

From: Salal Credit Union, John D. Iglesias
Subject: Reg I I - Debit card Interchange

Comments:

February 22, 2011

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

Re: Docket No. R-1404

Dear Madam:

Thank you for the opportunity to comment on the proposed "Debit Card Interchange Fees and Routing" rules. Salal Credit Union (Salal) is a state-chartered credit union in the State of Washington with an asset size of \$323 million and 94 employees. Our membership is predominately consumer-based.

We have carefully reviewed the proposed rules and offer the following comments for your thoughtful consideration. While Salal is exempt from the proposed interchange fee limitations due to our asset size, there is currently no defined or practical way in which to exclude small financial institutions. If the exemption is not enforced, small issuers like Salal may very likely be subjected to the same fees that will be required for large issuers; if the exemption language remains as proposed, there is the very real potential for significant and disparate impact against small institutions and their customers or members as it relates to the application of interchange fees. As the Board recognizes, larger financial institutions are in a much better position to absorb these fees.

Additionally, although Visa announced plans to introduce a dual interchange schedule in January of this year, no specific plan details have been announced. In the absence of any specific information, it's unknown how this dual interchange schedule will operate and whether it will provide the necessary financial protections to smaller financial institutions. Due to the many unknowns, we are unable to offer an informed opinion on this possible dual interchange schedule; however, we believe very strongly that this is information the Board must consider before any final rules are issued.

Historically, the Federal Government has made it a point to limit its rulemaking to consumer protections but absent any actual price setting. We are concerned that this rule sets a precedent of inappropriate government involvement in establishing pricing for products and services offered by the private sector. Such price setting limits the ability of any business to fairly price their products and services in consideration of the costs incurred to offer the kind of products and services the consumers want. Additionally, if adjustments to the fee must be made in the future, as they most assuredly will, how much slower and less responsive will the industry have to be to include the Board in setting the new limits?

As a smaller financial institution, we have significant concerns about putting a cap on debit card interchange fees as profit margins are already severely stressed due to many factors-including, but not limited to, a still-recovering economic climate. In drafting the proposed rule, the Board did not include any provisions to offset fraud-prevention costs associated with the processing of debit cards, yet these are true costs to all financial institutions.

Additionally, these costs have a disproportionate impact on smaller financial institutions as profit margins are much less. As a credit union, we return our profits to our members in the form of lower fees and better rates. When our revenue streams are radically cut, this curtails our ability to meet the expectations of our members.

Instead of addressing the above costs in the proposed rules, the Board is requesting comment on how to implement an adjustment to interchange fees for fraud-prevention costs. There are ten (10) questions on which the Board is requesting comment. Each question requires careful consideration and thoughtful response. We understand the Board is operating under a statutory timeline, and the Board seems to understand that financial institutions must absorb these costs in order to protect consumers against fraud and loss. However, the current timeline to comment on these points is insufficient. If these rules are implemented absent appropriate reimbursement costs for these consumer protections, the financial institutions that choose to provide their members or customers with exceptional protections will be unfairly penalized.

Smaller financial institutions such as Salal must also rely on third-party vendors for debit card processing-this comes at a cost. The proposed safe harbor fee of \$.07 per transaction or the cost-based approach of \$.12 per transaction does not appear to fully recognize the costs associated with this kind of outsourcing. We ask that more time and analysis be given on this point and how it impacts the small financial institutions.

There remain too many unknown variables in the proposed rule, and we find ourselves in the position of having to determine how to prepare for revenue loss when we have little understanding of the actual ramifications of the proposed rule.

Given the complexity of what is being proposed, the many parties impacted by these proposed rule changes, and the many as-yet-undetermined factors at play, we believe the timeline for compliance is unachievable. Just the myriad of systems that need to be put in place to comply with the proposed rules is staggering.

While we appreciate and agree with the Board's effort to make the interchange fee on par with the cost of conducting and processing debit card transactions, we don't see that the benefits of lower interchange fees will necessarily be passed on to the consumers. The cost of interchange fees is, presumably, already factored into pricing by retailers as an expected cost of doing business. Are we simply assuming that retailers will immediately reduce costs on consumer goods and services to reflect their savings? This would be a monumental undertaking, and with no enforcement capacity, we doubt consumers

would see consistent or even any benefit from the cap.

We further understand that the Board issued these proposed rules in response to a statutory mandate by Congress; however, there are far too many outstanding issues that warrant additional and much more careful consideration. At a minimum, rate setting rules should be delayed until the rules consider all applicable costs, including but not necessarily limited to fraud-prevention costs. Another reason to delay is the need to consider the impact of the Visa dual interchange schedule on any final rules issued.

Salal Credit Union appreciates the opportunity to comment on this very significant matter. If we may provide further information or you have questions, we hope you will not hesitate to contact the undersigned.

Sincerely,

John D. Iglesias