From: Nevada Federal Credit Union, Paul Parrish

Subject: Reg I I - Debit card Interchange

Comments:

January 26, 2011

The Honorable Ben S. Bernanke, Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket # R-1404; Comments regarding Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act and the proposed Section 920 of the Electronic Funds Transfer Act

Dear Chairman Bernanke:

I am writing on behalf of Nevada Federal Credit Union, which represents the financial interests of approximately 80,000 members, primarily from the state of Nevada. Our credit union is currently $690 million in total assets. Despite the fact that card issuers with less than $10 billion in total asset size are exempt from the interchange cap provisions of the proposed rule, I still have serious concerns about the unintended consequences of the proposed rule that will no doubt, eventually have to be borne by our members and other consumers nation wide.

The government should not be involved with setting interchange fees

The Government has no role in setting pricing for any free-market endeavor. Any activity in this direction creates an unnecessary constraint that inhibits growth, competition, and further investment critical to maintaining a healthy economy.

The proposed rule mandates a transfer of revenue from the banking sector to the merchant sector, with no consideration being given to the impact on the consumer. The over-reaching mandate itself is bad enough, but the fact that it will ultimately end up on the backs of the consumers, particularly in times of historic economic turmoil is outrageous. Furthermore, when one considers that this rule is intended to further the objectives of a "Consumer Protection Act," it can at best, only be puzzling to any reasonable observer.

This rule creates an expensive, unnecessary diversion at a time when credit unions need to be focused upon simply surviving

The cost and operational interruption involved with the implementation of this rule serves only to impede our efforts to survive as an industry. If you were to discuss this with the NCUA, I'm quite sure that they would suggest that credit union management currently needs to be focused upon more productive endeavors.

These are historically bad times for the credit union industry and this

regulation effectively throws a grenade into each institution's planning process. The costs involved with the time and effort that is being put forth to coordinate and implement this rule with our various networks and processors..all in an effort to accommodate a crippling amount of a critical revenue source to be removed from our respective operations, is not known at this point. I can only submit at this point that it will be substantial.

The proposed rule is silent regarding enforcement of exemptions, thus ultimately rendering the exemptions meaningless

As it pertains to Nevada Federal Credit Union, and other card issuers with less than $10 billion in total assets, I am quite concerned with the proposed rule's relative silence regarding the enforcement of the exemption to the cap provisions. If the merchants were able to convince our government that it needed to jump in and set interchange pricing, I'm quite sure they will be resourceful enough to figure out ways to discriminate against our card-holders, despite our exemption. As such, it is a common belief within the industry that interchange pricing will quickly gravitate toward the proposed cap, regardless of the existence of this unenforceable exemption.

The proposed cap does not cover issuer costs involved with a debit card program

The proposed maximum cap of twelve cents definitely accomplishes the government's goal of transferring revenue from one sector to another. The twelve cents would cover Nevada Federal's directly billed (from our third-party processor, STAR) cost to authorize, clear, and settle our members' debit transactions. But Nevada Federal still has other costs (other debit-related overhead) that are borne by the credit union related to our members conducting debit card transactions (e.g. systems overhead; card issue and re-issue costs; costs related to fielding member questions about transaction postings; costs related to handling questions about card functionality issues; costs related to processing charge-backs and related merchant disputes; insurance costs, costs of processing fraud claims; the cost of the actual fraud losses associated with those claims; and costs related to Reg-E disclosure & compliance issues).

These other on-going costs exceed the currently proposed cap of twelve cents. It will not be possible for us to continue offering this highly popular service unless we can, at least, recapture our costs. Consumer expectations and related competitive pressures will require us to address this government imposed dilemma in some fashion if Nevada Federal is to remain competitive.

The rule completely ignores the cumulative financial institution investment required to create the payment systems infrastructure as well as the substantial value that's been created for the merchants

Dating back to 1958 when the first general purpose bank card was introduced, the electronic payments system has progressed into the highly efficient, globally integrated, trusted intermediary between tens of millions of merchants and over a billion card-carrying customers who've benefited tremendously along the way. The investment and associated risk required over the past 50 years in developing the switching, authorizing, clearing, settlement, dispute resolution, data management, security, network redundancy, enhanced reliability, and interoperability among various systems has been borne entirely by the financial institutions.

Billions of dollars have been cumulatively sunk into the development of these

electronic payment systems which have provided substantial benefits not only to the cardholders, but also the merchants in the form of:

Faster and guaranteed payments (no worries about whether a check is going to be paid or not);
Substantially less vulnerability to theft and much safer workplaces for employees (much less reliance upon, or in many cases, complete elimination of cash and its associated costs and risks);
Much faster checkout;
Increased sales;
More efficient and more cost-effective systems (than the merchants creating their own proprietary system or other form of credit for their customers); and
Tremendously more efficient merchant record keeping and research.

This rule ignores the proud history of this successful endeavor. Its misguided objectives are pursued in a manner that mimics the elimination of a tax credit or government subsidy as opposed to reality, whereby it essentially confiscates the payments system from its financial institution developers and hands it to the merchants..at substantial further cost to consumers..all for simple political gains.

The rule is silent with regard to any requirement that the merchant's pass their windfall onto consumers

From the perspective of a not-for-profit financial cooperative, whose members currently conduct over 14 million transactions per year, this government mandate simply transfers $3.8 million of Nevada Federal Credit Union's members' money each year to the various merchants that our member/owners do business with. Our members have no assurance that they will be able to recoup this "tax" on their preferred financial institution through lower prices at the pump, at their favorite restaurant, or at Walmart, etc. In order to ensure that this "trickle-down" occurs, the government would have to start dictating pricing in these other market spaces too. I don't see this happening (at least not in the near-term).

The rule will necessarily require our credit union to raise prices on a wide range of services which will push a segment of our members out of the system

Actually, the Board is "suggesting" that we raise our prices to make up for this revenue transfer. The last sentence on page 71 of the recently issued notice states, "The Board notes that even the highest-cost issuers have sources of revenue in addition to interchange fees, such as cardholder fees, to help cover their costs." I submit that the Board is correct. Currently, this tax of $3.8 million amounts to 55 basis points of ROA that Nevada Federal will need to recapture in some fashion just to maintain current levels of capital. Our success in this endeavor will be critical to our survival and will be particularly challenging given the unstable condition of our economy. We will have to ask our already cash-strapped members to contribute more to the cooperative in the form of newly implemented transaction fees, higher account maintenance fees, and higher loan rates.

For example, Nevada Federal currently serves over 5,000 members through its increasingly popular "New Start" program. Most, if not all, of these members would be considered "unbankable" at other local financial institutions. We feel that we've done a fine job in balancing the costs and risks associated with servicing these accounts with the price that the member pays to maintain

the account. This is just one of many service areas where prices will have to be increased to recapture the $3.8 million in Nevada Federal Credit Union revenue that will be transferred to the merchants as a result of this rule.

As such, this rule will have the unintended effect of pushing a segment of our membership back out toward the eagerly awaiting check-cashing, title-loan, and pay-day lending outlets. Again, this obviously runs counter to the stated objectives of the Consumer Protection Act.

Comments solicited by the Board relative to decisions impacting the form of the final rule

In currently relenting to this hastily created and ill-conceived regulation, and in an effort to be responsive to the Board's solicitation for comments regarding decisions that still need to be made in order to finalize the rule, I submit the following.

Specifically, the Board seeks comments on two alternatives for setting the interchange fee and whether issuers would prefer alternative one, with a safe harbor of seven cents and a maximum fee of twelve cents per transaction, or alternative two, which would simply allow a fee up to twelve cents per transaction.

I submit that Alternative two would be better because it appears to be much less complicated for all parties involved. Also, although it's not entirely clear, it appears to eliminate any chance that our credit union would be subject to an interchange fee that's less than 12 cents per transaction.

The Board also seeks comments regarding what other costs, besides authorization, clearance and settlement costs should be included in the allowable interchange fee.

I submit that some factor should be included to cover indirect costs for overhead (as mentioned above) associated with offering this service. Also, some factor to offset the comprehensive cost of compliance and fraud losses imposed upon issuers, primarily by Regulation E, should be considered along with factors related to time and motion studies, and program cost allocation models. Furthermore, it is obvious that the spirit of this proposed rule is to maneuver existing payment systems activities into a space to be treated as a "utility", yet the Board has not provided this newly formed utility the same ability as other regulated monopolies to generate a reasonable return. Some allowance for a reasonable return should also be considered.

Understanding that each institution's operation is a bit different than the next though, a standard cost per transaction should be determined that includes the following items:

Card Issue and Re-issue;
Compliance;
Card-holder Maintenance;
Insurance;
Fraud Losses;
Security and Related Monitoring Systems; and
A Reasonable Return on Investment.

The Board also seeks comments regarding two alternatives for permitting a fraud

adjustment to the interchange rate. The first would require the Board to determine which anti-fraud technologies are sufficiently useful to justify an adjustment and would permit an adjustment only for those technologies. The second is more flexible, permitting an adjustment for reasonably necessary measures to maintain an effective fraud-prevention program.

I submit that Alternative two would be preferable since it appears that this alternative gives the card issuer some additional flexibility to present arguments for internally developed, non-standard fraud monitoring and prevention systems. Alternative 1 appears to leave any fraud adjustment determination solely to the Board's discretion.

The Board also seeks comments regarding which specific fraud monitoring technologies should be required if the Board chooses to adopt technology-specific standards.

I submit that any and all industry accepted neural network systems should be required. The Board should appoint a committee of fraud prevention experts from within the payment systems industry and rely upon their input regarding the effectiveness of varying fraud prevention technologies and each respective technology's cost-effectiveness.

If the Board adopts non-prescriptive standards, any and all industry accepted neural network systems, again, should be required..and then, allowances should be made for any certified internal system developed by the card issuer, with further allowances made for any utilization of dynamic data (current substantially developed technologies such as Certi-flash chips and dynamic mag-stripes are anticipated to cost between $4.00 and $10.00 per card to issue).

The Board should appoint a committee of fraud prevention experts from within the payment systems industry and work with them to develop a "fraud systems certification" program to enable issuers to apply for further expense offsets for internally developed fraud prevention technologies.

The Board also seeks comments regarding two alternatives to address the network exclusivity provision. Under the first alternative, card issuers would be required to provide two unaffiliated networks to route transactions. Under the second alternative, issuers would be required to provide two unaffiliated PIN networks and two unaffiliated signature networks

I submit, as Visa has previously suggested, that the Board strictly adhere to the statutory language and to not require that an issuer contract with more than two unaffiliated payment card networks, and that the issuer be given discretion in choosing among networks that meet the statutory criteria of being unaffiliated and determining the terms and conditions governing its participation. As such, following the plain language of Section 920(b)(1), a debit card issuer should be required to receive electronic debit transactions from no more than two unaffiliated networks of the issuer's choosing.

I hope you find these answers responsive and useful as you continue your efforts to finalize this assault on the consumers of America.

Sincerely,

Paul Parrish
Executive Vice President, CFO
Nevada Federal Credit Union