prevention for the following reasons:

- The interim rule calculates the 1 cent adjustment amount on what the Federal Reserve calculates to be the *median* fraud prevention costs of covered issuers, rather than the fraud prevention costs of issuers at the *80th percentile*, which is the percentile the Federal Reserve used in the final rule to determine the general debit interchange fee caps. By using median costs, the interim rule would deny half of all covered issuers the ability to recoup crucial fraud prevention costs that they incur above 1 cent per transaction.
- The 1 cent amount does not include the important fraud prevention costs that issuers incur in responding to customer inquiries about fraudulent or potentially fraudulent activity related to their debit cards. These inquiries are often crucial starting points to detecting and preventing fraudulent activity.
- The 1 cent amount does not include any costs incurred by issuers for adopting and utilizing new fraud prevention technology and systems, such as issuing new cards that contain superior fraud prevention technology.
- Finally, the 1 cent amount fails to consider at all the higher fraud prevention costs of issuers with assets under \$10 billion, despite acknowledgement by Board members that these “exempt” issuers likely will be subject, as a practical matter, to the same limits on interchange fees that the Federal Reserve imposes directly by law on non-exempt issuers.

We believe the flaws cited above warrant a much higher amount for the fraud prevention adjustment amount. The Leagues support the recommendation provided in comments submitted jointly by CUNA, NAFCU, and every major bank trade association that this amount should be at least 4 to 5 cents per transaction.

In closing, I would like to thank the Board for the opportunity to share our comments regarding the interim final rule. I appreciate your thoughtful consideration of our views and recommendations.

Sincerely,



Diana R. Dyksira
President/CEO