From: Eli Lilly Federal Credit Union, Joseph R Hasto

Subject: Reg I I - Debit card Interchange

Comments:

Date: Feb 22, 2011

Proposal: Regulation II - Debit Card Interchange Fees and Routing
Document ID: R-1404
Document Version: 1
Release Date: 12/16/2010
Name: Joseph R Hasto
Affiliation: Eli Lilly Federal Credit Union
Category of Affiliation: Commercial
Address:
City:
State:
Country: UNITED STATES
Zip:
PostalCode:

Comments:
February 22, 2011 Joseph R. Hasto Eli Lilly Federal Credit Union 225 S. East Street, #300 Indianapolis, IN 46202 The Honorable Ben S. Bernanke, Chairman Board of Governors of the Federal Reserve System 20th Street and Constitution Avenue, NW Washington, DC 20551 Dear Chairman Bernanke, I am writing this letter regarding the debit card interchange amendment included in the Dodd-Frank Bill passed by Congress last July. My institution, Eli Lilly Federal Credit Union, has approximately $920 million in assets, and would be considered a small issuer in this discussion. The changes being proposed by legislators will have a detrimental effect on both small issuers and consumers, in general, as it is currently written. Card issuers provide a valuable service to our members in that we help to provide a very easy, efficient form of payment for goods and services. This process also works well for the retailers due to the efficiency of the payment system. The merchant is paid quickly for debit card transactions with an associated cost paid to all of the players within the process. The current process is not broken. A two-tiered system was proposed, where the large issuers will have a lower interchange rate than the small issuers. While nearly all credit unions are theoretically exempt from the two tiered system (over $10 billion and under $10 billion), there are reasons to be concerned. 1. The two-tiered system is not yet built. Visa says they will build it on their side, MasterCard and the other providers have not yet committed. Will this system be built and tested to meet the legislator's timeframe? Is it economically feasible for the card networks to have a two-tiered system? 2. There is no guarantee in place that merchants will accept the cards from small issuers, especially if they are "more expensive." Point #2 is very important - merchants may be motivated to only accept the cards of larger issuers due to the pricing of the two-tiered system.
I
recognize the FED is only taking incremental costs into consideration - not including the fixed costs at play. When a member has a problem with a

transaction or their card, they do not call the merchant - they call the card issuer. There are costs associated with staff required to address these inquiries. Currently, card issuers take on all the risk of the debit card transaction. If there is fraud, the issuer will cover this cost. If there is a security breach created by a retailer - again, the card issuer will (albeit grudgingly) take on the cost of this error. After the transaction is completed, there is very little risk to the retailer. The Fed introduced a plan in December where the interchange would be fixed at $0.12 per debit card transaction. If implemented, this fixed pricing will create a scenario where all of the small issuers of debit cards will lose money in the process. I have included the income generated by debit cards as well as the expense allocations to
provide you with a better picture of how the pricing of interchange will affect our institution: 2010 numbers from Eli Lilly Federal Credit Union: Interchange income from debit cards @ $0.42 per transaction: $1,869,707 Less: Debit card processing expense: 1,123,994 Less: Internal Servicing Costs (employees) 235,000 Less: Fraud Losses 140,637 Net Interchange Income: $370,076 Here is what the numbers could look like if the interchange rate was changed to a flat $0.12 per transaction, keeping all other factors the same. Interchange income from debit cards: $534,202 Less: Debit card processing expense: 1,123,994 Less: Internal Servicing Costs (employees) 235,000 Less: Fraud Losses 140,637 Net Interchange Income: ($965,429) Our organization makes some revenue from this endeavor. However, our small gain would turn into a large loss if the debit card interchange was fixed at $0.12 per transaction. It
would force small issuers to either charge more/different fees to customers or leave the game altogether. It leads to less competition for the large issuers - less competition is bad for consumers. If the interchange is reduced substantially, the retailers will see some gains in the form of lower expense to those involved in the card process. They may or may not lower prices to consumers. Financial institutions will respond by altering the ways accounts are charged for doing business. The intent of the Bill was to improve the well-being of consumers. The unintended consequences will create a scenario where the consumer will see very little, if any, change in prices from the retailers but they will see additional fees from card issuers in the form of fees associated with providing a debit card. So the consumer will wind up worse off. Ultimately, the interchange amendment within the Dodd-Frank Bill will wind up increasing the overll costs for consumers. I urge you to consider shifting this back to Congress and the Senate for further review with a better understanding of how this will affect the consumer and small financial institutions. Short of that, I would ask you to reconsider the $0.12 per transaction price, as that will drive higher fees for consumers. Thank you for your consideration, Joseph R. Hasto, Jr. Chief Financial Officer Eli Lilly Federal Credit Union