From: Credit Union of America, Gary F Austin

Subject: Reg I I - Debit card Interchange

Comments:

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Proposal: Regulation II - Debit Card Interchange Fees and Routing
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Name: Gary F Austin
Affiliation: Credit Union of America
Category of Affiliation: Commercial
Address:

City:
State:
Country: UNITED STATES
Zip:
PostalCode:

Comments:
February 18, 2010 Mr. Ben Bernanke Federal Reserve Board 20th Street and Constitution Ave, NW Washington, DC, 20551 Dear Chairman Bernanke: I am writing on behalf of Credit Union of America and over 37,000 of our members in response to the Federal Reserve Board of Directors' request for comment on the proposed debit card interchange regulations (Docket No. R-1404). Credit Union of America is a $350+ Million credit union headquartered in Wichita, Kansas. Although we have been classified as an "exempt" financial institution according to the Durbin Amendment, we fear the unintended consequences of the amendment and your proposed regulations, if left unchanged, will permanently harm the credit union industry, Credit Union of America, and our members. In the following paragraphs, I will try to address all the points on which you have asked for comment. In the way of a general comment, let me start by saying that additional time is needed before implementation to avoid disruption to consumers, financial institutions, and the payment networks. The network exclusivity rule in particular would require, depending on whether option A or B is chosen, one to three years to implement. Regarding the $10 billion exemption, Visa has indicated they will support a two tier network with some important caveats. The implementation will be costly and involve complex coding and ongoing maintenance to ensure the proper rates are being charged to the exempt and non exempt institutions. Visa, Star, Pulse and others stated that they reserve the right to re-price their fees and the interchange rates for exempt issuers according to market forces. The large issuers are also major stockholders in Visa. The inevitable result will be pressure to minimize the difference in pricing between the tiers. As a solution, the board should require the networks to maintain two tiers with a materially higher rate for small issuers after factoring in costs, fees, and the charges paid by the exempt
issuers. You should prohibit merchants from discriminating against exempt

issuers, prohibit them from steering consumers to other cards or payment systems, and prohibit charges to consumers for using small issuers' cards. Most importantly, you should establish stiff penalties that merchants would incur for engaging in prohibited practices. As you know, the amendment was deficient in this regard. Without enforcement, the exemption is meaningless. We are not convinced that the regulations as presented will result in any consumer benefit. We believe it likely that it will actually be harmful to consumers in the long run. The rule as written merely transfers revenue from the issuer to the merchant. As your own study found, similar regulations in Australia and elsewhere have not helped the consumer as the big box retailers kept the increased revenue as profit and did not lower prices. To replace the interchange revenue that supports debit card operations and funds other member services,
Credit Union of America, will likely have to raise prices on other services and begin charging for "free" checking. Bank of America and other large banks have already announced their intentions to increase fees and prices. Smaller credit unions and community banks are very dependent on fee income to maintain profitability. The loss of interchange revenue combined with the earlier restrictions on NSF/OD income will restrict their ability to serve their members and may accelerate the trend to consolidation. In turn, this will reduce consumer choice and raise unemployment as the surviving institution cuts excess employees. How does this benefit consumers? How does this benefit anyone but the merchant? Regarding three party networks, we feel that American Express, Discover, PayPal, et al. should definitely be included. Since these issuers also function as the merchant acquirer there is not an explicit interchange fee, but the fee's equivalent is "baked in" - buried in the switch fees,
merchant discount, and other charges to the merchant. The Fed should prevent three party networks from circumventing the intent of the regulation and prevent the possibility of an unfair advantage. Your current proposal only allows consideration of authorization, settlement, and clearing costs, but ignores all other costs associated with providing debit cards. If the intent of the amendment is to treat issuers like a utility, please remember that even regulated utilities are allowed a reasonable rate of return and $0.12 per transaction doesn't begin to cover those costs. Other factors that should be considered include the following: Overhead including the cost of phone calls, IVR systems, call center employee salaries Plastics, including shipping, embossing, encoding, security, encryption, postage Issuance expense, such as activation, PIN encryption, maintenance of unique BINS, and rewards Exception processing, charge backs, disputes, and arbitration Fraud - oth actual and prevention expense, skimming, phishing, merchant breaches, and other compromises - the majority of card compromises have been caused by poor security practices at merchants and their processors, yet they are largely insulated from the losses they cause Compliance with PCI mandates, card technical specifications, international transaction support Technology advances like chip enabled cards (EMV), triple DES encryption, dynamic keys Payment infrastructure such as membership to the various payment networks, the merchant processors, core processor, card processors, and Internet Your proposed rates also fail to account for the value of debit cards to the consumer and the merchants. The consumer is freed from having to carry cash or check book and the merchant is guaranteed payment. The merchant usually benefits from increased sales and does not have the expense of purchasing, counting, securing or transporting cash or checks. The statutory language of the amendment is flawed in that
it says the Board is required to consider debit cards as the functional equivalent of checks, but the function dissimilarity should be considered as

well. The merchant is guaranteed payment - unlike checks. The card payment system is funded solely by voluntary users of the system. The debit card and electronic payment networks are under constant development, renewal and innovation unlike the paper check which is a mature and rapidly declining payment method. We would also argue that the Board did not get sufficient cost data in their study since only the largest issuers were surveyed. Smaller issuers typically have higher operating costs. If we are correct and despite the promise of an exemption our interchange rates are lowered by market or political pressure, your study should include costs of CUs and community banks when setting rate caps. You also asked for comment on how to monitor interchange rate compliance. By virtue of their place in the payment chain, the networks (Visa,
Star, et al.) are in the best position to certify compliance with the regulated rates. This would also simplify reporting since there are far fewer points to collect data from than asking each financial institution to provide the data.
As mentioned in the beginning of this letter the requirement for network exclusivity will be complicated to implement. Agreements must be negotiated, coding done, testing, ATM configuration, cards reissued, consumers educated and marketed to before adoption. Alternative A, or the "1+1" solution, would appear to meet the intentions of the regulation. While it is still complex, it would be much easier and cost effective to implement than Alternative B. The management of Credit Union of America understands that the Federal Reserve Board has been given the task of implementing a flawed piece of legislation that was rushed through without proper hearings or study before it was signed into law. We respectfully ask that you take our comments into consideration before you issue your final rule. In the interests of avoiding the unintended consequences likely if this rule is implemented prematurely, we further ask that you press for delay of at least one year and preferably more to allow time for more study before you publish your final rule. Sincerely,
Gary F. Austin - Credit Union of America