February 22, 2011

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave NW
Washington, DC 20551

RE: Regulation II - Debit Card Interchange Fees and Routing [R-1404]

Dear Chairman Bernanke:

On behalf of the NASA Federal Credit Union, its board of directors, and the 75,000 consumers and small businesses we serve nationwide, thank you for the opportunity to comment on the Board's proposal to regulate interchange fees and debit card routing, as required by the Dodd-Frank Act. We recognize and appreciate the difficult task given to Board staff to develop regulations to implement the interchange amendment, especially given the scope and complexity of this issue, the need to address a statutory exemption for small issuers, and the short implementation timeframe mandated by the Act.

Unfortunately, the proposal confirms our worst fears about the inadequacies of the purported protection for small issuers, like NASA Federal Credit Union, found in the Interchange Amendment. Until our major concerns outlined here are fully addressed, we would hope that the Fed would delay implementation.

10 billion exemption must be maintained and enforced. We are concerned that the proposal does not include provisions to enforce the small issuer exemption. We urge the Fed to use its authority to reinforce the small issuer exemption and ensure that it works as Congress intended. As you testified before the Senate Banking Committee earlier this month, there are two reasons why exemption might not work: merchants may reject cards and networks won't set up a two-tiered system.

Merchants may ultimately discourage the acceptance of higher interchange cards issued by exempt issuers. How the enforcement of the exemption will work is not yet known, but we urge the Board to adopt regulations detailing the enforcement of the exemption and also requiring that networks enforce the exemption under their network rules.

Even if a two-tiered system is permitted and works in practice, small 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.

We urge the Board to issue regulations that:

- require the networks to maintain a two tier interchange system at no charge to small issuers, with a requirement that the higher tier offer exempt issuers a materially higher effective rate of interchange after factoring in the network costs fees and charges paid by the exempt issuers;

- prohibit merchants from discriminating against exempt issuers either individually or as a group, by either steering consumers to other cards or payment forms, charging consumers for using small issuer cards, or refusing to accept small issuer cards, and

- establish penalties that merchants would incur for such prohibited activities.

Interchange rates need to be set at levels that balance the benefits and costs to both issuers and merchants. Any regulation of electronic debit transactions should retain and promote the economic viability of these transactions. Debit card issuers must make significant investments in their debit card operations. The costs should include a reasonable rate of return on the issuer's investments. If these investments do not yield a market rate of return, then over time the funds will simply not be available for investment.

The current proposal takes into account only three elements of interchange: authorization, settlement and clearing costs and has priced the transaction at 12 cents. These are incremental costs related to interchange. There are, however, comprehensive costs that haven't been fully recognized as part of the proposal.

Although these incremental costs define the actual function of a debit transaction, there are many other additional, comprehensive costs that allow a card transaction to be executed and are necessary for a debit program to exist in the first place, without which there would be no transactions. It is these comprehensive costs that will directly affect NASA Federal Credit Union. We believe that all of the factors should be reviewed and included in defining the interchange rate, including the cost of:

- Overhead - to manage card infrastructure which includes phone calls, IVR systems, call center employee salaries

- Plastic - to include Shipping/Embossing/Encoding/Security of Encryption/Reissuance

- Issuance - Activation, PIN encryption, Unique bins and varied debit programs

- Exception processing - chargeback, disputes and arbitration

- Fraud - Prevention and losses, Skimming, Phishing, Merchant breaches and compromises

- Compliance - PCI mandates, card technical specifications, international transaction support

- Technology - 64 bit keys, Dynamic Key, Chip (EMV), Triple Des Authentication, support for ISO 8583 specifications

- Payment Infrastructure - Association, Payment networks, Merchant processors, Core processors, Internet, Card processors

- Going green - Card life is 2-3 years versus Paper—Checks.

Exclusion of any of the line items could be prohibitive to maintaining solvency of NASA Federal Credit Union's debit card program for its members.

It is our opinion that the Federal Reserve did not get sufficient cost data by surveying only the covered issuers. Community financial institutions, such as NASA Federal Credit Union, will typically have higher operating costs than large national banks. Because the lowering of interchange rates will impact all debit card issuers, the Federal Reserve also needs to take the costs of credit unions and community banks into consideration when setting rate caps.

Proposed interchange structure will likely cost consumers more. NASA Federal Credit Union does not want to charge its members more fees. However, the result of the loss of interchange fee income for small issuers, and the costs of having to belong to more payment networks, will have negative impact on credit unions, like NASA Federal, that offer debit cards and their ability to build net worth.

Because of statutory requirements, credit unions can only build net worth (capital) from retained earnings. Any significant reduction in interchange income will likely require higher fees paid by consumers. Thus, consumers will be left paying for the financial break to merchants, which is not what Congress intended.

Moreover, we have returned millions of dollars to our members in the form of low loan rates and high deposit rates. The rule would not only prevent us from returning profit to our members in the future but would also cause us to search for alternate sources of revenue from them.

Delaying implementation is in consumers' best interests. We are hopeful that the Board, in issuing final regulations, intends to provide the framework to help ensure that smaller issuers, like NASA Federal Credit Union, are competing on a level playing field with the big banks. The goal of our credit union is to continue to participate in the industry while working to minimize cost increases and reduction of services to our members. We respectfully request that the Board delay implementation until legislation or other appropriate remedies address the key concerns outlined above.

Thank you for your consideration of our concerns.

Sincerely,

Doug Allman
President and CEO
NASA Federal Credit Union