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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:

This letter is submitted by Walmart, Inc., on behalf of itself and its affiliates[1] ("Walmart"), in response to the Federal Reserve Board of Governors' ("Board") request for comment on the Notice of Proposed Rulemaking ("NPRM"). The NPRM aims to amend Regulation II to reduce the maximum interchange fee for covered debit card issuers, and to create a standard process for updating the interchange fee on an ongoing basis ("Proposed Rule").

Walmart applauds the Board for recognizing that the current rate does not meet statutory requirements and needs to be lowered. We appreciate the opportunity to provide feedback as the Board works to further develop and finalize this rule. It is crucial to ensure that the rate is ***reasonable and proportional to issuer costs***, and that the calculation doesn't disproportionately impact other stakeholders in the payments ecosystem.

Below, we offer recommendations that will allow the Board to achieve its intended goals while providing some additional considerations when drafting the final rule.

The need to regulate debit interchange remains.

The Durbin Amendment was established to rectify a broken debit card market that lacked competition and transparency. The Amendment mandated the Board to establish a debit interchange fee cap for issuers with over $10 billion in assets who choose to have their rates centrally set by the

[1] Walmart Inc. has stores and clubs in 50 states and Puerto Rico offering low prices on the broadest assortment of products through a variety of brick-and-mortar formats including the Supercenter, Discount Store, Neighborhood Market and Sam's Club as well as e-commerce.

networks. This cap must be "***reasonable and proportional to the cost incurred by the issuer with respect to the transaction*** [emphasis added]."[2]

Congress further instructed the Board when prescribing regulations to distinguish between two (not three) categories of costs:

- "The incremental cost incurred by an issuer for the role of the issuer in the authorization, clearance, or settlement of a particular electronic debit transaction, which shall be considered..."
- "Other costs incurred by an issuer which are not specific to a particular electronic debit transaction, which shall not be considered..."[3]

Additionally, the Board was instructed to evaluate issuer costs every two years to ensure the interchange rate continues to be ***reasonable and proportional.***

While issuer costs vary significantly and the statute uses the singular term 'issuer' as the baseline, the Board established and maintains one standard for all issuers in the proposed rule. In December 2010, the Board proposed two approaches, both with a maximum interchange fee of 12 cents per debit card transaction (the Authorization, Clearing, and Settlement ("ACS") costs reported by the 80th percentile issuer). The Board also suggested excluding network processing fees, fixed, and overhead costs common to all electronic debit card transactions, as they were not attributable to the ACS of any one transaction.[4]

Additionally, the Board deemed fraud losses and the cost of fraud-prevention and reward programs unallowable because they were not attributable to variable ACS costs incurred by the issuer. However, after significant lobbying from banks and networks, the Board issued a final rule in June 2011 that substantially raised the cap to 21 cents plus 5 basis points, plus a penny for fraud. Thus, in addition to the variable ACS costs, the Board mistakenly[5] included:

1) Fixed costs related to processing a particular transaction, such as network connectivity, and software, hardware, equipment, and labor
2) Transaction monitoring costs
3) An allowance for fraud losses
4) Network processing fees

[2] EFTA § 920(a)2)
[3] EFTA §920(a)(4)(B)
[4] 75 Fed. Reg. at 81, 755, 81, 760
[5] While the board is not adjusting the ACS calculation, we continue to find it to be inconsistent with the law and should be revised.

The Board cited that issuers and large payment card networks objected to both of its proposed approaches for numerous reasons, arguing that "the limits in the proposals were not compelled by the statute". They expressed concerns that either proposed alternative would decrease revenue for issuing banks, increase cardholder fees, decrease the availability of debit card services, reduce benefits to merchants when compared to other forms of payment, stifle innovation in the payment system, among other things.[6]

It is appropriate and the law requires the lowering of the debit rate cap.

The law clearly states that the debit rate must be reasonable and proportional to an issuer's Authorization, Clearing, and Settlement (ACS) costs. When establishing the fee cap in 2011, the Board used self-reported issuer data from 2009, which showed an average cost of $0.077 per transaction. By 2021, the average ACS cost for covered issuers had dropped almost by half to $0.039 per transaction. Despite the dramatic decrease in issuer costs, the Board has not yet lowered the rate accordingly.

The Board's decade long delay in making any rate adjustments has cost Walmart, our customers, and other merchants billions of dollars every year. Conversely, the delay in lowering the rate has provided a windfall for the largest covered issuers, who currently enjoy over a 600% profit margin on covered debit transactions. Networks such as Visa and Mastercard continue to position themselves in the middle and restrict competition. They persistently impose new fees and rules on merchants for the financial benefit of the issuers and themselves.

Additionally, we know from when the Board initially set the debit fee cap, that the card brands raced to set their interchange rates at the cap. Today, there is no pressure to drive the rate lower than where the Board sets the cap, proving this is not a competitive market. Therefore, swift action by the Board to lower the cap is essential.

The formula used to set the debit rate cap must be sound and justifiable.

The proposal to codify the 3.7 multiplier is inappropriate and should be removed. It does the inverse of the intention behind the Board's proposal, incentivizing issuers to increase costs rather than decrease them. Every 1 cent increase in cost will drive 2.7 cents in incremental profit, while every 1 cent decrease in cost will reduce profits by 2.7 cents.

The Board's effort to use a multiplier to achieve cost recovery for the majority of issuers is a misguided endeavor, as cost recovery does not incentivize issuers to become more efficient. When the multiplier is >1, issuers are incentivized to increase their costs in order to increase profits.

[6] 12 CFR Part 235 Pg. 133

When the multiplier is =1, issuers are indifferent to reducing costs because they are guaranteed to have all costs covered. When the multiplier is <1, issuers are incentivized to become more efficient and reduce their costs to become profitable.

The proposed 3.7 multiplier would create a massive producer surplus at the expense of consumers. For example, on 98.4% of transactions, the merchant would overpay to capture that last 0.1% of debit volume, incentivizing bad behavior as the gap between the low-cost and high-cost issuers grows. Only the top 2% of volume needs to manipulate the system while the other 98% benefit from a producer surplus. This does not bring the interchange fee cap in-line with the statutory requirement that it be reasonable and proportional to an issuer's actual ACS costs.

The Board can achieve 100% coverage of all covered issuers by setting the regulated rate by issuer. This is more in-line with the statute than the proposed objective of 98.5% coverage. Additionally, if there are concerns with the feasibility of individualized rates by issuers, the Board could opt for a tiered approach. By tiering the rates, the Board could more closely align rates with issuer's costs than the current one-size-fits-all approach. Therefore, it's paramount that the Board reduce the rate even more to bring it in line with the covered issuers' reported costs and the statute.

Walmart's responses to questions posed by the Board.

Is the proposed two-year cadence appropriate, or should the Board determine these amounts more or less frequently?

> The two-year cadence may be appropriate; however, it is critical for the Board to ensure there are controls in place to prevent covered issuers from manipulating their reported costs. For example, the Board needs to ensure that covered issuers cannot accelerate or defer costs to the year(s) they report to the Federal Reserve, as this would artificially inflate the true costs for a given year. Similarly, safeguards must be put in place so issuers cannot game the system to skew costs higher by loading fraud expenditures, investments, and other expenses into years they report.
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> Issuers should be required to report expenses every year, regardless of whether it is on a bi-annual, annual, or other basis. This will ensure greater clarity into the actual incremental issuer costs for a debit transaction and the integrity of the data. The Board should outline specific checks and balances that will be used to audit and validate any material variances in costs over previous years from individual respondents.
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> From a merchant perspective, there may be a model(s) where a longer cadence in adjusting the rate could drive positive behavior. For example, if the multiplier were issuer-specific

and ≤ 1, then resetting the rate less frequently would incentivize good behavior. Issuers might work quickly to reduce their costs below 1 so that they could take advantage of a cost/price gap for as long as possible. In this instance, resetting the rate less frequently (e.g., every four years) could be reasonable; the key is to incentivize the correct behavior.

Additionally, the final rule must establish protocols in the event issuer-reported data would ever result in an increase in the regulated rate. If an issuer's or issuers' reported data would result in an increase in the rate, there must be a mandated independent audit of the data, a review of the formula for appropriateness, and an opportunity for merchants and all stakeholders' concerns to be heard and considered. It is essential that the Board establishes these protocols during the current rule-making process to create clarity and predictability for all stakeholders.

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?

Cost-recovery target (percentage of covered issuer transactions) (%)	Fixed multiplier	Base component (based on 2021 data)[83] (cents)	Decline in base component relative to current (based on 2021 data) (%)	Efficiency gap with respect to transaction processing between covered issuers whose transactions are above and below the cost-recovery target (based on 2021 data)[84]	Percentage of covered issuers that would have fully recovered their base component costs in 2021 had the relevant base component been in effect in 2021 (based on 2021 data) (%)
Current	....	21.0	....	....	77
99.5	4.5	17.6	16	7.7	76
99.0	4.0	15.6	26	5.8	71
*98.5	3.7	14.4	31	5.2	66
98.0	3.5	13.7	35	4.7	63
95.0	2.7	10.5	50	3.8	52

* Proposal.

Yes, the Board should select another cost-recovery target than the proposed 98.5%. If the proposed cost-recovery target equal to 98.5% of transactions is used, then the high-volume covered issuers will receive $0.144 in interchange. However, high-volume covered issuers' ACS costs are $0.035. A rate that allows the largest issuers, with the greatest volume of transactions, to reap a 400% profit on every covered debit transaction is neither reasonable nor proportional to their costs.

The largest issuers have control over the majority of covered transactions. The current proposal guarantees the largest issuers a higher profit margin than the original $0.12 per debit card transaction rate proposed over a decade ago, when their reported ACS costs were almost double what they are today. Today, 45 banks ("largest issuers") account for 94% of the regulated debit transactions and currently enjoy margins in excess of 600%. This is in direct conflict with what was written and specified in the Durbin Amendment.

Looking at the multiplier of 3.7 for the cost-recovery target of 98.5% of transactions, it is flawed as it disincentivizes efficiencies and removes the business case to lower underlying costs. If an issuer's ACS costs increase by $.01, the proposed formula would increase base interchange by $.037. By being less efficient, issuers would make an additional $.027 profit per transaction. Issuers would actually make MORE money by decreasing efficiency. While issuers would save $560 million in costs by reducing ACS costs by $.01 per transaction, they would lose $2.1 billion in interchange revenue due to the rate decrease.

If the Board chooses to keep a single rate in the final rule, it would be more in-line with the statute to select the cost-recovery target of 95% of the options presented to ensure the rate is both reasonable and proportional to issuer costs. However, a cost recovery target far below 95% would help ensure that the multiplier would not incentivize covered issuers to increase their costs in order to drive more profits.

If the cost-recovery target is 95% of transactions, then the interchange rate would be $0.105, which, while still high, would bring it more in-line with the statute. Otherwise, the "high volume" issuers will continue to enjoy the benefits of unreasonable and disproportionate interchange while the Board only captures an incremental 3.5% of the transactions. Additionally, as referenced above, a lower rate will incentivize greater efficiencies in the system.

Finally, the 95% cost recovery option from the chart above would be the most appropriate of those listed if the Board were to use one in the final rule. While still not ideal, the 95% cost recovery option's 2.7 multiplier is the same that was used by the Board in the final 2011 formula.

Should the Board adopt an alternative methodology for determining the ad valorem component? If so, why?

The *ad valorem*-based fee should be eliminated. The Board established the *ad valorem* component to "provide incentives for both issuers and merchants to take steps to reduce fraud losses."[7] Congress did not contemplate, nor direct, the Federal Reserve to allow issuers to recoup fraud losses from merchants.

Merchants shoulder a larger portion of the fraud liability now than when the rate was originally set. Card network rules continue to shift fraud liability away from issuers and onto merchants, particularly in the e-commerce space. Compounding the merchant's fraud

[7] 12 CFR Part 235.

liability further exacerbates the inequities in the market and removes the business case for issuers to actually reduce fraud losses. Today, the United States is the global fraud leader, a situation all stakeholders should be working to correct. If the largest debit issuers in the country can continue to have their fraud losses covered by merchants, where is their incentive to reduce fraud?

Continuing to allow for the *ad valorem* fee locks in a model where issuers have no incentive to reduce fraud, and many will profit from it. Historically, issuers may have argued that merchants were in a unique position to prevent fraud losses by checking cardholder identification, signature, or other security measures. Ironically, today, the network rules limit most of those same fraud-prevention tools. This is all contrary to the original intent of issuers reducing the occurrence of and losses from fraudulent electronic debit transactions.

If the Board does not choose to remove the *ad valorem*-based fee altogether, it should adopt an alternative methodology for determining it. For example, since the 5-basis point *ad valorem* component was established in 2011, the number of debit card transactions has more than doubled. And, between 2011 and 2024, the US Bureau of Labor Statistics shows that inflation increased by 40%.[8] Because the *ad valorem* is a percentage of the transaction amount, these two factors have geometrically impacted the size of the *ad valorem* fee since 2023.

Reducing the *ad valorem* component by 20% (from 5-basis points to 4-basis points) hardly offsets the massive increase over time. Additionally, the proposed 4-basis point maximum is excessive and not reasonable nor proportionate to issuer's costs. The data clearly shows that issuer's share of fraud losses has decreased from 59.8% down to 33.5%; therefore, at a minimum, the *ad valorem* component should be reduced proportionately.

Should the Board adopt an alternative methodology for determining the fraud-prevention adjustment? If so, why?

The Board should eliminate the fraud prevention adjustment allowance altogether. Looking back on the original guidelines from the Durbin Amendment, the Board may allow an adjustment for fraud-prevention costs for reasonable costs incurred by the issuer in preventing fraud, provided the issuer complied with the standards established by the Board, including taking effective steps to reduce fraud.[9]

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[8] Calculated using January 2011 and January 2024 on the USBLS CPI Inflation Calculator website, https://data.bls.gov/cgi-bin/cpicalc.pl

[9] 12 CRF Part 235.

As mentioned above, the Board's own data shows that merchants and other payments ecosystem players bear more of the fraud liability than issuers. With the continuous shift in liability, and ever-increasing fraud costs being shouldered by merchants, it is no longer appropriate for merchants to pay for an issuing bank's fraud prevention costs. It is a long-standing issue in the payments space that the networks, best positioned to prevent fraud, are actually incentivized to maintain a level of fraud in the ecosystem because they sell services that are dependent on fraud occurring. Merchants are charged mandatory network fees in the name of security and fraud prevention.

These fees are non-negotiable and not optional for merchants. Each party should be responsible for their own costs, and it is inappropriate to expect merchants to continue to pay for covered issuers' responsibilities. The Board is well-positioned to drive efficiency here, and the path to doing so is eliminating the loophole of allowing upward adjustments to the fraud-prevention fee.

If the Board chooses to keep the fraud adjustment fee, it should be modified. An issuing bank must demonstrate an actual fraud reduction in the overall system—this may not include shifting the fraud to other stakeholders (i.e., merchants, acquirers, consumers). This determination should be made at the individual issuer level; that is, not every issuer should automatically earn this adjustment, and the current system of self-certifying is not sufficient.

Individual issuer banks must submit substantiated evidence of actual fraud mitigation costs and successful fraud prevention. The cadence of this determination should be every two years, using annual data, or align with the Board's final decision as it relates to #1 above.

Determining 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).

> **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?**
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> Both fees should be eliminated moving forward. However, if the Board chooses to retain one or the other, it is essential that issuers report clear, accurate, and justifiable data. Currently, there is not sufficient specificity as it relates to what issuers can count as "in-house" costs. For example, an issuer could disguise costs that are not directly related to the processing of a debit card transaction. Additionally, until an individual issuer demonstrates that they can reduce both the amount and frequency of fraud, they should not benefit from any adjustment or *ad valorem* fee.

Should the Board amend §235.8 of Reg 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?

Yes, the Board should require covered issuers to retain all supporting data records, in detail, to justify their reported costs. The debit rate cap is determined by the covered issuers' self-reported data. Therefore, issuers have an intrinsic responsibility to be able to defend their data upon request. As previously stated, it would be beneficial for the Board to move to an annual data reporting schedule. By only using biannual data, it incentivizes covered issuers to shift costs to reporting years.

Additionally, the Board should provide for formalized third-party auditing of covered issuers' reported data with clear protocols to ensure accuracy and honesty. The Board should also stipulate that if covered issuers, for any reason, report an increase in costs that would result in an increase in the cap, there should be an automatic audit of the covered issuer's data and a review of the formula.

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?

Yes, 60 days would provide more than sufficient notice. There is no evidence to suggest that even 30 days is not enough time to implement changes to the interchange fees. 60 days should be the absolute maximum time allowed for implementation for all parties. Issuers and networks have already been given an extra 90 days at the higher rate as the Board granted their request for an extension to the public comment period.

Merchants have waited for over a decade for relief, and the longer the covered issuers are able to delay compliance, the longer they will be able to enjoy the windfall profits from the higher fees. The Board must stand firm and move quickly to finalize the rule and set the compliance date to quickly bring the fee cap within the statutory requirements.

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?

> Yes, the timeline would provide more than ample notice for issuers and payment card networks to comply. However, the final rule should provide a clear process for review, consideration, public comment, and adjustment if the issuer-reported costs would result in an increase to the debit fee cap.

Does the Board's economic analysis of the proposal 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 not be swayed by the same arguments the issuers and networks made prior to the original rate being finalized. For over a decade, large volume issuers have enjoyed windfall profits based on these false claims. On the other hand, merchants and their customers continue to overpay for debit due to the strong banking lobby.
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> In truth, the majority of banks are exempt from the cap, and continue to collect interchange higher than the covered issuer's fee cap. Additionally, for the covered small volume issuers, debit is far from being a central or revenue-producing line of business. However, they were used in the last rulemaking to drive up the cap, costing merchants and their customers billions of dollars in excess fees over the past decade. The Board must stand firm and reduce the interchange fee cap, ensuring it is both reasonable and proportional to the large volume covered issuers' costs.

In closing, the Board must hold firm against any effort to slow down the interchange fee cap decreases or be swayed by any request to increase the rate. Any delay will only cause greater harm to businesses across the country, benefitting the nation's largest banks, who enjoy the largest margins.

Kind regards,

Michael A. Cook
Senior Vice President, Assistant Treasurer
Walmart Inc.