KINECTA
FEDERAL CREDIT UNION
1440 Rosecrans Avenue
Manhattan Beach, CA 90266

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: Proposed New Regulation II, Debit Card Interchange Fees and Routing
Docket No. R- 1404
Dear Ms. Johnson:

On behalf of Kinecta Federal Credit Union, I appreciate the opportunity to comment on the Board's proposal to regulate debit interchange fees and debit card routing, as required by the Dodd-Frank Act. By way of background, Kinecta is a $3.5 billion institution, with over 225 thousand members and with $230 million of annual debit card activity.

We have concerns that the proposal does not accurately reflect the intent of Congress, and will cause harm to our members. Therefore, we do not support the proposal in its current form, and strongly urge the Board to suspend action on it until further study and discussion can be conducted by all stakeholders.

Our concerns are primarily in two aspects of the proposal:

- The small issuer exemption
- The determination of "reasonable and proportional" interchange fees

Small Issuer Exemption—§ 235.5(a)
While the proposal does contain language exempting issuers with assets under $10 billion from the interchange fee rate setting provisions of the regulation, there is no provision that requires networks to maintain separate debit interchange rates for small and large issuers.

As a result of the lack of enforcement for the exemption, small issuers may be subject to the fees that will be required for large issuers under the proposal. Further, even if the networks were to maintain separate interchange rates for small and large issuers, networks would have an incentive to minimize the spread between the two rates to make their brand more acceptable to merchants. Merchants would have an incentive to steer customers to use debit cards from larger issuers. These and other factors would serve to either reduce transaction volume at small issuers such as Kinecta, or eventually lead to a reduction in the debit interchange rate at smaller issuers to a rate very close to the rate for larger issuers. In our view the small issuer exemption provided in the Act, while well-intentioned, will be meaningless without sufficient regulatory enforcement. We urge the

Board to use its authority to reinforce the small issuer exemption to ensure it works as Congress intended.

Reasonable and Proportional Interchange Transaction Fees—§ 235.3
Under the proposal, larger issuers may receive no more than 12 cents per transaction (7 cents under the safe harbor provision). As discussed above, without sufficient enforcement of the small issuer exemption this cap may ultimately be applied to small issuers in the marketplace, including Kinecta. This cap represents a 66 percent reduction in the current average interchange fee of 27 cents per transaction experienced by Kinecta.

A reduction in revenue to 12c per transaction would seriously impact Kinecta's ability to offer this service as is. At 12c Kinecta would sustain an annual loss of $1.5 million from its debit card program. To recoup those losses Kinecta would need to charge about $15 per participating member; we expect 100 thousand active debit users in 2011.

At Kinecta program cost and revenue are similar. In 2010:

Interchange revenue	$280 thousand per month
Vendor costs	$150 thousand per month
Fraud costs	$ 50 thousand per month
Internal resource costs	$ 50 thousand per month

In addition, Kinecta has limited ability to manage program costs down as large portions of program costs are fixed due to using 3rd party vendors.

The impact would be significantly mitigated if the proposed cap were to factor in costs such as actual debit card fraud losses and the administrative functions of providing debit card services. While we understand that the interchange amendment language in the Act is limiting, we are not convinced that the proposed cap represents the full authority and discretion provided to the Board in crafting this provision.

There are already media reports of large national banks announcing the "end of free checking" and the restructuring of fee schedules in efforts to address lost revenue from interchange fees. Credit unions have a long history of offering their members lower fees, higher deposit rates, and lower loan rates than bank customers. Kinecta does not want to charge its members more or higher fees. Unfortunately, the tremendous pressure that this proposal will have on Kinecta's income and costs will force us into making such a decision. If the Board finalizes this proposal in its current form, without taking significantly more time to more fully study the issue, it will ultimately be consumers who end up paying for the merchants' windfall brought by drastic cuts to interchange.

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Kinecta recognizes and appreciates the difficult task given to Board staff to develop regulations to implement the interchange amendment. We thank the Board for its hard work, as well as its willingness to listen to credit union concerns. We appreciate your thoughtful consideration of our views and recommendations.

Sincerely,

Gary Harman,
First Vice President Consumer Lending