



February 4, 2010

Via Electronic Mail: [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)

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

Re: Debit Card Interchange Fees and Routing  
Docket No. R-1404

Dear Ms. Johnson,

This letter is written on behalf of Desert Schools Federal Credit Union (Desert Schools) in response to the call for comments regarding the regulation of debit fee interchange income, Federal Reserve Board Docket NO. R 1404. The very idea of regulating interchange income is of grave concern to the credit union, and we appreciate the opportunity to comment on the provisions currently under consideration.

Desert Schools is a \$2.8 billion, federally chartered and federally insured credit union serving more than 360,000 members and issuer of 240,000 Visa® debit cards. These cards generate more than five million transactions monthly as our members do business with a broad range of merchants within our community. Both consumers and merchants depend upon and benefit from these electronic transactions to conduct their business. Consumers rely upon the immediate access to their deposited funds, while merchants benefit from guaranteed payments and reduced labor and processing costs.

In support of our debit card program, Desert Schools incurs significant expense well beyond the transaction costs addressed in the legislation. These include, but are certainly not limited to, staffing to support member inquiries and problem resolution, Visa licensing fees, fraud prevention, intervention and losses as well as card issuing and maintenance. Interchange income covers these expenses and allows us to offer debit services to our members. Reduction in interchange income will have noticeable impact on our ability to continue to provide such services at no cost to our members.

The proposed rules impact two, distinct facets of the debit card process. First is the proposed cap on interchange income. Although issuers under \$10 billion in assets, including Desert Schools, are exempt from either of the proposed options to cap interchange fees, it is our belief that these protected, smaller issuers cannot help but be negatively impacted by such a cap. Our concerns regarding this provision include:

- The low level cap of no more than 12 cents per transaction (7 cents under the safe harbor) is of concern to Desert Schools because the cap ultimately may be applied to small issuers in the marketplace in spite of the exemption. The cap must be set high enough to take into account all costs associated maintaining a card program.
- Although Visa has indicated its intent to develop a two-tiered system for interchange, they cannot guarantee that the current interchange rate will prevail for the small issuers. In fact, economics seem to dictate that they will have to pass on to the small issuers part of the loss of income they will experience from the cap for large issuers. Therefore, a two-tier system is no guarantee for the small institutions.



- The lack of any enforcement mechanism for the exemption for small issuers fails to support the intent of the law which is to protect the smaller institutions.
- The control merchants will now have for routing transactions and offering discounts for certain payment methods could allow them to discourage the use of cards carrying higher interchange rates. In a two-tiered environment, this would unfairly favor the cards issued by the larger institutions.

The second provision of the rule calls for issuers to provide access through unaffiliated networks. Although we do have significant concerns about the costs this may incur, we urge adoption of Option A, which simply requires two unaffiliated networks. Our concerns include:

- Lack of protection from merchants refusing cards that do not access the lowest cost networks jeopardizes the acceptance of our cards at these merchants.
- Additional loss of interchange income is a potential as networks compete for business by reducing costs to merchants, therefore reducing income to issuers.
- The complexity of Option B which would require 4 networks per card, 2 for pinned transactions and 2 for signature transactions will result in added expense for all issuers. The cost for maintaining a relationship with one signature based network is huge. Adding a second could, conceivably, double that cost. Again, this would endanger the ability of a small institution to continue its debit card program without passing the increase in costs on to the consumers.
- Requiring more than two networks is inconsistent with statutory requirements and would place an unreasonable regulatory burden on our credit union that could negatively impact service to our members.

Additionally, we feel that the concerns of the smaller institutions can better be protected by including in the rule the exact language of the amendment (Electronic Fund Transfer Act Section 920(a)(1)). This would clearly cover the specific exemption and could provide further protection for smaller issues, as the law intended.

The result of the loss of interchange fee income and the costs of belonging to additional payment networks will have detrimental economic impacts on credit unions that will ultimately impact their ability to build net worth. Statutory requirements allow credit unions to build net worth (capital) only from retained earnings. Any significant reduction in interchange income will require higher fees paid by our members and consumers in general. Because debit cards have become an essential tool for consumers, not offering a debit card to our members is not an option. As proposed, the current regulation will come at a significant cost to our members and consumers in the marketplace.

Our comments in this letter have been directed at the rules presented by the Federal Reserve Board. We urge the Board to consider these concerns thoroughly. However, we do want to note that our issues with the law itself are many, and we will inform our representatives in Congress that the best course at the very least is significant revision and at the very best repeal. Thank you for your consideration.

Sincerely,

A handwritten signature in black ink that reads 'Susan C. Frank'.

Susan Frank  
President and Chief Executive Officer