

From: Rick Schmidt
Subject: Reg II - Debit card Interchange

Comments:

February 18, 2011

Federal Reserve Board
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Dear Federal Reserve Board:

Ms. Johnson:

I am writing on behalf of WestStar Credit Union. We are a \$135 Million credit union located in Las Vegas, Nevada, serving members throughout the state of Nevada.

This is the first letter that I have written to the Federal Reserve or any government agency regarding pending legislation. The issues raised in the Dodd-Frank Act are so significant that I need to express my concerns directly to you.

Without doubt, this legislation is well intentioned. However, the details on how it could be implemented and the consequences for organizations such as WestStar have not been sufficiently examined to understand whether or not the implementation will meet the letter and spirit of what Congress intended.

It is clear that the legislation has no mechanism to enforce the small issuer exception. Chairman Bernanke's recent comments support this position. He stated that "we are not certain how effective that exemption will be." That is very troubling as the small issuer exception was critical in the brief discussions prior to Congressional approval and is central to the success or failure of any implementation of this legislation.

Further, without meaningful restrictions on merchants to enforce the exception, there will be incentives for these merchants to direct transactions to the lower cost networks and over time effectively exclude small issuers from the market place. As Chairman Bernanke said "it is possible that because merchants will reject more expensive cards from smaller institutions or because networks will not be willing to differentiate the interchange fee for issuers of different sizes, it is possible that the exemption will not be effective in the marketplace." It is highly unlikely that Congress intended this Act to create a market imbalance and remove or restrict consumer choice.

On the basis of these issues raised by your own chairman, as well as the various concerns voiced recently by many Senators and Congressmen, it is obvious that further study is necessary before any actions are taken. At a minimum, the implementation of any new structure should be delayed to

allow for further detailed study and analysis.

The proposed debit interchange rates are also a concern, especially if the two tier system cannot be guaranteed or enforced. The rates do not take into account the very real costs that every issuer (big or small) must bear to support a debit card program. Fraud costs - both for prevention and for real losses from actual fraud - are not considered in the current proposal. That alone would create an unsustainable financial structure for card issuers.

As an example, when I worked at another credit union, a single fraud incident cost that credit union well over \$40,000 in actual losses as well as the costs for replacing several thousand debit cards for members whose card numbers had been compromised in the fraud. Multiple that by tens or hundreds of thousands of card users in some of the wider scale fraud incidents and the costs to recover are staggering. The Federal Reserve Board must find some means to effectively include these very real costs in any new debit interchange rate structure. If not, the current proposed structure would essentially cause any issuer to operate a card program at a loss. Congress cannot have intended financial institutions to be mandated to offer a product under governmental controls on that product that force it to operate at a loss.

As you are no doubt aware, Nevada is probably the state most impacted by the economy over the last few years. WestStar and all financial institutions in the state have struggled to maintain adequate capital levels, control loan losses and hopefully make a modest return to keep the doors open. WestStar is just now beginning to see the light at the end of the tunnel. We have made a small amount of positive income over the last few months and have started to see positive trends in loan delinquencies and charge offs.

All of that is at risk based on the proposed debit interchange rates. WestStar stands to lose anywhere from \$400,000 to \$500,000 if the estimates of 70% declines in interchange are accurate. We made a profit of \$5,760 in January of 2011. Obviously the negative impact of this proposal would be massive to our net income. In a struggling economy, WestStar will need to find new and different revenue sources to recover the lost income. The current capital could not sustain the credit union very long without additional revenue to offset the reduction in interchange revenue.

If this proposal takes effect, consumers will be the biggest losers. Small financial institutions will have no options but to look to consumers to maintain their bottom lines and stay in business. If the projections noted above are even close to accurate, WestStar may have little choice but to ask its members to bear higher costs for debit cards and likely other accounts and services to offset the lost revenues and ensure our survival. How will this impact low income wage earners who are least likely to be able to afford these costs and are the people who depend most on these types of services from their financial institution?

It is hard to conceive that these types of consequences were envisioned when the original amendment to the Dodd-Frank Act was approved.

In the strongest possible terms, I urge the Federal Reserve Board to

reconsider the proposal currently under discussion. I urge the Board to revisit the proposed rate structure to allow financial institutions to at a minimum have the opportunity to recover ALL of their costs (fraud and otherwise) as well as earn a positive return on their investment. I urge the Board to closely examine the small issuer exemption and find means to enforce that exemption to prevent the potentially disastrous impacts on both small financial institutions such as WestStar and on consumers nationwide. And I urge the Board to delay any implementation until these complex issues can be fully understood and the ramifications fully explored so that any final rules and regulations are crafted to best serve the consumers who in the end are the ones with the most at stake in these deliberations.

Thank you for your time and consideration on this matter.

Sincerely,

Rick Schmidt