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Via E-mail and E-Portal

May 10, 204

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

Re: **Comments on Debit Card Interchange Fees and Routing (88 Fed. Reg. 78100 (Nov. 14, 2023)**

Dear Secretary Misback,

The Retail Industry Leaders Association (RILA) strongly supports the Board's proposal to reduce the cap on debit interchange fees imposed by Regulation II. For more than a decade, retailers and consumers have been footing the bill for debit interchange rates far higher than the Durbin Amendment permits. Accordingly, and above all else, it is essential that the overall regulated rate come down to a level more commensurate with the costs that issuers actually incur, and that it do so soon. Because the primary effect of the proposed rule is to move the rate closer into line with issuer costs and thus closer to a level that is fair to retailers and consumers and better vindicates Congress's vision in the Durbin Amendment, RILA and its members support the Board's proposal, and urge the Board to follow through in its final rule.

These comments generally explain our support of the determination to lower the cap, *see infra* pp. 3-21, and then respond to several of the specific questions the Board posed in its Notice of Proposed Rulemaking. *See infra* pp. 21-34. We also write to make three overarching points, and to urge the Board to consider adopting a tiered approach to the regulated debit interchange rate rather than the proposed single rate applicable to the largest and smallest issuers alike. To be sure, the proposed reduction is undoubtedly a step in the right direction. But a tiered approach would better align the debit interchange system with Congress's stated goals and statutory commands.

Our three overarching points, which are explained in greater detail below, are as follows:

First, we note that—while the proposed reduction certainly improves the alignment between the Board's regulation and Congress's text—the Durbin Amendment permits the Board to adopt an approach that is even more fair to retailers and less generous to banks than its current approach. RILA continues to maintain that the statute affirmatively forbids reimbursement of certain costs that the Board has included since Regulation II was adopted. We understand that the Board is not interested in revisiting that decision at this time. *See* Notice of Proposed Rulemaking, 88 Fed. Reg. at 78113, n.82. But our key point here is that, even if RILA's reading of the statute is incorrect (as the D.C. Circuit has held), there is no doubt that the statute does not *require* the Board to include those costs (as the D.C. Circuit has also held), and so, in this regard, debit issuers are beneficiaries of the Board's discretionary largesse. Recognizing this reality makes current issuer complaints about reducing the cap ring hollow: Not only is the current proposed cap well within the reasonable discretion of the Board; it is well *above* the level that the Board could reasonably adopt.

Second, while RILA generally supports the Board's proposal to regularize the process of updating the rate based on biennial survey data, the process could be improved by tailoring it to address long-term trends and important asymmetries in the information available to issuers and other stakeholders (like merchants and consumers). The long-term trend has clearly been a significant reduction in issuer costs, which makes sense given technological progress and corporate incentives. But the survey data the Board publishes is opaque (particularly to non-issuers). Moreover, given the inclusion of fixed costs, strategically timed, one-time investments by issuers could lead to anomalous "increases" in cost over shorter time periods. RILA thus endorses certain steps to improve the reliability and transparency of the biennial survey data, and urges the Board to adopt a process where unexpected, short-term increases in the costs reported unilaterally by the banks do not lead to automatic increases in the regulated debit interchange rate absent an opportunity for merchants and other stakeholders to weigh in.

Third, we emphasize that—although Congress quite clearly intended the Durbin Amendment to create a cost-recovery regime where issuers should have limited (if any) profits from debit interchange—the current system in fact leaves a massive rent in place, particularly for the largest issuers. The Board's proposed change at least trims that rent down, and thus represents an unambiguous improvement from the status quo. But there are multiple indications from the very design of the Board's current proposal that a true cost-recovery regime remains a long way off. RILA urges the Board to recognize this gap and pursue ways

to improve the alignment between the regulatory design and the mandate in the Durbin Amendment's statutory text, which limits "an issuer" to debit charges that are "reasonable and proportional to the cost incurred *by the issuer*." 15 U.S.C. §1693o-2(a)(2). A system where a very large subset of issuers continues to reap a very large profit falls outside what Congress intended or enacted.

The best solution is to adopt a tiered approach that creates at least two rates: one for the largest issuers with the lowest costs, and one for all other regulated issuers. Such an approach would more effectively limit the excess profits extracted by the largest issuers, while maintaining equitable treatment for smaller issuers, thereby helping to address the concerns that Board Member Bowman has expressed.[1] It would also align more closely with the textual requirements and overall design of the Durbin Amendment. The Notice of Proposed Rulemaking dismissed this option without much analysis, *see* 88 Fed. Reg. at 78108 & n.48, and we strongly urge the Board to reconsider it.

These comments proceed in three parts. Section I provides some background on the Durbin Amendment and its implementation, including the merchant experience under the current regulation. Section II addresses the high-level points introduced above in greater detail, and explains the reasons supporting a tiered approach to the debit interchange rate. Section III then responds to the specific, narrower questions raised by the Board (and the issues raised by Member Bowman) in the Board's decision to publish the proposal.

I. Background Regarding the Durbin Amendment and the Merchant Experience

By the time of the 2008 recession, interchange expense (*i.e.*, the fees charged for accepting debit or credit cards to process transactions) had become "a significant cost of operating for merchants, in some cases even their second highest cost after labor."[2] These fees were difficult to justify in terms of processing costs; as experts pointed out, "processing costs [could] not possibly reach 3 percent of transaction value," *id.* at 3, which is where the fees were frequently pegged. Moreover, processing costs do not generally increase linearly with the size of the transaction; the cost of "processing a $100 transaction should not be 100x

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[1] Governor Michelle W. Bowman, Statement on Proposed Revisions to Regulation II's Interchange Fee Cap, October 25, 2023, https://www.federalreserve.gov/newsevents/pressreleases/bowman-statement-20231025.htm (hereinafter, "Statement of Member Bowman").

[2] Vladimir Mukharlyamov and Natasha Sarin, *The Impact of the Durbin Amendment on Banks, Merchants, and Consumers,* Faculty Scholarship at Penn Law 4 & 5 (2019).

the cost of processing a $1 transaction." *Id.* Nonetheless, issuers of debit and credit cards and the card networks routinely charged fees set at a percentage of the transaction—and a relatively large one at that. U.S. interchange fees were also considerably higher than in other nations, suggesting that financial institutions were not merely recouping their costs in the U.S. market, but rather exploiting market power to extract rents from merchants (and, inevitably, the downstream consumer).[3]

To challenge the collection of these excessive rents, the Department of Justice and various coalitions of merchants had for years repeatedly brought antitrust suits alleging collusive pricing practices that kept interchange rates substantially raised relative to the costs of processing these transactions. *See, e.g., United States v. Visa U.S.A., Inc.,* 163 F.Supp.2d 322 (S.D.N.Y 2001), aff'd, 344 F.3d 229 (2d Cir. 2003), cert. denied, 543 U.S. 811 (2004); In *re Visa Check/MasterMoney Antitrust Litig.*, 297 F. Supp. 2d 503 (E.D.N.Y. 2003). Those efforts generated only limited success, however, and ultimately left in place a market failure where interchange revenues far exceeded the costs of the parties collecting them with respect to both debit and credit cards.

Concerned about these excessive fees—particularly when it came to relatively low-risk debit transactions—Congress decided a more systematic approach was necessary and made a major legislative intervention by passing the Durbin Amendment in 2010. One essential premise of its decision was that debit transactions were fundamentally similar to transactions carried out with personal checks, which clear at par without any fees at all for those who use them. *See* 15 U.S.C. §1693o-2(a)(4)(A). Whatever differences there might be between the two systems, it seemed unlikely that they differed sufficiently in their benefits or cost structures to justify such a large discrepancy in the amount being charged to the systems' users; if anything, the technological efficiencies associated with debit cards should lead to *lower* costs and thus lower fees. The opposite was true, however, which convinced Congress that debit-card issuers (and the card networks) had undue leverage over those who accepted the cards, leading to excessive charges and supracompetitive profits. Congress thus chose to direct the Federal Reserve to impose regulations on the debit marketplace that would both increase competition itself and ensure prices at more competitive levels—*i.e.*, levels that reflected marginal cost rather than market power.

[3] *See* https://www.kansascityfed.org/documents/695/briefings-psr-briefingapr08.pdf; Press Release, Senator Richard J. Durbin, Durbin, Local Business Owners Call for Prompt Federal Reserve Action on Swipe Fee Regulations (June 10, 2011), available at http://www.durbin.senate.gov/public/index.cfin/pressreleases?ID=3103 1ccd-2dc6-4045886f-b7b5bO2cle26.

Accordingly, Congress mandated in the Durbin Amendment that all debit interchange fees charged by "an issuer" be "reasonable and proportional to the cost incurred by the issuer with respect to the transaction." 15 U.S.C. § 1693o-2(a)(3)(A). In doing so, it aimed to "enhance competition, transparency and choice in the debit system and squeeze out inefficiencies by reducing ... rates ... thereby compelling large issuers to compete against each other to manage their other costs more efficiently."[4] It vested "sole authority to prescribe rules" to implement this statutory command in the Federal Reserve Board, specifying that the Board consider the economic impact of any regulations issued, including "the effects upon competition in the provision of electronic banking services." 15 U.S.C. §1693b(a).

The Amendment uses two mechanisms to bring about the more competitive result that Congress sought. First, with respect to banks with assets over $10 billion, the Amendment directs the Federal Reserve Board to impose an interchange fee standard that permits an issuing bank to recover only its transaction-specific costs, and thus prevents issuers from exploiting the debit system to extract excess rents. Second, the Amendment seeks to create competition among issuers and among card networks—including issuers of any size—by, among other things, requiring that each debit card transaction be routable across at least two unaffiliated networks. To date, courts have understood the rate-setting provisions of the statute to provide the Board with relatively wide discretion, particularly because it involves a fine line-drawing exercise. *See, e.g.*, *NACS v. Bd. Of Governors of Fed. Rsrv. Sys.*, 746 F.3d 474, 489 (D.C. Cir. 2014) (citing *BNSF Railway Co. v. Surface Transp. Bd.*, 526 F.3d 770, 774 (D.C. Cir. 2008)).

Nonetheless, given the design and purpose of the Durbin Amendment, it is clear that, in exercising the discretion that the statute provides, the Board should evaluate proposed changes to the interchange standard in light of the statute's two goals: (1) aligning debit interchange rates with a limited cost-recovery regime and (2) encouraging competition of the kind that can further drive down the excess profits that banks extract from merchants and consumers through the debit interchange system.

Meanwhile, more than a decade of experience under the Durbin Amendment and its implementing regulations has demonstrated the extreme ingenuity of the banks and card networks when it comes to fighting against this statutory vision and holding on to their excess profits. For example, the Board has had to intervene *twice* in recent years to thwart efforts by the banks and card networks to prevent effective routing across competing debit networks,

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[4] See Brief of Senator Richard J. Durbin as Amicus Curiae in Support of Plaintiffs' Motion for Summary Judgment at 25, NACS v. Bd. of Governors of the Fed. Reserve Sys., 2013 U.S. Dist. LEXIS 107581 (D.D.C. July 31, 2013) (No. 1:11-cv-02075)

even though the statute is perfectly clear that behavior intended to interfere with dual routing is illegal.[5] Similarly, the Federal Trade Commission was recently compelled to take action against Mastercard when it used a new technology to unnecessarily constrain merchants' ability to route transactions over competing networks.[6] Meanwhile, Visa has debuted new fees designed to effectively frustrate dual routing and protect its market share (and high total prices) from the competitive dynamics the Durbin Amendment was crafted to unleash.[7]

In light of this history, the Board should recognize that whatever room its regulations might leave for the extraction of excess profits will be fully exploited by the debit issuers and card networks. Accordingly, it is exceptionally important for the Board's Durbin Amendment regulations and enforcement efforts to actively seek to minimize such opportunities for the deployment of market power. *Cf.* 15 U.S.C. §16930-2(a)(1) (specifically authorizing the Board to "prescribe regulations ... to prevent circumvention or evasion of" the Durbin Amendment).

RILA strongly supports the Board's proposal to lower the debit interchange rates. While RILA and its members continue to believe that the Board can and should do more to limit excess profit extraction by the largest issuers (even within the limited scope of the proposed rule),[8] as explained more fully below, RILA fundamentally agrees with the Board's determination that the current rate provides for issuer profits that far exceed the limited cost-recovery regime that Congress imposed and that that rate must be decreased immediately.

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5 *See, e.g.*, https://www.federalreserve.gov/paymentsystems/regii-faqs.htm (Board action to prevent card networks from frustrating dual-routing right through kiosk customer interface); https://www.federalreserve.gov/newsevents/pressreleases/bcreg20221003a.htm (Board action to require issuers to fully enable dual routing for online transactions).

6 *See https://www.ftc.gov/news-events/news/press-releases/2023/05/ftc-approves-final-order-requiring-mastercard-stop-blocking-use-competing-debit-payment-networks.* ("FTC Approves Final Order Requiring Mastercard to Stop Blocking the Use of Competing Debit Payment Networks").

7 *See, e.g.*, *Pulse Network LLC v. Visa, Inc.*, 30 F.4th 480, 491-94 (5th Cir. 2022) (explaining how Visa's "Fixed Acquirer Network Fee" (or FANF) was used, after the Durbin Amendment, to protect Visa's debit market share while keeping total fees as high or higher than before).

8 The notice of proposed rulemaking specifies that the Board is not inviting comments on allowable costs. See, 88 Fed. Reg. at 78113 n.82

II. The Text and Design of the Durbin Amendment Support Regulations That Limit Issuers' Opportunities To Obtain Debit Interchange Revenue That Exceeds Their Costs.

With this background in mind, we now turn to the three high-level points raised in the introduction, which share this through line: The Durbin Amendment is a cost-recovery regime that seeks to approximate a truly competitive environment. Accordingly, the Board's implementing regulations will align better with the statutory text and design when they limit issuers' abilities to extract revenues from transactions that substantially exceed that issuer's transaction-specific costs.

A. Because both the current and proposed formula allow banks to recover costs beyond those that Congress mandated, reducing the cap is clearly reasonable and within the Board's authority.

In implementing the competition-approximating, cost-recovery regime that the Durbin Amendment envisions, Congress set forth a statutory formula for the Board to use when establishing a standard for debit interchange fees. That formula requires the Board to promulgate regulations ensuring that "the amount of any interchange transaction fee … is reasonable and proportional to the cost incurred by the issuer with respect to the transaction." 15 U.S.C. §1693o-2(a)(3)(A). Durbin also directs the Board in doing so to "distinguish between the incremental costs incurred by an issuer" for its role in "the authorization, clearance, or settlement [ACS] of a particular electronic debit transaction" and "other costs incurred by an issuer which are not specific to a particular electronic debit transaction." *See* §1693o-2(a)(4)(B)(i)-(ii). The statute then directs that the former costs "shall" be considered, while the latter costs "shall not." *Id.* The most natural reading of this statutory formula is that it bifurcates issuer costs: Variable costs, which differ according to the number of transactions, must be considered in formulating the rate; fixed costs, which remain constant regardless of the number of transactions, must not.

When it first sought to implement the Durbin Amendment, the Board proposed a formula that adhered to this reading, setting the fee cap at an amount that permitted banks to recover variable but not fixed costs. *See* Notice of Proposed Rulemaking, 75 Fed. Reg. at 81736-39. RILA continues to believe that this is the correct reading of the statute and the superior approach to implementing Congress's policy. In competitive markets, the price that is available to sellers should approximate the marginal cost of the last sale, or something very

similar.[9] Tying the rate to issuers' *variable* costs thus would have come much closer to Congress's apparent desire to prevent banks from using the debit system to recover "costs incurred by [issuers] which are not specific to a particular electronic debit transaction." 15 U.S.C. §1693o-2(a)(4)(B)(i)-(ii).

Nonetheless, in the face of an extraordinary campaign against the proposed rule by the banking industry, the Board ultimately developed and adopted a different formula that "almost doubled the proposed cap," abandoning its definition of incremental costs. *NACS v. Bd. Of Governors of Fed. Rsrv. Sys.*, 746 F.3d 474, 481 (D.C. Cir. 2014). That approach relied on the creation of a third, extra-statutory category of costs: costs that were deemed "specific to a particular transaction" but not incremental to the card issuer's role in ACS. The end result essentially permitted banks to recover their "authorization, clearance, and settlement" costs generally, without attending to the statutory distinction between fixed and variable costs. And, at the same time, it allowed issuers to capture variable costs that were *not* tied to "authorization, clearance, and settlement"—like transactional fraud. This aspect of the Board's statutory interpretation of the Durbin Amendment survives in the Board's current proposal. And, for issuers, this reading allows them to have the best of both worlds: They get variable costs regardless of whether they are ACS costs, and ACS costs regardless of whether they are variable.

When this reading of the statute was challenged after its initial adoption, the D.C. Circuit ultimately affirmed the Board's decision by using *Chevron* deference to give the Board very wide discretion in interpreting the Durbin Amendment. Critically, however, the court's holding recognized that the Board had *discretion* to adopt either the reading suggested by its original proposal or the one it ultimately adopted. *See, e.g.*, *id.* at 488. (noting that "the Board may well have been able to interpret section 920(a)(4) as the merchants urge[d,]" given statute's "ambiguity."); *id.* at 489 (explaining that "[t]he merchants' argument certainly has some persuasive power" and that "[o]ne might think it a stretch if a shoe store claimed that the rent it pays its landlord is somehow 'specific' to a 'particular' shoe sale."). This is to say that, at least according to the D.C. Circuit, the statute can be read either way, and it is up to the Board's current members to adopt whichever interpretation they currently believe best suited to achieving Congress's stated policy goals.

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[9] Circumstances dictate whether prices in competitive markets converge towards marginal cost or something similar, like average variable costs. The key point, however, is that—in a reasonably competitive market—so long as the market price is above the cost of producing an extra item, there should be a pressure to increase production and lower prices in order to capture additional market share.

RILA continues to believe that the statute affirmatively forbids the Board from permitting debit issuers to recover fixed costs—and certainly does not permit both variable non-ACS costs (like the *ad valorem* fraud component) and non-variable ACS costs at the same time. RILA thus encourages the Board to reassess its position and stop allowing fixed cost recovery.[10] But even leaving that aside, RILA certainly agrees with the D.C. Circuit that, at a minimum, it is a *permissible* reading of the statute to exclude all fixed costs under §1693o-2(a)(4)(B)(ii), and that adopting and sticking with the contrary position was and is a major concession to debit issuers that the Board discretionarily adopted and the statute does not require.[11]

Recognizing this exercise of discretion, which remains in place in the current proposed rule, should give the Board a wide berth in refusing additional concessions to issuers that have the effect of generating profits from the debit system that far exceed issuer costs. No reasonable reading of the statute permits the banks to look this gift horse in the mouth and insist that, *in addition* to this considerable accounting benefit in their favor, the Board must also adopt a host of further, issuer-favoring assumptions about how to calculate costs or ensure that the fee cap is "reasonable and proportional" to those costs—ignoring in the process that issuers are already far ahead of any starting point that the statute requires.

Put another way, the formula currently in place—and the proposed new formula as well—both already incorporate the major concession to debit issuers of considering costs beyond those that Congress mandated. This concession stands in considerable tension with the overall goal of limiting fees and increasing competitive pressure on issuing banks, and so represents a good reason to avoid additional largesse. Indeed, further concessions would cause the regulatory scheme to drift even further from congressional purpose and should be rejected. Conversely, the Board should act with a relatively free hand in imposing a cost-

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[10] The Board's notice states that it is "not inviting comments on the allowable costs considered for purposes of the interchange fee standards." 88 Fed. Reg. at 78113, n.82. In line with the Board's guidance, RILA has chosen not to submit comments on that issue. We note, however, that RILA adheres to and reiterates its view that the statute unambiguously requires exclusion of fixed costs. And even if the statute affords the Board the discretion the D.C. Circuit identified, it would be superior as a policy matter and closer in line with Congress's stated goals to exclude fixed costs from these calculations altogether, as the Board originally proposed when it first implemented Regulation II.

[11] RILA notes that the Supreme Court is currently considering whether to overrule or modify *Chevron*. If the Supreme Court does so, it may become necessary for the Board to consider whether its prior reading is *the best* interpretation of the statute – as opposed to being a *permissible* interpretation that the Board adopted based on its policy views. In addition, the Board may need to revisit its interpretation at a future point based on the outcome of the currently-pending *Corner Post* litigation.

counting regime that both limits the rents that issuers can extract and challenges banks to reduce their current costs in light of the underlying regulatory structure.

For this reason, there should be no colorable question whether the current proposal to *lower* the regulated rate is within the reasonable discretion of the Board. Rate setting generally involves wide discretion. *See, e.g.*, *NACS*, 526 F.3d at 774. And the fact that the proposed rate still exceeds the cost-recovery level that would be mandated under a reasonable (and, indeed, better) reading of the statute virtually guarantees that the level the Board has chosen for the current reduction is a reasonable exercise of its discretion, even if not ideal.

Beyond this point, there are other textual indications in the Durbin Amendment that the Board should not indulge efforts by the banks to retain a regulated rate that far exceeds cost with respect to the overwhelming majority of transactions. For example, the statute directs the Board to "consider the functional similarity between electronic debit transactions[] and checking transactions that are required within the Federal Reserve bank system to clear at par." *See* 15 U.S.C. §1693o-2(a)(4)(A). This provision reflects the authority that Congress gave the Board to impose a regime where *no* bank turns *any* profit (or even takes in any *revenue*) with respect to these particular kinds of transactions. In other words, the Durbin Amendment's text reflects congressional support for a regime where debit transactions are not a profit center for issuing banks, even if it turns out that (as with checks) transactional costs are not fully recovered. This, too, should strengthen the Board's resolve in imposing the contemplated reduction in the regulated rate and demonstrates that the choice to reduce the rate is well within the discretionary authority that the Durbin Amendment confers upon the Board.

More importantly, RILA urges the Board to reassess its proposal by *explicitly* "consider[ing] the functional similarity between electronic debit transactions[] and checking transactions that are required within the Federal Reserve bank system to clear at par." 15 U.S.C. §1693o-2(a)(4)(A). The requirement to "consider" this point is clearly mandatory, and a discussion in the final rule of how the Board understood the two systems' functional similarity and incorporated that understanding into its current rulemaking is thus required. As explained below, the system the Board has proposed has—*on its face*—the necessary effect of preserving an enviably large profit margin on debit interchange, even for the average issuer and even with fixed ACS costs fully included. *See infra* pp. 14, 24-27. At a minimum, the Board should (and, indeed, must) explain why, from its perspective, that outcome is appropriate given "the functional similarity between electronic debit transactions and checking transactions that are required … to clear at par." 15 U.S.C. §1693o-2(a)(4)(A).

B. Given the statute's pro-competitive design, regular and automatic updates to the interchange standard to reflect *falling* costs are a reasonable implementation of the Durbin Amendment's text and the Board's discretion.

In the current proposal, the Board suggests a process where the regulated rate will be regularly updated every two years based on the results of a regular survey that requires issuers to report on their costs. This proposed procedure reflects an improvement over the current rule, *under which the cap has not been updated in more than ten years*. The statute contemplates a competitive dynamic that should drive costs down over time, *see supra* p. 5, and requires interchange fees "with respect to an electronic debit transaction" to be "reasonable and proportional to the cost incurred by *the issuer* with respect to *the transaction*." 15 U.S.C. §1693o-2(a)(2) (emphasis added). That text is not well implemented by a regulatory approach where the regulated rate applicable to a particular electronic debit transaction is "reasonable and proportional" not to the costs of "the issuer" for "the transaction" at issue, but rather to the costs that issuers were generally incurring in such transactions over a decade ago. Regular updates to account for falling costs thus accord better with the Durbin Amendment's text, and they reflect sounder policy as well.

That said, the contemplated procedure provides merchants with no formal opportunity to be heard or to raise concerns about the costs reported, even though the survey relies entirely on unverified data reported by parties with adverse interests. Notably, the Board has not proposed any mechanism to verify or evaluate debit issuers' responses or to take corrective action against banks that fail to report accurate cost data. As a result, issuers are not incentivized to report data in a timely and accurate fashion: Because the interchange fee is a function of their costs, issuers are likely to speedily report the costs of their investments in cost-saving technology (or interpret quite broadly what counts as an ACS investment), but unlikely to account as quickly or carefully for the cost-savings that those investments ultimately produce.[12]

[12] Moreover, because debit transactions are heavily concentrated among a small number of issuers, *see infra* p.19, there is also good reason to worry about tacit collusion. For example, a relatively small number of banks can, through tacit agreements, decline to make cost-saving investments, thereby maintaining interchange fees at higher rates than necessary while avoiding investment costs. This dynamic is exacerbated by the extent to which the largest issuers already have costs well below the 98.5 percentile mark the Board has chosen, and so lack any strong incentive to further reduce their costs. *See infra* at pp. 17-19.

Unsurprisingly, there have been persistent issues with data quality and transparency that may limit (1) the Board's ability to use the survey data to accurately approximate market-wide costs, and/or (2) merchants' ability to assess market trends and whether they are being accurately reported. For example, although the 80th percentile issuer was used as the peg for the $0.21 fee cap originally imposed in 2011, *see* Final Rule, 76 Fed. Reg. at 43422, the survey has never reported any change in the data respecting the 80th percentile issuer since then. Moreover, the survey does not segment between fixed and variable ACS costs, which compromises the Board's ability to distinguish between costs that Congress has mandated that the Board consider and costs that are only considered at the Board's discretion. *See supra* pp. 8-9. To make matters worse, reports on prior surveys acknowledge issues with data adequacy, noting that only a subset of issuers actually provide information at the level of detail presented in the report. *See infra* at p. 23 & n.17. Any systemic bias in which banks report or how they account for their included costs could have a major effect on the fee cap going forward, and while merchants will pay the regulated rate, they have no insight into the quality or completeness of the data being used to set their price.

More troublingly, setting a standard for periodic adjustment of the rate while simultaneously allowing the inclusion of non-variable ACS costs creates important and unaddressed questions of data quality and cost accounting. Suppose one or more of the largest issuers makes a very large investment in ACS infrastructure over a two-year data-collection period governed by the proposed rule. Depending on the accounting rules for those investments, those one-time expenses could increase the average per-transaction cost figure dramatically over that narrow period, yielding a higher base component than would be justified by an appropriate, medium-run analysis. These and other data anomalies could systematically skew calculations in favor of a higher fee in future years. As a matter of sound public policy, the Board should note the possibility that data from any given two-year reporting period could contain temporary anomalies or aberrations and reserve the discretion to address such issues should they arise.

As we outline below, certain foundational steps are important to begin addressing these issues, including strong data retention policies that will allow the Board to audit the responses from issuers and strong penalties for misbehavior. But it would also be good policy to create a process for merchants to comment upon—and the Board to thereby consider—potentially anomalous or transitory increases in ACS costs that might otherwise drive increases in the overall regulated rate. Given the long-term trend toward lower costs and the cost-accounting incentives for the issuing banks, the Board's two-year process should build in a safety valve that allows for notice-and-comment and a modified response in the event that the data starts to show that costs are going back up for no rational reason. Conversely, so long as the biennial

survey data accords with long-term trends and costs remain stable or continue to fall, there is ample reason for the Board to adopt a regular and automatic process for updating the interchange rate accordingly.

C. By retaining a single fee cap for issuers of widely varying sizes, the Board's current approach perpetuates a huge profit margin for the largest issuers (and the vast bulk of transactions) that is inconsistent with the statutory text and design.

In its proposal, the Board suggests retaining the current model of establishing a single fee cap for all issuers, regardless of their debit program size or per-transaction costs. The Board's accompanying explanation also suggests briefly that the Board considered adopting a tiered approach with more than one cap, but rejected this idea as too complicated. *See* 88 Fed, Reg, at 78108 & n.48. With respect, RILA submits that a minimum amount of tiering—including even one additional tier specific to the largest-volume issuers—could be reasonably implemented. Indeed, the interchange tables that the card networks and issuers impose on merchants are far more complex and, for credit cards, also involve tiering on the basis of merchant size. The added complexity associated with minimum tiering of regulated debit rates would be modest by comparison.

Moreover, for the reasons explained below, adopting this minimum tiering is necessary to implement the statutory text, which does not permit the Board to create a class of issuers and "electronic debit transactions" for which the charge on a transaction is *not* "reasonable and proportional to the cost incurred by *the issuer* with respect to the transaction," 15 U.S.C. §1693o-2(a)(2) (emphasis added). And that is precisely the result if the same regulated rate governs both JP Morgan Chase (total assets: $3.4 trillion) and Farmers and Merchants Bank of Long Beach (total assets: $12 billion)—Farmers and Merchants might or might not just recover its costs, but JP Morgan makes a killing either way.[13]

[13] Given the strong correlation between issuer size and issuer transaction volume, these comments occasionally refer to them interchangeably or use one measure as a proxy for the other. Ultimately, however, the appropriate focus is on the size of an issuer's *transaction volume,* which drives down its per-transaction costs.

1. Although the proposed cap is a substantial improvement over the status quo, it preserves a large, excess profit margin, particularly for the largest issuers.

As an initial matter, it is important to recognize that a very large profit margin for the largest-volume debit issuers is essentially built in to the design of the Board's current proposal. There are several ways to identify the existence (and considerable magnitude) of this problem, but they all boil down to the vast distance that exists between the cost-estimate that is used to peg the cap and the actual per-transaction costs incurred by the largest issuers.

Perhaps the most obvious indication of excess profits is the "multiplier" that the Board's proposal establishes for regularly updating the regulated rate in light of changes in average issuer costs. In the proposed rule, the Board calculates that the current average issuer cost must be multiplied by 3.7 in order to reach a cap that would ensure full cost recovery for 98.5% of transactions based on current data. It therefore proposes to multiply average issuer costs by 3.7 on a going-forward basis—using the new data from each biennial survey—to establish the base component of the regulated rate in subsequent cycles. But the implied (in fact, nearly explicit) meaning of this 3.7 multiplier is that the Board will permit an issuer to charge 3.7 times the cost incurred on the average transaction as the fee for every electronic debit transaction. This means that there is an enormous (270%) profit margin allowed in the *average* case, even leaving aside that the largest issuers operate at a per-transaction cost that is far below that average.

Digging further into the available data demonstrates an even more serious problem of excess profiting among the largest issuers. Using transaction-weighted average ACS cost data from 2021 (Table 13), we estimate that high-volume issuers (*i.e.*, issuers that report more than 100 million transactions) have combined ACS costs of approximately $1.93 billion on an annual basis. Under the current cap, however, they are permitted to charge $11.62 billion for the base component on their debit transactions. And even after the reduction the Board is proposing, these issuers will be able to charge nearly $8 billion. This demonstrates that, while the proposed rule is a significant improvement over the status quo, the system design still preserves an enormous profit margin for these issuers with the greatest volumes (and lowest per-transaction costs). For these issuers, the proposal permits base component charges that are more than four times their average costs, and total profits in excess of $6 billion dollars every year. *See infra* pp. 17-19, 27 (Charts).

This is particularly important because high-volume issuers processed 94% of regulated debit transactions (by dollar value) in 2021, (Table 12, Fed Report), and 100% of these issuers

had ACS costs below both the current and proposed new cap (*see* Table 15). In fact, the three largest issuers alone—Wells Fargo, Bank of America, and JP Morgan Chase—made up nearly 50% of all regulated spending and transactions in 2021, and it is a safe bet that their per-transaction profit margin is even higher than high-volume issuers as a whole. Thus, while the lower fee cap in the proposed rule is a big step in the right direction (saving merchants and their downstream consumers nearly $3 billion annually), the new formula still *significantly* overshoots a cost-recovery regime for the issuers that dominate the market.

In fact, while Congress directed the Board to consider the similarities between debit cards and personal checks—which generate no transaction fees at all and are more expensive to process—in setting the regulated rate, *see* 15 U.S.C. §1693o-2(a)(4)(A), the reality is that the average per-transaction profit margin that the Board's current proposal enshrines is far greater than the profit margin that banks earn not only on checking transactions, but on their business *as a whole*. Although the Board reiterated its analysis from the prior rulemaking and stated that it "continues to believe that its prior analysis remains sound," the Board should consider new evidence that has emerged since the prior rulemaking, which illustrates the dramatic difference in profit margins.

Indeed, a scholar from NYU Stern reports[14] that average bank profit margins are approximately 29.67%—far greater than the market average of 8.54%, but miles away from the 270% profit margin that banks will earn on the average debit transaction under the current proposal. Similarly, reported efficiency ratios for the banking industry (which compare total revenues net of interest expenses against non-interest costs) range from 1.5 to 1.6,[15] a multiplier far below the 3.7 multiplier in the Board's current proposal. Meanwhile, the NYU Stern data shows that industries that pay these inflated debit interchange fees have profit margins far below the 8.54% market averages, including 3.09% for general retail and 1.18% for grocery and food. Nothing in the Durbin Amendment nor common sense suggests that debit issuers should nonetheless be allowed a per-transaction profit margin that would be the envy of not only their paying customers but any business anywhere—including other lines of business within the same bank.

2. Minimal tiering or tailoring that would vastly improve alignment with the statutory text can be implemented without excessive confusion or cost.

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[14] Margins by Sector, https://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/margin.html.

[15] Quarterly Trends for Consolidated U.S. Banking Organization, Federal Reserve Bank of New York, https://www.newyorkfed.org/research/banking_research/quarterly_trends.

For large issuers, profit margins under the Board's proposed rule are so high that they violate Subsection 1693o-2(a)(2)'s command that "the amount of any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction shall be reasonable and proportional to the cost incurred by *the issuer* with respect to *the transaction*." 15 U.S.C. §1693o-2(a)(2) (emphasis added). This language cannot be squared with an outcome where "the issuer" can reap an enormous profit on *all* of its transactions.

To be sure, the proposed regulated rate may be "reasonable and proportional" in connection with transactions involving smaller issuers. But under the Durbin Amendment, the amount of "*any* interchange transaction fee"—not just some interchange transaction fees—must be reasonable and proportional to the cost incurred "by *the issuer* with respect to *the transaction*"—not with respect to some different issuer engaging in some different hypothetical transaction. Although it may be administratively convenient for the Board to subject each transaction to the same regulated rate, administrative convenience cannot be used to override the core statutory requirement that for *any* transaction, fees must be reasonable and proportional to the cost incurred by *the* issuer in *that* transaction.

This does not mean that every single transaction—or even every single issuer—must be analyzed separately for purposes of determining the appropriate regulated rate. The phrase "reasonable and proportional" grants the Board a measure of discretion, and in exercising that discretion, it may consider administrability. As such, in determining the "reasonable and proportional" cost of a transaction, the Board may group, average, and provide similar requirements for similar transactions or even similarly situated issuers.

At some point, however, the per-transaction cost gap between smaller issuers and larger issuers becomes so large that the statute does not permit a one-size-fits-all regulated rate: A "reasonable and proportional" cost for smaller issuers is *unreasonable* and *disproportionately* high for large issuers. At that point, the plain text of the statute requires tiering, which would impose a higher regulated rate on small issuers and a lower one on larger issuers with lower pre-transaction costs.

In RILA's view, the Board's proposed rates—while certainly better than the status quo—are still excessively high for the largest issuers, and hence not "reasonable and proportional." Those high caps should be lowered. If the Board concludes that lower caps would be too low for small issuers, then it should lower the cap for large issuers only.

Other provisions of the Durbin Amendment confirm that the Board has some discretion to adopt simplifying conventions, but at the time require using that discretion to address the needs of smaller-size issuers, rather than provide a windfall to the largest players. For

example, the statute provides the Board with the authority to make "such adjustments and exceptions … as in the judgment of the Bureau are necessary or proper to effectuate the purposes of [the statute], to prevent circumvention or evasion thereof, or to facilitate compliance therewith." 15 U.S.C. §1693(c). This considerable and general authority supports *some* grouping together of issuers to "facilitate compliance" with the statutory requirements.

Notably, however, that general authorization is further supplemented with the specific authority to "modify the requirements imposed … on small financial institutions if the Bureau determines that such modifications are necessary to alleviate" undue compliance burdens and consistent with the purpose of the statute. *Id.* Particularly in combination with the text of §1690o-2(a)(2), these grants of authority are best read to support a tiered system that protects smaller issuers while eliminating the windfall profits that accrue to the largest issuers when the calculation of the rate incorporates cost pressures that those largest issuers *do not face*. In other words, a more targeted and tiered formula is plainly within the Board's authority to adopt and would align far better with the statutory text by ensuring that even more transactions provide full cost recovery for smaller issuers while simultaneously establishing something much closer to the cost-recovery regime that Congress sought to create with respect to the large-volume issuers who impact the market most.

Such a tiered approach could be implemented in a number of relatively simple ways. One approach that immediately recommends itself, based on the tiered data that the Board already assembles and publishes, is a three-tiered system dividing banks into high-volume, mid-volume, and low-volume debit issuers.[16] For example, the following table is reproduced from the Board's 2021 report:

[16] High-volume issuers are those with greater than 100 million transactions; mid-volume issuers have between 1 million and 100 million transactions; and low-volume issuers are the smallest regulated issuers, having more than $10 billion in assets, but still less than 1 million debit interchange transactions per year. 2021 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions (hereinafter, "Board 2021 Report").

	Number of Issuers	% of transactions	% of transaction value
High-volume issuers	53	94.32%	93.86%
Mid-volume issuers	86	5.68%	6.13%
Low-volume issuers	24	0.01%	0.01%

Using that table, along with other data in the report (including Table 3 and Table 13) permits the following estimations, which can likewise be broken out into high-, mid-, and low-volume issuers.

	Est Spending (bns)	Est Transactions (bns)
High-Volume Issuer	$ 2,638.33	55.34
Mid-Volume Issuer	$ 172.34	3.33
Low-Volume Issuer	$ 0.36	0.00

	Total ACS Costs (bns)	Total Revenue From Proposed Cap (bns)	Total Revenue From Current Cap (bns)	Excess Profit From Current Cap (bns)	Excess Profit From Proposed Cap (bns)
High-Volume Issuer	$ 1.93	$ 7.97	$ 11.62	**$ 9.69**	**$ 6.04**
Mid-Volume Issuer	$ 0.36	$ 0.48	$ 0.70	**$ 0.34**	**$ 0.12**
Low-Volume Issuer	$ 0.00	$ 0.00	$ 0.00	**$ (0.002)**	**$ (0.002)**
Total	$ 2.29	$ 8.45	$ 12.32	**$ 10.03**	**$ 6.16**

Notably, this breakdown demonstrates that: (1) the system is working mostly as the Board intends with respect to mid-volume issuers, most of whom will cover their costs and even turn a modest profit by keeping their costs lower than their peers.[17] But it also shows that (2) the system is a massive windfall for large volume issuers, while (3) the smallest issuers are actually losing money on debit interchange both as a class and across the board.

Creating multiple caps that correspond to these three tiers would allow the Board to obtain the result that it is after much more precisely. In particular, in response to concerns identified by Board Member Bowman, small-volume regulated issuers could be protected against losses through a higher rate applicable only to them to reflect their less efficient cost structure. The negative impact on merchants would be limited because these small-volume regulated issuers make up a tiny proportion of the overall debit interchange market by volume (which is why their total revenue rounds to $0.00 billion in the above chart). But the salutary effect for those small issuers will be much greater, because turning debit interchange into a reasonable profit for them rather than a loss would permit them to continue as healthy community and regional institutions that could continue offering a competitive alternative to the largest nationwide banks. *See* Statement of Member Bowman.

[17] The data indicates that at least 50% of mid-volume issuers will fully recover their costs under the proposed base component of $0.144. Board 2021 Report (Table 14B).

At the same time, as the result for the middle tier demonstrates, the Board can get a better version of the intended outcome when the cap corresponds more closely to the data for the overall group of issuers to whom it is applied. Allowing high-volume issuers to take the same 33% percent profit margin that the system allows to mid-volume issuers would still leave them with several hundreds of millions in profits as a group. But it would also eliminate a windfall profit exceeding $5 billion that cannot be squared with a system that requires proportionality to "*the issuer*'s" costs.

Even simpler tailoring systems would be a major improvement from the standpoint of statutory alignment. For example, the three largest-volume issuers are all very similar in size, together represent nearly half of all transaction volume, and are qualitatively larger by volume than even their next-closest competitors. In 2021, JP Morgan, Wells Fargo, and Bank of America all had roughly $450-460 billion in debit purchase volume, while the next closest issuers (PNC Bank and Navy Federal Credit Union) had $127 billion and $100 billion respectively. A formula tailored to the cost structures of these uniquely large issuers would vastly reduce the excessive profits that "the[se] issuers" extract through a system that is tied not to the costs of those issuers, but to the costs of a radically different bank processing the transaction at the 98.5th cost percentile of the overall regulated issuer market. Indeed, the system could even assign a modest boost to these smaller-volume banks over their average per-transaction cost and still reduce by billions the windfall profits that the largest-volume issuers reap through a system that is pegged to the average per-transaction costs of wildly dissimilar market players.

The costs and complications associated with either of these limited tiering models would be modest and are easily justified by the improved precision of the results. The Board already collects, and issuers already produce, all the relevant data. The mathematical calculations necessary to establish the separate caps from the data the Board already assembles involve a modest—and perhaps even trivial—amount of additional work. Moreover, a tiered approach is also simpler than the derivation of the Board's proposal, which assumes the "stability of the shape of the distribution over time." Any changes to the shape of the distribution of issuer costs by transaction percentile range could diminish the accuracy of the fixed multiplier to achieve the 98.5th percentile cost recovery target. And while the Board has expressed concern that complications would arise as issuers move from one tier to another, *see* 88 Fed. Reg. at 78108 (a scenario that seems entirely implausible given the jump that would be required from $127B to $450B), the Board could adopt rough-and-ready rules for dealing with such scenarios and it would still reflect a massive improvement in precision over the status quo.

Indeed, given the existing complexities for players in the interchange system, such concerns are difficult to credit. Based on the most recent publicly available interchange tables, the average retailer is responsible for managing 31 interchange programs from Visa and 18 interchange programs from Mastercard, each of which can have a different set of rates for different kinds of transactions. In fact, within each of these programs are different card types (*i.e.*, consumer credit, commercial credit, high-rewards, low-rewards, etc.), that will likewise come with different rules and fees for different transactions. Taking the number of interchange programs and cards per program into account, a sample retailer pays fees that vary across nearly 250 different interchange programs for Visa and Mastercard. Thus, there should be no credible concern about whether debit transaction processing systems are capable of handling two or three different Board-established interchange rates instead of only one.

RILA accordingly believes that a system that incorporates some level of tiering or tailoring is not only feasible but clearly within the Board's discretion to adopt, best aligned with the statutory text, and best addresses the policy concerns that underlie the Durbin Amendment, including the concerns raised by Member Bowman with respect to smaller banks. We urge the Board to consider adopting such an approach in finalizing the current proposed modifications to Regulation II.

III. Responses to the Questions Raised in the Notice of Proposed Rulemaking.

The following represent RILA's responses to some of the specific questions posed by the Board. In providing these answers, we stress that our fundamental position remains that the Board should exclude fixed costs from the proper calculation of the base component. To the extent our answers imply otherwise, it is only because our answers reflect the Board's current posture. Our goal in answering the questions below is to assist the Board in its decisionmaking—we are in no way advocating affirmatively for the current system. In truth, many of the questions and difficulties posed would be mooted by adhering more closely to Congress's intent in terms of assessing the applicable costs, and by adopting a more tailored system that eliminates at least some of the windfall profits that accrue to the largest issuers.

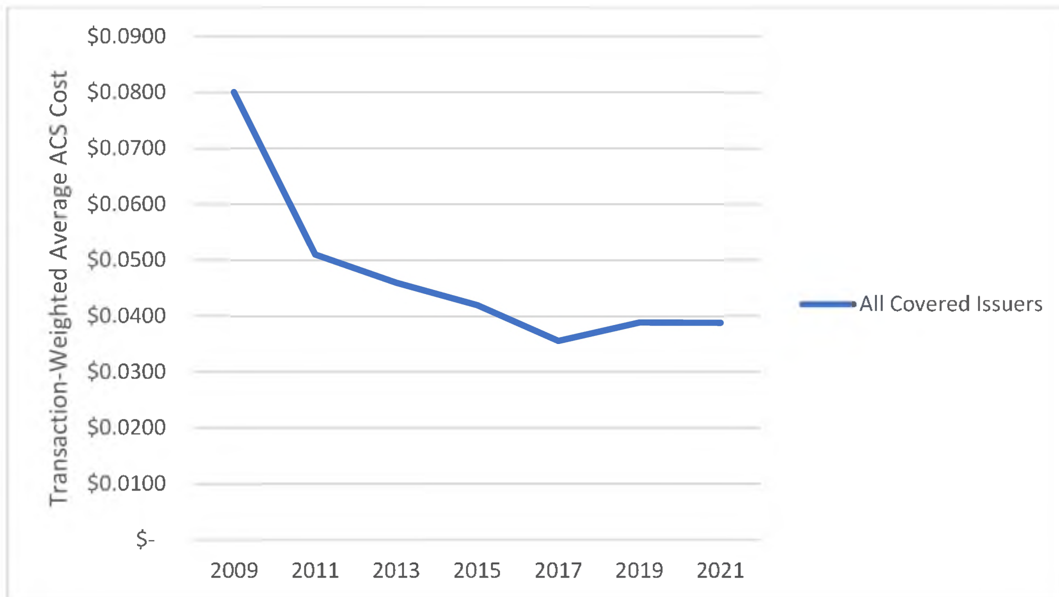
1. *As stated in paragraph (a) of proposed appendix B to Regulation II, the Board would determine the base component, ad valorem component, and fraud-prevention adjustment for every two-year period, beginning with the period from July 1, 2025, to June 30, 2027. Is the proposed two-year cadence appropriate, or should the Board determine these amounts more or less frequently?*

On its face, the 2-year cadence for updating the regulated rate is appropriate. It is important, however, that the Board's determination of the various components incorporate an analysis of both the short-term trend over the two-year reporting period and the longer-term trends in issuer costs. Temporary fluctuations, potentially as a result of bank-driven decisions about whether, when and how to incur or account for larger costs or investments, should not result in locking in higher fees for two years going forward. *See supra* pp. 11-13. But as long as the long-term trend reflects lowered or stable costs, a regular cadence of biennial updates is reasonable and ensures that the applicable rates better correspond to the costs issuers are incurring in *those* transactions. *See id.*

To further clarify the point, providing for more regularly updated rates in response to changes in the data every two years is a potential improvement in the process—particularly relative to the long delay between when the initial rate was set and the reduction that the Board has currently proposed. But given both the decade long trend downward in costs and the Board's proposal to create further downward cost pressure by setting the base component below full cost recovery for 100% of transactions, the process should not contemplate automatic *increases* in the cap if the data surprisingly report a reversal in cost trends.

That is true because (1) the data is within the unilateral control of debit issuers, who have an incentive to inflate their apparent costs by either reporting them or incurring them in strategic ways; and (2) the long-term trend establishes that increases in costs would be unexpected. Indeed, the consistency of the long-term trend was one of the express reasons for the Board's proposal to adopt the regular 2-year update process it currently proposes. *See* 88 Fed. Reg. at 78106 ("Further, the Board believes that the patterns observed in the cumulative data collected by the Board since the original rulemaking, described further below, are consistent over time and thus support the establishment at this time of a repeatable process that directly links the interchange fee standards to the data reported on the Debit Card Issuer Survey."). Consistent with that observation and reasoning, a process of regularized, automatic updates makes sense, but only insofar as the changes within the last 2-year period remain consistent with long-term trends.

As the graphs below indicate, the long-term trend—for both high volume and average issuers—has clearly been towards reduced costs since 2009. One of the goals of the Durbin Amendment is, of course, to introduce competitive dynamics that drive this trend, and the system should accordingly ensure that this trend continues, while avoiding any reward for issuers should the trend reverse.



Accordingly—and particularly in any case where the Board is contemplating an increase in the fee cap—the Board's two-year procedure should provide a mechanism for merchants and other stakeholders to be heard to ensure that data quality issues or temporary anomalies do not result in years of inflated rates. Currently, there is very little transparency in the data collection process. Indeed, the Board's public report does not clarify what proportion of institutions are fully compliant with the survey and providing all the information that the Board solicits, although the report itself demonstrates that compliance is certainly less than total.[18] As a result, it is difficult to assess whether the survey accurately captures the overall market.

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18 The Board maintains a public list of issuers exceeding the $10 billion asset cap. Even assuming that many of the entries in this list are inaccurate or duplicative, it is 534 rows long, suggesting hundreds of regulated issuers beyond the 53 respondents reported in the 2021 report. The 2021 Board Report also discloses that some respondents did not provide data at the level of detail necessary to fully incorporate it into the certain of the published statistics.

There is also little if any public information about enforcement against issuers who fail to report the necessary data. For individual issuers, this means there is little incentive to report data accurately and in a timely fashion: accurately reporting (decreased) costs will almost mechanically result in fee reductions but incomplete or inaccurate reporting has no formal consequences.

Merchants, as parties to the bulk of reported transactions, can provide additional checks on the data, facilitating greater accuracy and potentially identifying anomalous results.

2. *As described in paragraph (c)(1) of proposed appendix B to Regulation II, the Board would determine the base component as a fixed multiple of the transaction-weighted average of per-transaction base component costs (i.e., allowable costs (excluding fraud losses)) across covered issuers. As described in section III.B, supra, the fixed multiplier corresponds to the percentage of covered issuer transactions for which the Board believes covered issuers should fully recover their base component costs over time. Should the Board select an alternative cost-recovery target from among the possibilities below, or another cost-recovery target not included below? If so, why?*

To put it bluntly, the proposed multiplier of 3.7 is—on its very face—significantly out of step with the cost-recovery regime established by Congress.

As we explained above, the implied meaning of the 3.7 multiplier is that, in order to hit the Board's target statistic of cost recovery for 98.5% of transactions, the Board will permit an issuer to charge 3.7 times the cost that is reported on the average transaction. This inevitably means that the Board is allowing for an enormous profit margin (even over variable *and fixed* costs) in the *average* case—leaving aside that the largest issuers operate at below-average cost. In fact, this profit margin far exceeds ordinary profit margins, even within the banking industry. *See supra* pp. 14-15.

This result does not align well with what the Durbin Amendment directs or intended with respect to debit interchange. The statute instructs the Board to consider the similarities between debit and checking transactions, and the fact that checking transactions clear at par. *See supra* p.10. It also requires that the fees charged by an issuer for a transaction be proportional to the costs incurred by *that* issuer for *that* transaction. *See supra* pp. 15-16. While the latter proscription need not be implemented literally (*i.e.*, by requiring exact cost-recovery for every transaction on its own), taking the Amendment's provisions together must rule out a circumstance in which the *average* transaction has a 270% profit margin that vastly exceeds the bank's total business margin—let alone the negative margin it obtains on

checking transactions. In other words, had Congress contemplated a regulated rate at 3.7x the cost of the average transaction, it would not have written the statute the way it did.

To make matters worse, the size of the multiplier also disincentivizes banks from investing in cost reductions, and given the concentration among the largest issuers, it could also incentivize gamesmanship or tacit collusion when it comes to incurring or reporting of costs. To the extent banks can coordinate their conduct, incurring (or claiming) one additional cent of industry-wide per-transaction costs will raise the regulated rate (or prevent it from falling) by 3.7 cents, meaning banks directly benefit under this system by keeping costs *high*. The incentives will be particularly askew for the largest banks, who have an outsized effect on the average cost per-transaction and also know that—even if their costs vastly increase—they are likely to be well below the 98.5 percentile cost-recovery target. For these banks, the system now provides a reward for reducing efficiency.

Overall, a more appropriate multiplier, *if needed at all*, would be in the range of 1.3-1.8, based on various available benchmarks for general banking profit margins discussed above. *See supra* p.15. Moreover, Congress's reference in the statute to the system for clearing checks suggests that debit interchange transactions should be substantially *less* profitable than the average banking business. *See supra* p.10. Accordingly, a multiplier that corresponds to average cost-to-revenue ratios within the industry is far more supportable than the outsized multiplier the Board proposes to adopt.

Assuming that the Board is unwilling to utilize a multiplier that corresponds to average banking profits, Option 5 (a multiplier of 2.7x) comes closest to establishing the cost recovery regime that Congress anticipated. Under that option, 95% of all debit transactions remain profitable and the extravagant profit margin for the largest issuers will at least be reduced. As the table below (drawn from the Board's 2021 report) demonstrates, in addition to this salutary effect on the windfall profits of the largest issuers, the average mid-volume issuer would essentially break even under this proposal, creating a strong incentive for cost-cutting by such issuers. And given the concentration of transaction volume within the largest issuers, the total losses among mid- and small-volume issuers will be marginal relative to issuers as a whole.

	Total ACS Costs (bns)	Total Revenue From Current Cap (bns)	Total Revenue From Proposed Cap (bns)	Total Revenue From 95% Txn Cost Recoupment (2.7x Multiplier) (bns)	Excess Profit From Current Cap	Excess Profit From Proposed Cap	Excess Profit From 95% Txn Cost Recoupment (2.7x Multiplier) (bns)
High-Volume Issuer	$ 1.93	$ 11.62	$ 7.97	$ 5.81	**$ 9.69**	**$ 6.04**	**$ 3.88**
Mid-Volume Issuer	$ 0.36	$ 0.70	$ 0.48	$ 0.35	**$ 0.34**	**$ 0.12**	**$ (0.01)**
Low-Volume Issuer	$ 0.003	$ 0.00	$ 0.00	$ 0.00	**$ (0.00)**	**$ (0.00)**	**$ (0.00)**
Total	$ 2.29	$ 12.32	$ 8.45	$ 6.16	**$ 10.03**	**$ 6.16**	**$ 3.87**

As explained in detail above, however, the better option would be for the Board to introduce a tiered system to ensure that it can maintain a high percentage of cost-neutral transactions while addressing the excessive profits at the top of the market. *See supra* pp. 13-21. A system consisting of two or three tiers would represent a major improvement, with the cap for the largest issuers corresponding much more closely to those issuers' costs. *See id.* It is both good policy (for the reasons Member Bowman has enumerated) and corresponds better to Congress's statutory commands to have a system that takes into account the specific cost structures that are faced by smaller and larger issuers, rather than aggregating across the entire market. And the feasibility of this proposal has been partially established in credit-card payments, where the market bears hundreds of different fee rates. *See* supra pp. 13-21.

Conversely, the current system—with its single regulated rate—effectively rewards large issuers with enormous windfall profits by treating them as if they had cost structures similar to those of small-volume issuers. This has created miscalibration throughout the market: Small-volume issuers do not recover costs, and large-volume issuers, who handle the vast majority of transactions, generate significant and excessive profits. To the extent that Congress was focused on decreasing rates and eliminating excessive fees, the regulatory scheme should create a cost-recovery regime that functions correctly for the issuers who

receive the vast majority of fees. Tailoring or tiering would create this regime for large-volume issuers while preserving the ability of smaller issuers to cover costs and remain in the market.

3. *As described in paragraph (d)(1) of proposed appendix B to Regulation II, the Board would determine the ad valorem component, for a particular debit card transaction, as the median ratio of issuer fraud losses to transaction value among covered issuers, multiplied by the value of the transaction. Should the Board adopt an alternative methodology for determining the ad valorem component? If so, why?*

The ad valorem component is not a transaction-specific ACS cost. For that reason, it is not one of the costs that Congress mandated that the Board consider in formulating the cap. This cost is only considered as a result of the Board's exercise of discretion in favor of the banks in the 2011 final rule. There are both legal and policy reasons for the Board to stop granting debit issuers this discretionary windfall.

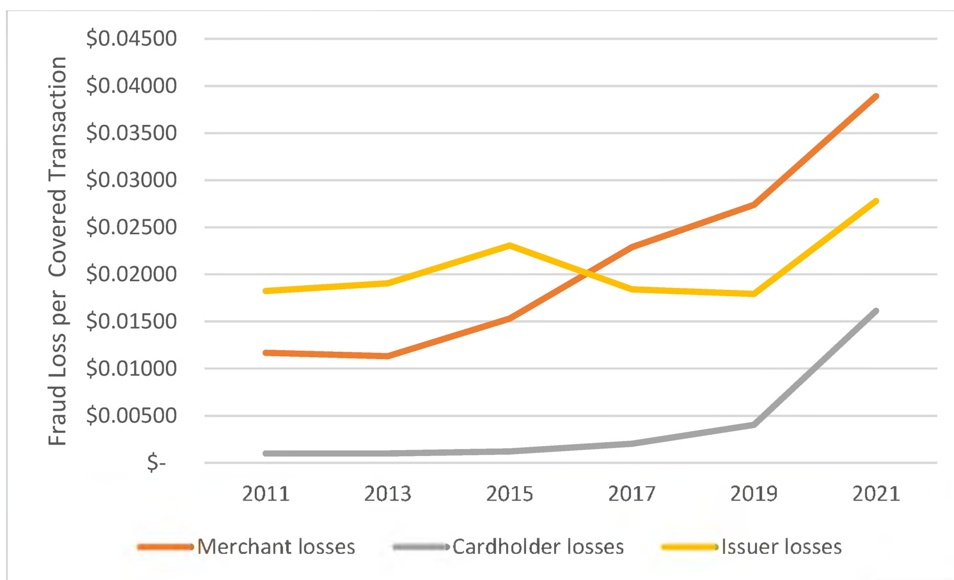
First, as a matter of statutory interpretation, it is evident that the Board's interpretation allows debit issuers to have their cake and eat it, too. As to ACS costs, the Board has taken the position that consideration of fixed costs is not prohibited consideration of "costs incurred by an issuer which are not specific to a particular transaction," *see* 15 U.S.C. §1693o-2(a)(4)(ii), in large part because the statute expressly requires recovery of *incremental* ACS costs, and the Board historically found it too difficult to distinguish between fixed and variable ACS costs. *See NACS*, 743 F.3d at 788. And yet the Board *has* distinguished between other fixed and variable costs and permitted the recovery of the *ad valorem* fraud component on the theory that fraud losses vary with individual transactions. *See supra* p.8. To the extent the D.C. Circuit has blessed that approach, RILA continues to disagree with that decision.

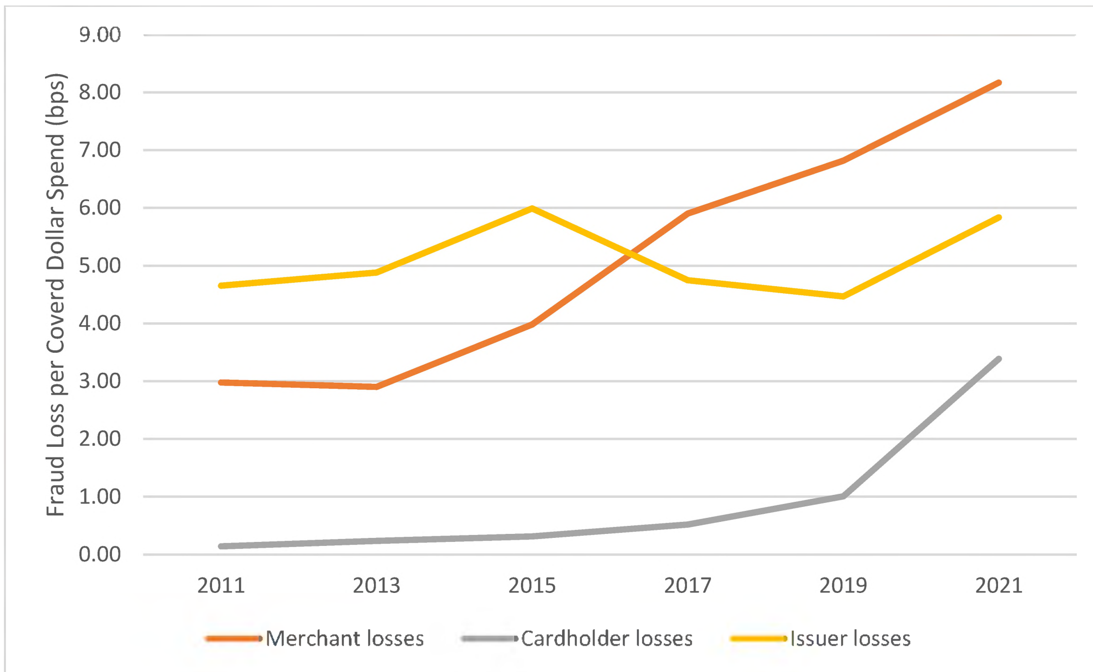
To be clear, the best reading of the statute is that Congress required the Board to exclude fixed costs, which would reduce the set of costs that contribute to the base component. But even if the statute can be read to permit the recovery of fixed ACS costs (on the theory that Congress distinguished between ACS and other costs), it pushes it too far to say that it permits all variable costs (like fraud) *plus* ACS costs that are incurred apart from any particular transaction.[19]

[19] Even if such a reading is a permissible interpretation of the statute today, it may no longer be in a post-*Chevron* world. The Board would have to assess whether its interpretation is the *best* interpretation, as opposed to a merely permissible one – and it is unlikely the Board would, or even could, reach that conclusion.

Even assuming the statute permits it, the Board should not exercise its discretion to permit the *ad valorem* fraud component. Increasing the fee cap for fraud *losses* provides no incentive to reduce fraud, and simply shifts the burden of fraud to rate-payers—*i.e.*, merchants and their customers. (In contrast, increasing the fee cap based on fraud *prevention* spending would incentivize investments that make transactions more secure, to the benefit of all parties sending and receiving payments.) On an industry level, the Board's present design leaves issuers essentially indifferent to reducing fraud losses.

The result has been an increase in overall fraud losses, all of which has been borne by retailers. Under the policies that the issuers and networks have established, more and more fraud losses are pushed onto retailers. As the charts below demonstrate, since 2011, issuer fraud losses have remained mostly stable. But beginning in 2013, merchant losses increased every year, and have nearly tripled in size (from about 3bps per transaction to over 8bps per transaction). The same is true for cardholder losses, which grew steadily from 2011 to 2019, and then grew dramatically between 2019 and 2021. At present, debit issuers bear no more than 1/3 of the overall burden of debit card fraud, even though they are the parties best equipped to address it. Nonetheless, the fraud-loss, *ad valorem* component continues to impose their costs on everyone else in the system without recognizing that the cost of fraud is already higher for their ratepayers than it is for the banks themselves.





This result is unfair and creates poor incentives for progress on debit interchange fraud among issuers. It should end.

4. *As described in paragraph (e)(1) of proposed appendix B to Regulation II, the Board would determine the fraud-prevention adjustment as the median per-transaction fraud-prevention costs among covered issuers. Should the Board adopt an alternative methodology for determining the fraud-prevention adjustment? If so, why?*

Were the board to eliminate the *ad valorem* fraud loss component, it could offset that decision with a modest increase in the fraud prevention adjustment, which appropriately rewards issuers for making *actual* investments in reducing debit card fraud. There is little information available to stakeholders, however, about how issuers invest in fraud prevention and whether the Board imposes any enforcement pressure on issuers who claim the adjustment. In principle, it would be sound policy for the Board to make the fraud prevention adjustment more valuable but also harder to earn, so that issuers are not rewarded for "preventing" fraud by simply pushing their costs on to others in the system. *See supra* pp. 27-29. As a recent whitepaper from Consumer Reports demonstrates, however, banks have shown an "incomplete commitment to fraud protection" as they move to digital platforms for banking and payments. *See* Consumer Reports, *The Case Study for a Digital Finance Standard* (Mar. 2024) at 4; *available at* https://advocacy.consumerreports.org/wp-

content/uploads/2024/03/Banking-Apps-Evaluation-Whitepaper-1.pdf. Findings like these recommend in favor of applying the fraud prevention award more stringently, so that only a "complete" commitment to actual fraud reduction is rewarded with an increase in a given issuer's regulated rate.

5. [Omitted]

6. *As described in paragraphs (c) through (e) of proposed appendix B to Regulation II, the Board would determine the base component, ad valorem component, and fraud-prevention adjustment for an applicable period using data reported on lines 1a, 3a, 5a, 5a.1, and 8b of the Debit Card Issuer Survey (FR 3064a).*

   a. *Are there any reporting challenges or data quality issues associated with these line items of which the Board should be aware? If so, how could the Board address these challenges or issues?*

   b. *Should the Board amend § 235.8 of Regulation II to specify that a covered issuer is required to retain records supporting the data that the covered issuer reports on the Debit Card Issuer Survey? Would this record retention requirement be duplicative of any existing recordkeeping requirements for covered issuers? If not, what would be the estimated additional annual burden of this requirement, in terms of hours and cost, for covered issuers?*

To begin with, the Board has acknowledged that a large percentage of banks do not supply the required data. Moreover, there is little transparency for other stakeholders into how the Board conducts the debit issuer survey and the incentives (or disincentives) it creates for issuers to fully and accurately respond. Merchants and other stakeholders do not know whether the results are skewed by reporting bias or other factors. Nor is there any way to know how much of the base component (and the different cost structures for large and small issuers) are attributable to the decision to include fixed ACS costs within the base component cost calculation. To facilitate better analysis, the Board should solicit the following information on the survey:

1) **ACS costs, divided into fixed costs and variable costs**. This clarifies how much of the current fee reflects what the Board is required by statute to consider and how much is purely discretionary. It will also allow stakeholders and the Board to accurately assess whether and how much of the per-transaction advantage reaped by the largest

issuers is purely due to scale economies and could be eliminated by taking (discretionary) fixed costs out of the base component calculation.

2) **The volume of transactions handled by the 25th, 50th, and 75th percentile issuers across the high, mid, and low volume issuer categories**. Currently, the report does not show the gross amount of transactions within each issuer tier, making it difficult to calculate where precisely in the market consolidation lies, and whether certain aspects of the data are heavily skewed by the largest issuers within each of the various tiers.

3) **Table 12 of the report should be provided with more granularity, clarifying the number of issuers who fit into each percentile based on tiers**. This will also help to demonstrate consolidation in the market and help to clarify whether certain aspects of the data are heavily skewed by the largest issuers within the various tiers.

4) **Information showing how interchange fees are split between regulated and unregulated issuers and how they differ by network type**. Additionally, it would be helpful to clarify how much of the interchange revenue is generated by card-not-present transactions, which are an increasing portion of debit transactions and may involve structural differences in either the costs of accepting them or the fraud losses they produce.

Separately, to facilitate enforcement of the survey reporting requirement, the Board should specify that covered issuers are required to retain records. Although RILA members are sensitive to the costs of record keeping, there is no evidence that record maintenance of the type warranted here imposes significant additional costs, and the ability to probe survey responses in greater detail would encourage accurate reporting by issuers, particularly given how much money is at stake based on the cost data issuers are reporting. The Board's proposal to automatically update the fee cap in light of the reported data makes this information (and its reliability) even more important; the system depends vitally on full and accurate reporting of both costs and total transactions by all issuers involved. In the absence of strong record keeping requirements and meaningful periodic audits, the incentive towards skewed reporting is very high.

7. *As described in section VI, with one exception, the Board proposes that the revisions would take effect on the first day of the next calendar quarter that begins at least 60 days after the final rule is published in the Federal Register. Would this proposed effective date provide sufficient notice to covered issuers, payment card networks, and other industry stakeholders*

to prepare for the initial changes to the base component, ad valorem component, and fraud-prevention adjustment?

In the prior round of rulemaking on interchange fees, the final rule was issued on June 29th, 2011, and made effective on October 1st, 2011. At a minimum, the effective date proposed here should not exceed this time period. The Board already extended the comment period by 90 days based on an extension request from debit issuers and affiliated industry groups. As shown in the chart below (drawn from data in the Board's 2021 Report), every single day that issuers are allowed to extract extra-statutory interchange fees from merchants is highly impactful. The Board should not endorse issuer efforts to claim an extra 30, 60, or 90 days of higher value fees for themselves. If anything, the 60-day period created by the proposal is too long and should be shortened to prevent additional days of windfall profits under conditions where it is entirely clear that the charges on current transactions do not correspond to current costs as the statute requires.

	Total Revenue Current Rate (bns)	Total Profit From Rate (bns)	Daily Revenue Current Rate (mns)	Daily Profit Current Rate (mns)
High-Volume Issuer	$11.62	$9.69	**$31.84**	**$26.56**
Mid-Volume Issuer	$0.70	$0.34	**$1.92**	**$0.92**
Low-Volume Issuer	$0.00	$0.00	**$0.00**	**$0.00**
Total	$12.32	$10.03	**$33.76**	**$27.47**

That is particularly true because there is no evidence whatsoever that 60 days (or even 30 days) is an inadequate amount of time to implement changes to the interchange fees. Merchants respond to changes in their interchange fees imposed by issuers or the card networks much more quickly. Adjusting the fees does not require extensive changes in technology or the creation of new infrastructure to support the rate change. It simply reduces the outsized profit margin that issuers reap on each transaction.

8. *As stated in paragraph (f) of proposed appendix B to Regulation II, going forward, the Board would publish the base component, ad valorem component, and fraud-prevention adjustment in the Federal Register no later than March 31 for an applicable period beginning July 1. Would this timeline provide sufficient notice to covered issuers, payment card networks, and other industry stakeholders to prepare for changes to these amounts? Should the Board increase or decrease the period between publication of these values and the beginning of the next applicable period?*

The proposed time period is adequate for adjustments by issuers that are in line with long term trends. But the final rule should provide that if the Board sees trends reverse or potentially anomalous increases in reported costs, it will evaluate the data in light of the long-term trends and may decline to increase the fee cap accordingly. In such circumstances, it would be appropriate to provide merchants and other stakeholders with an opportunity to comment on the data and explain why a fee-cap increase might or might not be appropriate under the circumstances. *See supra* pp. 11-13.

9. [Omitted].

10. [Omitted].

11. Does the Board's economic analysis of the proposal, set forth in section VIII.A, appropriately describe the likely impact of the proposal on various participants in the debit card market? Are there additional impacts of the proposal that the Board has not considered?

The Board should decline to consider speculative claims about how lowering the fee cap will affect small-volume issuers or issuers that are not covered by the cap at all. Critics of the new proposed cap argue that small-volume issuers will experience significantly decreased revenues that will force them to either pass on costs to consumers or exit the market altogether. But the best data available from the last round of interchange fee reform indicates that this is unlikely. For issuers in the asset range of $10-$30 billion that report their gross debit interchange revenue, this revenue only represents 2.1% of their overall total. Thus, even if their revenue from interchange fees did decline, this would be very unlikely to push them out of the market altogether. Further, for these same banks, their 2022 profit margin ranged from a little over 20% to over 35%, indicating healthy financial performance.

In any event, concern about the consequences or financial performance for the smallest issuers is not appropriately addressed by changing the system in ways that continue to bestow favor and windfalls on the largest issuers. As explained above, the most effective way to protect the interests of small-volume issuers would be to create individualized tailoring of the fee cap, which would both maintain (or even increase) the profit margins for small issuers and better align the overall market with congressional design and intent.

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RILA urges the Board to consider and respond to the foregoing comments in full and to reduce the debit interchange fee as quickly as possible.

Sincerely,

/s/ Brian Dodge
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The Retail Litigation Center, Inc. joins these comments in full.

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