May 12, 2024

Ann E. Misback, Secretary
Email: regs.comments@federalreserve.gov
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. R–1818, RIN 7100–AG67, Proposed Revisions to Regulation II's Interchange Fee Cap

Target appreciates the opportunity to provide comments to the Board of Governors of the Federal Reserve System (the "Board") on its proposal to revise the standard for assessing whether the debit card interchange fees received by a covered issuer are reasonable and proportional to the issuer's cost of the transaction (the "Proposal"). We strongly support a reduction in the regulated rate to reflect the significant reduction in issuer costs in the 13 years since the current standard was established. We further encourage the Board to move away from a simple uniform rate cap, which disproportionately rewards the largest debit issuers and correspondingly imposes unnecessary costs on retailers and consumers, in favor of a data-based standard derived from efficiency ratios that more closely reflects the statutory objective. We also recommend that the Board reform its approach to addressing fraud in the debit system in light of data clearly demonstrating that the current approach is not an incentive for fraud reduction.

Target is a general merchandise retailer with nearly 2,000 stores across all 50 US states and the District of Columbia. Our customers, referred to as "guests," can purchase products seamlessly in our stores and through our digital channels. We process approximately three billion retail transactions annually. Target's guests use debit cards more than any other form of payment, giving us extensive experience and insight into payment systems as a whole and debit transactions in particular.

Target strives to operate with speed, efficiency, and operational excellence to meet consumer demands and deliver consumer value in the highly competitive retail market. We view our loyalty program, Target Circle™, as a differentiator that offers robust rewards to drive guest loyalty and sales. Since 2010, guests who pay with a debit, credit, or reloadable Target Circle Card (formerly Target RedCard™) have enjoyed a 5% discount every time they shop at Target, in addition to free shipping, enhanced returns, and other perquisites. We recently relaunched the payment-neutral Target Circle offering with new benefits for all loyal guests, regardless how they choose to pay. We cite our rewards program in this context to rebut assertions made by financial institutions and networks that debit card rewards will be eliminated if debit interchange fees are reduced. Target has been able to offer 5% rewards for many years while operating with an annual net income margin rate of 4.3%.[1] This is an example of operating efficiently in a competitive environment and underscores that the banking industry, with net income margin rates of around 30%,[2] can certainly afford to offer rewards as a competitive strategy.

Any consideration of the regulated debit interchange rate must begin with the rationale for regulation, which is that ordinary competitive market forces do not apply to self-regulate interchange pricing. The debit interchange rates received by issuers are established by the card networks, which compete with each other to attract banks to issue debit cards under their respective network brands by offering higher interchange rates than competing networks. This, rather than issuer cost or enhancements to functionality, is the driving force behind rising interchange rates.

For merchants, accepting the global card networks is a business necessity due to their market power, but merchants do not receive any benefit from higher interchange rates. As Congress observed, a debit transaction is functionally similar to a personal check transaction, except that for the latter, banks and merchants each pay their own costs and the transaction clears at par. When interchange rates are untethered to issuer costs and there is no competition among the dominant networks for merchant acceptance, the result is excessive fees that unfairly burden merchants and inflate retail prices in a way that affects all consumers, including those who do not pay with plastic.

Before government intervention, issuers enjoyed excessive interchange rates that bore no relation to the cost of the card program or the value of that program to the merchants who funded it. As is clear from financial institutions' response to the Proposal, issuers today are still using debit interchange to fund totally unrelated bank operations – which only confirms that interchange remains significantly in excess of the cost of the debit card program. For example, in its statement responding to the Board's rulemaking announcement, the American Bankers Association claimed that "this proposal has the potential to make checking accounts, debit cards and *a range of financial products* more expensive for American consumers."[3] Issuer concerns about their ability to fund unrelated financial products and operations are not an appropriate consideration to establish the regulated debit interchange rate. Debit interchange is intended to cover the costs of authorization, clearing and settlement of debit transactions. To be consistent with statutory text and intent, the regulated rate must be adjusted to reflect the substantial reduction in covered issuer costs.

In response to the Board's invitation, we offer the following feedback on key aspects of the Proposal as well as certain specific questions posed by the Board.

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[1] Target Corporation (2024). *Annual Reports 2013-2023*, available at https://corporate.target.com/investors/annual/annual-reports-and-archive (ten-year average of net earnings divided by total revenue, as reported for 2013-2023).

[2] *See* New York University, "Margins by Sector (US)," Data as of January 2024, available at https://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/margin.html (showing Money Center Bank net profit margin at 30.89% and Regional Bank net profit margin at 29.67%).

[3] ABA Statement on Federal Reserve's Proposed Regulation II Changes, October 25, 2023, available at https://www.aba.com/about-us/press-room/press-releases/federal-reserve-proposed-regulation-ii-changes (emphasis added).

Base Component

The Board proposes to determine the interchange rate base component by establishing a new formula that applies a multiple to the transaction-weighted average of issuer allowable cost, adjusted as costs are periodically reported. We note that allowable costs should be limited to incremental Authorization, Clearing and Settlement (ACS) costs as directed by the statutory language and intent. We disagree with the Board's previous decision, which is preserved in the current Proposal, to recognize certain non-incremental costs within the scope of ACS costs, and we urge the Board to reconsider this aspect of the calculation, but this comment does not reiterate our arguments on allowable costs.

While we agree with the Board that the current base component must be reduced as it clearly fails to meet the statutory reasonable and proportional requirement, the Board's new formula also falls short of that requirement because it establishes an excessively high multiple designed to accommodate a small number of covered issuers with low debit volumes and high costs. Any formula designed to accommodate the relatively few covered issuers with the highest costs will necessarily result in unreasonable overcompensation of the lowest cost, largest volume issuers, and correspondingly, unreasonable overcharging of merchants.

The proposed multiple of 3.7 was selected to meet a cost recovery target of 98.5% of all covered issuers' costs over time. As a formula for cost recovery, a multiple of 3.7 over average cost is arguably excessive by any measure, but it is especially egregious as applied to issuers whose costs are significantly lower than the average. Issuer data submitted to the Federal Reserve over the past decade demonstrates a wide range of actual costs by issuer, with a substantial majority of transactions processed by issuers at the low end of the cost range.[4] The Proposal would provide "recovery" of about *5 times* actual cost for the top quartile of high-volume banks, which account for approximately 75% of all covered transactions.

Given the extreme cost disparity across issuers, the trade-off for a "one size fits all" rate must be a lower overall compensation target for the highest-cost issuers. In its 2011 rulemaking, the Board drew the line for cost recovery at 80%. As compared to the 98.5% target in the current Proposal, the 80/20 rule is closer to a fair representation of "most, but not all."

To arrive at a reasonable rate, Target believes a more conceptually sound approach would be to calculate the base component based on the efficiency ratio of covered issuers. As the Board knows, the efficiency ratio is the quotient of a bank's operating expense and operating revenue.[5] This is the inverse of the multiple the Board is proposing, which is based on revenue divided by cost. The efficiency ratio is better aligned with the reasonable and proportional standard, and it would

[4] Board Of Governors of the Federal Reserve System, *2009-2021 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions* and Data Tables, 2024 ("2021 Debit Card Issuer Survey"). Web archive https://www.federalreserve.gov/paymentsystems/regii-data-collections.htm.

[5] Operating revenue is the sum of net interest income and other operating income.

appropriately encourage the issuer to apply the same operational discipline and cost management to its debit card operations as it does its other lines of business.

Available data indicates that the asset weighted average efficiency ratio across covered issuers' total operations is 62%,[6] the inverse of which is revenue that is a multiple of 1.6 times expense.[7] Under an efficiency ratio analysis, a multiple any higher than 1.6 would effectively compensate banks over and above their allowable costs. Applying the 1.6 multiple to 2021 reported transaction-weighted average ACS cost of $0.039 would result in a base component rate of $0.062 per transaction. This rate would fully compensate covered issuers for allowable ACS cost on about 80% of transactions. By contrast, to arrive at the Board's proposed $0.144 base component rate in the context of an average efficiency ratio of 62% would require average issuer ACS cost to be $0.09, which is more than double the actual average $0.039 ACS cost. The proposed rate would result in excess revenue that issuers could repurpose to subsidize other operations or expenses not contemplated by the statute, which belies the Board's own interpretation of allowable ACS cost.

Applying an efficiency ratio to determine the base component likely still overcompensates covered issuers for allowable ACS cost. Bank operations such as lending present significantly more risk than issuing debit cards. It is a common economic principle that the higher the risk, the higher the reward—a business generally needs more revenue relative to expense to support higher-risk activities. Facilitating debit transactions is more akin to operating a public utility. Public utilities generally report a 10% operating margin,[8] which translates to a revenue-to-expense multiple of 1.1. This suggests that a 1.6 multiple is more than sufficient as reasonable compensation for allowable debit ACS cost.

Establishing a single rate based on the average efficiency ratio of covered issuers as set forth above would fully compensate about 30 of the largest debit card issuers for their entire costs. Those issuers account for 80% of covered debit transactions. Applying a single rate based on the average efficiency ratio would be a powerful and appropriate incentive for the other 130 covered issuers to improve their own efficiency. However, if the Board is concerned about potential under-compensation of covered issuers with smaller and less efficient debit programs,[9] the Board could establish a formula that results in individualized base component rates to compensate each covered issuer based on its actual reported allowable costs and efficiency ratio. With this approach, each issuer would enjoy the same margin of revenue over expense for debit transaction processing as it does in the rest of its operations. For example, high-volume Issuer A with a cost of $0.029 per transaction and an efficiency ratio of 66% would be entitled to a $0.044 base component fee,

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[6] Exhibit A to this comment sets forth the 2021 efficiency ratios for most covered debit issuers.

[7] In this analysis we are using asset-weighted average as a proxy for transaction weighted average, which we expect would yield a comparable result.

[8] Sean Ross, "What's the Average Profit Margin for a Utility Company?", *Investopedia*, updated April 22, 2022. Retrieved April 30, 2024, from https://www.investopedia.com/ask/answers/011915/what-average-profit-margin-utility-company.asp.

[9] Low volume covered issuers, which have the highest per-transaction costs, are not small institutions, as each has at least $10 billion in assets; moreover, it should also be noted that they are not necessarily the smallest among covered institutions. For some relatively large banks, debit cards are offered as a convenience for their customers but are not a significant component of the bank's overall business.

thereby approximating the same ratio of revenue to cost as it achieves in its overall business. Lower-volume Issuer B with a transaction cost of $0.10 and an efficiency ratio of 58% would be entitled to a $0.17 base component fee, again approximating its overall ratio of revenue to cost.

Establishing an individualized base component rate based on each issuer's efficiency ratio and transaction costs is clearly consistent with the statute:

> "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 [*emphasis added*]."[10]

Establishing a standard to be applied to individual issuers is eminently feasible. There are currently 163 covered issuers. This is clearly a manageable number of individual rates for card networks and processors to administer. Comparatively, processors and merchants are required to accommodate about 300 separate interchange rates for credit card transactions, as defined by the card networks, and those rates are revisited semi-annually.

Importantly, the statute calls for a *standard,* not a uniform rate. Merriam Webster defines "standard" as "something set up and established by authority as a rule for the measure of quantity, weight, extent, value, or quality."[11] A single rate for all issuers without regard to their individual circumstances is not a *measure* by which a particular issuer's fee can be established as reasonable and proportional to that issuer's cost. Since the more tailored alternative of individualized rates is reasonably available, we urge the Board to consider it.

In summary, we believe that to be fully consistent with the statutory reasonable and proportional standard, the Board should calculate the base component rate for covered issuers by applying a multiple that is derived from the issuers' efficiency ratios. If the Board is determined to keep its current approach of applying one uniform base component rate across all issuers, we would advocate a multiple of no more than 1.6, applied to the average transaction-weighted cost across covered issuers, resulting in a base component rate of $0.062 per transaction. This provides reasonable and proportional reimbursement of issuers' allowable costs while incentivizing issuers to be more cost-efficient in their debit card operations. If the Board is concerned that a uniform rate might undercompensate small-volume, high-cost covered issuers (even though those issuers are generally large financial institutions that simply do not operate a significant debit program as part of their operations), the correct response is not to raise the multiple and thus unreasonably overcompensate large volume covered issuers; rather the Board should apply individualized base component rates that are based upon each individual covered issuer's own efficiency ratio multiplied by its own reported cost.

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[10] 15 U.S. Code § 1693o–2(a)(2).
[11] https://www.merriam-webster.com/dictionary/standard.

Ad Valorem Fraud Reimbursement

In response to the Board's Proposal to maintain the ad valorem fraud loss component of the regulated rate with only a slight reduction in the rate, Target reiterates its assertion that requiring merchants to reimburse issuers for their share of fraud losses is both inappropriate and counterproductive. In 2020, we joined with over 200 businesses in advocating for elimination of the ad valorem component, and we stand by the information provided to the Board at that time.[12] We believe that the Board acted inconsistently with Congress' intent and design in creating the ad valorem component, and in the process has overcompensated issuers for fraud losses while also diminishing incentive for issuers to reduce those losses. Furthermore, the Board's approach to addressing fraud losses and fraud prevention—which differs from the approach Congress designed—has not worked to decrease fraud. The Board's data shows that overall covered issuer fraud incidence and fraud losses as a share of transaction value have both approximately doubled since 2009.[13] The Board made a discretionary decision to create the ad valorem fee, and we believe the Board should exercise its discretion to discontinue it in favor of a more effective approach to fraud prevention.

Congress did not intend that issuers would recover their share of fraud losses through uniformly applied interchange fees. As the lead sponsor of the statute, Senator Richard Durbin, stated on the Senate floor, "[a]s long as big banks are guaranteed the same interchange revenue no matter how much or how little fraud they have, the banks have no incentive to keep fraud costs low."[14] Rather than uniformly subsidizing fraud losses in advance through interchange, Congress directed the Board to establish a system whereby covered issuers would receive an interchange fraud prevention adjustment to compensate those issuers who undertake *effective* fraud prevention activities. Fraud losses were only mentioned in the statute in the context of establishing the fraud-prevention adjustment:

> "The Board may allow for an adjustment to the fee amount received or charged by an issuer under paragraph (2), if * * * the issuer complies with the fraud-related standards established by the Board under subparagraph (B), which standards shall—
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> > (I) be designed to ensure that any fraud-related adjustment of the issuer … *takes into account any fraud-related reimbursements (including amounts from charge-backs) received from consumers, merchants, or payment card networks* in relation to electronic debit transactions involving the issuer … [emphasis added]."[15]

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[12] Meeting Between Staff of the Federal Reserve Board and Representatives of Merchants and Merchant Trade Associations, September 23, 2020, available at https://www.federalreserve.gov/regreform/rr-commpublic/merchants-and-merchant-trade-associations-meeting-20200923.pdf.
[13] 88 Fed. Reg, 78118.
[14] 156 Cong. Rec. S4841 (daily ed. June 10, 2010) (statement of Sen. Durbin).
[15] 15 U.S. Code § 1693o–2(a)(5)(A).

Congress clearly understood that fraud losses were incurred by all participants in a debit transaction. If its intent was for covered issuers' share to be indemnified by merchants through the interchange fee, fraud losses would surely have been specified among the reimbursable costs.

The Board itself initially recognized that reimbursement of issuer fraud losses was outside the scope of ACS costs deemed allowable by the statute.[16] When the final rule was issued, however, issuer fraud losses were added to the expanded universe of "allowable" costs. The Board offered the following rationale for its about-face:

> "Permitting issuers to recover at least some fraud losses through interchange fees is reasonable given that the source of fraud could be any participant in an electronic debit transaction and that the exact source of fraud often is unknown. Payment card network rules allocate responsibility for fraudulent transactions, but this allocation does not necessarily result in the loss ending up with the party that was in the best position to prevent the fraud."[17]

The Board was misguided in substituting its discretion for Congress' design and thereby exacerbating the disproportionate share of fraud already borne by merchants. As the Board observed, the source of the fraud may be unknown or multi-faceted, but that does not logically lead to the conclusion that merchants rather than issuers are "the party … in the best position to prevent the fraud." Through the combination of the upfront ad valorem interchange fee and the shifting of fraud liability under the network chargeback rules, issuers essentially end up incurring minimal or no debit fraud losses. Even the networks – which have total control over the fraud allocation and chargeback rules – do not go that far.

As demonstrated by the Board's latest data[18], covered issuers have taken advantage of the Board's largesse by pocketing the ad valorem fee while also avoiding liability for fraud losses, which network rules have increasingly shifted onto merchants and consumers. In 2009, network rules allocated 61.2% of fraud losses on covered issuer transactions to issuers, 38.3% to merchants, and 0.5% to cardholders.[19] In contrast, in 2021, those losses were borne 33.5% by issuers, 47% by merchants, and 19.5% by cardholders.[20] Issuers are charging back two-thirds of fraud losses to merchants and cardholders, even though merchants (and ultimately consumers) are paying the ad valorem fee on every covered transaction ostensibly to cover such fraud losses. That is unreasonable on its face.

Of greater concern, as explained in the next section, is that by shielding covered issuers from the risk of fraud loss, the Board has undercut an essential element of the fraud-prevention regime contemplated by the statute. If issuers are protected from the cost of fraud losses, they have no

[16] Debit Card Interchange Fees and Routing: Proposed Rule, 75 Fed. Reg. 81760 (December 28, 2010) ("Fraud losses…are not included as allowable costs.")
[17] Debit Card Interchange Fees and Routing; Final Rule, 76 Fed. Reg. 43431 (July 20, 2011).
[18] *See* 2021 Debit Card Issuer Survey, *supra* note 3.
[19] 88 Fed. Reg. 78118.
[20] *Id.*

direct incentive to control fraud. The Board should correct this misinterpretation and eliminate the ad valorem fee altogether, thus restoring Congress' plan for addressing fraud through an adjustment awarded to issuers who demonstrate they are taking effective fraud prevention steps.

Fraud Prevention Adjustment

Congress designed the fraud prevention adjustment as a mechanism both to reduce fraud in the debit system and to appropriately compensate covered issuers who were taking effective steps to prevent fraud. However, the Board has not implemented the fraud prevention adjustment as Congress intended. As directed by the statute, the fraud prevention adjustment must be tailored to incentivize, and must be conditioned upon, *effective* fraud prevention efforts.

Congress authorized the Board to *consider* allowing a fraud prevention adjustment to issuers who comply with established fraud prevention standards that require the taking of effective fraud prevention steps. As the statute states:

> "The Board *may* allow for an adjustment to the fee amount received or charged by an issuer under paragraph (2), *if*—
>
> (i) such adjustment is reasonably necessary to make allowance for costs incurred by the issuer in preventing fraud in relation to electronic debit transactions involving that issuer; *and*
>
> (ii) *the issuer complies with the fraud-related standards* established by the Board under subparagraph (B), which standards shall—
>
> (I) be designed to ensure that any fraud related adjustment of the issuer is limited to the amount described in clause (i) and takes into account any fraud-related reimbursements (including amounts from charge-backs) received from consumers, merchants, or payment card networks in relation to electronic debit transactions involving the issuer; and
>
> (II) require issuers to take *effective* steps to reduce the occurrence of, and costs from, fraud in relation to electronic debit transactions, including through the development and implementation of cost-effective fraud prevention technology [emphasis added]."[21]

The prerequisites to assessment of the fraud prevention adjustment are clear: The Board is first required to evaluate whether a fraud prevention adjustment is reasonably necessary to make allowance for the issuer's fraud prevention costs. If the Board determines that a fraud prevention adjustment is reasonably necessary, it is then required to establish standards designed to ensure the adjustment: (a) is limited to the fraud prevention costs incurred by the issuer, *taking into account any fraud-related reimbursements to the issuer* from consumers, merchants, or payment card networks, and (b) requires issuers to take *effective* steps to reduce fraud. In other words, to satisfy the statutory mandate, the fraud adjustment *cannot* be a one-size-fits-all reimbursement

[21] 15 U.S. Code § 1693o–2(a)(5)(A).

granted to every issuer upon a mere self-certification of compliance without a demonstration of effectiveness.

Over the last 13 years, it appears that all covered issuers have been awarded the same fraud prevention adjustment as another reimbursement of their costs, with no apparent evaluation of the nature or results of any issuer's fraud prevention efforts. In that time, the total fraud rate on covered debit transactions has more than doubled, and as discussed above, nearly all that increase has been borne by merchants and consumers. It seems evident that the fraud prevention adjustment is being awarded without regard to the effectiveness of issuers' fraud prevention efforts. Meanwhile, merchants are left to absorb a triple hit. We are required to pay the same fraud prevention adjustment on every covered transaction without regard to whether the issuer has implemented effective fraud prevention measures. We reimburse issuers' entire share of fraud loss through the ad valorem interchange fee, while also bearing our own ever-increasing share under the network chargeback rules as more transaction volume moves to digital (network rules dictate that card-not-present fraud losses are to be borne by merchants). On top of that, we incur significant costs to implement our own fraud prevention measures.

The Board must reform its approach to addressing fraud on covered transactions. It should do so first by eliminating the ad valorem fee and allowing the burden of fraud losses to be allocated to responsible parties after fraud has occurred, rather than placing that burden on merchants both in advance through interchange and after-the-fact through network chargeback rules. The Board should then award the fraud prevention adjustment on an issuer-by-issuer basis to those issuers that provide data to the Board identifying the specific fraud prevention measures they have taken, consistent with the standards established by the Board, *and* demonstrating how those measures have proved effective at reducing fraud. The Board should further revise its fraud prevention standards to make clear that the fraud prevention adjustment will not be available to issuers who cannot demonstrate that their fraud prevention measures both meet the standards established by the Board and are effective in reducing fraud. For example, fraud losses continue to increase particularly for card-not-present dual message debit transactions.[22] To qualify for the fraud-prevention adjustment on those transactions, an issuer must demonstrate that it is taking effective measures to address the increasing incidence of fraud on those same transactions. Such an approach would align with the statutory design and properly align incentives for fraud prevention across all parties in the debit system.

Additional Considerations

The Board invited feedback on specific questions set forth in Part VII of the Proposal. We respond to certain of those questions here:

Question 1: The Board asked if the proposed two-year cadence for updating the regulated rate is appropriate. Target supports a regular cadence to review and update the debit interchange standard using survey data from banks and networks, but data standardization and transparency are

[22] *See* 2021 Debit Issuer Survey, *supra* note 3.

imperative. The final rule should provide for periodic auditing of reported data to ensure accuracy, and as discussed below in the answer to Question 7, should provide for transparency of issuer-reported information. Additionally, shortcomings in the Board's proposed formula for determining the regulated rate must be corrected before a regular cadence of adjustments sets in.

We further urge the Board to consider annual rate adjustments. As discussed below in response to Board Question 7, issuers should be required to report data on an annual basis to ensure integrity. Assuming the Board arrives at a reasonable formula based on clearly articulated and accurately reported data points, the rate can be adjusted automatically, without the need for Board intervention other than publication of the applicable rate based on the most recent survey data. Annual adjustments will allow for more timely accommodation of changes in issuer cost, as well as variations in the population of covered issuers.

<u>Question 2</u>: The Board asked if it should select a cost recovery target other than 98.5% of covered issuer transactions. The full cost-recovery target of 98.5% for the base component is unreasonably high, not to mention that attempting to achieve that or any other cost-recovery target for all covered issuers through a single base component rate results in gross overcompensation of the largest issuers. As discussed above, we recommend the Board abandon the single rate in favor of a more tailored formula that accommodates the wide range of issuer costs without significant over- or under-compensation, and we also suggest the Board consider efficiency ratios as its basis for determining an appropriate cost-recovery target.

<u>Questions 3 and 4</u>: The Board asked if the median ratio of issuer fraud losses to transaction value, multiplied by the value of the transaction, is an appropriate methodology for determining the ad valorem component, and if median per-transaction fraud-prevention costs are an appropriate methodology for determining the fraud-prevention adjustment. We support the Board's view that a median measure is appropriate for these methodologies. As discussed above, however, we believe that the ad valorem component is inconsistent with Congress' design and should be eliminated altogether and that the Board's fraud prevention adjustment methodology is flawed in both design and application.

<u>Question 7</u>: The Board asked if there are reporting challenges or data quality issues associated with the Debit Card Issuer Survey line items that will form the basis for periodic adjustments to the regulated rate, and if covered issuers should be required to retain records supporting the data. We have three concerns in this regard: relevance, standardization, and accountability; and we further propose that issuer data should be reported on an annual basis.

First, we urge the Board to carefully evaluate the data points collected in the issuer and network surveys and ensure that future surveys are designed to obtain the precise information that is relevant to calculate the regulated rate pursuant to the standard the Board adopts. Future surveys should remain consistent to allow for accurate periodic adjustment of the interchange standard.

Second, it is apparent that in surveys to date, covered issuers have not always responded to each survey question with the same level of detail. Going forward, it must be mandatory that each covered issuer provides all data points relevant to establishing the interchange standard, completely and at a consistent level of detail. In addition, to ensure an accurate representation of allowable costs, issuer data should be reported on an annual basis. This would protect against manipulation of the data, for example, by concentrating expenses in the "reported" year to inflate the interchange rate at its next adjustment. If the Board does not elect to implement annual adjustments, as we suggested above, issuers could maintain the current bi-annual survey cadence and simply include data for each of the two years since the previous survey.

Finally, key information relevant to establishing the regulated rate should be publicly available in the same manner as other institutional data, such as Call Reports. In our view, making the ACS costs, fraud prevention costs, and fraud losses of each covered issuer publicly available would provide the transparency needed for the industry to rely on the Board's survey to govern the billions of dollars in interchange fees assessed annually. Transparency is critical to effective implementation. Since the establishment of Regulation II, card networks and financial institutions have repeatedly attempted to circumvent its requirements, and both major card networks are currently under investigation by the U.S. Department of Justice for alleged anti-competitive practices.[23] The US Department of Justice challenged VISA's attempt to acquire debit card processor Plaid in 2019, citing violations to existing competition law.[24] The retail community has been compelled multiple times to request that the Federal Reserve and the Federal Trade Commission issue clarifications on issues related to routing requirements, including their applicability to e-commerce transactions as well as the impact of technological updates (in the form of misleading consumer-facing screens) that the global networks used as opportunities to attempt to circumvent the routing rules.[25] Simply put, card networks and covered financial institutions have a track record of trying to evade the purpose of the statute, which is to alleviate the impact to merchants and consumers of the flawed market forces and lack of competition in the payments ecosystem. It is legitimate to be concerned that those circumvention efforts will carry over to the survey responses when those survey results will impact the banks' revenue. Auditing and verification of issuer-reported data is necessary, but transparency would further ensure that concerns can be raised and addressed in a timely manner.

<u>Question 12</u>: The Board asked if the Board's economic analysis appropriately describes the likely impact of the proposed rule. We believe the Board's economic analysis understates the windfall

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[23] *See* Reuters, "Visa discloses further demands from US Justice Department over antitrust probe," July 26, 2023, available at https://www.reuters.com/business/finance/visa-discloses-further-demands-us-doj-over-ongoing-anti-trust-probe-2023-07-26/ ; Reuters, "Mastercard reports U.S. antitrust probe of debit card program," April 27, 2023, available at https://www.reuters.com/world/us/mastercard-reports-us-antitrust-probe-debit-card-program-2023-04-27/.

[24] *See* U.S. Department of Justice Antitrust Division, "Protecting Nascent Competition: Visa and Plaid Abandon Anticompetitive Merger," available at https://www.justice.gov/atr/division-operations/division-update-spring-2021/protecting-nascent-competition-visa-and-plaid-abandon-anticompetitive-merger.

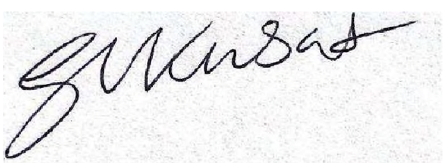
[25] *See* FTC closing letter to Visa, November 22, 2016, available at https://www.ftc.gov/system/files/documents/closing_letters/nid/closing_letter_from_james_frost_to_visa_-_11-22-16.pdf ; *see generally* Reuters, "Visa, Mastercard draw FTC inquiry over debit card transactions," November 13, 2019, available at https://www.reuters.com/article/us-ftc-visa-mastercard-probe/visa-mastercard-draw-ftc-inquiry-over-debit-card-transactions-bloomberg-law-idUSKBN1XN291.

that the Proposal would provide to high-volume covered issuers, who account for 80% of covered transactions and would receive more than five times their allowable costs from the base component alone. In addition, the Board's analysis wrongly speculates that a reduction in debit interchange revenue will necessarily be made up through additional cardholder fees or cuts to checking account features. Financial institutions have myriad sources of revenue, and as discussed above the banking sector enjoys net profit margins of around 30%, which means that covered issuers are fully capable of continuing to offer debit programs and other account features and services after interchange is reduced from the current excessive rate.[26] Additionally, issuers presumably already look to maximize cardholder fee revenue to the fullest extent they are able, but they are constrained by the fact that there is market competition between banks for cardholders; cardholders can leave one issuer for another if the other offers lower fees. This competitive dynamic stands in contrast to the interchange fee system, where all issuing banks receive the same centrally-fixed rates. Similarly, covered issuers that cut checking account features because of reductions in debit interchange revenue risk losing customer business to other issuers, such as the thousands of issuers who are not covered issuers under Regulation II. Issuers do not need protection from the effects of competition.

Conclusion

We appreciate the Board's recognition that the regulated rate must be lowered to be consistent with the statutory reasonable and proportional standard. However, the Proposal is not sufficient to satisfy the standard. We have recommended changes to the Board's formulas that would bring the Proposal into compliance while making the debit system more efficient, fair, and secure. We thank the Board for its consideration of our comments.

Sincerely,



Mrs. Gemma Kubat
President, Target Enterprise Services
Target

[26] *See* New York University data, *supra* note 1.

Exhibit A

Available Data on Efficiency Ratios of Banks with Over $10B in Assets[27]

	Efficiency Ratio[(2)]										
	10-Yr. Avg.	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
Asset Weighted Average	**62%**	**63%**	**62%**	**61%**	**59%**	**59%**	**60%**	**61%**	**63%**	**67%**	**68%**
Multiple (Inverse of the Efficiency Ratio)	**1.6**	**1.6**	**1.6**	**1.6**	**1.7**	**1.7**	**1.7**	**1.6**	**1.6**	**1.5**	**1.5**

Bloomberg Data[(1)]

By Bank	Index	Assets ($B)	10-Yr. Mult.	10-Yr. Avg.	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
JPMorgan Chase&Co	BIBIGSIX	$3,307	1.7	60%	59%	58%	55%	56%	58%	58%	58%	62%	64%	72%
Bank of America Corp	BIBIGSIX	$2,548	1.5	67%	64%	67%	64%	60%	58%	62%	65%	69%	87%	77%
Wells Fargo&Company	BIBNK	$1,804	1.5	65%	77%	68%	77%	67%	64%	61%	59%	57%	58%	58%
Citigroup Inc	BIBIGSIX	$1,670	1.6	62%	68%	67%	59%	57%	57%	58%	60%	57%	72%	64%
US Bancorp	BIBNK	$ 564	1.8	56%	61%	60%	57%	56%	55%	58%	54%	54%	53%	52%
PNC Financial Services Group	BIBNK	$ 552	1.6	62%	62%	67%	61%	62%	63%	63%	62%	61%	61%	60%
Truist Financial Corp	BIBNK	$ 529	1.6	63%	63%	67%	65%	63%	59%	65%	61%	64%	62%	60%
Toronto-Dominion Bank/The	BICABAN	$ 454	1.6	61%	56%	60%	56%	60%	58%	60%	62%	65%	65%	66%
Morgan Stanley	BIBIGSIX	$ 436	1.4	74%	71%	65%	67%	71%	70%	71%	73%	74%	89%	85%
Goldman Sachs Group Inc/The	BIBIGSIX	$ 434	1.6	62%	61%	50%	61%	65%	61%	61%	63%	72%	61%	63%
Fifth Third Bancorp	BIBNK	$ 210	1.7	58%	56%	60%	62%	56%	57%	54%	62%	58%	61%	58%
SVB Financial Group	BIBNK	$ 209	2.0	51%	58%	52%	51%	48%	45%	51%	54%	53%	49%	45%
Citizens Financial Group Inc	BIBNK	$ 188	1.4	72%	61%	61%	58%	59%	59%	61%	64%	68%	68%	164%
KeyCorp	BIBNK	$ 184	1.5	65%	61%	61%	61%	61%	62%	65%	75%	67%	67%	68%
Huntington Bancshares Inc/OH	BIBNK	$ 173	1.6	63%	58%	73%	58%	58%	58%	62%	68%	65%	66%	64%
Bank of Montreal	BICABAN	$ 167	1.6	64%	46%	63%	63%	68%	65%	68%	69%	69%	68%	64%
M&T Bank Corp	BIBNK	$ 167	1.7	58%	61%	60%	57%	56%	55%	55%	57%	60%	60%	57%
Regions Financial Corp	BIBNK	$ 162	1.6	62%	56%	58%	58%	59%	61%	62%	63%	66%	65%	67%
Signature Bank/New York NY	BIBNK	$ 118	2.8	35%	32%	35%	38%	38%	37%	34%	32%	34%	35%	36%
Royal Bank of Canada	BICABAN	$ 99	1.7	60%	57%	60%	60%	61%	59%	61%	61%	60%	62%	62%
Comerica Inc	BIBNK	$ 95	1.6	61%	57%	63%	60%	52%	54%	59%	68%	67%	64%	67%
Zions Bancorp NA	BIBNK	$ 93	1.5	66%	58%	59%	60%	61%	60%	62%	66%	76%	75%	83%
First Horizon Corp	BIBNK	$ 89	1.4	69%	55%	63%	48%	61%	63%	76%	72%	89%	70%	93%
East West Bancorp Inc	BIBNK	$ 61	2.2	46%	37%	44%	44%	44%	45%	46%	51%	48%	52%	48%
New York Community Bancorp	BIBNK	$ 59	1.9	53%	42%	40%	44%	49%	49%	48%	45%	124%	44%	44%
First Citizens BancShares Inc/	BIBNK	$ 58	1.4	69%	61%	66%	64%	64%	67%	66%	73%	74%	80%	76%
Synovus Financial Corp	BIBNK	$ 57	1.6	61%	52%	55%	58%	56%	58%	60%	64%	65%	69%	70%
Western Alliance Bancorp	BIBNK	$ 56	2.2	46%	45%	45%	39%	43%	43%	41%	47%	50%	51%	55%
Cullen/Frost Bankers Inc	BIBNK	$ 51	1.7	57%	57%	60%	55%	57%	55%	55%	57%	57%	58%	60%
Wintrust Financial Corp	BIBNK	$ 50	1.6	62%	56%	61%	59%	59%	58%	58%	65%	68%	67%	65%
BOK Financial Corp	BIBNK	$ 50	1.6	64%	63%	63%	59%	62%	64%	66%	71%	65%	66%	65%
Canadian Imperial Bank of Con	BICABAN	$ 49	1.7	59%	58%	58%	61%	58%	57%	58%	58%	62%	62%	58%
Cadence Bank	BIBNK	$ 48	1.4	70%	67%	67%	63%	67%	68%	68%	72%	75%	74%	78%
Valley National Bancorp	BIBNK	$ 43	1.6	62%	55%	51%	49%	57%	63%	65%	65%	78%	72%	65%
UMB Financial Corp	BIBNK	$ 42	1.4	70%	61%	65%	63%	69%	69%	69%	72%	78%	77%	74%
SouthState Corp	BIBNK	$ 42	1.5	67%	57%	68%	70%	62%	64%	68%	65%	65%	72%	77%
PacWest Bancorp	BIBNK	$ 40	1.6	62%	56%	49%	170%	43%	43%	44%	41%	42%	58%	76%
FNB Corp/PA	BIBNK	$ 39	1.7	59%	57%	59%	61%	57%	57%	61%	62%	58%	60%	63%
Pinnacle Financial Partners In	BIBNK	$ 38	1.9	52%	50%	50%	51%	49%	48%	53%	53%	53%	55%	58%
Prosperity Bancshares Inc	BIBNK	$ 38	2.3	43%	42%	42%	43%	48%	44%	42%	42%	41%	41%	41%
Hancock Whitney Corp	BIBNK	$ 37	1.6	64%	54%	62%	62%	63%	62%	63%	65%	71%	68%	72%
Commerce Bancshares Inc/MO	BIBNK	$ 37	1.7	58%	56%	56%	57%	56%	55%	59%	60%	60%	60%	59%
BankUnited Inc	BIBNK	$ 36	1.8	55%	54%	58%	51%	53%	61%	55%	58%	58%	55%	50%
Associated Banc-Corp	BIBNK	$ 35	1.5	65%	59%	66%	60%	64%	66%	65%	65%	68%	69%	70%
Webster Financial Corp	BIBNK	$ 35	1.7	60%	55%	60%	64%	57%	59%	62%	63%	61%	60%	62%

[27] Information not available for all institutions (including 22 covered issuer credit unions)

Exhibit A cont.

Bank	Index	Assets ($B)	Mult.	Eff. Ratio	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
Texas Capital Bancshares Inc	BIBNK	$ 35	1.7	57%	59%	66%	67%	56%	53%	55%	55%	54%	55%	55%
United Bankshares Inc/WV	BIBNK	$ 29	1.9	53%	53%	57%	55%	52%	51%	53%	49%	50%	52%	56%
Bank OZK	BIBNK	$ 27	2.5	39%	36%	39%	41%	40%	38%	35%	36%	38%	45%	45%
Glacier Bancorp Inc	BIBNK	$ 26	1.8	55%	56%	53%	51%	58%	56%	54%	57%	56%	55%	56%
Fulton Financial Corp	BIBNK	$ 26	1.5	65%	62%	65%	67%	65%	65%	65%	67%	69%	66%	63%
Simmons First National Corp	BIBNK	$ 25	1.6	63%	62%	60%	55%	57%	56%	62%	60%	67%	73%	76%
Old National Bancorp/IN	BIBNK	$ 24	1.6	61%	59%	61%	37%	62%	40%	70%	67%	70%	70%	70%
Ameris Bancorp	BIBNK	$ 24	1.6	64%	51%	55%	55%	67%	63%	62%	66%	76%	70%	74%
Bank of Hawaii Corp	BIBNK	$ 23	1.8	57%	59%	59%	55%	56%	56%	55%	56%	59%	57%	60%
United Community Banks Inc/G	BIBNK	$ 21	1.7	58%	53%	56%	56%	56%	57%	60%	60%	64%	58%	63%
Cathay General Bancorp	BIBNK	$ 21	2.2	46%	38%	44%	48%	45%	44%	44%	50%	49%	45%	50%
Independent Bank Corp	BIBNK	$ 20	1.6	61%	51%	65%	57%	56%	58%	60%	62%	67%	64%	69%
Atlantic Union Bankshares Cor	BIBNK	$ 20	1.6	64%	56%	61%	59%	61%	63%	64%	64%	67%	73%	70%
WaFd Inc	BIBNK	$ 20	2.0	50%	54%	59%	57%	52%	51%	48%	50%	50%	47%	37%
Heartland Financial USA Inc	BIBNK	$ 20	1.6	64%	60%	62%	60%	63%	67%	67%	66%	43%	73%	75%
Home BancShares Inc/AR	BIBNK	$ 18	2.3	44%	50%	42%	43%	41%	39%	42%	38%	41%	44%	54%
Hope Bancorp Inc	BIBNK	$ 18	2.0	51%	51%	53%	54%	55%	51%	49%	52%	48%	49%	48%
Trustmark Corp	BIBNK	$ 18	1.4	71%	85%	75%	67%	68%	67%	70%	70%	69%	69%	72%
WesBanco Inc	BIBNK	$ 17	1.7	59%	60%	59%	58%	60%	59%	57%	61%	61%	60%	61%
Banner Corp	BIBNK	$ 17	1.8	54%	59%	63%	63%	35%	36%	37%	39%	78%	65%	67%
Renasant Corp	BIBNK	$ 17	1.5	66%	62%	65%	71%	62%	63%	63%	66%	69%	66%	76%
Towne Bank/Portsmouth VA	BIBNK	$ 16	1.5	67%	64%	61%	59%	67%	66%	66%	71%	67%	73%	71%
International Bancshares Corp	BIBNK	$ 16	1.9	52%	40%	44%	52%	53%	52%	56%	57%	54%	53%	59%
CVB Financial Corp	BIBNK	$ 16	2.3	44%	39%	41%	41%	40%	46%	43%	47%	49%	45%	46%
WSFS Financial Corp	BIBNK	$ 16	1.7	60%	62%	61%	55%	49%	55%	65%	63%	64%	66%	63%
First Merchants Corp	BIBNK	$ 15	1.7	57%	54%	52%	52%	54%	52%	56%	58%	63%	65%	67%
Community Bank System Inc	BIBNK	$ 15	1.6	62%	62%	62%	63%	63%	60%	66%	61%	61%	60%	62%
Northwest Bancshares Inc	BIBNK	$ 15	1.5	66%	64%	64%	66%	64%	64%	64%	78%	70%	66%	64%
Enterprise Financial Services	BIBNK	$ 13	1.8	56%	51%	57%	51%	57%	52%	54%	52%	58%	64%	61%
First Financial Bankshares Inc	BIBNK	$ 13	2.1	48%	43%	46%	45%	49%	50%	49%	49%	48%	49%	50%
First Busey Corp	BIBNK	$ 13	1.6	63%	63%	65%	58%	64%	58%	60%	63%	64%	67%	68%
Sandy Spring Bancorp Inc	BIBNK	$ 13	1.8	56%	50%	49%	54%	52%	55%	57%	59%	59%	67%	61%
NBT Bancorp Inc	BIBNK	$ 12	1.6	62%	59%	60%	60%	60%	61%	60%	61%	63%	65%	66%
Eagle Bancorp Inc	BIBNK	$ 12	2.4	42%	46%	41%	39%	40%	37%	38%	40%	42%	51%	50%
First Bancorp/Southern Pines N	BIBNK	$ 11	1.6	61%	49%	57%	54%	57%	58%	67%	71%	70%	66%	60%
Seacoast Banking Corp of Flori	BIBNK	$ 10	1.5	68%	62%	57%	57%	53%	62%	64%	73%	73%	93%	83%
Capitol Federal Financial Inc	BIBNK	$ 10	2.1	47%	52%	57%	51%	47%	44%	41%	44%	45%	44%	48%
Park National Corp	BIBNK	$ 10	1.6	62%	61%	61%	63%	66%	62%	62%	62%	61%	62%	64%
First Commonwealth Financial	BIBNK	$ 10	1.6	61%	56%	55%	59%	59%	57%	64%	60%	65%	69%	68%

(1) Compiled from Bloomberg indices BIBNK, BIBIGSIX, and BICABANP, accessed Jan. 9, 2024

(2) Efficiency Ratio (also known as Cost to Income Ratio) is an efficiency measure commonly used in the financial sector. The efficiency ratio measures costs compared to revenues.

Calculated for Banks as:

$$\frac{\text{Operating Expenses}}{\text{Net Interest Income + Net Other Operating Income + Net Commissions\&Fees + Net Trading Account Profits + Net Gain on Investment + Net Other Income}}$$