

February 21, 2011

Ms. Jennifer Johnson  
Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue, NW  
Washington, DC 20551

Filed via [regcomments@federalreserve.gov](mailto:regcomments@federalreserve.gov)

**Re: Docket No. R-1404 and RIN No. 7100 AD 63**

Dear Ms. Johnson:

This letter represents the views of the Michigan Credit Union League (MCUL) regarding the Federal Reserve Board's proposed Regulation II to implement the interchange provisions of the Dodd-Frank Wall Street Reform and Financial Protection Act. See Pub. L. No. 111-203, § 1075, 124 Stat. 1376 (2010), which added new Section 920 to the Electronic Fund Transfer Act, codified at 15 U.S.C. § 1693o-2. The MCUL is the primary credit union advocacy organization in this state, representing roughly 95% of the state's 327 state and federal credit unions which serve more than 4.5 million members.

The MCUL strongly opposes the Board's proposal because it is inconsistent with the statutory interchange provisions in a number of areas. The proposal would severely impact the seventy percent of credit unions that provide debit card programs to their members.

We recognize the Board was given a relatively short period to develop a proposal, particularly in light of the significance of the debit interchange statute for financial institutions and consumers. We believe the compressed time frame contributed to the development of a proposal that reflects several misinterpretations of the interchange statute. Rather than advancing this proposal, we urge the Board to work with Congress to support and achieve a reasonable delay of 24 months in the implementation of the interchange provisions to allow policymakers time to address unresolved issues, including how to ensure the interests of small issuers are protected, as intended by Congress. If the Board determines it must proceed with the proposal, we urge the Board to amend the proposal to ensure successful implementation of the small issuer exemption.

### **The Proposal Fails To Fully Implement The Small Issuers Exemption (Section 235.5)**

In our opinion, the Board's proposal does not properly implement the exemption for small issuers. See proposed 12 C.F.R. § 235.5(a). The statutory exemption for small issuers under Section 920(a)(6) provides:

This subsection (rate regulation provisions, parenthesis added) shall not apply to any issuer that, together with its affiliates, has assets of less than \$10,000,000,000, and the Board shall exempt such issuers from regulations prescribed under paragraph (3)(A).

The significance of the exclusion was emphasized by the primary author and proponent of the interchange amendment, Sen. Dick Durbin (D-IL), in a statement following adoption of the Act. He said the exemption for small issuers:

Means that (payment networks, parenthesis added) continue to set the same debit interchange rates that they do today for small banks and credit unions. Those institutions would not lose any interchange revenue that they currently receive. 156 Cong. Rec. S4977-S4978 (daily ed. Jun. 16, 2010) (statement of Sen. Durbin).

We are aware of at least five letters to the Board from 20 Members of Congress, including the current Senate Banking Committee Ranking Member Richard Shelby, House Financial Services Chairman Spencer Bachus and Ranking Committee Member Barney Frank, who helped shepherd the Dodd-Frank Act through conference and to a successful House vote, all urging the Board to ensure small issuers are protected from unintended consequences under the proposal. In our view the Board has not fulfilled its responsibilities under the statute regarding the implementation of the small issuers' exemption, as acknowledged in the Board's discussion of Regulatory Flexibility Act requirements:

The Board's proposed rule does not require payment card networks to distinguish between issuers with assets of more than \$10 billion and small issuers. Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722, 81,754 (proposed Dec. 28, 2010).

We believe this is an unsupportable misinterpretation of the interchange statute that will achieve a result that is the exact opposite of what Congress intended. It will render the exemption and intended protection for small issuers meaningless. The Board cannot be indifferent as to whether the exemption for small issuers works or not. In addition to those mentioned above, Michigan House Financial Services Committee member Gary Peters (MI-9) voiced his concerns with the proposal in a comment letter forwarded on January 24, 2011:

"In drafting section 1075, Congress was cognizant of the fact that these regulations could have a particularly adverse impact on small issuers. Small issuers rely on the fees generated by electronic debit transactions to provide free checking services to their customers, and to cover the costs associated with fraud prevention and data security. These costs can be extensive and would not be fully recoverable under the proposed rule. If small issuers are unable to profitably offer debit services to their customers the result could be decreased consumer choice and accelerated industry consolidation. Because of these concerns, those institution with less than \$10 billion in assets were specifically exempted."

While the statutory language provides an exemption for small issuers, it is not self-executing as there must be a two-tiered rate structure under which large issuers receive interchange fees that comply with the Board's rule and small issuers receive higher fees that are not limited by the Board's regulation, as Senator Durbin clearly articulated. One of the major payment networks has indicated a willingness to pursue a two-tiered structure but has not indicated whether such a structure would be developed and implemented by the time the final rule is set to take effect. Some of our member credit unions are concerned networks may not provide a two-tiered

structure once the rule is final or may not maintain it into the future. Without a two-tiered structure, there is no exemption. The Board is the only entity that has the statutory authority -- and responsibility -- under the interchange provisions to oversee the development and maintenance of such a structure in order to put the exemption into effect, as Congress intended. As the Board is the only regulator of the interchange provisions, it is clear the Board has a congressionally-imposed responsibility to implement the exemption in order for it to have meaning.

It is also clear that the Board is empowered under the statutory interchange provisions to ensure the exemption will be implemented. Section 920(a)(1) of the EFT Act, 15 U.S.C. § 1693o-2(a)(1), authorizes the Board to write regulations “to prevent circumvention or evasion of this subsection” (on interchange rate provisions). This is a general grant of authority to the Board and applies to all of the provisions in the interchange amendment that address interchange rate limitations, including the exemption for small issuers. We believe the implementation of the exemption could be fairly straightforward. Under Section 920(a)(1), and under Section 920(a)(3)(A), the Board is authorized to collect data from any issuer or payment card network “to provide the Board with such information as may be necessary to carry out the provisions of this subsection.” 15 U.S.C. § 1693o-2(a)(1).

Under these provisions, we believe the Board should require the networks to provide periodic reports on whether they have established a two-tiered system as Congress intended, whether small issuers have lodged complaints with the networks about the fees they are receiving under a two-tiered system during the reporting period, how such complaints were resolved, and the percentage of total interchange fees that smaller issuers received during the reporting period compared to the percentage of total network fees small issuers paid during the same period.

Such reports should be accessible to small issuers and key data provided in the aggregate to Congress and the prudential federal financial regulators. We believe that requiring reports on the two-tiered system from the networks and the fact that such reports would be subject to congressional oversight should provide sufficient regulatory incentives to ensure the networks will maintain two-tiered systems. However, if that is not the case, the Board and Congress would be able to utilize the information received from the networks to determine if changes to the statutory interchange provisions are needed to further reinforce the exemption.

### **Proposed Fee Structures Artificially Low and Inconsistent with Statutory Requirements (Section 235.3); Entire Michigan Legislature Voices Concern by Adopting Resolutions**

Michigan credit unions are understandably concerned about the interchange fee caps the Board is proposing under two alternative approaches as they fear no one will ensure their exemption will actually work and as a consequence, they will be subjected to interchange fees that are comparable to what will be permitted for large issuers.

The Board’s rate caps are based on costs for authorization, clearing and settlement in connection with debit card transactions. Both of the Board’s proposed alternatives would generally limit interchange fees for issuers to 12 cents per transaction, far less than the total costs issuers actually incur to provide debit card programs. Based on Credit Union National Association (CUNA) surveys of credit unions and data from CO-OP Financial Services, national

credit union debit interchange fees have been between \$0.35 and \$0.44 per transaction for the last several years.

The Board does not permit different interchange fee schedules for PIN-based versus signature-based transactions. As the Board's discussion of the proposal in the Supplementary Information indicates, signature-based transactions are more costly, in part because they involve a two-step authorization process, as opposed to the single step used for PIN transactions. Further, despite the statute's indication that Board may consider fraud prevention and data security costs in determining the standards for interchange fees, the proposal does not include an adjustment for such costs.

The entire Michigan House of Representatives and State Senate recently approved resolutions (HR21 and SR14 respectively) calling on the federal government to delay or stop implementation of the debit interchange regulatory provision. Senator Darwin Booher, chairman of the Senate Banking and Financial Institutions Committee, sponsored the Senate resolution and was quoted:

"I sponsored this resolution to send a strong message to Congress: Stop any rules from being adopted that would harm our community banks, credit unions and the millions of Michigan consumers that use them. As currently proposed, the rules would force credit unions and community banks to absorb the costs of fraud and data security. That would result in less credit available for job providers, increased fees and the ending of popular services like free checking."

The Board indicated it will develop a separate proposal on these issues. The MCUL believes the rule making process would be improved if the Board addresses these issues in a cohesive manner as part of one proposal.

### **The Board Should Reissue a Proposal for Additional Comments**

Given the nature and number of deficiencies with the Board's proposal, we do not think the Board should proceed with the document it approved for comments on December 16, 2010. I am enclosing a copy of the resolutions adopted by the Michigan House of Representatives and State Senate for your review (see Appendix A).

Regardless of how the current proposal is implemented, it would likely result in merchants discriminating against small issuer cards that carry higher interchange rates. Enforcement by the Federal Reserve is critical to the exemption working in a two-tiered system. The MCUL urges the Board to work with Congress to obtain more time to address these issues. If the Board is certain it must promulgate some form of this proposal, we urge the Board to implement the exemption for small issuers so it will have the impact Congress directed; or drop the rate cap provisions and include a set of standards to assess interchange rates; and regulate the routing and exclusivity provisions so that merchants will not be able to steer transactions illegally to large issuers.

The regulation of interchange is a critical issue for Michigan's credit unions. Thank you for the opportunity to provide comments on this important proposal.

Sincerely,

A handwritten signature in black ink, appearing to read 'DA', with a long horizontal flourish extending to the right.

David Adams  
Chief Executive Officer

## Appendix A

### **Michigan House Resolution No. 21**

A resolution to memorialize Congress to take steps to insure that the Wall Street Reform and Consumer Protection Act does not result in increased fees on consumers at exempted institutions.

Whereas, Under certain provisions (section 1075) of the Wall Street Reform and Consumer Protection Act (Public Law No. 111-203), the Federal Reserve Board is required to issue regulations that would provide for reasonable interchange transaction fees for electronic debit transactions and place limitations on payment card network restrictions; and

Whereas, In drafting Section 1075, Congress included language to exempt small issuers from this provision, defining small institutions as those "with less than \$10 billion in total assets." Small issuers rely on debit interchange fees to provide free checking services to their customers and to cover costs associated with fraud prevention and data security. If these costs were not fully recoverable, small issuers would be unable to offer debit services to their customers, and the result could be decreased consumer choice and higher fees. Because of these concerns, Congress specifically exempted those institutions with less than \$10 billion in assets; and

Whereas, The Federal Reserve Board's current debit interchange fee regulatory proposal (Docket No. R-1404) could lead to the unintended consequences of increasing costs on consumers and limiting consumer choice. The proposal does not include any provision designed to enforce the carve-out for small issuers. It is incumbent on Congress to revisit this issue and help insure that these regulations do not ultimately result in less choice and higher costs for consumers; now, therefore, be it

Resolved by the House of Representatives, That we urge Congress to stop or delay the implementation of Section 1075 so that statutory changes can be made to ensure institutions with less than \$10 billion in assets are exempted without consequence in order to ensure Section 1075 does not result in increased fees on consumers at exempted institutions; and be it further

Resolved, That copies of this resolution be transmitted to the President of the United States Senate, the Speaker of the United States House of Representatives, and the members of the Michigan congressional delegation.

### **Senate Resolution No. 14**

A resolution to memorialize Congress to take steps to ensure that the Wall Street Reform and Consumer Protection Act does not result in increased fees on consumers at exempted institutions.

Whereas, Under certain provisions (Section 1075) of the Wall Street Reform and Consumer Protection Act (Public Law No. 111-203), the Federal Reserve Board is required to issue regulations that would provide for reasonable interchange transaction fees for electronic debit transactions and place limitations on payment card network restrictions; and

Whereas, In drafting Section 1075, Congress included language to exempt small issuers from this provision, defining small institutions as those "with less than \$10 billion in total assets." Small issuers rely on debit interchange fees to provide free checking services to their customers and to cover costs associated with fraud prevention and data security. If these costs were not fully recoverable, small issuers would be unable to offer debit services to their customers, and the result could be decreased consumer choice and higher fees. Because of these concerns, Congress specifically exempted those institutions with less than \$10 billion in assets; and

Whereas, The Federal Reserve Board's current debit interchange fee regulatory proposal (Docket No. R-1404) could lead to the unintended consequences of increasing costs on consumers and limiting consumer choice. The proposal does not include any provision designed to enforce the carve-out for small issuers. It is incumbent on Congress to revisit this issue and help ensure that these regulations do not ultimately result in less choice and higher costs for consumers; now, therefore, be

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Resolved, That copies of this resolution be transmitted to the President of the United States Senate, the Speaker of the United States House of Representatives, and the members of the Michigan congressional delegation.