

From: Valley Community Credit Union , Ryan Drake
Subject: Reg I I - Debit card Interchange

Comments:

Ryan Drake

January 11, 2011

Dear Federal Reserve Board:

I write to comment on Docket No. R-1404, Regulation II, Debit Card Interchange Fees and Routing. I am the CEO of Valley Community Credit Union. Valley Community Credit Union is a cooperative financial institution with 2350 members and \$8.4 million in assets. Approximately 24% of our members have debit card access to the funds in their accounts. The Board of Directors of our credit union is very concerned that this proposed regulation will adversely affect those members. As an institution that has been specifically exempted by Congress from the Federal Reserve's debit interchange fee setting responsibilities, we believe the proposal does not do enough to adequately protect exempted institutions from merchant or network action to avoid the exemption. Congress decided that it was important enough to include an exemption for our credit union and now the Board should use its statutory authority under EFTA Section 920(a)(1) to add additional language to the proposed regulations that will ensure that the exemption works as Congress intended. One way to do this would be to require debit networks to maintain a dual pricing system and bar merchants from discriminating against exempt issuer debit cards. The proposed alternatives on setting debit interchange rates also concern us, especially if the establishment and maintenance of a two-tiered fee structure cannot be assured. The Board should consider all costs of operating a debit interchange system to the maximum extent allowable by law. It is especially disconcerting that the proposed Regulation does not allow issuers to include their network processing fees in the calculation of the costs of authorization, clearing, and settlement activities. As the Board's proposal acknowledges, issuers, even the largest among us, must pay network fees in order to have any authorization, clearing or settlement activities. To exclude these fees from the calculation simply ignores the true incremental costs of processing a debit transaction and evades the intent of Congress. The Board's stated rationalization in Section III. A. 1. that such fees should not be included because to do so would put merchants in the position of effectively paying all network fees is not supported by statutory authority. EFTA Section 920 (a)(4) requires that the "amount of any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction shall be reasonable and proportional to the cost incurred by the issuer with respect to the transaction" (emphasis added). This is a statutory mandate that any costs required to be paid by an issuer to allow for authorization, clearing, and settlement of debit transactions should be included in the calculation of incremental costs. Even if a two-tiered system is permitted and works in practice, small issuers will be, as the Board itself noted in its comments, disadvantaged under either of the Alternatives proposed. Credit unions typically are aligned with only one debit processing network and to require them to add another one will further erode interchange income to

the detriment of our members. We estimate that our debit card program does not operate at a profit when we consider all of our costs, including fraud-prevention and losses, under the current interchange fee system. The Board acknowledges in its proposal that requiring issuers to offer two or more processing networks is not required by the law. This requirement is inconsistent with statutory mandates and would place an unreasonable regulatory burden on our credit union that could negatively impact service to our members. Therefore, we urge the Board to drop this requirement. If the Board feels compelled to adopt one of the routing alternatives, we urge it to adopt "Alternative A," which would only require issuers to use two unaffiliated networks. The Board's proposal also asks for comment on how best to include fraud prevention costs and suggests two alternatives. The "Technology Specific Approach" would establish technology-specific standards that an issuer must meet to be eligible to receive the fraud adjustment to the interchange fee. This proposal would impose a further hardship on smaller issuers and we urge the board to reject it in favor of the "non-prescriptive approach." The later approach would allow each credit union to determine what would be necessary for it to maintain an effective fraud prevention program within the Board's guidelines. This flexibility is necessary to ensure that smaller issuers are not frozen out of the debit market by the imposition of technologies that may be beyond their financial capabilities.

Sincerely,

Ryan C. Drake