From: Community Financial Credit Union, Greg Hill

Subject: Reg I I - Debit card Interchange

Comments:

TO: Federal Reserve Board

RE: Comment regarding Debit Card Interchange Proposed Regulation.

After viewing the Federal Reserve Board meeting in which staff proposed new debit card interchange fee and routing regulation, I became very concerned that the law of unintended consequences was about to become reality for the thousands of financial institutions who were supposedly going to be "exempted" from this regulation. It was clear that staff had no proposal or answers as to how the Fed would actually enforce, let alone implement this rule.

This proposal should be completely scrapped and The Federal Reserve Board should request that congress either repeal the law as written or re-write it to better reflect the intent. Unless the Fed can guarantee that the exemption for small issuers will apply and be enforced, there is no way to actually implement this rule as the legislators intended.

If the proposal does go forward as proposed, the impact on our members will be significant. Reducing interchange income to a fixed price per transaction is not a reasonable method for charging merchants for the costs and risks wholly incurred by the card issuing financial institution. The variable percentage based pricing currently in existence allows the networks and institutions to risk price various merchants more appropriately. It might be feasible to create a hybrid model where a fixed price per transaction is charged and then networks and issuers could surcharge a percentage fee based on potential fraud risks based on merchant types.

The actual per transaction rate proposed for "reasonable and proportional" costs is much too low. My credit union is small with $120 million in assets and approximately 7,000 demand accounts with active debit cards. See below for how the effective rate of $.12 per transaction would affect our membership.

Current costs per transaction: $.25 - includes authorization, processing and support/settlement and fraud prevention detection

This does not include fraud losses / staff / overhead or issuing costs

Number of transactions annually: 1,380,000

Current revenue per transaction: $.49 - average interchange assuming $35.50 average transaction

Based on the $.12 per transaction limit, our revenue would be reduced by about $72 per demand account. We would realistically need to recoup virtually all of this lost revenue by increasing fees for all accounts by approximately $6 per month. The other option would be to incent members to NOT use their debit cards as the credit union would experience a loss of approximately $.20 per transaction. This creates a perverse incentive to push our members back to cash transactions which I would assume no one would in congress or at the Fed would support.

It is interesting that the Federal government is attempting to regulate a price on a completely VOLUNTARY service for merchants. They are not required to accept any debit or credit cards. They CHOOSE to accept these cards because of the benefits for them such as faster, guaranteed settlement, virtually no fraud costs and lesser bank depository fees.

The other portion of this proposal will be just as difficult for a small issuer to comply with. Even if a two-tiered system is setup and works in practice, smaller issuers will be disadvantaged if the provisions on routing and exclusivity that allow merchants to choose how debit card transactions are processed are not implemented properly. Requiring multiple networks will not only increase costs for all issuers, it will also provide more cover for merchants to not accept certain cards. I believe it is safe to say that regardless of the cost, we would not retain many of our members if they cannot use our cards to perform transactions at merchants who refuse to pay the "higher" tier cost.

Again, I was very nervous after listening to the meeting in which staff had no answers about how to solve the two-tiered system and they even stated that it was unlikely to be able to do anything about it. Based on that fact, it would be reckless to finalize this proposal in its current form. It would put thousands of credit unions and banks in a perilous earnings position and have significant negative effects on consumers as they will be forced to pay more for basic banking services. This will likely force even more of these consumers into the unbanked population.

By my math, merchants would save approximately $.30-.40 on each average transaction of $35. Does anyone actually believe they will lower prices by the corresponding amounts? I have not heard about any merchant publicly stating that yet. I just read an article regarding the letter sent to the Federal Reserve from a bipartisan group of senators stating they now believe this is not a good idea. I would hope they will act to repeal this provision of the Dodd-Frank Act. If they do not, I would urge the Federal Reserve to formally request they do so as your current proposal will cause significant issues for financial institutions and consumers in the short-term and unknown unintended consequences into the future.

Sincerely,

Greg Hill
Community Financial Credit Union

Cc: Senator Michael Bennet
Senator Mark Udall
Congressman Ed Perlmutter
Congressman Jared Polis