Testimony of

Ron Celaschi
Vice President of Lending
Clearview Federal Credit Union
Moon Township, Pennsylvania

Before the
Subcommittee on Investigations and Oversight
Committee on Small Business
United States House of Representatives

Hearing on
"The Impact of Interchange Fees on Small Businesses"

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Mr. Chairman, Ranking Member Fallin and Members of the Subcommittee, thank you very much for the opportunity to testify at today's hearing. My name is Ron Celaschi and I am the Vice President of Lending for the Clearview Federal Credit Union, located in Moon Township, Pennsylvania. My credit union serves 78,000 members and has $630 million in total assets. Initially, my credit union served the employees of US Airways. Today, with a modified charter, we serve communities in a 10 county area around Pittsburgh. I appreciate the opportunity to present my views on interchange regulation.

We are very concerned with the provisions of the recently enacted Wall Street Reform and Consumer Protection Act which relate to interchange fee regulation. The interchange provisions of that legislation were inserted by the Senate into the legislation without hearings or Committee process. No appreciation was given to the consequences that the legislation would have on community financial institutions, like Clearview Federal Credit Union. Quite simply, any reduction in interchange revenue would be a serious blow to Clearview Federal Credit Union, and more importantly, its members. We urge Congress to repeal these provisions before the intended and unintended consequences of interchange regulation are realized.

In many credit unions, interchange revenue covers all of the costs of providing debit access to members. However, for Clearview FCU, that is simply not the case. Last year, our total expense from offering debit access to members was $2.9 million. Our total debit based interchange was only $1 million, falling short of the costs by $1.9 million.

Clearview Federal Credit Union has an aging membership, and older members tend to use their cards less frequently than do younger members. In a recent survey of credit unions conducted by the Credit Union National Association (CUNA), credit unions reported the average number of debit transactions per member per year at 160. At Clearview Federal, it was only 69. Even though my members use their debit cards with less frequency than members of other credit unions, we still incur all the costs of providing that access. We run our debit program at a loss because our members value the program; however, any reduction in interchange will require us to impose fees on members to make up the lost revenue. This will harm to our members and it will be a direct result of the recently enacted Wall Street Reform and Consumer Protection Act.

Debit Interchange Provisions

The Wall Street Reform and Consumer Protection Act included provisions that give the Federal Reserve the authority to regulate "interchange transaction fees," which are defined as "any fee established, charged or received by a payment card network for the purpose of compensating an issuer for its involvement in an electronic debit transaction."

Generally, the provisions require that the amount of any debit or prepaid interchange transaction fee must be "reasonable and proportional to the cost incurred by the issuer with respect to the transaction." The Federal Reserve is required to set standards for assessing whether the amount of any interchange transaction fee is "reasonable and proportional" to the incremental cost incurred by an issuer in connection with a particular electronic debit transaction.

The amendment allows the Federal Reserve to adjust the interchange transaction fee for certain types of fraud-related costs if the issuer complies with fraud-related standards set by the Federal Reserve. The Federal Reserve is directed to issue the "reasonable and proportional" standards within nine months of the date of enactment (*i.e.*, no later than April 21, 2011). The amendment includes exemption language for the following: (1) issuers with less than $10 billion in assets; (2) debit cards or general-use prepaid cards for government-administered payment programs (provided, however, that the issuer does not charge the cardholder certain overdraft or in-network ATM fees); and (3) reloadable general-purpose prepaid cards not marketed or labeled as gift cards (provided, however, that the issuer does not charge the cardholder certain overdraft or in-network ATM fees).

The Small Institution Exception Does Not Work

Currently, the payments networks are supported by the large institutions. About 80 percent of debit volume is accounted for by a small number of large issuers; the other 14,500 or so financial institutions share the remaining 20 percent of debit volume. The scale of large institution transactions permits the construction and maintenance of a national and global network with enough capacity that small banks and credit unions can participate.

The plain language of the amendment envisions a substantial reduction in debit interchange. It is highly unlikely that large banks would continue to support that part of the network so institutions such as the one that I run could issue debit cards at market rates of interchange because there is nothing in the legislation that requires the payment card networks to operate a two-tier debit interchange rate system and there is no economic incentive for them to do so. Further, small bank and credit union debit volume is effectively limited by their deposits; there is no way that small banks and credit unions can support the system.

We do not know precisely how the system will change and in what ways, but below is one scenario from a payments system expert that gives a good idea of the variables:

> **Arbitrarily regulating a portion of the fee merchants pay in order to accept debit cards will create an artificial marketplace for a service utilized by the vast majority of Americans. If the amendment is enacted, the largest 105 U.S. banks (those with at least $10 billion in assets that are regulated in the amendment) will immediately see their debit transaction revenue source greatly diminish, and will likely then focus on issuing credit cards and providing/developing credit card merchant services and technologies over debit services. The remaining U.S. banks and credit unions that do not need to adhere to the regulation face their own problems. These smaller banks will face customer attrition as they are unable to compete with electronic payments rates at larger, fee regulated banks. They will also see a significant drop in debit transaction fee revenue as merchants are incented to promote acceptance of cards issued at regulated banks, resulting in higher operating costs as declines in debit transactions processed increases their cost of completing a transaction.**
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> **Beyond the banks involved in the transaction, the debit payment transaction is driven by thousands of companies that make up the payments supply chain, including card associations (VISA, MasterCard), processors (provide the rails on which the transaction moves), merchant acquirers (provide the ability to accept cards including back-office reporting, etc), independent sales organizations (sell on behalf of merchant acquirers to merchants), POS manufacturers, technology providers, and others who built the infrastructure and developed the technology that make not only debit, but all forms of electronic payments possible. These payments companies employ tens of thousands of people all around the country, with large pockets in Omaha, Atlanta, and Louisville; these cities have been estimated to each have more than 10,000 people working in the payments industry. From these suppliers' perspectives (suppliers that all depend on revenue from all forms of electronic payments transaction fees), the new artificial marketplace favors cash, check, and credit card payments over debit payments. Consequently, like the forementioned banks, payments companies will drive resources and sales initiatives towards merchants receiving credit card payments over debit. Inherently, over time, debit payments will stagnate or drop in number of transactions and in dollar volume. This would come despite consumers' recent adoption of a "pay as you go" mentality, accomplished via debit card use – in late 2008, VISA debit card volume surpassed VISA credit card volume for the first time in response to the recession, as consumers experienced the pains of deleveraging from years of excessive credit card spending.[1]**

Routing Provisions

[1] Mike Strawhecker. "Trickle-Down Legislation: Potential Impacts & Unintended Consequences of Interchange Regulation." The Straw Group. July 9, 2010. (www.thestrawgroup.com).

The Wall Street Reform and Consumer Protection Act also includes provisions which direct the Federal Reserve to issue regulations providing that neither an issuer nor a payment card network may restrict the following: (i) the number of payment card networks on which an electronic debit transaction may be processed to only one such network, or two or more affiliated networks; and (ii) the ability of a merchant to route debit transactions over any "network that may process such transactions." Such regulations must be issued within one year after the date of enactment (*i.e.*, no later than July 21, 2011). No small issuer exemption applies to this provision of the new law.

This provision causes small issuers like me significant concern because it gives the merchants the ability to steer consumers toward cheaper payment networks that may result in lower costs for the merchant, but have negative consequences for the consumer. Not all networks are created equal – they provide different liability fraud safeguards, chargeback and other consumer protections. When entering into agreements with these payment networks, we evaluate what they offer to our members in order to act in the best interest of our members. If merchants are able to route transactions as they see fit, our members could lose important fraud protections.

Furthermore, even though we believe that the small issuer carve-out in the debit interchange provision is ineffective, the intent of the interchange language in this legislation, as repeatedly stated by the proponents of the legislation, was not to harm small issuers. The routing provision does not carve-out small issuers and would disproportionately affect small issuers because these are the issuers which are least likely to have relationships with more than one network. In essence, this provision would require any issuer that currently operates on only one network to go out and establish a relationship with multiple networks – an expensive proposition that will result in not only one-time expenses, but monthly expenses as well. In this regard, the debit interchange provisions actually make it more expensive to operate a debit card program while at the same time significantly reducing the amount of revenue earned from such program.

Making More Credit Available to Small Businesses

Mr. Chairman, the debate over the interchange provisions was a trade association fight that pitted depository institutions against merchants. These groups may disagree on this issue, but one issue that we can agree on is the need to increase the amount of credit available to small businesses.

Legislation has been introduced in both the House and the Senate to increase the credit union member business lending cap. In the House, this legislation, H.R. 3380, is sponsored by Representatives Paul Kanjorski (D-PA) and Ed Royce (R-CA), and cosponsored by 124 members. In the Senate, Senator Mark Udall and a bi-partisan group of nine Senators have proposed increasing the credit union member business lending cap from its current level of 12.25% to 27.5%, while at the same time enacting important safeguards to ensure this lending continues to be done in a safe and sound manner. The Credit Union National Association estimates that if either the Kanjorski-Royce bill or the Udall amendment were law, credit unions could lend an additional $10 billion, helping small businesses create 100,000 in the first year after enactment, at no cost to taxpayers. I was pleased to learn that earlier this year the Obama administration endorsed the Udall approach to lift the cap to 27.5%.

Credit unions have proven for years that they are capable of doing this type of lending safely and soundly. During this most recent financial crisis, while bank business lending has contracted, credit union business lending has expanded. In fact, even though my credit union is not what most would consider "near the cap" – we're at about 5% of the 12.25% cap – we have seen our business lending increase dramatically. However, without an increase in the credit union business lending cap, this credit union business lending will have to slow.

Credit unions should be a part of the solution to the small business credit crisis. Clearview Federal Credit Union is committed to helping the small businesses in our community. In fact, our average business loan is approximately $70,000. I hope Congress will increase the credit union member business lending cap as soon as possible so that the business lending at my credit union, and other credit unions like mine, does not have to slow. Small businesses are counting on it.

Mr. Chairman, thank you very much for the opportunity to testify at today's hearing. Clearview Federal Credit Union is proud to serve the citizens and small businesses of western Pennsylvania.