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January 19, 2011

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

Subject: Regulation II: Debit Card Interchange and Routing (Docket No. R-1404)

Dear Ms. Johnson,

Thank you for the opportunity to comment on the Federal Reserve Proposed Regulation II: Debit Card Interchange and Routing. As the Chief Executive Officer of a Credit Union, I am writing to express my deep concern about certain aspects of the proposed rule and its potential impact on my organization.

According to your own study, debit card payments have grown more than any other form of electronic payment over the past decade, increasing to 37.9 billion transactions in 2009. Debit cards are accepted at about 8 million merchant locations in the United States. In 2009, debit card transactions represented almost half of total third-party debits to deposit accounts, while approximately 30 percent of total third-party debits to deposit accounts were made by checks.

As a debit card issuer, we incur significant costs above and beyond the "costs incurred by an issuer with respect to the transaction" to provide this valuable and convenient service to our members. These costs include employee, chargeback and fraudulent activity, mailing, processing, production and insurance costs. Any significant reduction in interchange income may require higher fees paid by our members to offset the significant costs of our card program. Although my organization is under $10 billion in assets, I am concerned the proposal does not include provisions to enforce the small issuer exemption. Therefore, I recommend the Federal Reserve use its authority to reinforce the small issuer exemption and ensure that it works as Congress intended.

With respect to fraud, industry-wide losses to all parties of a debit card transaction were approximately $1.36 billion in 2009 in which card issuers bear the vast majority of the losses. In addition, on average, issuers incurred costs of 2.2 cents per signature-debit transaction for fraud-prevention and data-security activities and 1.2 cents per PIN-debit transaction. Therefore, I would encourage the Federal Reserve to adopt a non-prescriptive approach to the fraud-prevention interchange adjustment.

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Issuers should take reasonable steps necessary to maintain an effective fraud-prevention program but not be required to adopt technology-specific approaches (e.g., end-to-end encryption, tokenization, chip and PIN) mandated by the Federal Reserve in order to be eligible for receiving a fraud-prevention adjustment. Furthermore, the non-prescriptive approach should include an adjustment for research and development to invest in new innovative technologies to reduce the risk of fraud in PIN or signature-based transactions.

I encourage the Federal Reserve to adopt a network exclusivity provision that requires a debit card to have at least two unaffiliated payment card networks available for processing an electronic debit transaction (e.g., Proposed Alternative A). Therefore, an issuer could comply by having one payment card network available for signature debit transactions and a second, unaffiliated payment card network available for PIN debit transactions. As the Board has indicated, requiring multiple unaffiliated payment card networks on a debit card for each method of card authorization could potentially limit the development and innovation of new authorization methods. Furthermore, it would disproportionately affect small card issuers who may be unable to implement these new methods of card authorization if the rule requires that such transactions be capable of being processed on multiple unaffiliated networks.

In closing, I would like to recognize the significant time and consideration employees of the Federal Reserve have spent in crafting the proposed regulation. I understand the Federal Reserve is obligated to implement the Debit Interchange Fee Amendment as written, but I encourage the Federal Reserve to take the time to consider all implications of this rule, especially the impact it will have on consumers as well as institutions under $10 billion, and exercise the discretion granted to the Federal Reserve to minimize negative consequences. I urge the Federal Reserve to take sufficient time to gather and analyze all of the relevant facts and information before finalizing the rule.

Thank you very much for your time regarding this matter.

Sincerely,

Jeanine M. Morse
President and Chief Executive Officer