



February 16, 2011

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

Re: Interchange Rule Proposal (Docket No. 1-404)

Dear Ms. Johnson:

On behalf of United Federal Credit Union I would like to provide the following comments for the official record regarding the above referenced proposal. In our comments we will address both what we see as the flaws in the proposed rule and in the statute which initiated it. We see the problems with the proposed rule and the statute as intertwined, and we encourage the Federal Reserve to show both broad latitude within the confines of the statute and to take the lead in calling upon Congress to revisit the statute due to the challenges the Board will face in implementing this rule.

Among the key problems with both the statute and the proposed regulation is that its provision that financial institutions with less than \$10 billion in assets will not be subject to the new interchange rates. With all due respect, we disagree with such an assertion and cannot see how this can possibly be the case in actual practice with the large number of different networks. VISA and MasterCard may be able to handle two fee assessment tiers; however, all of the smaller networks used by merchants will not necessarily have that capability. Likewise, we feel that, because there is no requirement that retailers cannot discriminate in what networks they use for processing debit transaction, we will indeed be affected because the merchant will force our members to choose the network with the lower fee – which will not be the network used by the financial institutions under \$10 billion in assets. In practice, the “below \$10 billion asset exemption” is essentially without value without a regulatory mandate that prevents merchant discrimination.

We would also like to address our concerns about the issue of fraud. Although they will be the beneficiaries of this new rule, we do not see the liability for fraud being shifted from the debit card issuer to the hands of the merchant. At present, financial Institutions bear the brunt of 100 percent of the liability in data base compromises. This liability, indeed great in today’s marketplace, is at least somewhat offset by the current reasonable debit interchange fees received by the issuing financial institution. Under this proposal, the liability remains but the fees received to help counter balance the significant risk are diminished to a point well below an appropriate cost-benefit calculation. This is, in our view, patently unreasonable and inequitable.

It has been mentioned by the proponents of both the statute and this proposed rule that the consumer will benefit from the pass through by the merchants of lower debit interchange fees. Our question is how the Federal Reserve will be able to ensure that cost savings by the merchant is indeed passed along to the consumer. In this proposed rule, we see nothing that will guarantee this promised consumer benefit. And, while it would at least make good on the promises made by the proponents in their political efforts to further this retailer-driven manipulation of the marketplace, the only way for the Federal Reserve to guarantee this “pass through” of the savings would be through price controls that we believe are beyond the bounds of appropriate action by the Board. So, if there is to be no price controls solely to benefit the consumers (which we deem appropriate), why then are there price controls put in place solely to benefit

the merchants? We encourage the Federal Reserve to not engage in price controls at either level, the consumer level or in the relationship between the retailer and the debit card issuer.

It is quite possible, and even likely, that many financial institutions will now – because of the loss of their debit interchange revenue but not the loss of the fraud liability associate with it - be forced to make up that revenue loss by moving away from free checking products. The new trend, in the “carry the risk but lose the counter balancing revenue” era of debit card issuance, will likely be to begin charging monthly checking account fees, retreating from reward points programs and eliminating the recent growth in high rate checking accounts. We fail to see that the consumer actually benefits in this new reality – particularly with no assurance of the merchant “pass through” of their considerable savings in interchange fees paid for these transactions that so help drive their businesses.

There will be an effect on the overall payments industry from the implementation of the Board's proposed rule. For example, if financial institutions begin charging members for debit card usage to help compensate for potential fraud losses, the result will naturally force many consumers to move to other options such as cash and checks. If so, this new statute and the Board's corresponding rules have the potential to take the progress in the payments industry backwards 20 years or more!

Convenience for both consumer and merchant will be significantly diminished as the debit card is primarily a convenience-related transactional instrument. This will bring about an increase in prices to cover the extra administrative costs, plus the cost of handling cash and checks will certainly go up. Therefore, even to the merchants, as the cost of interchange fees go down it will be offset by a set of different costs. We are curious as to whether any empirical data has been gathered about the costs/benefits of handling cash and checks from a retailer's perspective versus the costs/benefits of debit transactions. When the shifting of the fraud liability from the financial institution to the merchant is factored into the equation, we would submit that the retailer is better off under the current arrangement than under one where the liability was his. Of course, under the current proposal, the merchant gets the best of both worlds – a drastically reduced interchange fee and no corresponding liability. The financial institution gets the counter side of that arrangement, and the costs will force them to change their business model regarding checking accounts dramatically.

We also question why the proposed rule does not include prepaid cards. Except that many merchants sell them and want to continue the demand, we see no reason for the disparity. Likewise, we have questions about how the 12 cents maximum that the Federal Reserve wants to implement as the interchange on every transaction was derived. It appears to be arbitrary and does not seem to have factored in all of the costs associated with processing/servicing a debit transaction.

Although some costs are mentioned in the proposed rule, among the factors that do not appear to have been considered are the network compensation for providing the service in an amount sufficient to warrant them continuing to do so; direct administrative costs and overhead for both the network and the issuing financial institutions in their contractual interrelationship; research and development to fight fraud and to ensure that new tools are developed to battle the continuing evolution of fraudulent techniques.

Regarding the amount of financial institution costs, United Federal Credit Union's direct costs are an average of \$0.245 per transaction. At 12 cents per transaction we will be almost 15 cents in the hole on every debit transaction. We will not be in a position to assume that loss without restructuring some of the ways that, as a not-for-profit financial cooperative, we return our earnings to our members. For example, we return value to our members through a checking account reward points program and a high interest checking product available for all members, no minimum balance required just by meeting qualifications which include doing a minimum number of debit card transactions. Approximately 60 basis points of the amount we return to our members through our high rate checking product comes from the interchange revenue. Therefore, with a loss of 15 cents per transaction, the reward point and high interest checking products will have to be reevaluated. So, rather than benefiting from the new rule on the retail side (of which there is no guarantee), the consumer will end up paying for it on the financial institution side (which is virtually guaranteed because of the profit and loss considerations with which these regulated institutions must keep positive).

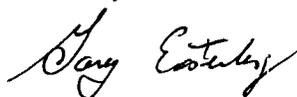
Below is a table to demonstrate United Federal Credit Union's Income vs. Costs per debit transaction. We include this data so that the Board can know that this issue is not simply one of philosophy or which interest group has a better argument than the other. Our costs will not be covered with a 12 cent maximum on debit interchange fees per transaction.

	Convenience/ Platinum Plus Signature-Based Transaction	Interest Plus Signature-Based Transaction	PIN Based Transactions
Interchange Income	\$.495	\$.495	\$.335
Processing fee	\$ (.179)	\$ (.179)	\$ (.179)
Overhead Costs	\$ (.030)	\$ (.030)	\$ (.030)
Plastic Costs	\$ (.006)	\$ (.008)	\$ (.006)
Fraud Cost	\$ (.027)	\$ (.027)	\$ 0.00
Fraud Prevention Costs (Risk Manager)	\$ (.003)	\$ (.003)	\$ 0.00
Net Income	\$.25	\$.25	\$.12
TSYS Maintenance Fees	\$ (.016)		
TSYS Redemption S7	\$ (.116)		
ATM Fees Refunded		\$ (.061)	

In closing, we ask that the Board take a strong position to protect the ability of financial institutions to at least cover the amount of their direct costs on a debit transaction, plus a reasonable ability to earn sufficiently above those direct costs to make the risk worth taking in issuing debit cards. The marketplace has made this work effectively for a number of years, and any attempt at price fixing is ill advised. Whereas we recognize that the statute somewhat ties the hands of the Board in some regards, where it does not we ask for maximum flexibility. The two tiered fee structure must have integrity, be administered by all networks and enforced by the Board. Discrimination among networks or card issuers by retailers must be strictly prohibited and enforced. Prepaid cards should be included, and the per transaction fee should have a maximum that is commensurate with the actual costs of both expenses and risk, plus an amount of additional earnings sufficient to prevent issuers from being forced to shift losses in their interchange program to other product areas.

Thank you for the opportunity to express our thoughts on this important proposal. If you need additional information, please do not hesitate to contact me at 269-982-4764. We appreciate your consideration.

Sincerely,



Gary L. Easterling
President/CEO

cc: NCUA Board of Directors
Michigan, Ohio, Nevada, North Carolina and Arkansas Congressional Delegation