May 10, 2024

By electronic delivery via e-mail to: regs.comments@federalreserve.gov

Ann E. Misback, Secretary
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; Notice of Proposed Rulemaking: Debit Card Interchange Fees and Routing

Dear Board of Governors:

I commend the Federal Reserve Board for taking long overdue steps to lower the regulated debit cap for issuers over $10 billion in assets and strongly encourage further reduction in the final rule. Although the proposed formula and rate cap are steps in the right direction, additional measures are necessary to ensure the final rule aligns with Congressional intent for it to be reasonable and proportional to an issuer's authorization, clearing, and settlement (ACS) costs.

Merchants use price, service, quality, and variety to compete for my business every day. As a consumer, I appreciate and benefit from that robust competition. In my long career in the retailer space, I also appreciate how that fierce competition drives us to strive for improvement more efficiently serve our customers and win their loyalty every day. Unfortunately, I also see how the lack of competition in the U.S. debit and credit card market artificially increases the cost of doing business, and the harm it does to our overall economy.

While in retail and most other industries competition drives prices lower when costs decrease, the same cannot be said for our debit and credit card market. Instead, its perverse design encourages networks and banks to increase processing costs for retailers instead of reducing them as the system becomes more efficient. Thankfully, Congress recognized these market flaws and passed the Durbin Amendment to bring much-needed relief to Main Street businesses and U.S. consumers.

While the proposed rule acknowledges that the current rate is too high, it falls short of preventing issuers from increasing their costs instead of finding savings in the system. The Board should ensure all parties are equally invested in preventing fraud by eliminating the *ad valorem* component altogether. Additionally, the Board should establish robust protocols to guarantee the integrity and accuracy of all data and processes for future rate cap adjustments.

The base component should be adjusted downward.

The base component, as proposed, would multiply the average issuer ACS costs (3.9 cents) by 3.7. While the Board explains that this multiplier ensures that 98.5% of transactions recover costs, it overlooks that the average issuer cost is far below 14.4 cents. Even more concerning, using the 3.7 multiplier could incentivize issuers to accept higher ACS costs, knowing that they would yield larger profits. For instance, every 1-cent increase in average ACS costs multiplied by 3.7 would result in a 2.7-cent profit for the issuing bank. It's hard to believe this was the Board's intention when adjusting the formula.

The Board could solve this issue in myriad ways, such as creating a tiered interchange cap based on the size of a bank's issuing portfolio. The Board already categorizes banks into large, medium, and small issuers. This same categorization could be used to create an interchange fee cap that is reasonable and proportional for each, while ensuring cost recovery for the vast majority of issuers. If the Board were to choose from one of the options presented in its posed questions, it should select the 95% cost recovery with the 2.7 multiplier at most.

The *ad valorem* component should be eliminated.

When passing the Durbin Amendment, Congress did not instruct the Board to have merchants pay for issuer fraud losses. Instead, the Board used its discretion in creating the component and should use that same discretion to eliminate it in the final rule. The Board would be justified in doing this because fraud losses have shifted significantly since the original rule was implemented, and every stakeholder should be invested in driving fraud out of the system.

When the original rate was set, issuers bore the majority of fraud losses. The Board chose to allow issuers to seek reimbursement from merchants for such losses by including the *ad valorem* component in the rate. Over the past decade, the dynamics have changed considerably, with merchants now bearing 47% of fraud losses in 2021 compared to issuers absorbing only 33%. Network rules continually shift to favor issuers, creating larger chargeback and fraud burdens for merchants. It is inappropriate for merchants to continue to pay for both their own and issuer fraud.

Equally compelling is the notion that having each party responsible for their own losses creates stronger incentives to actively drive fraud out of the system. The question arises: where is the issuer's business case to invest in fraud prevention if they are shielded from the losses? Merchants continually invest in solutions to help prevent fraud in their operations. In addition, networks constantly impose new mandatory fraud monitoring and prevention costs on merchants. Merchants must cover all of these costs from their own operating budget, but are also currently expected to pay for the issuer's fraud losses. Therefore, while there is a clear business case for merchants to do everything in their power to prevent fraud, the same cannot be said for issuers, who are often better positioned to identify and prevent fraud from occurring. The Board should level the playing field for all stakeholders to join in the fight to prevent fraud by eliminating the *ad valorem* component.

Ensuring the data is accurate and processes are established is essential.

Ensuring data accuracy and establishing processes are essential. In the proposed rule, the Board announced plans for an automatic adjustment to the rate every two years. While this is appreciated, it is crucial that it is implemented correctly and doesn't allow for manipulation. Issuers should be required to report their annual ACS costs. By having annual data, the Board can ensure that issuers are not front-loading costs into a specific year to artificially increase ACS costs. Additionally, annual data would help provide a more accurate picture of the market and reflect trends or anomalies. The Board must also establish a clear system for ensuring accuracy.

In conclusion, I appreciate the Board's interest in this issue and request that it take a strong stand for U.S. merchants and consumers. A significant reduction in the debit rate cap to reflect the nearly 50% reduction in ACS costs will provide tangible relief to Main Street businesses and consumers across the country. Most importantly, it will reflect Congressional intent and the statutory requirement that the regulated issuer debit interchange cap be reasonable and proportional to their ACS costs.

Respectfully,

Hannah vL Walker