



KANSAS CREDIT UNION ASSOCIATION

February 18, 2011

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

Re: Regulation II – Debit Card Interchange Fees and Routing

Docket No. R-1404 and RIN No. 7100 AD63

Ms. Johnson:

I am writing on behalf of the 92 natural-person credit unions and one corporate credit union represented as members of the Kansas Credit Union Association. The intent of this letter is to help you understand the many concerns raised in your proposed rule on debit interchange fees and routing. The rule has the potential to jeopardize the continued existence of debit card programs in no less than thirty-six Kansas credit unions. I believe that this proposed rule, if left unaltered, may result in the demise of many Kansas credit union debit card programs. Let me share some concerns.

Enforcement of exemption

Your proposal has no provisions to enforce the small issuer exemption so I recommend that you include enforcement provisions to reinforce this exemption. Congress clearly intended for the exemption to provide protections to smaller issuers. I suggest that without enforcement provisions, your proposal fails to meet the intent if not the purpose of the law.

Small issuer certification

Your proposed small issuer certification process seems burdensome. It is unreasonable to require a credit union to notify a payment card network that it is a small issuer in order to be eligible for the exemption. A more feasible alternative would be to permit payment card networks to develop their own small issuer certification processes. This would assure that a single certification process would be required by all users.

Transaction fees

You offer two alternative standards for debit interchange price controls for credit unions and banks with \$10 billion or more in assets, although this could ultimately apply to all credit unions if the two-tiered system fails.

Alternative 1 would give issuers a choice between a safe harbor of 7 cents per transaction or give the issuer's allowable expenses up to 12 cents per transaction. Alternative 2 would allow a fee which is a percentage of the transaction's value up to a maximum 12 cents per transaction without requiring documentation of expenses.

Although Alternative 1 may seem the less onerous, you should understand that neither of these alternatives would provide the needed income to preserve existing credit union card programs. If the program cannot be supported by transactions fees, either fees will be passed on the consumer in some other way or the program will be terminated. Therefore, you should revisit the transaction fee section and consider all of the costs associated with providing debit card programs, then establish transaction fees that will allow issuers to have enough transaction fees to support their respective debit card programs (such as expenses associated with fraud that are not under the control of the financial institution).

Debit card routing and exclusivity restrictions

You propose limitations on debit card routing and you propose exclusivity restrictions. Again you present two alternative approaches to implement the statute's required rules that prohibit network exclusivity.

Alternative A states an issuer or payment card network may not restrict the number of payment card networks over which an electronic debit transaction may be carried to fewer than two unaffiliated networks. Alternative B states an issuer or a payment card network may not restrict the number of payment card networks over which an electronic debit transaction may be carried to less than two unaffiliated networks for each method of authorization selected by the cardholder.

I believe Alternative A is the only feasible solution if for no other reason than it is consistent with the law. Alternative B is not feasible for small issuers because it would effectively require at least four networks per debit card. In reality, neither alternative is feasible for some of the smallest issuers because the cost of offering transactions through more than one network may be too high to allow them to continue offering the debit card program. You could help these smaller issuers preserve their debit card programs by implementing a hardship exemption for the smallest issuers.

Fraud-prevention costs

You identify two possible approaches to interchange fee increases related to fraud-prevention efforts; 1) a technology-specific approach and 2) a non-prescriptive approach. The second approach is more feasible because it would allow fraud-prevention costs related to an effective fraud-prevention program, but would not require the use of specific technologies that must be employed as part of the program.

Even though one of your proposed fraud prevention approaches is feasible, this provision creates a serious problem for small issuers because you propose to include fraud-prevention costs in the interchange fees rates only after you receive comments. This means small issuers may not be able to afford their debit card programs if they initially have to bear all of the fraud costs without any way to pay for the cost. Please delay the rate setting rules until you include fraud prevention costs in the rates.

Coverage of ATM transactions and networks

Comments on whether ATM transactions and ATM networks should not be included within the scope of this rule since this law do not specifically address ATM transactions. Furthermore, as a practical point, if the restrictions were to limit the income of the small issuers while the costs stay the same, then this could make the program unaffordable for the small issuer. Therefore, ATM transactions and ATM networks should remain outside the scope of this proposal.

Definitions

You propose to define a variety of terms, some that seem to follow the current law while other definitions appear to be based on other existing statutory & regulatory definitions or are based on terminology from the debit card industry. Consistency and agreement on these definitions is important, so you should seek counsel from the industry to assure no unintended consequences will occur by adding these various definitions.

Recommendations/Conclusions

Please listen carefully to all of the entities within the debit card industry before moving forward. A short delay now in the implementation date may greatly benefit all and will certainly serve all in the long term. As stated earlier, the combined affect of the proposed changes, without further amendment, may well mean the demise of many credit union debit card programs. Credit union members value their debit card programs and this new law could potentially eliminate options for consumers.

Thank you for considering my comments. Please contact me at any time to discuss the proposal.

With Best Regards,

Jerel Wright
AVP – Consulting & Compliance