OSU Federal

*Your Community Credit Union*®



February 11, 2011

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

RE: **FEDERAL RESERVE SYSTEM 12 CFR Part 235 Regulation II; Docket No. R–1404, RIN 7100–AD63 Debit Card Interchange Fees and Routing**

Dear Chairman Bernanke:

Thank you for the opportunity to comment on the Federal Reserve Board's proposed changes to interchange rules. O.S.U. Federal Credit Union is federally chartered credit union representing 65,000 members headquartered in the great state of Oregon. On behalf of my credit union and members, I have serious concerns about proposed changes to current payment card interchange routing and fees. These changes would significantly and negatively impact my credit union's ability to compete with larger issuers and help serve those of modest means.

Credit unions already have lower fees and charger lower interest on loans, and higher rates on deposits, to their members. The inherent worth of credit unions, as smaller institutions, was recognized by the legislature in carving out an exemption for financial institutions under $10B in assets. This exemption was designed to help credit unions continue in their mission of providing financial services in a way that benefits the entire membership rather than a small group of stockholders. The exemption for small institutions is not protected by the regulation and although the industry will provide a two-tier system, it is expected that market forces will eliminate this two-tier system, which was created to protect small institutions from the impact of the regulation.

Also, there is no assurance in the law or proposal that any savings for merchants as a result of government-set interchange fee caps will be shared with the consumer. There is absolutely no way to regulate if this would benefit anyone other than the merchants.

It has been estimated that the proposed cap to interchange fees would be set at a rate nearly 70 percent lower than rates in 2009. As the manager for our credit, debit and ATM services, I see the daily cost of offering these programs to our membership. The proposed artificially low caps on debit interchange does not reflect the true costs of running a secure, reliable and efficient debit network, which will force financial institutions to raise consumer fees or reduce debit services.



PO Box 306, Corvallis, Oregon 97339-0306
800-732-0173 • www.osufederal.com

It is unfortunate that the Federal Reserve used a few large institutions to gather estimates of cost when they are the most likely to achieve the greatest economies of scale and negotiate the lowest prices due to volume. Then these figures were looked at only on a marginal basis rather than looked at from a total overall cost of providing transactional services. The marginal rate might not even begin to cover the lowest cost that a small organization will incur. Since it is unlikely the two tier system will survive, due to market pressures, the rate ceilings created by the regulation will unfairly impact smaller issuers. Even the authors of the broader bill, retired Senator Christopher Dodd (D-CT) and Representative Barney Frank (D-MA), have said the Federal Reserve overreached in its efforts of financial reform.

It seems inappropriate that the Federal Reserve is using only transaction processing costs rather than the cost associated with maintaining a network and ensuring that consumer data is secure. In addition, the financial intuitions are forced to absorb costs of any fraudulent transactions charged to the cards. The merchant should share in the cost of supporting this very affective payment process that they benefit from. This system has reduced their payment risk significantly. In fact, when checks were a main source of payment the merchant incurred most of the risk. With the migration to card payments, the merchant has been able to transfer this risk to the issuing institution. At times the merchant's carelessness has actually increased the costs to issuers through data breaches and yet through this regulation, these merchants will not even be required to pay a more appropriate share of supporting this payment process.

Since the cost of supporting the network, providing fraud prevention, and absorbing the cost of fraud & credit losses will not go away just because the Federal Reserve has created a regulation that limits the cost sharing between the merchant and the issuing institution, the consumer is the one who will be required to pay up for the convenience of using a card. They will very clearly pay more for transactional and deposit services at all financial institutions. I am not sure that was the intent of the legislation. In fact, it is my belief, as well as that of my credit union, that the intended purpose of the proposed rules was to protect consumers, and it is also my belief that this legislation will have precisely the opposite effect intended in the original Dodd-Frank legislation. Instead, financial institutions will levy fees on a range of products and/or services which in turn, mean consumers will pay more yet get fewer benefits. Case in point, Bank of America, JP Morgan Chase and US Bank have already announced the end of "Free Checking". The competitive nature of this industry will dictate that other financial institutions may need to follow suit.


PO Box 306, Corvallis, Oregon 97339-0306
800-732-0173 • www.osufederal.com

The proposal offers two options to help fight network exclusivity, requiring a prescribed number of unaffiliated networks per payment card. Of those proposed options, "Alternative A" offers the most flexibility to issuers requiring only two unaffiliated networks per payment card as compared to "Alternative B" which requires two PIN-based networks and two signature-based networks. "Alternative B" is virtually unworkable for credit unions. Implementing changes to routing and exclusivity must be done carefully as proposed "Alternative B" would place an undue burden on credit unions and likely negatively impact our members. "Alternative A" which requires two unaffiliated payment networks for all cards is preferable and while still burdensome, it would have the least detrimental impact.

In closing, the proposed changes to debit interchange rates, and the inability to enforce a two-tiered payment system cause us great concern. Not taking into account the actual costs of processing transactions and maintaining the system - while still being able to innovate - leaves credit unions fewer resources to implement new processes that will help to reduce fraud overall.

Thank you for your time and consideration, please contact me with any questions you may have.

Sincerely,

David M. Newman

David M. Newman
Payment Systems Manager
OSU Federal, *Your* Community Credit Union
PO Box 306, Corvallis, Oregon 97339-0306
(541) 714-4270