January 13, 2011

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System **VIA E-MAIL**
20th Street and Constitution Avenue, NW.
Washington, DC 20551

RE: Docket No. R-1404 and RIN No. 7100 AD63
Debit Interchange Regulations

Dear Ms. Johnson:

Credit Union ONE is a $720 million state-chartered credit union that serves 105,000 members primarily in the Metropolitan Detroit area, as well as Grand Rapids and Traverse City, Michigan. The credit union is a debit card issuer and currently services a card portfolio of approximately 50,000 debit cards. This letter is written in very strong opposition to the proposed Regulation II regarding debit interchange price controls. The reasons for the credit union's opposition are set forth below.

Time for Implementation

We strongly urge consideration and prudence when determining the implementation dates for the final regulation. Although the statutory language dictates implementation of interchange fee restrictions by July 21, 2010, we urge consideration of delaying final rule effective dates to assure that network operators and systems capabilities are in place and capable of compliance with any final rules. Clearly the legislation imposes significant and substantial changes to the payment system and it is critical for that system to continue to function efficiently and effectively. If additional time to assure compliance is required, we urge that such additional reasonable time be provided.

In addition to technological readiness for compliance are the fundamental questions related to fraud prevention and cost. The statutory mandate for the Board to consider an adjustment to interchange fees for fraud prevention must be part of any final regulation in order for the payment system to adjust to the new reality created by the statue and final regulatory framework. To leave this question unanswered and move ahead with implementation would create confusion and uncertainty in the market place and payment system. We strongly urge that any final regulation incorporate both components of the fee and that due consideration for time be given to assure that the statutory intent is met and the payment system will be capable of fully functioning.

Exemption is not an Exemption

The legislative intent of the exemption language for institutions with less than $10 billion was negotiated and inserted into the legislation to protect smaller issuers from the potentially significant negative impact on income from any cap on interchange fees. This exemption is designed to protect smaller institutions and to preserve their current interchange fee structure as a means of allowing them to continue to compete and provide debit card services to their cardholders, many of whom are the underbanked. It was and still is clear that significant differences in economies of scale between the largest issuers and the smaller issuers create substantially different cost structures both in on the transaction and on the fraud prevention sides of the business.

The exemption unfortunately is poorly drafted. However, we do not believe that poor legislative drafting should mean that the intent of the statute be ignored or that the Board ignores the realities of market forces on pricing. The failure on the part of the Board to address this issue with the creation of an interchange regulatory framework that will preserve the current fee structure for smaller institutions will result in significant financial harm to smaller institutions and the consumers and communities they serve.

We very strongly oppose any final regulation that does not more clearly address this issue and that does not recognize the reality of the ultimate impact of a two-tiered pricing system – one with price controls for the largest issuers and one without for the smaller issuers. We urge reconsideration of the manner in which the Board has proposed the treatment of smaller issuers under the $10 billion exemption.

Flawed Data

The methodology utilized by the Board to obtain data from issuers is flawed and does not acknowledge the reality of the under $10 billion asset "exemption." The proposed regulation arrives at issuer cost based upon survey data of institutions over $10 billion and ignores those issuers who fall below that category and are statutorily exempted from compliance.

The statutory exemption simply ignores the reality of market forces and the direct impact of the regulation on exempt issuers. The implementation of price controls and market setting fees by the Federal Reserve for larger issuers will assuredly drive market pricing downward on exempt institutions that have little or no market presence or leverage with merchants to negotiate pricing. Smaller institutions do not have the economies of scale and pricing leverage of the larger institutions in gaining access to, or participate in, the payment system. Thus costs are higher – costs that have not been considered in arriving at a reasonable and proportional cost for a substantial number of issuers. In the aggregate these smaller issuers are a large enough portion of total debit transactions and cardholders that to ignore them when imposing price controls makes that process arbitrary and the cap that has been set, severely flawed. The end result will be smaller institutions being harmed and barriers placed in their way to meet the needs of their customers/members and the communities they service.

We strongly urge the Board to consider the potential impact of the$10 billion exemption on the price controls is it implementing and determine whether it is appropriate for gathering of additional sufficient data on cost and pricing for smaller institutions. There must be, at a minimum, an acknowledgement that the final regulation in whatever form it takes, will ultimately impact exempted institutions.

Routing Proposal

Assuming a two-tiered pricing mechanism can be established and function properly the proposed regulatory requirements related to routing, we support "Alternative A." This option most closely tracks the legislation and is the least burdensome on issuers, especially smaller institutions. With no protection from the assured decline in interchange income the additional burden of providing access to more networks than required by the statute would be arbitrary.

Consumer Consideration

The proposed regulation fails to address what was clearly the legislative intent of the sponsor of the legislation, i.e. consumer protection. Senator Durbin's own statement regarding his amendment that is the underlying statutory authority for the proposed regulation makes this clear:

> "By requiring debit fees to be reasonable, and by cleaning up VISA's and MasterCard's worst abuses, small businesses **and their customers will be able to keep more of their own money."**[1]

It is incredulous that given this clear intent the proposed regulation indicates financial institutions who have higher proportional costs – i.e. smaller institutions, implement fees. The proposed regulation states:

> "The Board notes that even highest cost issuers have sources of revenue in addition to interchange fees, such as cardholder fees, to help cover their costs."

The rhetorical question must be asked with respect to the intent of the legislation to provide consumers with more of their own money and how that squares with the proposed regulation expressly indicating an increase in fees to consumers is a solution to the reduction in interchange income. To offer this solution clearly indicates that legislative intent is absent from the Board's consideration of the proposed regulation. We strongly urge that legislative intent for some form of consumer benefit resulting from the regulation becomes part of any final regulation. The current proposed rule is harmful to consumers, especially the underbanked.

We urge consideration of the definition of reasonable and proportional to incorporate the negative consequences of placing a limitation on the interchange fees that has a perverse and negative impact on the consumer account holder of the issuer. The "cost" incurred by the issuer specifically must relate to the consumer benefits (as well as those provided to merchants) provided by access to the most efficient payment system in the world. The cost of the transaction above that proposed in the regulation must consider the reasonableness of how consumers will be impacted by the regulation. The regulation is void of any such consideration and as a result fails to meet the Congressional intent that the legislation, in part, protects consumers and provides them with a financial benefit.

Credit Union ONE offers its members a cash back rewards program that provides its consumer-members with a real and tangible financial return for use of a debit card. This cash reward is funded by the interchange income received from transactions. We actually do what Senator Durbin's amendment purports to do, that is allow consumers to keep more of their money. In just over twelve months cardholders in this program have earned approximately $400,000.00 – that is real money going back into the pockets of consumers. It is a fiction that a merchant will now reduce prices because of lower interchange expenses. We highly doubt that a gallon of milk paid for with a debit card at Wal-Mart will be reduced upon implementation of the final regulation. It is not fiction that institutions offering cash back and other interchange funded checking programs that incent economic activity will either be

[1] Statement of Senator Dick Durbin, May 13, 2010 (emphasis added).

discontinued or significantly altered as a result. In the end the regulatory impact of a cap in interchange has a detrimental impact on consumers, which will be harmful and contrary to the legislative intent.

Credit Union ONE also offers its members a basic checking account. This account is designed to provide those who do not qualify (based upon certain risk characteristics) for our standard checking product. This product is targeted at the underbanked consumer and provides access to the debit payment system that otherwise is not available through traditional banks. Interchange income derived from this product has allowed the credit union to even consider offering a debit card and keep monthly maintenance fees within a range that makes the account affordable for the lower income and unbanked members. The impact of a significant reduction in interchange income will result in either eliminating this product altogether and thus cutting off access to much needed services to the underbanked population, or an increase in maintenance fees (as the Board has suggested) to those who can least afford such fees. The end result in either scenario is that the proposed regulation is anti-consumer and will have very serious consequences for the underbanked consumer.

The proposed regulation in its current form will result in a significant decrease in interchange income that will ultimately cause our institution to take action that will result in elimination of service or increase the cost of services to members. The control exerted over the market in such a punitive and arbitrary manner by this regulation will have consequences far beyond enriching large retailers and other merchants. It is truly unfortunate that a shortsighted and poorly drafted piece of legislation passed without hearing or debate may result in promulgation of an even more shortsighted and even more poorly drafted and conceived regulatory framework. Playing into the hands of anti-bank rhetoric is expected from Congress but not the Federal Reserve Board.

Fraud Prevention Issues

With respect to the Board specific questions regarding fraud-prevention costs, we reiterate earlier comments on the need for consideration of the impact of any final regulation on smaller institutions.

The issue of specifying fraud preventative measures by technology or some other methodology presents significant challenges and we believe there should be no such technology-specific standards with respect to an adjustment to the fee. The pace and breadth of technological advancement on all sides of the fraud equation – those attempting fraud and those attempting to prevent it – make it almost impossible for the Board to effectively maintain the regulation in concert with the market. In addition, non-technology costs such as human resources must be considered as part of the equation. As a smaller issuer we deploy both technology via our own internal systems as well as those provided by third party vendors and networks, and people who engage in monitoring and acting to prevent fraud – these are real and substantial costs incurred for the purpose of protecting cardholders and merchants that must be considered as part of the Congressional directive to include such costs in any regulation framework that limits fees.

The methodology to determine eligibility for reimbursement must consider current industry standards and the relative cost effectiveness of implementation of those standards in relation to risk presented to the issuer. Cost effectiveness will directly relate to the proportional cost of technology for the reimbursement. A technology that is capable of preventing fraud, but is not proportional to potential losses and is not supported by the fee an issuer can charge cannot be forced upon an issuer – as a result the Board must devise a system that allows for regular and individual determination of whether or not industry standards are met and the cost associated with such standards may be charged. When making such considerations it is critical that third party provider pricing of such systems and their availability as well as relative cost to smaller institutions are part of any final regulation related to this matter.

Further, the regulation must consider the impact of and costs related to fraud prevention on smaller issuers. Again, the relative cost effectiveness for a larger issuer to implement and provide its cardholders with fraud prevention in relation to smaller issuers is obvious, but no data has been gathered or analyzed to determine what those inequities are or how a regulation can be fashioned to minimize the impact on all issuers, especially exempted issuers. Current market standards related to the protection and maintenance of cardholder personal information and prevention of fraud are not based upon the asset size of the institution. Expectations from regulators, insurance/bond companies, and cardholders themselves are that the most effective measures are taken to prevent fraud. The cost associated with providing such protection is significantly higher on any proportional measure one wants to use when comparing a larger (more than $10 billion) issuer to a smaller issuer. Any final regulations considering the cost of fraud prevention must include provisions related to smaller issuers.

Conclusion

In its current form the proposed regulation is seriously flawed, incomplete and fails to address the statutory intent with respect to small institutions and consumers. We very strongly urge the Board to reconsider its proposal and that it address those issues we have raised in this letter. Thank you for the opportunity to comment on this proposed regulation.

Sincerely,

Gary A. Moody
President and Chief Executive Officer

cc: Honorable Carl Levin
Honorable Debbie Stabenow
Honorable Gary Peters
Honorable Sander Levin
Honorable Candice Miller
Honorable Hansen Clarke
Honorable John Conyers
Honorable Justin Amash
Honorable Dan Benishek
Credit Union National Association
Michigan Credit Union League