FMI THE FOOD INDUSTRY ASSOCIATION

Submitted via email to regs.comments@federalreserve.gov

Federal Reserve System
Board of Governors of the Federal Reserve System
Jess Cheng, Senior Counsel
Legal Division

August 10, 2021

Re: Debit Card Interchange Fees and Routing; Regulation II; Docket No. R-1748; RIN 7100-AG15

Dear Ms. Cheng,

On May 13, 2021, the Board of Governors of the Federal Reserve System (Board) published in the *Federal Register* a proposal to amend Regulation II (Reg II)[1] to clarify that the requirement that each debit card transaction must be able to be processed on at least two unaffiliated payment card networks applies to card-not-present transactions, to clarify the requirements that Regulation II imposes on debit card issuers to ensure that at least two unaffiliated payment card networks have been enabled for debit card transactions, and to standardize and clarify the use of certain terminology.

FMI appreciates the opportunity to comment on these important issues. As the food industry association, FMI works with and on behalf of the entire industry to advance a safer, healthier and more efficient consumer food supply chain. FMI brings together a wide range of members across the value chain — from retailers that sell to consumers, to producers that supply food and other products, as well as the wide variety of companies providing critical services to retailers, wholesalers and suppliers — to amplify the collective work of the industry. Additional information about our organization is available at www.FMI.org.

[1] 86 Fed. Reg. 26189 (May 13, 2021), Debit Card Interchange Fees and Routing; Docket No. R-1748, hereinafter "Reg II."

FMI Supports Clarifications in Regulation II

FMI strongly supports the Board's clarification that the debit routing provisions in Reg II guarantee merchant choice regardless of where or how the transaction occurs. As consumers continue to shift from in-store to online shopping, it is essential that the Board quickly clarify and strongly enforce the law guaranteeing merchant choice for debit routing. According to estimates, lack of online routing options cost U.S. merchants and their customers $3 billion annually, or $250 million each month.

FMI members encompass the broad food retailing ecosystem, including fourth generation single-store operators, national and international chains, and online-only entities. All our members compete in the open market based on price, service, and selection, continually finding new and innovative ways to attract customers and earn their loyalty. This fierce competition greatly benefits the consumer who expects the safest, most abundant, and affordable food supply in the world. As a result, the food retail industry functions on a razor thin profit margin, averaging below 3% annually. [2]

FMI Members Invested in Significant Resources During the COVID-19 Pandemic

U.S. food retailers are quick to respond to changing consumer demand, always keeping the customer's interest at the forefront of every decision. Throughout the past year, the industry's commitment to their customers has been demonstrated like never before. As our nation responded to an unprecedented public health crisis, the food retail industry took extraordinary measures to remain open and find new, innovative ways to serve its customers. Food retailers accomplished this while also investing significant resources and capital to help keep their associates and customers safe. In only a few short months, food retailers invested more than $24 billion in safety measures, including for around-the-clock sanitation and installation of plexiglass barriers at checkout and personal protective equipment to keep both employees and customers safe.[3]

In addition to the significant in-store investment, food retailers also dedicated considerable resources to providing online grocery services as consumer demand for this service significantly expanded almost overnight. Grocers who already had an online

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[2] https://www.fmi.org/our-research/supermarket-facts/grocery-store-chains-net-profit

[3] Receipts From The Pandemic: Grocery Store Investments Amid COVID-19 and the Resulting Economics of an Essential Industry, May 2021, *FMI-The Food Industry Association.*

presence dedicated substantial manhours and resources to acceptance, fulfillment and both pick-up and delivery services. Many smaller grocers did not yet have online sales and responded by rapidly investing to develop and deploy online shopping platforms and fulfillment services. These investments, combined with the previously mentioned $24 billion investments in-store to protect associates and consumers, were not previously planned or budgeted but were required to ensure American families continued to have access to food and other necessities at such a critical time.

Consumers' shift to online purchasing had additional impacts, including higher costs associated with processing transactions. Prior to 2020, U.S. consumers used a mix of tender types when purchasing groceries, with a growing reliance on debit and credit cards. The events of 2020 drastically accelerated a change in tender usage and the move to online shopping. Debit card purchase volume alone increased more than 15% over that of the prior year, to $2.23 trillion in 2020.[4] This change in consumers' shopping habits has remained durable even as states and localities reopen. A recent FMI survey noted that two-thirds of U.S. consumers now buy groceries online and the average consumer is allocating more than 20% of his or her grocery spend online.[5]

As commerce continues to evolve and diversify from the traditional checkout experience of a customer swiping and now dipping their card, so must the enforcement of the federal debit routing law. When the Board first implemented Reg II, online grocery sales were still minimal and solutions such as PINless were in their infancy. Today, all debit networks have developed and deployed a PINless solution, which should allow for merchants to easily access competitive networks in the online space. However, as the Board notes, only 6% of online debit transactions are being processed by single-message networks, Visa's and Mastercard's competitors, despite the ability to do so.[6] This is clear evidence of the need for immediate clarification and robust enforcement from the Board to defend the merchant's right to choose among competitive networks, regardless of where or how the transaction occurs or is authenticated. The current lack of enablement by a few of the largest issuing banks is blocking competition in the online routing space, increasing merchants' costs, and in the end, harming the consumer.

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[4] Nilson Report, February 2021, issue 1191
[5] U.S. Grocery Shopper Trends 20201, FMI - The Food Industry Association
[6] "Debit Card Interchange Fees and Routing." Federal Register 86:91 (May 13, 2021) p. 26189.

While some argue that the market is continuing to evolve and greater network enablement will come, the facts tell a much different story. In a truly competitive market, as usage and efficiencies increase, the end result should be a decrease in costs. Unfortunately, when it comes to the payments card market in the U.S., the exact opposite has occurred. Instead, costs have gone up and the dominant participants have used their market power to keep the market closed to any competition. The Durbin Amendment's clear intent is to ensure and foster competition in the debit card market. History has shown the two dominant players, Visa and Mastercard have repeatedly attempted to find ways to usurp the law and stifle competition. FMI applauds the Board for taking much needed steps to clarify that merchants must have a choice among networks whenever and wherever a debit transaction occurs.

FMI Urges the Board to Make Additional Changes as Technology Evolves

While FMI applauds the Board's proposal and advocates for a swift finalization of its contents, we suggest some improvements to ensure the law is complied with as technology evolves. First, the Board states, "Section 235.7(a) requires an issuer to configure each of its debit cards so that each electronic debit transaction initiated with such card can be processed on at least two unaffiliated payment card networks. In particular, section 235.7(a) requires this condition be satisfied for every geographic area, specific merchant, particular type of merchant, and particular type of transaction for which the issuer's debit card can be used to process an electronic debit transaction."[7] FMI supports the statement; however, we also recognize that in order to preserve the intent of this statement and prevent usurpation of the law as technology evolves, additional action is required. As written, an issuer could, for instance, enable a card with a dual-message signature provider, and single-message retina scan provider. Should the Federal Reserve allow for only one payment card network by authentication method, merchants would find themselves at an even greater disadvantage than they do today. First, if this type of approach were allowed (using the previously outlined example), a second available network would not be ensured for an online transaction as there is not a commercial retina scan solution for online in the marketplace today. Second, biometric authentication is not widely used in-store today, therefore leaving the merchant with only the dual message signature option to process the transaction. FMI therefore requests the Board remove, "As long as the condition is satisfied for each such case, section 235.7(a) does not require the condition to be satisfied for each method of

[7] Reg II at 26189.

cardholder authentication."[8] Furthermore, FMI requests that the Board expand on the first statement by clarifying that neither payment card networks nor issuing banks can use authentication methods to limit merchant routing choice. Any debit network enabled on a card should be allowed to process and authenticate any transaction it is capable of completing. This solution would prevent arbitrary limits on merchant routing choices while encouraging networks to enable the multiple authentication solutions. This clarification will also help ensure that merchant routing rights do not fall through an authentication loophole and will allow for the development of new innovative authentication methods, and as the Board notes "the lack of a method of cardholder authentication."[9]

FMI Urges the Board to Enforce the Law for P&I to Banks

FMI and our members also urge the Board to take steps to ensure the payment card networks comply with the law, particularly with regard to the payments and incentives (P&I) to issuing banks. The Board's biannual survey demonstrates the market power the global payment card networks hold in providing P&I, particularly to the largest covered issuing banks. Specifically, the survey noted "per-transaction P&I paid to issuers by dual-message networks were roughly 3.5 times as high as those paid by single-message networks in 2019, a difference that almost doubled from 2009 to 2019."[10] The Board also reported that "by contrast, the amount of P&I that issuers received from dual-message networks represented a much higher percentage (46.8%) of the network fees they paid than the corresponding value for acquirers/merchants (22.9%)."[11] FMI is concerned that the global payment card networks are leveraging P&I to unfairly incentivize the largest issuing banks from enabling additional networks, resulting in a lack of options for merchants. These concerns are only compounded by the fact that covered issuers received P&I equal to 68.2% of network fees paid from the dual-message networks, far higher than the amount smaller issuers received or the single message networks could pay.[12] EFTA section 920(b)(1)(B) requires the Board to prohibit networks and issuers from directly or indirectly inhibiting merchant routing choice. The evidence of heavily weighted P&I paid by the global payment card networks to the

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[8] Reg II at 26189.
[9] Reg II at. 26189.
[10] 2019 Interchange Fee Revenue Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions, May 2021.
[11] Id.
[12] Id.

largest issuing banks is clear and the Board must take immediate steps to prevent further manipulation of the debit routing market by these parties.

FMI Appreciates the Board's Clarifications in Reg II

FMI applauds the Board's desire to provide clarifications to the debit routing provisions in Reg II. In addition to the above stated concerns, FMI urges the Board to vigilantly enforce against any card payment network's practices or rules that impact or limit a merchant's routing ability. As an example, the Board should clarify that those solutions, including tokenization, must also comply with the law. Tokenization, as currently being deployed by the global payment card networks, raises significant obstacles to merchant routing choice. Today, the dominant global payment card networks are preventing new entrants into the space and require tokenized transactions to be sent to them for detokenization even if they are not the chosen network for a transaction. FMI views this as a clear violation of merchant choice for debit routing and should be addressed by the Board. Any participant that meets the requisite security standards should be allowed to serve as a token service provider (TSP) and compete openly in the market.

Additionally, the global card payment network's deployment of the EMV Common AID does not allow for a debit network to transmit that a mobile or in-app purchase was verified by biometrics. This arbitrary restriction is not based on functionality or a debit network's ability to send the data; it is simply another barrier created to inhibit a merchant's ability to route transactions. Challenges remain with the global card payment network's requirement that issuing banks prioritize the Global AID over the Common AID, despite the Board's previous clarification that merchant debit rights were being blocked in the EMV rollout in the U.S. Requiring issuing banks to prioritize the Global AID, which only houses the global card payment network, forces a merchant to override the system to access the U.S. compliant Common AID. In fact, the Visa VSDC Contact & Contactless US Acquirer Implementation Guide explains that by default the transaction will go to the Global AID, and that a merchant must implement "special logic" to access the compliant Common AID.[13] There is no technological need to prioritize the Global AID nor for the merchant to have to deploy special logic to access the Common AID. These rules limit merchant routing choice. The Board should explicitly clarify that market manipulations like the three listed above do not comply with Reg II and then act quickly to enforce the law.

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[13] VSDC Contact & Contactless U.S. Acquirer Implementation Guide, version 3.0, effective June 2020.

The Board Should Act Quickly to Reduce the Regulated Debit Rate

Finally, FMI respectfully asks the Board to act immediately to reduce the regulated debit rate. The current rate does not reasonably nor proportionately reflect covered issuer costs as required by the law. Since the regulated rate was first implemented, covered issuer costs have reduced by about half, now less than $.04.[14] While covered issuers have become more efficient and have reduced costs, the regulated rate of $.21 plus five basis points times the value of the transaction plus a one cent adjustment for fraud has not changed since it was finalized a decade ago. Furthermore, the fraud burden has shifted away from issuers and on to merchants over the past decade, as the Board noted "From 2011 to 2019, the percentage of losses from fraudulent transactions reported by covered issuers absorbed by merchants steadily increased from 38.3% to 56.3%, while the percentage of losses absorbed by covered issuers steadily decreased from 59.8% to 35.4%."[15] Individually, the reduction in costs and in fraud burden merit a reduction in the regulated rate, and combined, they demand it. Merchants paid more than $24 billion in 2019 in debit interchange, remarkably the same amount grocers invested to help protect our customers and associates in 2020. Now is the time for the Board to address the disparity in the regulated rate by reducing the $0.21 limit to correspond in the drastic reduction in issuer costs and removing the one-cent fraud adjustment permanently.

FMI thanks the Board for the opportunity to share input and thoughts on the proposed clarification of Reg II. FMI emphatically encourages the Board to finalize the clarification with the suggested changes above to ensure no greater harm is done to the debit market, merchants, and the consumer. FMI also calls on the Board to reduce the regulated rate to bring it into alignment with the statutory requirements. We greatly appreciate the opportunity to provide comments today and are happy to answer any questions you may have.

Sincerely,

Leslie G. Sarasin, Esq.
President and Chief Executive Officer

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[14] 2019 Interchange Fee Revenue Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions, May 2021.
[15] Id.