By Electronic Delivery to regs.comments@federalreserve.gov

May 10, 2024

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Docket No. R-1818: *Debit Card Interchange Fees and Routing* (RIN 7100-AG67)

Ladies and Gentlemen:

This letter is submitted by Visa Inc. ("Visa") to the Board of Governors of the Federal Reserve System ("Board") in response to the Board's notice of proposed rulemaking to amend Regulation II and the official commentary to Regulation II related to debit interchange fees (the "NPRM" or "Proposal").[1] Visa believes that the Proposal represents a meaningful and significant change in the Board's methodology and approach to implementing the debit interchange fee standard provisions of the Electronic Fund Transfer Act ("EFTA"), and that the Proposal would have a significant adverse impact on issuers of all sizes and their customers.[2] We believe that the Board should withdraw the Proposal. If the Board believes that it must revise the interchange fee cap, the Board should only do so following issuance of a new proposal that adequately addresses the Proposal's infirmities, meaningfully considers the costs of the Proposal, and takes into account the shifting debit card landscape, which is undergoing substantial change.

Debit cards represent an increasingly important, and often the primary, method for retail depositors to access their deposits and make electronic payments. Retail depositors use debit cards because they are simple, quick, and safe, and eliminate the need to carry cash. Access to debit cards is especially important to those retail depositors who have limited access to other forms of electronic payments, such as credit cards. This is particularly true in the U.S., where, according to the 2021 FDIC National Survey of Unbanked and Underbanked Households, 18.6% of households are unbanked or underbanked, representing 24.6 million households.[3]

Competitive debit card offerings are essential for small and mid-sized depository institutions to retain and grow their retail deposit customers; as such, deposits remain an important source of stable funding for these institutions. Visa believes that it is critical to support debit card programs offered by depository institutions of all sizes to expand access for consumers and small businesses to basic banking services, maintain a healthy and diversified range of deposit-taking banks and credit unions, and preserve the two-sided market that makes it significantly easier and more efficient for consumers and merchants to

---

[1] Debit Card Interchange Fees and Routing, Proposed Rule, 88 Fed. Reg. 78,100 (Nov. 14, 2023).

[2] 15 U.S.C. §§ 1693 *et seq*. This is contrary to statements made in the NPRM and subsequently in public comments made by Board members suggesting that the Proposal is based on the same methodology and approach that was originally taken in promulgating Regulation II in 2011. *See, e.g.,* The Brookings Institution Webinar, *A Conversation with Federal Reserve Governor Christopher Waller*, transcript at 10 (Jan. 16, 2024), *available at* https://www.brookings.edu/wp-content/uploads/2024/01/20240116_Waller_Transcript.pdf. We respectfully disagree with this assertion for the reasons discussed herein.

[3] Federal Deposit Insurance Corporation, 2021 FDIC *National Survey of Unbanked and Underbanked Households*, at 75 (Oct. 25, 2022), *available at* https://www.fdic.gov/analysis/household-survey/2021report.pdf.

transact, which directly benefits both. For the foregoing reasons, Visa believes that significant regulatory changes to the payment system should only be undertaken where there is a clear legal mandate to do so, and subject to the goals of enhancing integrity, trust, and confidence in the payment system, with careful consideration of the impact on all stakeholders.

I. Executive Summary

Visa strongly urges the Board to withdraw the Proposal as it is neither required nor justified, is replete with legal defects, and effectively would implement new policy goals not supported by the statute.[4] The Proposal also does not adequately analyze or address the extensive harmful potential impacts. Should the Board nonetheless believe that it is necessary to revisit the cap, a second, less-favored option is for the Board to issue a new proposal that uses the same statutorily consistent methodology it adopted in promulgating Regulation II in 2011 and update the interchange fee cap to reflect updated cost data (e.g., adding cardholder inquiry costs, which the Board recognized as authorization, settlement and clearance ("ACS") costs in 2011).

Visa's principal issues with the Proposal are:

- In setting the proposed base component, the Board's reliance on the transaction-weighted average of per-transaction base component costs across all covered issuers is inconsistent with the plain language reading of the statute previously adopted by the Board that considers the costs incurred by a representative issuer; is arbitrary, capricious, and an abuse of discretion; and contains Constitutional defects.

- The Board fails to provide a reasoned explanation for its shift from interpreting the "reasonable" base component standard as one that allows cost recovery for a substantial majority of covered issuers (80 percent), to the proposed standard that would allow cost recovery for only 66 percent of covered issuers. Moreover, the Board's proposed target of full cost recovery for 98.5 percent of covered issuer transactions is arbitrary, as is the 3.7 fixed multiplier. Rather than articulating a principle grounded in the plain language of the statute, and implementing that principle based on the data available at the time, the Board appears to adopt a target result it wants to achieve based on an entirely new metric not contemplated or supported by the statute and simply describes a formula consistent with that result.

- The Board's reliance on an "efficiency gap" is not supported by the statute. Nothing in the statute requires or implies that the Board has the authority to (i) determine whether the actual and legitimate costs incurred by representative debit issuers are not "efficient" enough, and (ii) establish an interchange fee cap based on the Board picking and choosing among those issuers' cost structures. The Board was instructed by the statute to determine a standard for reasonable and proportional interchange rates based on issuer costs; not to discard the incremental costs incurred by issuers outside of Board-determined benchmarks. For issuers in the "low-volume" and "mid-volume" tiers identified by the Board, the actual costs of running a debit program are their costs and the Board has made no reasoned justification or basis for deeming certain issuers to be "inefficient" and, therefore, ineligible to recover their reasonable and proportional costs, or that their costs are "outliers" or unreliable from a data standpoint. Moreover, we have doubts that certain covered issuers will ever be able to become "efficient" enough to achieve full cost recovery

[4] This option is consistent with recommendations of members of the Community Depository Institutions Advisory Council. *See* Fed Record of Meeting, Community Depository Institutions Advisory Council (Nov. 16, 2023), *available at* https://www.federalreserve.gov/aboutthefed/files/CDIAC-meeting-20231116.pdf.

for ACS costs. There is no basis in the statute to cap their interchange fee far below their actual costs.

- The Board fails to recognize that the formulaic approach it proposes inherently would adopt two critical policy choices not found in the statute or in the 2011 regulations: a) that the law was intended as a one-way ratchet to reduce the operating costs of debit programs for all covered issuers based on the lowest cost structures achieved by the largest issuers, creating constant downward pressure on cost recovery for low- and mid-volume issuers; and b) that the Board's allowable cost standard should ignore actual market-driven stability in costs for low- and mid-volume issuers, or even increases in such costs whether from inflation, complexity of transaction environments, new regulatory requirements, greater competition for customers or resources, or otherwise. Contrary to these policies, the statute and the initial Board regulations were agnostic as to whether actual costs incurred by issuers, or the associated standard, went up or down over time.

- Contrary to the Board's analysis in the NPRM, the proposed substantial cut in the interchange cap likely would discourage deposit customers from banking with "low-volume" and "mid-volume" issuers because these issuers may be less able to provide competitive debit offerings, and would adversely impact debit interchange revenues for exempt small issuers, as market forces drive down interchange rates toward the lower cap. Moreover, the proposed lowering of the cap would exacerbate existing disincentives for smaller financial institutions to grow to meet the needs of the communities they serve, potentially making them less competitive with their peers and new debit and prepaid offerings from three-party networks.

- The Proposal violates the Fifth Amendment to the U.S. Constitution by denying a substantial number of covered issuers the right to recover their costs and a reasonable rate of return for debit card transactions.

- The costs included or excluded in the interchange fee calculation are intrinsically linked to the Board's assessment of whether the amount of the interchange fee is reasonable and proportional to the cost incurred by the issuer in effecting electronic debit transactions, as is required by statute. In 2011, the Board determined what costs should be included or excluded. Some of those costs were excluded at the time because the appropriate cost data was not available; this is no longer the case. The Proposal, like the current rule, omits various costs that either are required to be included or may be included under the plain language of the statute. As such, if the Board does not withdraw the Proposal, the Board must revisit costs it previously excluded as part of this rulemaking and should issue a re-proposal following its determination of which of those costs it proposes to include.

- The Proposal does not take into account the recent card-not-present routing revisions to Regulation II, which may affect issuer costs, including an increase in the magnitude and incidences of fraud losses on debit card transactions. The Board is expected to have completed the collection of new survey data in May 2024; that said, the full extent of issuer impacts from the recent Regulation II revisions is still likely to be unknown for at least another year. The Board should withdraw the Proposal and consider issuing a new proposal at such time as the impact of these changes is understood and reflected in the data submitted in response to the Debit Card Issuer ("DCI") Survey.

- The interchange fee standard should continue to include the *ad valorem* component and fraud-prevention adjustment, and the ad valorem component should be increased.

- Changes to the interchange fee cap should only be made on the basis of significant and sustained changes in issuer costs and should not be undertaken on an arbitrary two-year schedule that would

create uncertainty for issuers and networks and discourage improvements in services that require longer periods of time to develop and implement.

These issues, as well as additional comments, are discussed in further detail below.

II. Specific Comments on the Proposal

a. The Proposal is an Unnecessary Rulemaking Exercise.

The Board elected to implement the statutory directive that it establish "standards" for assessing "reasonable and proportional" costs by adopting the current fee cap. Since the adoption of the interchange fee cap in 2011,[5] the percentage of covered issuers that are able to fully recover their base component costs (77 percent) appears to have been relatively stable.[6] This suggests that the current rule fulfills the statute's purpose that a standard be established for determining whether the amount of an interchange transaction fee is reasonable and proportional to the cost incurred by an issuer with respect to transactions,[7] and it is unnecessary for the Board to revisit the standard at this time. Moreover, as discussed in greater detail below, lowering of the interchange fee cap would create disincentives for issuers to invest, innovate and become more efficient given the dramatic reduction in revenue associated with debit transactions under the Proposal, and would create the potential that lower costs could result in an even lower interchange fee cap, especially if the Board adopts an automatic adjustment mechanism as proposed. Such an outcome could further penalize smaller covered issuers who would be unable to achieve the same efficiencies given the lack of resources and economies of scale, yet would still be impacted by the lower cap.

b. The NPRM's Methodology for Determining Whether Costs Are "Reasonable and Proportional" is Inconsistent with the Plain Language of the Statute and is Arbitrary, Capricious, an Abuse of Discretion, and Contrary to Constitutional Requirements. Moreover, the Board Fails to Provide a Reasoned Explanation for Adopting a New Methodology for Determining the Base Component.

Regulation II currently reflects the Board's interpretation that, in developing standards for assessing whether the amount of any interchange fee is "reasonable and proportional" to issuer costs pursuant to Section 920, the Board was authorized to set "a reasonable limit on the highest amount of an interchange fee that an issuer may receive . . . ."[8] In the Supplementary Information to the 2011 Rule, the Board stated:

> As an initial matter, the Board believes [the adopted] approach is consistent with the language in Section 920(a)(2). Section 920(a)(2) refers to 'an issuer' and 'an electronic debit transaction;' in other words, to a representative issuer and transaction. Section 920(a)(2)'s subsequent use of 'the issuer' and 'the transaction' is reasonably read as a reference back to the original representative use of each term (*i.e.*, an issuer receiving an interchange fee and a transaction for which a fee is received). This reading fulfills the purposes of the provision by allowing a standard to be set that ensures that interchange transaction fees are reasonable and are proportional to allowable costs without imposing undue compliance burdens on issuers or networks. This approach also provides

[5] Debit Card Interchange Fees and Routing, Final Rule, 76 Fed. Reg. 43,394 (July 20, 2011).

[6] *See* 88 Fed. Reg. at 78,113.

[7] *See* EFTA Section 920 (codified at 15 U.S.C. § 1693o-2).

[8] 76 Fed. Reg. at 43,423.

> transparency to issuers, networks, acquirers, merchants, and supervisors that will result in the most effective monitoring and enforcement of compliance.[9]

Based on these interpretations, the standard adopted by the Board resulted in a base component amount of 21 cents per transaction, which corresponded to the per-transaction allowable cost, excluding fraud losses, of the issuer at the 80th percentile.[10] According to the Board, this cap was appropriate because the "average per-transaction cost of the issuers above the 80th percentile [in 2009] is 49 cents, more than double the level of the [21-cent] cap, and greater than the average interchange fee level recorded in the survey."[11] In adopting the current standard, the Board declined to accommodate issuers above the 80th percentile on the basis that, according to the Board, setting interchange fee standards to accommodate these higher-cost issuers would not be reasonable or proportional to "the overall cost experience of the *substantial majority of covered issuers*."[12]

In the NPRM, the Board proposes to adopt a fundamentally different approach that would establish a fee cap not based on issuer cost, as the statute requires, but rather based on the "transaction-weighted average of per-transaction base component costs" across <u>all</u> covered issuers. The Board asserts that this metric is "preferable to alternative metrics, such as the unweighted average across covered issuers, or a given percentile across covered issuers[,]" because it is "less affected than these alternative metrics by outliers . . . ."[13] Unlike the Board's explanation in 2011 when it surmised that so-called "outliers" above the 80th percentile were those "higher-cost issuers [that] may face unique circumstances regarding their overall business orientation; for example, . . . organizations whose commercial banking operations (and associated debit card programs) [were] small relative to their overall operations,"[14] the Board does not specify what constitutes an outlier in the NPRM. Moreover, the Board asserts that the current approach to setting the base component costs is no longer appropriate because the Board determined that the results since the 2011 survey (i) did not show a clear discontinuity or showed multiple apparent discontinuities, and (ii) "the amount corresponding to a particular discontinuity did not reflect the overall trend in the transaction-weighted average of per-transaction base component costs across covered issuers."[15] However, as discussed further below, the Board did not provide any information or analysis explaining the basis for its conclusion that the data did not demonstrate any clear discontinuities. Instead, the Board refers to an "efficiency gap" that appears to be more linked to inherent economies of scale rather than the nature of issuers' debit card programs.

The Board's proposed methodology for determining recoverable base component costs is inconsistent with a plain language reading of Section 920(a), which requires the Board to establish standards for assessing whether the interchange fee received or charged by "an issuer" is "reasonable and proportional to the cost *incurred by the issuer* with respect to the transaction."[16] According to the Board, the proposed methodology (i.e., transaction-weighted average of per-transaction base component costs times a fixed

---

[9] 76 Fed. Reg. at 43,422.

[10] The Board notes in the NPRM that while the base component of 21 cents adopted in 2011 roughly correlated to the 80th percentile of covered issuers, the Board did not adopt any particular cost-recovery target at the time. 88 Fed. Reg. at 78,104, n.30.

[11] 76 Fed. Reg. at 43,433.

[12] *Id.* (emphasis added).

[13] 88 Fed. Reg. at 78,105, n.36. In addition, the Board asserts that the "transaction-weighted average of per-transaction base component costs" metric is preferable to the median because, unlike the median, "its value depends on all covered issuers' per-transaction base component costs, rather than only on whether such values fall above or below the median." *Id.*

[14] 76 Fed. Reg. at 43,433.

[15] 88 Fed. Reg. at 78,106.

[16] 15 U.S.C. § 1693o-2(a)(2)-(3) (emphasis added).

multiplier) is "reasonable because it would allow covered issuers to fully recover their base component costs over time for a *significant majority of covered issuer transactions*."[17] This approach ignores the statutory language that the interchange standards be based on the costs incurred by an issuer, which according to the Board's original interpretation, referred to the costs incurred by a "representative issuer."[18] Instead, the approach taken in the NPRM unjustifiably departs from the statutory language by tethering the base component calculation to average transaction costs pooled across all covered issuers. The costs for low- and mid-volume issuers of running a debit card program only appear in the data beginning with the "90-95" percent bucket. By targeting transaction costs across all covered issuers (as opposed to targeting the per-transaction costs of a representative issuer), the Proposal is substantially skewed to only cover the costs of the high-volume issuers.

However, for covered issuers in the "low-volume" and "mid-volume" tiers identified by the Board in its 2021 Interchange Fee Revenue Report ("2021 Report"),[19] the actual costs of running a debit card program are *their* costs and a fundamental error of the Proposal is that there is no legal basis to cap interchange fees at rates that prevent recovery by low- and mid-volume issuers of *their* actual costs based on a false notion of "efficiency," particularly where there is no data discontinuity suggesting that the cost data of any single issuer or group of issuers are not reliable or even notably outside a range common to the size of the institution. Notably, as reflected in Figure 19 of the 2021 Report, the average ACS costs of low-volume issuers is $0.595 per transaction, which means that even if low-volume issuers reduced their costs by 75%, they would still not be able to recover costs under the proposed cap. Further, Figure 19 shows that since the promulgation of Regulation II, ACS cost trends have decreased for "high-volume" issuers, while low- and mid-volume issuers have not seen a corresponding decrease in their ACS costs.[20] Figure 19 appears to confirm that the difference in the ACS costs of low- and mid-volume issuers relative to those of high-volume issuers is not due to a lack of effort (or efficiency); rather, high-volume issuers are able to maintain lower per-transaction ACS costs due to economies of scale and bargaining power, advantages that low- and mid-volume issuers will not meaningfully have available to them.

The approach in the Proposal, therefore, errs by holding all covered issuers to the costs and cost trends determined only by the largest covered issuers. Nothing in the statute requires or implies that the Board has the authority to determine whether the actual and legitimate costs experienced by representative debit card issuers were, compared to the largest bank issuers in the nation, not "efficient" enough, and to limit the interchange cap based on the Board picking and choosing among such valid costs. In other words, the Board was instructed to determine reasonable and proportional interchange rates based on issuer costs, not to discard the actual costs of banks outside of specific benchmarks arbitrarily selected by the Board.

Through our discussions with numerous banks and credit unions, it is clear that the Proposal likely would significantly impact smaller institutions with debit card portfolios core to their business strategy. These are not merely "organizations whose commercial banking operations (and associated debit card programs) are small relative to their overall operations" that the Board previously concluded would not have costs that are "reasonable and proportional" to the substantial majority of covered issuers.[21] For example, one bank with approximately $15 billion in assets shared that building its customer relationships around a debit card program within its local community is central to its core banking strategy. This bank projected that the Proposal would limit its ability to offer no-fee ATMs, high interest savings accounts, and

[17] 88 Fed. Reg. at 78,107 (emphasis added).

[18] 76 Fed. Reg. at 43,422.

[19] Board of Governors of the Federal Reserve System, *2021 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions* (Oct. 2023), *available at* https://www.federalreserve.gov/paymentsystems/files/debitfees_costs_2021.pdf.

[20] *Id.* at 25.

[21] *See* 76 Fed. Reg. at 43,433.

low-fee to fee-free accounts. Another financial institution with approximately $35 billion in assets that services the military community emphasized that the cost of operating a debit card program does not go away when interchange is reduced and highlighted that reductions such as those proposed would adversely affect its ability to offer surcharge-free ATM network access, free access to desired consumer services like Zelle, and fee-free delivery of physical cards. This institution also noted that it would likely have to rethink the types of cardholders it can service, such as by requiring a minimum credit score even for debit cards, as individuals with lower credit scores generally cost more to bank, which would significantly impact its mission to serve its core customers and community. Visa found these conversations with smaller institutions highly informative, as these institutions offer core debit card products that depend on interchange to partly recoup costs, which are these institutions' actual costs, and likely would have to increase fees or limit debit card services in a way that would impact their customers, especially low- and moderate-income individuals. All this underscores the point that while the Board appears to view debit cards as a stand-alone product, for many community banks and credit unions, debit cards are a core offering that is central to their ability to serve their communities. The Proposal would significantly impact their ability to provide services that are fundamental to this core offering, with the likely impact that their customers may seek to move their business to other issuers that are able to continue to offer a more competitive debit card product.

This exposes a related and fundamental flaw with the NRPM—that is, the Board failed to engage in "reasoned decision making" to explain the proposed change in methodology that targets full cost recovery for 98.5 percent of covered issuer transactions. The Board justifies the 98.5 percent target as reasonable by relying on the "efficiency gap" with respect to transaction processing between covered issuers whose transactions are above, and at, the target percentile. However, this reasoning is flawed. As noted above, the so-called "efficiency gap" makes a qualitative judgment about issuers that erroneously equates efficiency with economies of scale made possible through retail deposit asset volume, issuer size and resources, and thereby penalizes a low- or mid-volume issuer that is as "efficient" relative to its peers but that incurs higher costs than high-volume issuers. The Board fails to explain the statutory basis for introducing the concept of a "collective efficiency" and "efficiency gap" based principally on the understandably lower cost structures of the largest debit issuers, or how the statute justifies use of those concepts to create constant downward pressure on the cost structures of all covered issuers, regardless of size. The Board fails to discuss why the actual costs of low- and mid-volume issuers, which appear by the Board's own numbers to be stable or increasing, are any less valid for assessing whether an interchange fee is "reasonable and proportional" to their costs. Instead, without explanation, the Board has adopted a theoretically neutral formulaic approach which, in application, implements a strong policy bias toward constant reduction of the interchange fee, a policy decision wholly unsupported by the statute or the Board's prior regulatory approach.

Even assuming that the "efficiency gap" provides a reasonable basis for allowing cost recovery for some issuers and not others, which Visa strongly disagrees with, the Board does not explain why the "efficiency gap" at 98.5% is appropriate. According to the Board's cost-recovery target table,[22] the "efficiency gap" increases from 5.2 at 98.5% to 5.8 at 99.0% to 7.7 at 99.5%. The Board does not explain why it selects 5.2/98.5% as a cost-recovery target rather than any other particular "gap." For the numerous reasons described above, the Board's proposed methodology, including the cost-recovery target of 98.5 percent of covered issuer transactions, is fundamentally arbitrary.

The lack of a rationale provided by the Board to support its new proposed methodology, including the cost recovery target, is especially noteworthy given that, out of the covered issuers, an estimated 17 percent fewer would recover even their base component costs if the NPRM were adopted without change. The public is left to assume that the Board believes its proposed standard meets the "reasonable"

[22] 88 Fed. Reg. at 78,113.

requirements of the statute if 66 percent of covered issuers are able to fully recover their base component costs. However, the Board does not assert, and in our view, could not reasonably assert, that 66 percent represents a substantial majority of covered issuers, or even a "representative issuer."

The Board's current standard, which contemplates at least 80 percent of covered issuers recovering their base component, is a more reasonable interpretation of the statutory language.[23] Whether or not the Board intended to set a cost recovery target of 80 percent when it adopted the current cap, an interchange fee cap standard that allows recovery of base component costs for only 66 percent of covered issuers does not represent a rate that is reasonable and proportional to the costs incurred by a representative issuer.

We further note that the proposed 3.7 fixed multiplier is arbitrary. As the Board notes in the NPRM, the multiplier was derived only after the Board determined to establish a cost-recovery target of 98.5 percent of covered issuers' transactions.[24] Working backwards from an arbitrary preferred outcome that does not comport with the statute to determine the multiplier underscores that the multiplier itself is also arbitrary. Nor does the Board propose to revisit whether the multiplier continues to achieve the statutory purpose or the Board's preferred outcome in the future. Given the importance of the multiplier, the arbitrary nature of the multiplier renders the entire methodology as arbitrary.

c. The Board's Prior Exclusion of Allowable Costs Must Be Reconsidered.

i. The Board Must Reconsider Its Prior Determination to Exclude Certain Allowable Costs Before Moving Forward with a Final Rule.

The NPRM errs in failing to reconsider the allowable costs included in the interchange fee standards, in part, because the 2011 final rule relied on a limited data set for cardholder inquiry costs, for which robust data is now available. Cardholder inquiry costs and other costs that are specific to a particular electronic debit transaction but that the Board excluded from consideration in 2011 are critical to the determination of whether the interchange fee caps proposed under the NPRM are reasonable and proportional to the actual costs incurred by the issuer with respect to the transaction. At a minimum, the Board must consider cardholder inquiry costs that the Board acknowledged would have been appropriate at the time to include as allowable incremental ACS costs but for the fact that it did not have data to determine the appropriate allocation of these costs within the base standard. The Board now has that data.

If the Board does not withdraw the Proposal, the Board should re-propose a rule and request comment on (i) cardholder inquiry costs and other costs that are specific to a particular electronic debit transaction that the Board proposes as recoverable under the statute and regulation; and (ii) the updated proposed fee caps that result from the consideration of additional costs.

ii. The Board Must Reconsider Its Prior Exclusion of Allowable Costs and Take into Account Changes in Available Information Since 2011.

Under the NPRM, the base component cost would be derived from the same set of allowable costs that informed the current fee cap.[25] These allowable costs do not include certain costs that are either incremental costs incurred in the authorization, clearance, or settlement of a particular electronic debit transaction or that are specific to a particular electronic debit transaction so that no electronic debit

[23] *See* 76 Fed. Reg. at 43,422.

[24] 88 Fed. Reg. at 78,107.

[25] The NPRM would add a definition of "allowable costs" in new Appendix B to Part 235, 88 Fed. Reg. at 78,132.

transaction can occur without incurring these costs.[26] For example, under the Proposal, and unchanged from the current rule, recoverable costs would not include the following costs, among others:

(1) costs associated with handling cardholder inquiries, including costs of dispute handling;

(2) costs associated with non-sufficient funds ("NSF") handling; and

(3) other costs associated with running a debit card program (e.g., the cost of producing and distributing debit cards, providing periodic cardholder statements, research and development costs, etc.).

We address each of these costs below.[27]

Cardholder Inquiry Costs. The costs associated with handling cardholder inquiries meet the statutory standard for "incremental cost[s] incurred by an issuer for the role of the issuer in the authorization, clearance, or settlement of a particular electronic debit transaction,"[28] which are costs that *must* be considered in establishing the interchange fee calculation.[29] Responding to customer inquiries about debit card transactions is not only a necessary customer service by covered issuers to assure accurate settlement of electronic debit transactions, but it is also a regulatory compliance obligation, as many of these "inquiries" are related to disputes governed by the EFTA and Regulation E. In its 2011 rulemaking, the Board acknowledged that at least a portion of cardholder inquiries are transaction-specific—and, thus, should be considered in the interchange fee calculation—and noted that "[f]ielding these inquiries is partly a cost of a service *required* by regulatory and network rule requirements[.]"[30] Despite this acknowledgement, because the Board did not have data available to "accurately separate out and assess cost data for customer inquiries related solely to particular debit transactions,"[31] such costs were not originally included in the interchange fee calculation.

Cost data related to cardholder inquiries is now readily available in the Board's DCI survey data and, therefore, must be included by the Board as part of any amendments to the base component standard of Regulation II. Moreover, as CNP transactions grow faster in incidence, inquiry costs are likely to substantially increase for issuers given that exception items tend to be higher for CNP transactions. Failure to include such costs as recoverable in the base component would be inconsistent with both the Board's statutory mandate to include incremental costs incurred by an issuer for its role in the authorization, clearance, and settlement of a debit transaction, and with the Board's own 2011 interpretation of the statute. We believe that cardholder inquiry costs must be included as recoverable ACS costs as set forth in the Board's express interpretation of allowable costs, given that the only basis on which the Board did not include these ACS costs in 2011 no longer applies.

NSF Handling Costs. The costs associated with NSF handling also must be included in the interchange fee calculation under the statutory standard. Whether or not the issuer incurs a related loss, handling of NSF transactions—including collections costs—are costs incurred in connection with a specific debit transaction.

---

[26] 76 Fed. Reg. at 43,427.

[27] Visa supports the discussion of additional costs in the Letter from The Clearing House Association L.L.C. et al. to Board of Governors of the Federal Reserve System (May 10, 2024) (the "Joint Trades Letter").

[28] 15 U.S.C. § 1693o-2(a)(4)(B)(i).

[29] *NACS v. Board of Governors of the Federal Reserve System*, 746 F.3d 474, 483 (D.C. Cir. 2014) ("Recall that section 920(a)(4)(B)(i) *requires* the Board to include 'incremental cost[s] incurred by an issuer for the role of the issuer in the authorization, clearance, or settlement of a particular electronic debit transaction,' . . . .").

[30] 76 Fed. Reg. at 43,429 (emphasis added).

[31] 76 Fed. Reg. at 43,429.

In its 2011 rulemaking, the Board cited the fact that issuers "generally impose[] fees to recover the associated risk that a cardholder may fail to provide subsequent funding for the transaction"[32] as a reason to exclude such costs from the interchange fee calculation. However, NSF handling costs are required to be included as incremental ACS costs by the statutory language even if separate fees are charged for these services. Moreover, significant changes in NSF fees have occurred since 2011. A 2023 report by the Consumer Financial Protection Bureau ("CFPB") found that the vast majority of NSF fees have been eliminated.[33] In addition, the CFPB's recent proposals would change the way overdraft services are regulated,[34] and would prohibit issuers from charging NSF fees on transactions that are declined instantaneously or near instantaneously and limit the NSF fees that covered issuers could charge.[35] Taken together, the factual basis for the Board's original justification for excluding such costs from the interchange fee calculation has changed and does not support the exclusion of NSF costs. Despite these facts, the NPRM fails to provide analysis of the evolution of NSF handling fees since the 2011 rulemaking and fails to request comment on the exclusion of NSF fees from the calculation of allowable costs. A Regulation II proposal must include an up-to-date rationale for the Board's decision to include or exclude such costs.

Other Costs Associated with "Running the Debit Card Program." The Board's own interpretation of the statute acknowledges that costs that are specific to a particular electronic debit transaction may be included in the interchange fee calculation if they are "specific to a particular electronic debit transaction" and "consistent with the purpose of the statute."[36] The Board has also described these costs by stating that "no electronic debit transaction can occur without incurring these costs . . . ."[37] The costs associated with running the debit card program appropriately fall under this category of costs because such issuer costs are necessary for enabling electronic debit transactions and developing up-to-date technological enhancements to facilitate processing of such transactions. For example:

- Periodic statements are *required* by law when electronic debit transactions occur.
- Electronic debit transactions would not occur but for the capital investment, including research and development that enabled such transactions.
- Electronic debit card transactions cannot be performed without the issuance of debit cards (whether physical or virtual) and the establishment and maintenance of checking and demand deposit accounts.
- Costs associated with issuer compliance functions—whether required by federal or state law or by network rules are necessary for electronic debit card transactions to occur.

To reiterate, if costs are "specific to a particular electronic debit transaction" and are "reasonable and proportional" to the costs incurred by the issuer with respect to a transaction (regardless of whether such costs are direct or indirect, fixed or variable, or voluntary or involuntary), they should be included in the interchange fee calculation as long as they are necessary for electronic debit transactions to occur. The Board's decision to exclude costs that are statutorily required to be included, and costs that fit within the category of costs that the Board determined *could* be included, without even revisiting the bases under which such costs were excluded, results in a rulemaking that is arbitrary and contrary to the statute. As

---

[32] *Id.*

[33] The CFPB's analysis found that "[n]early two-thirds of banks with over $10 billion in assets have eliminated NSF fees[,]" eliminating nearly 97 percent of the NSF fee revenue of such banks. CFPB, *Vast majority of NSF fees have been eliminated, saving consumers nearly $2 billion annually* (Oct. 11, 2023).

[34] CFPB, Overdraft Lending: Very Large Financial Institutions, Proposed Rule, 89 Fed. Reg. 13,852 (Feb. 23, 2024).

[35] CFPB, Fees for Instantaneously Declined Transactions, Proposed Rule, 89 Fed. Reg. 6,031 (Jan. 31, 2024).

[36] 76 Fed. Reg. at 43,427.

[37] *Id.*

such, Visa believes that, if the Board does not simply withdraw the Proposal, the Board must reconsider the allowable costs included in the NPRM taking into account more recent and fulsome cost data and changes in business practices, and issue a re-proposal that accounts for such costs.

d. The Board Has Not Provided Sufficient Information to Enable Meaningful Comment on the Board's Analysis of the DCI Survey Data.

Under the NPRM, the proposed (and any future) base component and fraud-prevention adjustment would be determined using data reported by covered issuers in response to the DCI Survey. In addition, the Board justifies its shift in the methodology for calculating the base component, in part, on grounds that the Board's analysis of DCI Survey results since 2011 does not show a clear "discontinuity" in the distribution of per-transaction base component costs across covered issuers. However, the Board has not published the underlying disaggregated data and the empirical analysis on which the Board relies (it has only published aggregated data and its conclusions).[38] Therefore, and notwithstanding the release of additional data by the Board, the public is significantly hindered in its ability to comment on the proposed methodology as these data do not show how transaction costs are incurred at the issuer level.[39] While we appreciate that disclosure of individual issuer data could raise issues of data confidentiality, the Board should explore ways to release more detailed issuer data that is reflective of the three categories in the Board's October 2023 report on the 2021 DCI Survey in order to give the public the opportunity to provide meaningful comment.

In addition, the 2021 DCI Survey reflects data originating during the Covid pandemic, a once-in-a-lifetime event that substantially impacted the economy, as well as consumer and issuer behavior, and, moreover, does not reflect the card-not-present ("CNP") routing final rule that was adopted in 2022. The 2021 data is, therefore, of limited value and should not be relied upon when establishing a fee cap that will have a significant effect on the debit card industry. The importance of this rulemaking calls for the Board to take care that any new fee cap be based on a large sample size of reliable and verifiable data that has shown consistency over time, and in a variety of economic circumstances. This responsibility takes on greater importance if the Board intends to adopt an automatic adjustment, which would raise additional problems, as discussed below.

The data collection for the 2023 DCI Survey has also now been completed, which presents both an opportunity and a challenge. Notwithstanding the fundamental defects of the DCI Survey instrument, the 2023 DCI Survey will provide the Board with more current data, and the data should largely be free from skewing effects of the pandemic and may provide some early insight into the impact of the CNP routing amendments to Regulation II, which took effect on July 1, 2023, although a more complete view of the effects of the routing amendments will likely not be known for at least another year. In addition, with the extension of the comment period on the NPRM, it is increasingly likely that any final rule based on the NPRM would be issued some time in 2025, the same year the 2023 Interchange Fee Revenue Report ("2023

[38] *See* Letter from the American Bankers Association, Bank Policy Institute, Consumer Bankers Association, Credit Union National Association, Electronic Payments Coalition, Independent Community Bankers of America, Mid-Size Bank Coalition of America, National Association of Federally-Insured Credit Unions, National Bankers Association, and The Clearing House to Ann E. Misback, Secretary of the Board, at 2 (Nov. 22, 2023).

[39] Under the APA, "the most critical factual material that is used to support the agency's position on review must have been made public in the proceeding and exposed to refutation." *Window Covering Mfrs. Ass'n v. Consumer Prod. Safety Comm'n*, 82 F.4th 1273, 1283 (D.C. Cir. 2023) (*citing Air Transp. Ass'n of Am. V. FAA*, 169 F.3d 1, 8 (D.C. Cir. 1999) (emphasis omitted); *accord Ass'n of Data Processing Serv. Orgs., Inc. v. Bd. of Governors of Fed. Reserve*(ADPSO), 745 F.2d 677, 684 (D.C. Cir. 1984)). As the D.C. Circuit has explained, it "is the agency's duty to identify and make available . . . data that it has employed in reaching the decisions to propose particular rules." *Owner-Operator Indep. Drivers Ass'n v. FMCSA*, 494 F.3d 188, 199 (D.C. Cir. 2007) (Garland, J.) (quotation marks and citation omitted).

Report") will be published. This means an interchange fee cap based on the 2021 Report could be in effect for a short period of time, if at all, before the 2023 Report is published if the automatic adjustment update is included in the final rule. This would create additional unnecessary burden to networks and issuers, and this specific concern can be avoided if the Board issues a final rule, if any, to coincide with the issuance of the 2023 Report. As noted, the 2023 Report also should be free of the skewing effects present in the 2021 Report, although additional DCI Surveys would provide more robust data on which to base any changes in the fee cap. The Board's rush to propose a rule not required by statute without the benefit of more current and normalized data is unwarranted, arbitrary and capricious. Instead, the Board should withdraw the Proposal and, if it seeks to issue a re-proposal, should do so only after these changes are fully reflected in the DCI Survey.

e. The Proposed Automatic Adjustment to the Fee Cap is Arbitrary Under the APA.

In the NPRM, the Board asserts that automatic adjustments to the interchange fee cap are subject to the good cause exemption from the Administrative Procedure Act ("APA") notice-and-comment rulemaking process because such adjustments are subject to the methodology set forth in the NPRM and are not subject to discretion by the Board.[40] We disagree.

While it is true that the methodology is established within the NPRM, (i) the data underlying such methodology (and, therefore, the impact of such methodology) is not available to the public, and (ii) as discussed in further detail above, working backwards from a preferred outcome, that is itself arbitrary, would result in a multiplier that was determined arbitrarily and would create a substantial likelihood that the multiplier, when applied to a new set of future data, will result in a future interchange fee cap that is arbitrary and does not comport with the statute. Indeed, the Board provides no sufficient independent justification for determination of the multiplier in the NPRM, and instead states that the fixed 3.7 multiplier "targets full cost recovery for 98.5 percent of covered issuer transactions."[41] While we are left to speculate given the limited data published by the Board, it appears that the cost structure of a relatively small number of large issuers effectively determines the "base number" by comprising a large percent of the overall transactions, and, as a result, the percentage of covered issuers that receive minimal cost recovery continues to decline.

Further, while we acknowledge that adopting a self-executing methodology in some rulemakings may be permissible, the Proposal suggests that the Board plans to revise the interchange fee cap every two years based on the Board's new, untested formulaic approach, without performing any new analysis of whether (i) the resulting interchange fee cap is reasonable and proportional, (ii) the multiplier continues to result in the Board's intended outcome or cost recovery target, and (iii) the data on which the multiplier is based is consistent with the allowable costs, as such costs may evolve over time.[42] Moreover, the Board acknowledges that the proposed methodology would not guarantee that a precise level of cost recovery in any particular year will be met. Rather, the Board expects the actual cost recovery of covered issuer transactions to be close to the Board's cost-recovery target *over time*. The Board does not define "over time" or provide any details on how the Board will determine whether it must revisit the formula. Taken together, not only are the key elements of the proposed formula arbitrary, but the Board would also arbitrarily determine whether the formula will continue to be appropriate going forward.

---

[40] 88 Fed. Reg. at 78,109 n.58.

[41] 88 Fed. Reg. at 78,101.

[42] For example, and as discussed in Section II.c.ii of this comment letter, the Board acknowledged in its 2011 rulemaking that certain cardholder inquiry costs should be included in the interchange fee calculation once data about such costs were available to the Board. 76 Fed. Reg. at 43,429.

Finally, the Board suggests that the use of a formulaic approach to setting future fee caps is possible because of "consistent patterns that the Board has observed in the data reported by covered issuers related to per-transaction base component costs since 2009." However, as discussed above, potential significant changes arising from the implementation of the Board's CNP routing rule could alter the cost distribution in meaningful ways. This demonstrates the risks of using a formulaic approach that is unable to account for market developments that have the potential to modify future data sets in ways that are inconsistent with historical data.

For these reasons, Visa strongly believes that the Board should not adopt an automatic adjustment to future interchange fee caps, as proposed. Any future changes to the interchange fee cap would be a substantive change for which the good cause exemption to the APA does not apply. Any proposed changes to the interchange fee cap must, therefore, follow the notice-and-comment requirements of the APA.

f. A 60-day Implementation Period Presents Operational Challenges.

If the Board moves forward with an automatic adjustment despite these fundamental difficulties, automatically updating the interchange fee cap every two years, with an implementation period of only 60 days, would place undue burden on issuers and create operational risks, introducing uncertainty for long-term planning and investment in debit card and related programs. The proposed 60-day implementation period for new interchange fee caps would not provide sufficient time for issuers to adjust their investment plans and otherwise operationalize compliance with Regulation II. For example, issuer marketing budgets are typically set 12 or more months in advance; and issuer development, training, and testing plans are typically set six to 12 months in advance of network rules updates (e.g., mandatory processing updates, optional features/functionality, and security enhancements). More significant technology and strategic investments take place on a longer time horizon. Accordingly, if the Board determines to persist with an automatic adjustment notwithstanding these concerns, we believe that, at a minimum, the Board should adopt an implementation period of at least 180 days.

g. The Costs and Impacts of the Proposal Should be Understood Before Finalization.

Section 904(a)(2) of the EFTA requires the Board, in prescribing regulations to carry out the purposes of Section 920 of the EFTA, to prepare an economic impact analysis that considers the costs and benefits to financial institutions, consumers, and other users of electronic fund transfers.[43] The analysis must address the extent to which additional paperwork will be required, the effect upon competition in the provision of electronic fund transfer services among large and small financial institutions, and the availability of such services to different classes of consumers, particularly low-income consumers. EFTA Section 904(a)(2) also requires, to the extent practicable, that the Board demonstrate that the consumer protections of the proposed rule outweigh the compliance costs imposed upon consumers and financial institutions.

We agree with Governor Bowman's statement accompanying the NPRM on the potential effect the Proposal will have on competition between large and small issuers, and the effect on consumers, particularly low-income consumers.[44] We observed the unintended consequences of the fee cap following the adoption of the 2011 rule, when the share of free basic checking accounts (i.e., accounts with a $0 monthly minimum for all customers, regardless of account balance) fell from 60 percent to 20 percent, average monthly checking account fees increased from $4.34 to $7.44, and the monthly minimum account balances required

[43] 15 U.S.C. § 1693b(a)(2).

[44] Board of Governors of the Federal Reserve System, *Statement on Proposed Revisions to Regulation II's Interchange Fee Cap by Governor Michelle W. Bowman* (Oct. 25, 2023), *available at* https://www.federalreserve.gov/newsevents/pressreleases/bowman-statement-20231025.htm.

to avoid these fees increased by 25 percent.[45] We also observe that some consumer debit programs are already unprofitable today, and a lower fee cap would likely result in additional issuers taking steps that are detrimental to consumers, especially low-income consumers, which is the consumer segment that is least likely to have access to alternatives, including credit.[46] Of concern are recent studies that suggest that if the Proposal is adopted, consumers will pay an additional $1.3 billion to $2 billion annually in higher bank account fees.[47] The dramatic reduction in revenue from debit card programs could also be a factor in the continuing trend of closing bank branches, particularly for communities where the loss of nearby physical bank branches would be most acute.[48] A lower fee cap also would be likely to impact the availability of safe and affordable banking products, such as Bank On accounts, which would hamper financial inclusion efforts nationwide.

This effect would not be limited to covered issuers; a substantial cut in the interchange cap also would be likely to adversely impact debit interchange revenues for exempt small issuers as market forces drive down interchange rates toward the lower cap.[49] We have seen evidence of this effect. Following the original implementation of the Durbin Amendment, exempt debit interchange has decreased.[50] Upon the implementation of the Proposal, the exempt interchange share in merchants' overall cost of acceptance would become a larger proportion, which could, in turn, drive increased market pressure to further reduce exempt interchange.

In addition, we believe that a lower interchange cap would further disincentivize issuers, particularly smaller issuers, from growing, even if growth would be in the best interest of the communities

---

[45] University of Pennsylvania Carey Law School: Legal Scholarship Repository: The Impact of the Durbin Amendment on Banks, Merchants, and Consumers (Jan. 31, 2019), *available at* https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=3048&context=faculty_scholarship.

[46] If the Board were to retain a standard that allows 80 percent of covered issuers to fully recover their base component costs, only 130 out of 163 covered issuers would fully recover their allowable costs. The Proposal would reduce the number of covered issuers that would fully recover their allowable costs to 107.

[47] *See* Bourke, Nick, *How Proposed Interchange Caps Will Affect Consumer Costs* (Jan. 24, 2024), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4705853 (finding (i) that economists confidently measured a drop in bank interchange revenue and an increase in fees consumers pay for bank accounts due to the Durbin Amendment, (ii) if the Proposal is adopted, the research suggests that consumers will pay an additional $1.3 billion to $2 billion annually in higher bank account fees, and (iii) any corresponding merchant and consumer savings under the Durbin Amendment are contested or not measurable).

[48] Kreiss, Kimberly M., *Bank Branches and COVID-19: Where Are Banks Closing Branches During the Pandemic?*, FEDS Notes (Dec. 17, 2021), *available at* https://www.federalreserve.gov/econres/notes/feds-notes/bank-branches-and-covid-19-where-are-banks-closing-branches-during-the-pandemic-20211217.html. The paper discusses how, following a period of strong branch growth, branches have been steadily closing since 2011.

[49] *See* Fed Record of Meeting, Community Depository Institutions Advisory Council, at 13 (Nov. 16, 2023), *available at* https://www.federalreserve.gov/aboutthefed/files/CDIAC-meeting-20231116.pdf. ("With regard to Regulation II, Council members voiced concerns about pending restrictions on their fee income. Council members are interested in correcting the misperception that the Durbin Amendment 'exempts' community banks, including as it relates to the current price cap that the Federal Reserve proposes to amend. CDIs rely on fee income (1) to support the cost of services, such as free checking, that are currently available at no extra charge and (2) to cover increases in operating expenses to implement fraud prevention and mitigation measures. Debit card interchange fees are one example. In the past, these and other fees covered most costs of debit card programs, but that coverage has already been eroded. Per-transaction fee revenue is difficult to track because of core processor limitations, but the general impression is that it has been dropping. Even for those CDIs not subject to Regulation II, competitive pressures from larger banks mean that fee limitations affect CDIs. If fees continue declining, at some point, CDIs will begin to curtail customer services.")

[50] Board of Governors of the Federal Reserve System, *Average Debit Card Interchange Fee by Payment Card Network, available at* https://www.federalreserve.gov/paymentsystems/files/Avg_IF_by_PCN.pdf.

they serve. Given the potential negative effects of a lower interchange fee cap, we agree with Governor Bowman's statement that before adopting a final rule, "it is incumbent upon policymakers to understand the intended and unintended consequences of [the] revisions."[51] Related to our concerns about the effect of the Proposal on consumers discussed above, we believe that the Proposal would adversely affect future issuer investment and innovation in debit card programs. The development of, and subsequent improvements to, the debit card payment system have required significant private investment, both initially and on an ongoing basis. For example, issuers offering tokenization services need to invest in life cycle management capabilities to keep tokens up to date when customers lose their cards or when cards expire. Merchants cite life cycle management capabilities as one of the key benefits of implementing tokens because they result in improved authorization rates. If an issuer faces revenue loss resulting from lower interchange fees, it may serve as a disincentive to invest in these types of modern solutions for debit card products.[52] This would place the issuer at a competitive disadvantage relative to other issuers and would negatively impact consumer and merchant experience.

Despite comments provided in response to the 2010 proposal that debit card innovation and investment could be discouraged if the Board did not allow recovery for the full measure of statutory costs, the Board adopted a rule that does not compensate covered issuers for their investments made to innovate and improve the safety and efficiency of the electronic debit services, including investments in security and fraud prevention programs and technology. While the Board's adoption of a higher interchange fee cap than was proposed helped to ameliorate some of these concerns, issuers nevertheless had to adjust their product offerings. A lower fee cap that does not account for the costs of investment and innovation would result in issuers once again reviewing their product offerings with the likely result being to the detriment of consumers, particularly low-income consumers. A lower cap, moreover, would deprive issuers of resources that may be necessary to invest in new tools and systems to address new and evolving changes in electronic debit transactions, including those that are likely to be introduced by the Board's recent CNP routing rule. In addition, even for those covered issuers that are motivated to make investments to innovate and improve electronic debit services, the cost to access the best technology solutions may become increasingly expensive because issuers that are not subject to the interchange fee cap are able to recover the costs of their investments through unregulated interchange fees.[53]

---

[51] *See supra* note 44. In studying the potential effects of the Proposal, we encourage the Board to rely on peer-reviewed scholarship or other reliable analyses, rather than advocacy pieces developed for lobbying purposes on separate legislative proposals, which are of limited utility. *Compare* Wang, Zhu, Schwartz, Scarlett & Mitchell, Neil, *The Impact of the Durbin Amendment on Merchants: A Survey Study*, 100 Federal Reserve Bank of Richmond Economic Quarterly 183 (2014), *available at* https://www.richmondfed.org/-/media/RichmondFedOrg/publications/research/economic_quarterly/2014/q3/pdf/wang.pdf, *with* Berkovich, Efraim & He, Zheli, *Rewarding the Rich: Cross Subsidies from Interchange Fees* (Hispanic Leadership Fund, May 3, 2022), *available at* https://hispanicleadershipfund.org/wp-content/uploads/2022/05/HLF_Report_RewardingTheRich-InterchangeFees_03May22.pdf. We further note that the latter also is entirely focused on credit cards, and does not address debit interchange dynamics at all.

[52] European issuers reported reduced investment in innovation after the 2015 EU interchange fee regulation took effect due to challenges generating a return on investment. Edgar, Dunn & Co., *Interchange Fee Regulation Impact Assessment*, at 36 (Jan. 2020), *available at* https://www.edgardunn.com/reports/interchange-fee-regulation-ifr-impact-assessment-study-report.

[53] This concern could be ameliorated if, in setting the interchange fee cap, the Board allowed recovery for the costs of investments made today by issuers that will improve the processing of future debit card transactions. This is part of the reason that we believe the Board should allow, at a minimum, full cost recovery for all costs incurred by issuers directly related to electronic debit transactions, plus a reasonable return on investment. We believe that this is required by the U.S. Constitution, but also is right as a policy matter.

h. Reasonable Fee Caps Include Consideration of Their Effect on Consumers and Competitive Factors

The reasonableness of fee caps also necessarily must include the consideration of competitive factors, as recognized by Section 11A of the Federal Reserve Act establishing the principles for the pricing of Federal Reserve Bank services.[54] Visa believes that competition whereby networks compete through pricing, security, efficiency, and innovation yields the greatest benefits to issuers, acquirers, merchants, and consumers. Visa competes against businesses across the technology and retail spectrums to be the best way to pay and be paid. With all of the new payment options on the market, competition in payments has never been stronger and more robust. Rapid developments in payments are increasingly driven by new technology. For example, since the 2011 rule, debit cards have moved from magnetic stripe to chip and contactless, tokenization, and wallets and mobile apps, among other major innovations. As consumers and merchants transact digitally, introducing a new payment solution is as easy as developing and marketing a mobile app. Competition in the payments industry features some of the most established and trusted brands, like Visa, alongside disruptors that rely on new rails, including real-time payment rails. In 2022, the U.S. Treasury recommended that the "U.S. government should promote development and use of innovative access technologies by payment providers, to facilitate greater consumer access to, and use of, instant payment systems."[55]

As proposed, the NPRM could result in limiting investment in a debit card system that competes with new offerings like real-time payments and pay-by-bank services, and may make debit card transactions less attractive overall relative to those alternative services. While changing user preferences and payment system efficiencies could lead to such a shift in consumer payment preferences over time, such an outcome is more appropriately determined by market forces, and not by government intervention.[56] The statute does not contemplate nor signal Congress's intent that the Board, through a fee cap, place covered issuers at a competitive disadvantage.

In addition to the competitive disadvantage smaller covered issuers have relative to large issuers in their ability to recoup the costs of their investments through interchange fees, all covered issuers would also be at an even greater disadvantage relative to today in relation to debit and prepaid offerings from issuers that are able to offer feature- and rewards-rich debit products as a result of the Board's prior decision to carve out three-party networks. In the face of such an increasingly unlevel playing field, the potential for significant migration of retail debit accounts away from "low-volume" and "mid-volume" debit issuers, who will see the greatest strains from the Proposal, and the potential impact of that trend on the diversity of community banking services is uncertain. Yet, the Board has not provided any analysis of the competitive, financial inclusion, community banking, and other potential systemic impacts from its Proposal.

As the Board continues to analyze the costs and benefits of the Proposal on consumers and issuers, the Board should give more careful consideration to the costs and cost trends that have been borne by consumers since the adoption of Regulation II and are measurable, and place less weight on hypothetical cost savings that key stakeholders speculated would occur, but either never did materialize or have been

---

[54] 12 U.S.C. § 248a(c) ("…the pricing principles shall give due regard to competitive factors…").

[55] U.S. Department of the Treasury, *The Future of Money and Payments: Report Pursuant to Section 4(b) of Executive Order 14067*, at 47 (Sept. 2022), *available at* https://home.treasury.gov/system/files/136/Future-of-Money-and-Payments.pdf.

[56] Board of Governors of the Federal Reserve System, *Policies: Standards Related to Priced-Service Activities of the Federal Reserve Banks* (1984), *available at* https://www.federalreserve.gov/paymentsystems/pfs_standards.htm.

determined to not be measurable.[57] As the costs and impact of dynamic debit ecosystem changes cannot be known and measured at this time, the Board should withdraw the Proposal.

i. Reasonable Fee Caps Require Consideration of Issuer Balance Sheets

A further reduction of fees received from debit card transactions could adversely affect issuers' balance sheets at a time when issuers face significant headwinds, including, but not limited to, higher interest rates, economic and geopolitical uncertainty, and costs associated with new regulations.[58] One such regulatory headwind specific to debit card transactions is the recent final rule amending Regulation II to require CNP transactions to be enabled for processing on at least two unaffiliated payment card networks.[59] As previously noted, the responses to the 2021 DCI Survey relied on for the NPRM did not reflect the impact of these amendments, which will impact covered issuers' cost structure as a result of managing multiple networks with different operational, risk, and fraud capabilities.

Similarly, the Proposal fails to consider the interplay of the Proposal with the broader regulatory landscape applicable to debit card products. For example, the Board initially argued that NSF handling costs should be excluded from the interchange fee calculation, in part because such costs could be recovered through fees charged to the cardholder.[60] However, as discussed in further detail above, NSF fees have largely been eliminated and may be prohibited by the CFPB, and, instead, issuers may be forced to recover such costs, in part, through overdraft fees. (Importantly, as discussed above, the CFPB has issued a proposed rule that, if implemented, would substantially limit permissible overdraft fees.) These rulemakings, and their cumulative impact on the payments system, must be considered together.[61]

i. The NPRM Violates the Fifth Amendment to the U.S. Constitution by Denying Covered Issuers the Right to Recover their Costs and a Reasonable Rate of Return for Debit Card Transactions.

In addition to the rulemaking infirmities discussed above, price controls ultimately directly affect property rights and returns on investment, require a constitutional calculation of reasonableness, and are unconstitutional if arbitrary and capricious.[62] The U.S. Supreme Court has emphasized that the "power to regulate is not a power to destroy" and instructed that, where the government regulates prices, it must also enable a company to "maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed."[63] With respect to debit card interchange fees, we believe that a fulsome assessment of reasonableness requires an assessment not only of the effect of the price controls on individually affected issuers, but also an assessment of the overall effect on competitiveness, the health of the banking system, and the competitiveness, safety, and efficiency of the retail payments system.

---

[57] *See* Bourke, Nick, *How Proposed Interchange Caps Will Affect Consumer Costs* (Jan. 24, 2024), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4705853.

[58] As noted above, although exempt issuers may arguably be able to recover costs, the income they receive from interchange may nonetheless be reduced as a result of the downward pressures of a lower fee cap.

[59] *See* Debit Card Interchange Fees and Routing, Final Rule, 87 Fed. Reg. 61,217 (Oct. 11, 2022).

[60] 76 Fed. Reg. at 43,429.

[61] The EFTA requires the Board to "consult, as appropriate, with the Comptroller of the Currency, the Board of Directors of the Federal Deposit Insurance Corporation, the Director of the Office of Thrift Supervision, the National Credit Union Administration Board, the Administrator of the Small Business Administration, and the Director of the Bureau of Consumer Financial Protection" in prescribing regulations to implement the Durbin Amendment. 15 U.S.C. § 1693o-2(a)(4)(C).

[62] *See In re Permian Basin Area Rate Cases*, 390 U.S. 747, 769 (1968).

[63] *Id.* at 769, 792.

Although debit cards are offered in a private market and not through a public utility, utility rate cases nonetheless provide a baseline for constitutional requirements when the government engages in price control regulation. Under this type of regulation, a utility is allowed to set rates based on the cost of providing services to its customers, including the right to earn a limited profit or return on investment. The Supreme Court has determined that just and reasonable rates allow a utility the opportunity to recover its costs and earn a return "commensurate with returns on investments in other enterprises having corresponding risks."[64] Moreover, unlike rate cases involving utilities where fixed infrastructure and maintenance costs may be more stable and predictable, payments including debit cards are part of a dynamic, innovative industry where new technologies are critical to meeting new and evolving payment needs as well as increasing and more sophisticated risks. For example, as mentioned above, debit cards have undergone significant innovation since 2011 from magnetic stripe to chip and contactless, tokenization, and wallets and mobile apps among other major innovations. The Board should consider the investments necessary to continue with this accelerating pace of innovation. Accordingly, Visa continues to believe that the Constitution requires, at a minimum, full cost recovery for all costs incurred by issuers directly related to electronic debit transactions, *plus* a reasonable return on investment.[65] By contrast, the NPRM proposes a cap that would deprive many issuers of even recovering base component costs and ignores many of the costs that all issuers incur.

j. Regulation II Should Continue to Include the *Ad Valorem* Component and Fraud-Prevention Adjustment, and the *Ad Valorem* Component Should be Increased.

We understand that as part of a petition for rulemaking received by the Board, two merchant trade associations requested the elimination of the *ad valorem* component and fraud-prevention adjustment. We believe that the Proposal's inclusion of the *ad valorem* component and fraud-prevention adjustment is appropriate. The *ad valorem* component is important to compensate covered issuers for fraud losses, and the fraud-prevention adjustment is important to compensate issuers for costs incurred in preventing fraud in relation to debit card transactions involving that issuer. The reasons underlying the Board's initial inclusion of these components have not changed.

In addition, we believe that an increase to the *ad valorem* component is warranted given the evolution that has occurred in the provision of electronic payments. In 2010, only about 20 percent of consumer debit volume was CNP, versus over 50 percent of consumer debit volume today.[66] Fraud rates are about five times higher in CNP environments than in card-present environments.[67] This contrast in fraud rates may only widen as debit transactions are routed to new networks that have never processed a substantial volume of CNP debit transactions or transactions in the non-PIN environments and use cases they may begin to see. Therefore, debit issuers today are more likely to experience substantially increased fraud losses relative to 2010,[68] and the Board should increase the *ad valorem* component to compensate for these losses.

k. Tiering Would Raise Practical Challenges and Serious Policy Concerns and Would Not be a Logical Outgrowth of the Proposal.

---

[64] *See Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

[65] A more extensive discussion of the constitutional and government ratemaking precedent is included in the Joint Trades Letter. Visa agrees with the positions on constitutional requirements set forth in that letter.

[66] VisaNet Data.

[67] Visa Risk Datamart, NA, YE'1Q23.

[68] In addition, the *ad valorem* component does not account for international fraud losses, which are riskier and more costly for issuers.

We believe that the Board's decision not to propose a tiered base component approach is also appropriate given the numerous practical challenges and serious policy issues raised by such an approach.[69] Moreover, consistent with the Board's conclusions in 2011, we believe that a tiered approach is unnecessary for the Board to comply with its statutory mandate to establish standards that are "reasonable and proportional" for a representative issuer with respect to that issuer's debit card transactions. If the Board were to change its position regarding a tiered approach, the form, measurement or definition, and calibration of tiers, as well as the separate tier caps, would raise a multitude of issues and would not be a "logical outgrowth" of the Proposal, and, therefore, would require the Board to issue a new proposal to address those issues.[70]

III. Conclusion

In light of the legal and policy flaws in the Proposal, the Board should withdraw the Proposal and maintain the cap based on the current methodology of per-transaction allowable cost, excluding fraud losses, of the issuer at the 80th percentile. Notably, at the November meeting of the Community Depository Institutions Advisory Council ("CDIAC"), a request was made by CDIAC members for the Board to withdraw the NPRM. At the CDIAC meeting, "Council members noted the opaque nature of these [merchant] practices [(i.e., surcharges)], and generally believe that the Regulation II proposal is picking winners (merchants) and losers (banks) with no evidence of customer benefit. Council members suggested that the Federal Reserve withdraw the proposal and re-introduce it once an appropriate cost-benefit analysis has been conducted."[71]

If the Board believes it must revisit the cap based on more current and available data, it should use its current methodology of ensuring that the cap is reasonable and proportional to the underlying costs of a representative issuer (e.g., at the 80th percentile) and update the interchange fee cap to reflect updated cost data (e.g., adding cardholder inquiry costs which the Board previously recognized as includable ACS costs in 2011), following another round of notice-and-comment, consistent with the APA.

* * *

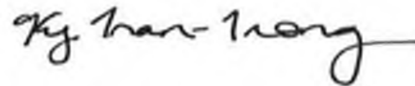
[69] *See* 88 Fed. Reg. at 78,108.

[70] *See CSX Transp., Inc. v. Surface Transp. Bd.*, 584 F.3d 1076, 1079 (D.C. Cir. 2009) (citing *Covad Communications Co. v. FCC*, 450 F.3d 528, 548 (D.C. Cir. 2006)).

[71] *See* Fed Record of Meeting, Community Depository Institutions Advisory Council, at 13 (Nov. 16, 2023), *available at* https://www.federalreserve.gov/aboutthefed/files/CDIAC-meeting-20231116.pdf.

Visa appreciates the opportunity to provide our perspectives to the Board. If you have questions about any of the foregoing or would like to further discuss our comments, please do not hesitate to contact me at 202-419-4109 or ktrantro@visa.com.

Sincerely,



Ky Tran-Trong
Vice President and Associate General Counsel
Global Risk and Regulatory Affairs
Visa Inc.