

TO: Louise Roseman
Director, Reserve Bank Operations and Payment Systems
Board of Governors of the Federal Reserve System

FM: Mary Dunn, CUNA Deputy General Counsel

RE: Regulation of Debit Interchange Fees Under Section 920 of the Electronic Fund Transfer Act

DT: December 9, 2010

Louise, this memorandum is intended to supplement previous communications from the Credit Union National Association to the Federal Reserve Board regarding the implementation of Section 920 of the Electronic Fund Transfer Act (EFT), which addresses debit card interchange fees. We appreciate your willingness to consider our concerns and the opportunity to present our issues to you.

We understand that there may be consideration in Congress of delaying the implementation of the interchange provisions and CUNA would urge the Board to support these efforts. If such a delay does not materialize, we urge the Board to consider phasing in requirements to the greatest extent permissible in order to facilitate compliance and minimize disruption to the operations of issuers, networks, and processors.

Meanwhile, we realize that proposed rule is imminent, and in light of that, this communication will be brief and focus on only two broad provisions of the EFT Act amendments: the exemption for small issuers under Subsection 920(a)(6) and the routing and exclusivity provisions under Subsection 920(b)(1).

Small Issuer Exemption

Because credit unions are under growing pressure to build net worth as a result of the current economic situation, the issue of fee income is an important one. That is because under prompt corrective action statutory provisions, credit unions may only build capital through retained earnings, which includes fee income, such as debit interchange fees. About 70% of the nation's 7,700 credit unions offer debit card programs.

The language of Section 920(a) and the legislative history associated with the Durbin amendment make it clear that Congress intended to protect small

issuers' debit transaction fee income from the letter of the interchange rule as well as from its impact.

Since well before the enactment of the Dodd Frank Act and consistently since, CUNA has been meeting with our members, payment network representatives, and key congressional officials, in addition to our communications to the Board. A major focus has been how to implement the exemption in a manner that will make it as meaningful for small issuers as Congress intended.

It now appears that networks may be able to accommodate two- tiered debit interchange fee structures, under which smaller issuers would avoid the fee limitations anticipated for large issuers.

However, as discussed further below regarding the exclusivity and routing provisions, the ability of merchants to determine the routing of debit transactions could undermine the benefits to small issuers of two- tiered structures.

We believe the Board has the statutory authority to help avoid that outcome. Under Section 920(a)(1), Congress directed the Board to write regulations on interchange transactions fees “to prevent circumvention or evasion of this subsection.” This language provides authority for the Board to help ensure the exemption for small issuers is implemented.

In that connection, monitoring the development and implementation of two- tiered approaches is an important role that the Board could undertake. This role would be permissible under Section 920(a)(3)(B) of the EFT Act. That provision would allow the Board to collect information from networks on their efforts to provide two- tiered systems, any impediments to the successful implementation of such approaches, networks' efforts to address those impediments, and their recommendations for legislative or regulatory changes to facilitate two- tiered systems. Small issuers and their representatives should also have the opportunity to provide information to the Board about debt interchange fee concerns.

Based on this information, the Board could develop proposed regulatory amendments to the interchange rule and/or recommend legislative changes to Congress to Section 920 of the EFT Act that would help ensure the exemption for small issuers is feasible.

Routing and Exclusivity Provisions

While monitoring by the Board of the two- tiered approach and developing proposals to address any material deficiencies would be extremely useful, the statutory purpose of the exemption for small issuers will be frustrated if merchants are allowed to direct the routing of debit card transactions in a manner that disadvantages small issuers.

Under Section 920(b)(1), the Board must regulate the prohibition on exclusivity arrangements, which prohibits networks and issuers from limiting the number of networks on which a debit card transaction may be processed to only one (or two affiliated networks). How the Board implements the prohibition will significantly impact debit card interchange income for small issuers.

Credit unions are very concerned about the costs they will have to incur if they need to participate in more networks than they do currently. We urge the Board to do all it can in issuing the regulation on this section to minimize costs to issuers.

If issuers must participate in additional networks, we urge the Board to allow issuers to have options in how they are able to comply. Such options should include, as examples, the ability to participate in two independent PIN networks or the ability to participate in one PIN network and one signature network.

This approach is consistent with Section 920 and will allow merchants to have routing choices that will help to limit their costs. It will also facilitate the ability of small issuers to select networks that are willing to provide a two-tiered debit interchange fee structure.

Thank you for your consideration of our concerns, which we request be addressed in the proposal or Supplementary Information accompanying the proposal. Please let me know if you would like additional information from us on the points raised in this memo.