

From: Cynthia Negri
Subject: Reg I I - Debit card Interchange

Comments:

Federal Reserve Board
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Dear Federal Reserve Board:

February 9, 2011

Re: Debit Card Interchange Fees

Dear Respected Members,

We have reviewed the Federal Reserve Board's proposed new Regulation II on Debit Card Interchange Fees and Routing. We are a state-chartered credit union with assets under \$10 billion, headquartered in Santa Rosa, California, just north of San Francisco. We serve eight counties, 185,000 Members and employ over 350 employees.

We offer our comments and grave concerns about the proposal under four key premises: the lack of process by which the amendment was passed; the impact of the network, routing and exclusivity provisions; the narrow definition of what is reasonable and proportional; and most importantly, our belief that the proposed rules will harm the consumer, and harm our organization and communities.

LACK OF ADEQUATE AND STANDARD PROCESS

Under standard process, prior to issuing a ruling, the Fed should have conducted hearings, debates and analysis on the impact of such a far-reaching amendment in order to understand impact and potential unintended consequences. It is clear the suggested 7 to 12-cent ceiling on debit interchange fails to take into account many critical factors, and that's why not adhering to a fair and reasonable process for analysis before issuing a ruling is inadequate and causing us significant concern. The fact is, the debit provisions adopted by the 111th Congress were never subject to public debate, hearings or independent review, and the vote was cast at the last minute. Changes of this magnitude should not be imposed without serious debate, analysis and study. We recommend the 112th Congress recognize this failure in due process and deficiency in adequate information, and issue a stay of the effective date of the Federal Reserve's rulemaking for at least two years. That will allow them to hold hearings and direct joint federal agencies to study the debit provisions' real impact, and take informed, appropriate and effective action as suggested by study results.

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NETWORK, ROUTING AND EXCLUSIVITY PROVISIONS

The proposed ruling is flawed on many levels and has the potential for consequences unintended by the amendment. We believe the original intent of the legislation included a desire to minimize impact to small issuers. Nothing in the proposed ruling provides any assurance and/or consequences for the establishment and sustainability of a true two-tier pricing network. And, regardless of a two-tier network, small issuers will be disadvantaged if the provisions on routing and exclusivity are not implemented properly and the retailers achieve full control of the debit transaction. Retailers could simply ignore our Members' choice of payment, and substitute one of their own, without the knowledge or permission of the Member. The technology and infrastructure necessary to support two PIN and two signature networks would be costly and burdensome for a small issuer. It is inconsistent with statutory requirements and would place an unreasonable regulatory burden on our Credit Union that could negatively impact service to our Members.

FAILURE TO ACHIEVE REASONABLE AND PROPORTIONAL STANDARD

The Federal Reserve's very narrow definition of what is "reasonable and proportional" has resulted in artificially low caps on debit interchange that do not reflect the true costs of running a secure, reliable and efficient debit network. The 12-cent cap does not include operational and fixed expenses that are incurred for fraud losses, fraud prevention costs, card issuance, network fees, overhead expenses, and data security for debit card transactions. These are substantial costs and 12 cents is not adequate to cover them. Our estimated expenses to cover our debit operations are more than double that per transaction. We do not want to be forced by this proposal to raise fees to our Members or reduce debit services. As a not-for-profit credit union, our mission is to serve our Members with affordable financial services and operate in their best interests. Responding to this ruling under its current proposal would force us to negatively impact our Members by burdening them with additional fees in order to pay for our debit program, and it would contradict our commitment to Members that we have spent the last 61 years building. Even the authors of the broader bill, retired Senator Christopher Dodd (D-CT) and Representative Barney Frank (D-MA), have said the Federal Reserve overreached. The Fed should consider all costs of operating a debit interchange system to the maximum extent allowable by law, including all fraud prevention costs such as the cost of new technology that reduces potential fraud, while also allowing issuers to gain some reasonable income from these programs so we may continue to extend these services to our Members.

HARM TO CONSUMERS, MEMBERS, ORGANIZATION AND COMMUNITY

The justification behind the proposal was seemingly that consumers would benefit by reduced merchandise costs, however there is absolutely no guarantee that any savings from merchants would be passed on to the consumer, and there is no defined method for monitoring this key item. In fact, according to respected industry analysts at Aite Group, under the proposed regulations, "there would be little in terms of actual savings for consumers." Simply put, there isn't any evidence that prices would be reduced for the already recession-weary consumer.

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Financial institutions, including our own, work to be efficient and

appropriately cover costs. If we are forced to run a debit card program in a deficit, other products and services will suffer, and perhaps be eliminated. Fewer service offerings equates to the need for fewer staff. A dramatic reduction in income can cause loss of jobs, added consumer fees, and fewer contributions to our communities and local charities that are desperately in need of support. The impact of this ruling can have devastating, rippling effects on our Members, communities and the economy. We are already seeing the demise of free checking, and at a time when consumers are trying to recover from the worst recession since the Great Depression, it is irresponsible to pass a ruling that will cause them to pay more for services they currently want and need.

Based on these four key deficiencies of the proposed ruling and the significantly negative impact, we urge the Fed to delay the effective date of their rulemaking for at least two years, hold hearings on and direct joint federal agencies to study the debit provisions' impact, and take appropriate and informed action only after true impacts and consequences are fully vetted.

In addition, between the two routing alternatives proposed, we urge the Feds to adopt "Alternative A." This alternative would only require issuers to provide debit cards that can be used over two unaffiliated networks, such as one PIN-based network and one unaffiliated signature-based network.

Should you have any questions or need further input on this critical proposed ruling, please contact me directly at 1 (800) 479-7928, ext. 5101.

Sincerely,

Cynthia Negri