

From: Indiana Credit Union League, John McKenzie
Subject: Reg I I - Debit card Interchange

Comments:

February 17, 2011

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

Re: Docket No. 1404 - Debit Card Interchange Fees and Routing

Dear Ms. Johnson:

Thank you for the opportunity to provide comments related to the Federal Reserve Board's (Fed's) proposed rule implementing provisions from the Dodd-Frank Act impacting debit card interchange fees and debit transaction routing. The Indiana Credit Union League represents 90% of Indiana's 190 credit unions, which have more than 2.2 million members. The implementation of these significant changes will have a serious impact on the way credit unions can provide debit card services to their members. We understand that the Fed faces a number of challenges in developing and implementing this proposed rule based on certain constraints within the Dodd-Frank Act; however, in developing the final rule, we urge the Fed to utilize the authority provided in the Act to the fullest extent possible to protect smaller card issuers, like credit unions, that are provided with a statutory exemption from the interchange rate restrictions. We believe that protecting credit unions and other card issuers with less than \$10 billion in assets was a critical component of Congress' intent when the legislation was passed and we are concerned that the Fed has not done all it can do to draft a rule that honors this intent. There are a number of provisions of the proposed rule about which we are providing comments.

Small Issuer Exemption

It is clear from the debate and discussion regarding the interchange issue during the passage of the Dodd-Frank Act and from subsequent communications from congressional leaders that Congress intends for debit card issuers below \$10 billion in assets to be exempt from the impact of the debit interchange fee restrictions placed on larger card issuers by the new law and the proposed rule. While the proposed rule does include the exemption from the proposed interchange fee limits, there are no provisions in the proposed rule that would enforce the exemption. Technically, small issuers would be exempt from the fee limit, but there is no assurance that the payment systems providers will be operating a two-tier system that allows for one interchange fee for large issuers and another interchange fee for small issuers exempt from the fee limit. While Visa has indicated publicly that it intends to develop and operate a two-tier system, no other payment system provider has made such a commitment. This is a concern particularly for the smaller payment system providers, especially the dozens of PIN-based networks, will not have the time or resources necessary to develop a two-tier system, which will necessarily result in a one-tier system that complies with the interchange fee limits. Without an enforcement mechanism, we believe that the exemption intended to

protect small issuers will not function and we urge the Fed to fully consider using the authority it has under the new law to issue rules prohibiting the evasion or circumvention of the law to enforce the exemption in a way that protects small issuers as Congress intended.

Merchant Discrimination

In addition to protecting small card issuers from the interchange fee limits, it also is clear that Congress intended to protect consumers who utilize debit and credit cards issued by small issuers from potential discrimination at the point of sale. While Congress did provide retail merchants with new options for lowering their transaction costs by prohibiting network exclusivity and transaction routing limits, it also provided a measure of protection for consumers by stating that the law shall not be construed to authorize any person to discriminate between debit or credit cards within a payment card network based on the issuer that issued the card. While the merchant is now allowed additional routing options that lower the merchant's costs, at least on paper, the merchant is not allowed to refuse to accept a card based on who issued it. However, as with our concerns over the two-tier system, we are very concerned that the network exclusivity and routing provisions of the proposed rule do not address the critical anti-discrimination provisions from the law and do not include any enforcement that would protect consumers from having their cards refused based on who issued the card. As in the case with the two-tier interchange fee system, we urge the Fed to fully consider using the authority it has under the new law to issue rules prohibiting the evasion or circumvention of the law to address the anti-discrimination protections allowed by the law and protect consumers from card discrimination by retail merchants at the point of sale.

Network Exclusivity and Routing

The Fed has offered two alternatives in implementing the new law's prohibition against network exclusivity arrangements. Of the two alternatives proposed, we strongly suggest that the Fed implement rules based on Alternative A because we believe that it meets the requirements of the law while having the potential to lead to less consumer confusion and lower implementation costs for credit unions resulting in lower costs to members. The law does not allow payments to be restricted to one network or to two or more related networks. Alternative A meets this standard by allowing a debit card to be processed on one signature-based network and one PIN-based network not related to each other. This alternative, combined with the proposed rule's provisions that prohibit routing restrictions, allows a merchant to choose to process a transaction on whichever network offers the lowest cost to the merchant. For example, a consumer using a debit card for a particular transaction could be told by the merchant that the transaction must be made using a PIN rather than a signature based on the merchant's preference. In our view, Alternative B (which would require each card to offer at least two unrelated PIN-based networks and two unrelated signature-based networks) would be challenging for credit union card issuers and potentially confusing to credit union members who could be faced with a number of complicated payment alternatives at the point of sale when all he/she wants to do is pay the bill and leave. The cost to credit unions to join additional networks would negatively impact credit union members as those costs would likely have to be passed on to members in some fashion while there is no expectation that merchants will pass along their savings to consumers.

Fraud Prevention Costs

We understand that the Fed is under specific time constraints for developing these rules, but we are very concerned that the initial proposed rule for determining the "reasonable and proportional" interchange fee did not include consideration of fraud prevention costs as allowed by the Dodd-Frank Act. Fraud and fraud prevention costs can be a significant cost to credit unions issuing debit cards, and interchange plays a key role in helping credit unions recoup these costs since retail merchants bear essentially no fraud-related expenses related to debit transactions. Understanding that the Fed intends to develop an additional proposed rule related to an allowable fraud prevention adjustment to the interchange fee limit, we strongly urge the Fed to consider the broadest possible array of fraud prevention costs allowed by the new law. In the explanation of the proposed rule, the Fed suggests it is considering two possible approaches to the fraud prevention cost adjustment. The first suggestion appears to limit the allowable costs to those associated with major, technology-based prevention measures deployed industry-wide. The second approach would not prescribe specific allowable fraud costs, but would rather give institutions broader leeway to implement and account for fraud prevention programs that are effective for their own card programs. We believe that the second proposed approach is the correct approach and is keeping with the intent of Congress to allow institution-specific fraud prevention costs to be considered. By requiring under the first approach that fraud prevention costs lead to "industry-wide fraud losses," we are concerned that an institution's significant efforts to prevent fraud within its own program will not be able to be factored into the adjustment to the interchange fee limit. This appears to run counter to what the law intends when it says the adjustment is allowed if it is "for costs incurred by the issuer in preventing fraud in relation to electronic debit transactions involving that issuer" (emphasis added). Understanding that the Fed did not have sufficient time to fully research the best way to implement the fraud prevention cost allowance, we urge the Fed to fully explore alternatives beyond the two suggested in the proposed rule. We are concerned that each of these proposed approaches has shortcomings that may preclude legitimate fraud prevention costs from factoring into the allowance. We ask the Fed to develop an approach that allows the widest possible allowance for legitimate fraud prevention costs while still emphasizing the importance of developing industry-wide fraud prevention technologies.

The Indiana Credit Union League understands that the Fed faces tight statutory timeframes. Given that the Fed has acknowledged the timeframes for developing and implementing the rules required by the law, we believe that the Fed should ask Congress to delay the effective date of the requirements. We also understand that the Fed is somewhat limited by statutory constraints regarding some elements of the proposed interchange rule. However, we believe that the Fed has more authority within the statutory framework to help insure that the protections in the law for credit unions, as small card issuers, function as Congress intended. We strongly believe that these small issuer protections provided a foundation for the passage of the interchange fee provisions in the Dodd-Frank Act and it is very important that the Fed do as much as it can to implement rules that enforce these protections. Thank you again for the opportunity to comment on this critical proposed rule.

Sincerely,

John McKenzie
IndianaCredit Union League