

From: Virginia Credit Union, Inc., Beverley Rutherford
Subject: Reg I I - Debit card Interchange

Comments:

Thank you for the opportunity to comment on the Federal Reserve Board's (FRB) proposal regarding regulation of debit interchange fee income and debit card routing under the Dodd-Frank Act.

I am responding on behalf of a state chartered credit union located in Virginia with more than \$2 billion in assets and over 200,000 members. Approximately 120,000 of our members have our debit card that enables them to enjoy free or low cost access to their accounts.

In summary, we are extremely concerned with the proposal and its impact on our members. Consequently, we oppose all aspects of the proposal. The proposed changes and regulation of debit interchange income is a complex issue, one that requires thorough analysis and evaluation of the far reaching effects it will have. As the nation faces continued high unemployment and a slow recovery, we question the wisdom of implementing such costly regulation so swiftly without proper evaluation of its impact. We urge the FRB to use their authority to postpone acting upon these rules until a more thorough investigation and analysis of its impact can be determined.

While we acknowledge within the proposal there is an exemption from the interchange fee rate setting limitations for issuers with assets under \$10 billion, nonetheless we anticipate it will have a significant impact on our ability to provide services in an affordable manner to our members. The income derived from interchange fees supports our members with low balances, which comprise a large percentage of our membership. These members have been able to enjoy free or low cost services. If this proposal is passed, it may force these members to more expensive financial services as we and other institutions may have to increase fees for basic services to compensate for the lost income. Further, with the other legislation passed and implemented over the last couple of years (such as the Credit CARD Act of 2009), all members are already feeling the effects of the increased regulatory burden and compliance costs. Financial institutions like ours are faced with tough decisions about how to serve our members while maintaining capital and other financial requirements amidst the growing regulatory burden and compliance costs and reductions in revenue.

Should the FRB choose not to withdraw the proposal in its entirety, we have the following comments and concerns:

We have doubts that the small issuer exemption will protect us as intended. While a two-tiered system is expected to be developed and maintained by the payment card networks, it remains to be seen how it will be maintained, at what cost, and whether it will protect small issuers from the lower fees that will be applied for larger issuers. Further, while we expect it to be developed, there are no regulations that require it. We urge the FRB to use its oversight and authority to ensure that smaller issuers are protected. The FRB asks for comments on how the small issuer exemption should be determined and if each network should develop its own method. We disagree that each network should be responsible for this. It would be burdensome to credit unions (and others) to have to report this in a different way to each network

it is involved in. There should be a standard reporting mechanism that is very simple. In addition, there are so many institutions that are so far below the limit, it does not make sense for this to have to be reported annually in order to retain the exemption. The exemption should remain in place until you inform the network otherwise.

We are concerned that even with a two-tiered system, there are debit routing and exclusivity provisions which will apply to all debit card issuers regardless of asset size. If we had to choose between the two alternatives for network routing, our preference would be "Alternative A" because we perceive the cost of this alternative and its impact on our membership to be less than the other alternative. However, even if Alternative A is adopted, we are concerned that without appropriate enforcement, merchants will steer transactions toward large issuers operating under lower interchange fees. With merchants choosing the payment network, they will naturally use the lowest cost network, ultimately negatively impacting smaller issuers.

We are very concerned about the proposed debit interchange rates. We estimate a potential 15-20% reduction in non-interest income if this proposal goes forward. Currently, we use non-interest income to provide free or low cost services to low balance members, many of whom reside in communities that are underserved by traditional banks. These are the very members who rely on their credit union for affordable financial services. If this income stream is reduced as estimated, these members will pay more for their financial services. Further, all members will feel the impact as our ability to expand products and other services is curtailed. We do not believe this was the intent of Congress when this legislation was passed.

We believe the FRB should take into account the true cost of administering a debit card program and re-evaluate its interpretation of "reasonable and proportional." Reasonable and proportional does not mean exactly equal to cost, so we feel that there is still room based on statute to include costs other than authorization, clearing and settlement. The costs of preventing fraud and protecting members who experience card fraud have not been considered in the proposed limits. In our credit union (as in other financial institutions) we employ various tools to minimize the impact of debit card fraud to individual members and the overall membership. The resources it takes for software, labor and other operational costs is significant and it is essential that the cost of such resources is included to get an accurate picture of the true cost of debit card programs. There are numerous other functions as well that are critical to operating a debit card program including member service, card production, etc. Any businessman (merchants included) should agree that pricing must include the full costs of an item plus a reasonable markup for profit. Additionally, other overhead of the business must be covered by products and services if an entity plans to stay in business.

As the FRB points out, the statute instructs them to compare the debit card transaction to a check and it is also prohibited from including fraud losses in the fraud prevention costs. We would argue that the fraud losses and other losses are specific costs incremental to the authorization, clearing and settlement of the debit card transaction. These costs result from the settlement of a transaction that either was not legitimate or had some other reason for not completing in the proper manner. In the case of a check, this transaction would be returned to the merchant with the merchant taking full responsibility for the amount. In the case of debit cards, this is borne by the financial institution and should be recoverable through interchange.

The FRB proposed two alternatives for determining the interchange fees. While we do not support the absolute value of the 12 cents proposed, we feel that the structure proposed in Alternative B is superior to Alternative A because it is

less complex. It would be burdensome for smaller institutions in particular to keep up with allowable costs and supporting documentation. While it may seem easy and basic on the surface, billings received from networks do not necessarily break down costs in the same way. It can also be complicated to make sure that the appropriate costs are matched up with the same time period of transactions.

We are very much concerned that there appears to be no oversight to ensure that savings to the consumer -- the stated intent of this proposal -- is achieved.

What is to keep merchants from realizing increased profits, rather than passing savings on to consumers? How would you even measure this as merchants are constantly changing pricing and strategies to maximize their own profits?

Merchants are in an enviable position: They enjoy the savings and convenience debit card payment options provide (as opposed to paper checks and cash that add to their operating cost) while card issuers incur most of the other costs such as fraud protection and producing cards. Interchange income has served to offset the legitimate costs incurred by the issuers, but this proposal puts that relationship in jeopardy.

The FRB asks if ATM transactions should also be covered under the proposed rule. We feel that inclusion of these transactions would be completely overstepping as they are not mentioned at all in the legislation and are completely different. There is no product being purchased by the consumer, and it is more of a privilege of being able to use another institution's machine.

While not always, many ATM transactions are between financial institutions and this system has been in place and working for many years. There is no need to "fix" it. As far as allowing the acquiring institution to route the transaction as it desires, there is not a need for this. The acquirer already has the ability to charge a surcharge to the consumer on top of the fee it is receiving from the network (issuer). The acquirer is the one receiving all the income; they should not be in the driver's seat to determine which network the issuer must pay.

Thank you again for allowing us to voice our concerns with this proposal. Should you have any questions about our comments, feel free to contact me.

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