

From: Coastal Federal Credit Union, Larry T. Wilson
Subject: Reg I I - Debit card Interchange

Comments:

February 22, 2011

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

Re: Docket No. R-1404, Proposed Rule for Debit Interchange Fees and Routing

Dear Secretary Johnson:

On behalf of Coastal Federal Credit Union and the 190,000 members that we serve and represent, thank you for the opportunity to comment on the Federal Reserve Board's proposed rules on the implementation of Section 1075 of the Dodd-Frank Wall Street Reform Act.

We recognize the complexity of the Board's task of writing rules to govern a system as intricate as the card payment system. However, we believe that there are two primary flaws in the proposed rules - (1), lack of enforcement to ensure the establishment and maintenance of a two-tier network to protect exempt institutions and (2) inadequate consideration for the true costs associated with debit card programs when establishing the interchange rate.

Lack of Enforcement for Exempt Institutions

The Act provides an exemption from the Board-established interchange rate for issuers under \$10 billion in assets and provides the Board with the authority to "prescribe regulations. to prevent circumvention or evasion" of the Act. We believe that, when considered together, this demonstrates that Congress provided the Board with the authority to ensure the establishment of a functional two-tiered system that protects the ability of small card-issuing institutions to continue to recoup the costs of offering card programs to our members.

At \$1.9 billion in assets, Coastal technically falls within the category that is covered in the exemption clause. However, without specific action from the Board directing them to do so, we have little reason to believe that card networks will have any incentive to offer two rate tiers. Likewise, because the provision affords merchants the opportunity to steer consumers to lower-rate cards and because, even with a two-tier system, market conditions would force smaller institutions to compete with the lower rate dictated to larger institutions, we fully expect a de facto limit to our rates, as well.

Chairman Bernanke himself has expressed doubt over the viability of a two-tiered system and acknowledged that small issuers like Coastal may either be forced to accept the same limitations placed on larger issuers, or risk having merchants turn away our members at the point of sale. He is quoted by the Credit Union Journal as saying in his testimony before the Senate Banking Committee on February 17, "It is possible that because merchants will reject more expensive cards from smaller institutions or because networks will not be

willing to differentiate the interchange fee for issuers of different sizes, it is possible that the exemption will not be effective in the marketplace."

Therefore, it our belief that this rule, despite the intent of Congress, would be severely detrimental to our own card program and could be devastating to many smaller institutions.

Inadequate Consideration for the True Costs of Transactions

From 2009 to 2010, Coastal saw the total volume of debit card transactions increase from 15.9 million to 17.6 million and forecast that to rise this year, all at no direct cost to our members.

Providing debit card services encompasses far more than just the cost of transmitting information between merchants and issuers. In 2010, Coastal's direct third party costs of merely processing signature transactions was 15 cents per transaction - far above the proposed 12 cents per transaction cap - without factoring in any of the back-office staff and systems necessary to properly support a card program and the underlying transactional accounts.

Among these, is the cost of fraud protection. Under the current system, issuers like Coastal bear nearly all of burden of preventing and insuring against losses, allowing merchants and consumers the confidence of utilizing the system with little or no liability for fraud. Yet, the majority of fraud losses are tied to merchant or processor breaches, while the balance is related to individuals having their cards lost, stolen or skimmed. We bear the cost of these losses, but have never caused them.

We find it unfair to move forward with enactment of this rule without further consideration for the true costs associated with providing debit card services.

Conclusion

We provide debit card services that are mutually desired by consumers and merchants alike and that offer convenience and security to consumers while being cost-effective and financially beneficial to merchants. Under the current system, merchants share most of the costs and reap all of the financial benefits. Under the anticipated changes, financial institutions like Coastal will be forced to shift much of those costs onto consumers, while there is no indication that merchants will share those costs savings with their customers.

Based on the proposed rule, we project a \$5 million annual shortfall in our debit card program. To put that into perspective, that would wipe out nearly a third of our projected net income for 2011. In order to account for that lost revenue, Coastal will have to shift the burden of providing a debit card system onto consumers, and will likely have to begin charging members a monthly service fee to have and use a debit card. We estimate having to charge members with checking accounts a fee of up to \$8.50 per month.

Because of these points, we believe that this is bad legislation that was passed without proper study to determine the true costs, benefits and consequences.

In conclusion, we urge the Board and Congress to reconsider this legislation or delay its enactment until further consideration may be given to degree to which it will be harmful to consumers and small financial institutions.

Thank you for the opportunity to comment on this matter.

Respectfully,

Larry T. Wilson,
Coastal Federal Credit Union

cc: Senator Richard Burr
 Senator Kay Hagan
Representative G.K. Butterfield
Representative Howard Coble
Representative Renee Ellmers
Representative Virginia Foxx
Representative Walter Jones
Representative Larry Kissell
Representative Patrick McHenry
Representative Mike McIntyre
Representative Brad Miller
Representative Sue Myrick
Representative David Price
Representative Heath Shuler
Representative Mel Watt
Credit Union National Association
National Association of Federal Credit Unions
North Carolina Credit Union League