

Comment Letter for Debit Interchange Rulemaking

Ann. E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th St. and Constitution Ave. NW
Washington, DC 20551

**Re: Docket No. R-1818, RIN 7100-AG-67
Notice of Proposed Rulemaking: Debit Card Interchange Fees and Routing**

Dear Ms. Misback:

I am the President of Calloway Oil Company and E Z STOP FOOD MARTS of MARYVILLE, TN. I appreciate the opportunity to submit this comment in response to the Federal Reserve Board's ("Board" or "Fed") Notice of Proposed Rulemaking ("NPRM") on debit card interchange fees. EZ STOP operates 25 convenience stores in East Tennessee and Calloway Oil supplies 15 small stores as well. My companies employ 250 workers. We are Family-owned businesses started by my father-in-law and his father-in-law in 1957 as a Phillips 66 Distributor. My oldest daughter and her husband are the fourth generation of our family involved in active management of our convenience stores and EXXON Distributorship.

I write to express my general support for the Board's proposal to reduce the maximum debit interchange fee for regulated debit card issuers and to establish a regular process for updating the interchange fee limit every other year. These steps are much needed and long overdue. However, I want to make clear that the Fed's new proposed fee limits, while lower than the current limits, are still much too high; in fact, the data clearly show that the limits should be made even lower when the Fed writes its final rule. It is also critically important that the Board safeguard the process for future fee limit adjustments so that banks are not able to manipulate it by inflating or misrepresenting costs.

Interchange fees, or swipe fees, are a significant challenge for our business. It is not feasible to operate a convenience store these days without accepting Visa and Mastercard payment cards, but the cards carry high fees that cut significantly into our profit margin every time a card is swiped. In fact, swipe fees are one of the highest operating costs we face.

OUR SMALL MARKETSHIP IN EAST TENNESSEE PAID OVER 3.3 MILLION DOLLARS IN CARD FEES IN 2023. There are several companies our size or much larger in this region alone that pay that much or more in Credit Card Fees.

NOT A ONE OF THOSE COMPANIES HAVE A NET PROFIT MARGIN AFTER TAX OVER 50% LIKE VISA AND MASTERCARD DO!!!

You see our signs in high school gymnasiums and Little League parks but you don't see Visa and Mastercard signs in Tennessee athletic facilities!

. For almost all of our other operating costs, we can reduce costs by negotiating with suppliers or finding marketplace alternatives; however, Visa and Mastercard dominate the payment card market and do not negotiate with us over fee rates. Our stores compete vigorously every day to offer low prices for our customers, but when we face costs that we cannot reduce through competition, our consumers end up paying higher prices.

When the Fed issued Regulation II in July 2011 to implement the Durbin Amendment, the Fed's final rule adopted a base limit of 21 cents for debit swipe fees fixed by card networks on behalf of banks with over \$10 billion in assets. It was surprising that the Fed set the limit that high in 2011, for several reasons. First, even with a generous interpretation of allowable costs, large bank debit card issuers had an average base per-transaction cost of only 7.7 cents at that time, which is far less than 21 cents. Second, debit cards are essentially electronic versions of paper checks, and for more than a century the Fed has regulated paper checks to clear at par, meaning the banks that issue the checks deduct zero fees from the transaction amount received by merchants as checks pass through the system. Third, the initial rule the Fed proposed in December 2010 would have set the limit at no higher than 12 cents, which was more than adequate to cover bank costs and provide a healthy profit margin.¹ It is troubling that when the Fed proposed this reasonable and justifiable fee limit in 2010, the banking industry waged an aggressive and ultimately successful effort to lobby the Fed for significantly higher fees. That bank lobbying effort was largely based on specious arguments and speculative claims that did not prove true, and I hope that misleading banking industry lobbying does not sway the Fed this time around. The debit fee limits that the Fed established in 2011 were higher than they should have been then, and as the NPRM notes, they are unquestionably excessive now.

The current proposed rulemaking by the Fed would lower the debit swipe fee base component from a maximum of 21 cents to 14.4 cents. That reduction is a long-overdue step in the right direction, but given that the Fed's latest data found that the average allowable costs of covered issuers are "approximately half" of what they were when the rate was initially set, it is unreasonable that the NPRM only reduces the base component fee by less than one-third.² The NPRM says that it bases its 14.4 cent proposal on a "fixed multiplier" of 3.7 times the actual average covered issuer cost of 3.9 cents, but this fixed multiplier caters too strongly toward low-volume, high-cost issuers in an attempt to hit an arbitrary target of full cost recovery for 98.5% of covered issuer transactions.

I think it is telling that Exxon has developed a Direct Debit Plus Program for its customers that costs the EXXON retailer a TOTAL OF 20 cents a transaction. OUR LOYALTY PROGRAM USES THE ZIPLINE WHICH IS ELECTRONIC DEBIT AND WE PAY 18 CENTS A TRANSACTION AND STAND THE FRAUD WHICH IS NEGLIGIBLE!!

EBT CARDS which are government issued debit cards cost us 15 cents a transaction. NO MULTIPLIERS OR ADD ONS NEEDED WITH THESE FOLKS!!

¹ In fact, the 2010 proposal would have limited debit fees to 7 cents but allowed banks to charge up to 12 cents if they could demonstrate that more than 7 cents was needed to appropriately cover the individual bank's costs. This range of fees was "reasonable and proportional" to costs given average costs of 7.7 cents and typical profit margins in U.S. businesses of single digit (or low double digit) percentages.

² Federal Reserve Board, "2021 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions," October 2023, at p. 3.

And, the multiplier is much higher than it was when the Fed finalized its current rule. It would provide a margin of 370%. Businesses in developed market economies simply do not make margins coming anywhere close to 370%. By way of comparison, businesses in my industry average margins of less than 2.5%.

The proposed rule allows the largest banks who have the vast majority of debit transactions to enjoy a debit interchange windfall that nearly quadruples the amount of their costs. This is neither reasonable nor fair to the merchants and consumers who are forced to pay higher prices when swipe fees are fixed at windfall levels. The final rule should further reduce the 14.4 cent base component limit to a level that actually reflects that the average allowable costs for covered issuers are now “approximately half” of what they were when the base component fee was set at 21 cents.

The current NPRM would also reduce the *ad valorem* component of the Fed’s debit fee limit, which the Fed designed to cover issuer fraud losses, from 0.05% of the transaction amount to 0.04% in light of the Board’s recognition that “the issuer fraud losses on which the Board based the *ad valorem* component have fallen.”³ Again, a reduction is warranted, but the final rule must acknowledge and factor in that big card-issuing banks are increasingly charging back debit fraud losses to merchants and cardholders while continuing to claim that they need higher interchange fees to cover those same fraud losses.

The Fed’s most recent data found that for covered big bank issuers, from 2011 to 2021 the percentage of losses from fraudulent transactions absorbed by issuers decreased from 59.8% to 33.5%, while the percentage of losses absorbed by merchants increased from 38.3% to 47% and the percentage absorbed by cardholders increased from 1.8% to 19.5%.⁴ The banks should not be able to have their cake and eat it too. They make merchants absorb more of the costs of fraud losses than they absorb themselves. Therefore, they should not be able to require merchants prepay for issuer fraud losses through interchange. The *ad valorem* component of the fee should be completely eliminated unless and until issuers once again pay for more of the fraud losses than merchants.

The NPRM would also increase the current issuer fraud-prevention adjustment from 1 cent to 1.3 cents per transaction. The Board should not make this adjustment available for all covered issuers, but rather the Board should require each issuer to demonstrate in each data collection period that the issuer is complying with steps that are actually effective in reducing fraud. For example, it is clear from the Fed’s latest data collection that fraud is low and getting lower for single-message (i.e., PIN-authorized) debit transactions, while fraud is high and getting higher for dual-message (i.e., Visa and Mastercard signature-authorized) debit transactions.⁵ Why should issuers automatically get the fraud prevention adjustment amount if they are steering transactions toward more fraud-prone networks and forms of authentication? The law Congress

³ 88 Fed. Reg. 78100.

⁴ Federal Reserve Board, “2021 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions,” October 2023, at p. 3.

⁵ Federal Reserve Board, “2021 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions,” October 2023, at p. 20.

passed requires issuers to comply with fraud prevention standards that are actually effective in reducing fraud, and the Fed must do a better job of holding issuers to it. My business has made significant investments to prevent debit fraud, including installing expensive EMV terminal technology in the amount of \$7,500 dollars per pump at a store with no decrease in fees by the way!! Issuers should likewise do their part before getting rewarded with the fraud prevention adjustment.

Finally, I support the Board's proposal to regularly update the debit swipe fee limits every other year, especially given that the limits have not been updated at all in the 12 years since Regulation II was issued. However, the Fed must not lock in the excessively high 3.7 multiplier for the base component fee. That must be lower (with 2.7 being a very high, maximum number). The Fed also must take great care to monitor the cost data being submitted by covered issuers to watch out for issuers that try to inflate or misrepresent their costs or to shoehorn non-allowable costs into the calculation. There is a long and growing history of big banks and card networks trying to game the requirements of the Durbin Amendment, which has forced the Fed, the Federal Trade Commission, and the Department of Justice to take action in response, and we also saw during the LIBOR scandal that banks have been willing in the past to misrepresent their costs when reporting to regulators. The Fed must be vigilant in watching out for continued banking industry efforts to manipulate the system under the regular updating mechanism.

In closing, I urge the Board to move forward with its proposed fee reductions and its process for regular future adjustments, but with lower fee levels and with careful safeguards to prevent big bank manipulation of the process. Reining in debit swipe fees will help Main Street businesses manage a cost that has for too long been insulated from marketplace competition, and that will benefit businesses like ours, our customers, and our communities. Thank you for considering my views on this important matter.

Sincerely,

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PRESIDENT
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