



National Association of Federal Credit Unions
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Fred R. Becker, Jr.
President and CEO

February 16, 2011

The Honorable Shelley Moore Capito
Chairman
House Financial Services Subcommittee on
Financial Institutions
and Consumer Credit
United States House of Representatives
Washington, D.C. 20515

The Honorable Carolyn Maloney
Ranking Member
House Financial Services Subcommittee on
Financial Institutions
and Consumer Credit
United States House of Representatives
Washington, D.C. 20515

Re: Consequences of the Durbin Amendment on Credit Unions

Dear Chairman Capito and Ranking Member Maloney:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association exclusively representing the interests of our nation's federal credit unions, I write today in conjunction with the Financial Institutions and Consumer Credit Subcommittee hearing: "Understanding the Federal Reserve's Proposed Rule on Interchange Fees: Implications and Consequences of the Durbin Amendment."

NAFCU strongly opposes the Federal Reserve's proposed rule that, as prescribed by the Durbin Amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act (PL 111-203), would implement burdensome new price caps on debit interchange fees. We are pleased that the subcommittee is holding a hearing on this subject and urge immediate legislative action to stop the Federal Reserve's proposed rule from going into effect later this year.

The Federal Reserve's price cap scheme interjects the government between two industries, and destroys a free market system that has worked successfully for the American public, as evidenced by the continued record use of debit cards during the holiday season. The Durbin Amendment and the proposed rule amounts to a multi-billion dollar give-away to our nation's largest retailers at the expense of our nation's not-for-profit credit unions and their 92 million member-owners. For example, the corporate parent of the one large privately-owned retailer appearing before the subcommittee in this hearing had higher worldwide revenues in 2009 (\$57.6 billion)¹ than the entire federally-insured credit union industry (\$55.9 billion). The implementation of the Durbin Amendment and the Federal Reserve's proposed rule is sure to expand that margin.

Based on the Federal Reserve's proposed rule, it appears that the worst case scenario is materializing for all issuers including those community institutions under \$10 billion in assets. The proposal will lead to job losses, higher costs for consumers, and may even force some small credit unions out of business as

¹*Breaking New Ground in Retail, Annual Report 2009, Seven and i Holdings Co., Ltd., p.2; (www.7andi.com)*

small issuers will ultimately be forced to accept the same below market interchange rates the rule imposes on large institutions.

Recent NAFCU surveys of our membership, found that nearly 65% of credit unions are considering eliminating free checking to help mitigate lost revenue from the debit interchange rule, and 67% are considering imposing annual or monthly fees on debit cardholders. Implementation of this rule could also lead to lower dividends and higher costs of credit, as 52% of credit unions may consider reducing rates on deposit accounts and 25% will consider increasing rates on loans. Furthermore, it may lead to job losses, as nearly 19% of credit unions will consider reducing staff at their credit unions and nearly 21% will consider closing existing branches or postponing plans to open new ones if the capped rate becomes the default rate for all issuers.

Implementation of this rule is a clear and present danger to credit unions, regardless of their size, and their ability to serve their 92 million members. Congress must act to stop it. While proponents of this price cap point to a “carve-out” for institutions under \$10 billion, the fact remains that it is essentially toothless as written. While there are provisions in the act designed to prevent merchants from steering customers to lower-rate cards, there are no enforcement mechanisms in the act, or the proposed rule, to protect consumers and small institutions from this devious behavior. Furthermore, there are no mechanisms in the act to guarantee the creation of a two-tier payment system (one for those above \$10 billion, one for those below \$10 billion) to benefit exempt institutions. Even if networks propose one now, there is nothing to stop them from changing their mind at any point in the future. This means that, ultimately, market pressure is likely to force interchange rates for institutions under \$10 billion to the “capped” rate.

The flaws of the proposed Federal Reserve rule become even more egregious here, when you consider the fact that the Federal Reserve did not consult and factor in the debit interchange costs for financial institutions under \$10 billion in crafting the price cap. Rather, their “capped” rate was based on the larger economies of scale of those institutions above \$10 billion. If those institutions under \$10 billion are driven to the “capped” rate, the impact on their ability to offer debit products to those they serve will be devastating.

We believe that Congressional action to repeal the Durbin Amendment, and to delay or prevent the Federal Reserve rule from going into effect later this year, is especially warranted given the numerous factors the Federal Reserve failed to take into consideration as part of the rule making process. It is clear that the cost of maintaining a debit card portfolio at a not-for-profit credit union was never taken into account.

First and most significantly, there should have been more consideration given to fraud losses and data security concerns when drafting any regulation limiting interchange fees. Credit unions have suffered steep losses in recent years due to the direct and indirect costs of data breaches. They are often forced to charge-off fraud losses and incur additional expenses in making their members whole again, much of which stem from the failure of merchants to protect sensitive financial information about their customers. Such costs include, but are not limited to, the re-issuance of new cards, creation of new personal identification numbers, and fraud insurance. These were not factored into the Federal Reserve’s proposal.

Second, the Federal Reserve should have also taken into consideration all of the significant costs associated with maintaining a debit card portfolio. Network fees, licensing fees, personnel training, regulatory compliance, and the technology (including ongoing improvements to the system) needed to operate a debit card program add up quickly and become a significant burden for small financial institutions. Neither the Durbin Amendment, nor the Federal Reserve’s proposed rule, currently account for these considerable costs.

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Furthermore, the destructive price fixing amendment fails to recognize that use of the debit card system provides a significant benefit to merchants, such as by allowing for the immediate transfer of payment at the point of sale. Proponents of this amendment sold it by falsely asserting that debit cards are just like paper checks. Recently, a representative from the National Retail Federation was quoted in the *Financial Times* as saying "A debit card is nothing more than a plastic cheque." However, unlike paper checks, the use of plastic cards leaves the onus on the financial institutions to recoup losses incurred by a defrauded customer. If debit cards are to be treated equivalently to checks, then recovering the cost of a fraudulent transaction on a debit card should lie with the merchant, just as it does for a paper check.

Finally, the amendment did not require the Federal Reserve to consult with functional regulators about the impact the proposed rule would have on the safety and soundness of our nation's financial institutions. Thus, they did not do so. This is of paramount importance for not-for-profit, member-owned credit unions, as they are structured and operated differently than large financial institutions that can turn to their shareholders or capital markets to raise funds. The National Credit Union Administration (NCUA), which serves as the regulator for all federally-insured credit unions, can provide a more accurate depiction of how the proposed price caps will negatively impact the credit union industry.

NAFCU urges the subcommittee to focus on the above factors at tomorrow's hearing when considering the credit union perspective with regard to the proposed rule. Make no mistake, if this proposed rule goes into effect, it will have a disastrous impact on credit unions and their 92 million members.

Should you or your staff have any questions or require any additional information please do not hesitate to contact Brad Thaler, NAFCU's Vice President of Legislative Affairs, at 703-842-2204 or me.

Sincerely,



Fred R. Becker, Jr.
President/CEO

cc: Members of the Subcommittee on Financial Institutions and Consumer Credit
The Honorable Spencer Bachus
The Honorable Barney Frank