Inland Empire
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February 22, 2011

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

Re: Proposed New Regulation II, Debit Card Interchange Fees and Routing Docket No. R-1404

Dear Federal Reserve Board:

I am writing this letter on behalf of Inland Empire Credit Union, a $37 million Credit Union. We have 2,500 checking accounts and are roughly 80% penetrated for debit cards. Annually we have generated approximately $136,000 from interchange fees. If the interchange fee rule is adopted at the "Alternative Two" level, allowing a cap of $.12 per debit card transaction, the fee income will be reduced to roughly $32,000.

I don't feel it is necessary to delve into the entire discussion on the benefits of the interchange fee other than to say, it, the process of the payment systems brings substantial benefits to consumers, merchants and financial institutions. The consumer receives value through the convenient access to their checking account; the merchant receives guaranteed, expedited payment through the system, eliminating the risk of transacting with cash or check; and finally, the financial institution or card issuer receives an interchange fee which reimburses the card issuer for a portion of the cost they incur. The portion is due to the fact that the financial institution assumes all of the risk (fraud, loss of data from merchant security failures, etc.) much of which is in the direct control of the merchant. To this point today, it has been a win-win-win proposition for all parties; consumers, merchants and financial institutions.

The interchange fee has been an agreed upon condition of accepting debit cards by merchants, contractually negotiated for the benefit of both the merchant and the financial institution. To have this agreement newly regulated to the benefit of the merchant suggests government intrusion to restrict financial institutions from the opportunity to make a profit from any endeavor. It should be reasonable to expect to make a margin from this or any product or service provided to the market. To have government requiring the operation of a program at a loss is objectionable and fails the safety and soundness test that the regulators rightly insist upon. Changing the rules of long agreed-upon agreements in order to choose winners and losers should not be in the purview of legislators.

The proposed rule, as anticipated to be implemented, renders the small issuer exemption virtually meaningless. Even though small issuers have been assured that this will not impact them, as recently as this week in testimony by Fed Chairman Bernanke he stated that likely this would not be a workable solution, meaning that small issuers that were to be protected by the legislation will not be! Just as the interpretation of what the Fed defines the basis for the fee to be charged should be, we feel it is equally your challenge to implement this guidance so it does not impact the small issuer as clearly defined by the legislation.

So what are the implications for Inland Empire Credit Union and other small issuers (less than $10 billion)? The organization will change a service, interchange fee, from one that generally covers expenses of the program and makes a small margin, to one that loses money. This will be despite the exemption and Congressional pledges to the contrary. As proposed, the amount of interchange income earned will decrease substantially, in our estimate by $104,000 or 76% of the previous income. Depending on the final guidance implemented this could be even more.

The $104,000 is equivalent to 28 basis points (bps) of average assets.

Inland Empire Credit Union has been designated a Low Income Credit Union (LICU) by NCUA. This means that over half the membership meets the regulatory definition of low-income member. Providing service to this membership is financially very challenging. The membership will be seriously impacted by the eventual implications of this legislation. As our name Inland Empire Credit Union implies, we provide financial services to nine communities within the Inland Empire of Southern California. This area and consequently the membership have been severely impacted by the Great Recession. With construction and real estate, being two of the primary employment sectors, the membership and consequently the Credit Union has "taken it on the chin." We anticipate three to five years before the economy in this area recovers back to its former vibrancy. The Credit Union nor the membership, were not part of the cause of the significant downturn in the economy. Now both will be impacted by the interchange fee fix, when they can least afford it. The Dodd-Frank Act was meant to focus on large financial institutions that were grossly profiting from consumers. However, the proposed implementation of the Durbin Amendment will severely impact these exact consumers the legislation was proposed to remedy.

Finally, and most importantly, is the negative impact the Amendment will have on our members and consumers in general. Going forward, NCUA, the regulator, will insist credit unions maintain adequate net income levels and consequently net worth levels to avoid Prompt Corrective Action. The loss of 28 bps of net income will have a depressing impact on this activity.

To think that merchants will return any portion of the interchange fee to the consumer is nonsensical. This same effort of reducing the interchange fee in other countries has occurred and nowhere has the consumer benefitted. In fact, just the opposite is true and is even occurring today. The consumer will continue to pay the same amount for their purchases. Additionally, financial institutions will need to make up for this shortfall. How will they do it - through new fees. In a *Wall Street Journal* article from this weekend (Feb. 19-20, 2011), under the headline, "Checking Isn't Free At More Branches", the following is the lead paragraph:

> "The nation's largest banks are testing how much their customers are willing to pay for checking account services that used to be free."

Having observed bank pricing for the 19 years of my career in credit unions, I fully expect the cost to the consumer for this previously free service will be $100 to $150 annually. Additionally, other fees will be implemented such as an annual debit card fee and/or a debit card transaction fee for the use of a card. Another venue would be to increase fees on the nonsufficient funds (NSF)/overdraft protection fees. Not only are these fees egregious, but they will impact much more often on the low income consumer, who can least afford it. Large financial institution will and are implementing these fees today, exempting more wealthy consumers who can maintain a relationship (high balances) with the financial institution. So to summarize, the low income consumer who can least afford it, will be paying the merchant the same price for goods and services and then paying their financial institution additional fees for their lack of relationship.

Inland Empire is a credit union and like many of our brethren cooperatives, we will do everything possible to not charge the additional checking and debit card fees. We are different, in that we provide our products and services to benefit the member/owners of the Credit Union. Having said that, the anticipated 28 bps shortfall of net income from the implementation of the interchange fee will be a challenge to face.

Solutions

1. It is imperative that this legislation is reviewed again by Congress. The unintended consequences for small financial institutions and consumers is too great to not ensure there is a viable work around so that the legislation does not impact them.
2. Once it is reviewed by Congress, they should direct the Board to begin the rulemaking process again taking into consideration the results of the treasury study and the operational impact of the regulation on all issuers; and to set standards for a rate which is reasonable and proportional to the full costs and risks of transaction.

Thank you for your consideration of this matter.

Rick Hoffman
President/CEO