February 22, 2011

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

Re: Request for Comment on Regulation II – Debit Card Interchange Fees and Routing

Dear Ms. Johnson:

On behalf of my credit union, Boeing Employees' Credit Union (BECU) and its members, I would like to express serious concern about the current proposal to regulate debit card interchange fees and impose new routing requirements for debit transactions. These changes are likely to have a severe impact on credit unions' income and the ability of credit unions to offer lower cost products and services to their memberships.

Due to their cooperative nature, credit unions are restricted in the type of capital they may raise. In general, credit unions can only build net worth from retained earnings. Any significant reduction in interchange income will impact the ability of credit unions to offer innovative and competitive financial products desired by their members. In BECU's case, the current proposal to cap interchange fees at 12 cents per transaction would likely result in a 25% decrease in non-interest income. Alternative proposals, capping interchange fees at even lower rates, would have an even more deleterious effect.

Credit unions provide their members with lower fees, lower interest rates on loans, and better service than many larger banking institutions. In order to offer low-cost debit card access to checking accounts, credit unions depend on interchange fee income to offset their actual incurred costs. Those costs include variable costs that the Board of Governors (Board) did not include in its determination of maximum interchange fees, including, but not limited to the costs of card production, staff support, fraud monitoring and reporting, and direct losses from debit card fraud. In addition, interchange fees are generally the only source of income for credit unions to directly offset direct costs it must pay to others, such as network switch fees.

But interchange income also helps allay real fixed costs associated with offering free or low-costs checking accounts. Without considering all of the costs associated with debit card transactions, such a drastic reduction in interchange fee income will mean that credit unions must subsidize these increasingly essential services by placing fees on other products or services or through the imposition of additional transaction account fees. The result could be a serious blow to the mission of credit union cooperatives to offer low-cost financial service alternatives to their membership. I understand that the Board is required by the statutory provisions to implement some sort of limitation on debit interchange fees. But, even if the Board is unable to ignore this mandate, I urge the Board to reconsider whether the costs attributable to authorization, clearance and settlement need be so narrowly defined as to exclude the total true costs of offering these services to credit union members.

In addition to these general concerns, I provide the following comments on the proposed regulation:

- The current proposed regulation provides a "small institution" exception for financial institutions with less than $10 billion in assets. Even if debit card networks permit a two-tiered system, allowing smaller institutions to charge higher interchange fees, there is no enforcement mechanism for ensuring that networks allow this two-tiered system to work in practice. The final regulation should provide certainty for smaller institutions that they will not be forced into a regime designed for large banks. Further, a credit union such as BECU, currently with assets below $10 billion, may in the future face a problem of "falling off the cliff;" i.e., BECU may at some point have to make strategic decisions about member and asset growth, considering the loss of significant interchange fee revenue once a $10 billion threshold is passed. The unintended consequence may be to severely limit growth possibilities of "mid-sized" financial institutions, since any revenue reduction is not phased-in.

- The Board asked for comment on one of two alternatives for setting caps on debit card interchange fees. While 12 cents a transaction is far too low to cover real incurred costs and severely reduces needed non-interest income, BECU generally favors a flat fixed cap applicable to all institutions (or all institutions of certain size). A standard requiring a card issuer to justify its actual costs above a safe harbor will impose additional costs and uncertainty. The final regulation should not exacerbate the problem of reducing revenue by also unnecessarily increasing costs.

- The Board asked for comment on alternative rules for prohibiting debit card network exclusivity. Either method would impose significant additional costs on BECU, including many fixed costs such as systems upgrades, staffing, vendor management costs, etc. The Board's alternative B, which would require at least two unaffiliated networks for each type of authorization method (e.g., signature and PIN), would impose much higher costs, as between the two alternatives. Alternative B may also limit incentives for smaller institutions to adopt new innovative technologies, since each new technology for transaction authorization might trigger the need for additional networks. I note that under the current proposal, the requirements for prohibiting network exclusivity apply to all financial institutions, regardless of size. BECU believes that alternative A will likely accomplish the Congressional purpose of increased network competition without the need to further burden financial institutions.

- The Board's proposals on adjustments for fraud-prevention costs appear to ignore those costs that many institutions are already incurring to combat fraud and reduce consumer losses. While BECU has so far been fortunate to have fairly small losses due to debit card fraud, its current fraud monitoring/reporting and losses already account for over 2.3 cents per transaction on average. I anticipate those costs will grow as thieves and fraudsters master more sophisticated technologies. These are real costs that the Board did not consider in setting its proposed cap on interchange transaction fees. If the Board determines that only certain costs incurred in employing new technology-specific fraud prevention methods will qualify for a further interchange fee adjustment, then many of the actual fraud costs incurred (particularly by small institutions) will likely be ignored. I would encourage the Board to instead revise its proposed interchange transaction fee caps to more accurately reflect the true costs that institutions incur in combating fraud and protecting consumers.

Thank you for your consideration of these comments.

Sincerely,

Gary Oakland
President and CEO
BECU,
A Washington state-chartered credit union