

From: Eastman Credit Union, Patty Davis
Subject: Reg I I - Debit card Interchange

Comments:

January 14, 2011

Federal Reserve Board

Dear Federal Reserve Board:

Eastman Credit Union based in Kingsport, Tennessee, wishes to share with you specific comments from Patty Davis, Manager, Card Services, our debit card content expert. (423-578-7560)Patty's comments are as follows:

The Interchange Act guarantees an issuer \$.07 interchange per transaction. You may be able to receive up to a maximum of \$.12 per transaction, but this would have to be justified due to processing costs and that has not yet been explained. A two-tier system will be difficult to implement and support. If that happens, these amounts are extremely low when you consider that the costs associated with the actual process are minor related to the overall debit card program.

Card transactions benefit merchants with an approval code, and they are guaranteed receipt of the funds. They also benefit in other ways such as no returned checks and the costs associated with these, no cash costs, an electronic audit trail exists, etc.

If the card is present for the transaction, the merchant receives approval for the transaction and can provide a signed sales draft (regardless if it is forged), the merchant has no liability. If it is an Internet purchase which utilized the CVV code from the reverse side of the card, the merchant has no liability. Instead, the financial institution bears the burden of the costs associated with processing fraud claims along with the actual fraud losses.

Since merchants' processing costs will diminish drastically, the burden to alleviate fraud should be borne by the merchants AND the financial institutions. The United States needs to begin migration to the EMV chip cards. This has been delayed due to implementation costs for merchants involving new POS machines. However, with Australia and Canada now migrating to EMV cards, fraud will continue to increase in the United States. In Europe, where EMV cards were first introduced, merchants are now liable for all fraud that results from transactions on non-EMV systems. Therefore, their incentive to install the EMV POS machines was greater.

ECU processed over 13M debit card transactions from Jan-Nov 2010. During that time, for debit cards, we had over 2,100 fraud cases reported totaling over \$200K. The costs associated with these fraud cases exceeded \$31K which does not include staff time or loss of member confidence.

In part, the additional interchange compensates the financial institution for increased fraud risk as it occurs much more frequently with signature based transactions. This legislation does not differentiate between the two channels and does not compensate financial institutions for accepting the additional risk. Again, merchants have no liability if they can provide a signed sales receipt and a card was present at the time of the transaction.

We encourage you to reinforce the small issuer exemption and ensure that it works as Congress intended. Please adopt routing "Alternative A," which would only require issuers to provide debit cards that can be used over two unaffiliated networks, such as a PIN-based network and an unaffiliated signature-based network. More than two networks would place an unreasonable regulatory burden on ECU that could negatively impact service and potentially cost to members. In addition, the

proposed debit interchange rates also cause ECU concern. Can the establishment and maintenance of a two-tiered structure be assured? We also encourage you to consider all costs of operating a debit interchange system to the maximum extent allowable by law, including all fraud prevention costs such as the cost of new technology that reduces potential fraud. Thank you for your consideration. With regards,

Sincerely,

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