



A Helpful Smile In Every Aisle

May 12, 2024

Ms. Ann. E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th St. and Constitution Ave., NW
Washington, D.C. 20551

RE: Docket No. R-1818, RIN 7100-AG67

Dear Ms. Misback:

On behalf of Hy-Vee, Inc., I write to comment on the Debit Card Interchange Fees and Routing notice of proposed rulemaking (“NPRM” or “proposed rule”).

Hy-Vee, Inc., appreciates the Board of Governors of the Federal Reserve System (“Board”) for heeding the request for a rulemaking to update Regulation II and thanks you for initiating this rulemaking to lower the debit regulated rate cap and establish an every other year cycle of updates under Regulation II. The increasing cost of accepting debit cards is affecting our customers and our business every day.

I. Introduction

Hy-Vee is an employee-owned company operating more than 570 business units across nine Midwestern states – Illinois, Indiana, Iowa, Kansas, Minnesota, Missouri, Nebraska, South Dakota and Wisconsin – with sales of more than \$13 billion annually. We have more than 75,000 employees in our region and millions of customers that we serve each week, many of whom pay with debit cards.

Across our territory we serve as a retail point-of sale for feeding programs such as Supplemental Nutrition Assistance Program (SNAP) and the Supplemental Nutrition Assistance Program for Women, Infants, and Children (WIC). We also operate retail pharmacies in most of our grocery stores and are a health care access point for our communities - dispensing medicines, vaccines, and flu shots.

We are a business known for investing in our local communities. Last year alone, we provided more than \$55 million in charitable giving in the form of monetary and food donations to organizations and people in need across the states we are located in. We are also known for our superior quality, variety, convenience and customer service, which is why it’s imperative that we continue to advocate keeping “built-in” expenses low in a variety of areas, including this one.



A Helpful Smile In Every Aisle

Hy-Vee negotiates prices on every product sold and every service from vendors and operates on razor thin profit margins. We are doing everything possible to avoid passing inflationary production costs onto shoppers. Competition in the grocery sector is fierce, and the battle for market share helps keep prices down for shoppers. As more grocery customers have progressively increased their use of credit and debit cards over this time, our operations costs have been squeezed. A “reasonable and proportional” debit regulated rate is keenly important to the slim-margined grocery industry.

Merchants, like Hy-Vee, pay expensive processing swipe fees to accept cards as payments from their customers for goods and services. Credit and debit card processing fees totaled \$172.05 billion in 2023, an increase of 7.1% in just one year, costing an average of over \$1,100 per American family. Hy-Vee incurred a 4.6% increase during that same period. These fees negatively impact U.S. consumers, as they indirectly drive-up prices customers pay for goods and services. In return, this disproportionately hurts lower-income Americans who are looking for the best value to meet their needs and put food on the table for their families. Since 2019, Hy-Vee has seen a 14.3% increased use of debit cards. Our debit rate costs have increased 8.46% over the same period.

Since the current debit regulated rate went into effect in 2011, banks’ costs to process payments have [decreased dramatically](#), while the regulated capped rate charged to merchants for the same debit payments has never been adjusted until this proposed rulemaking. As the law makes clear, when card networks collectively set interchange debit rates charged to merchants on behalf of card issuers with over \$10 billion in assets, the debit rates must be “reasonable and proportional” in relation to the costs incurred by the card issuers and must be adjusted as the costs to banks decrease.

II. Comments on the Proposed Rule

To ensure that the debit regulated rate going forward is “reasonable and proportional,” we request that the Federal Reserve Board modify its methodologies for the three components that comprise the rate – the base component, the *ad valorem* fraud loss fee component, and the fraud prevention adjustment – in the final rule. Further, a process for careful oversight and auditing of issuer-reported data by the Federal Reserve must be implemented to ensure that issuer costs are not misrepresented or inflated when those costs are considered for future rate adjustments.

As we note in the comments below and those filed by FMI – The Food Industry Association, we recommend the following policy modifications to the Regulation II NPRM.

- 1. The base component fixed multiplier must be reduced to a level no higher than the fixed multiplier used in 2011 to reflect the subsequent decrease in issuer costs.**

The base component rate that the Federal Reserve Board established in 2011 is too high and must be reduced. As noted in the NPRM, “several data points show that the allowable costs incurred



A Helpful Smile In Every Aisle

by covered issuers have fallen significantly since the original Regulation II rulemaking.”¹ The Board observed that the transaction-weighted average of per-transaction base component costs across covered issuers decreased from 7.7 cents in 2009 to 3.9 cents in 2021, which “represents a decline of nearly 50 percent.”² The NPRM explicitly states that “the Board believes it is necessary to revise the interchange fee standards to reflect the decline since 2009 in base component costs.”³ However, the NPRM’s proposed rate of 14.4 cents represents a decline in the base component fee of less than one-third from the current Regulation II rate of 21 cents, which does not reflect the nearly 50 percent actual decline in issuer costs.

The Board’s proposed methodological approach of choosing a 3.7 fixed multiplier based on a full cost recovery target over time of 98.5 percent is arbitrary and would result in unreasonably high fees. The grocery industry recommends a fixed multiplier of no higher than 2.7 times the average per-transaction cost – effectively the same multiplier that was applied by the Board in 2011.⁴ Then, the Board set the base component rate at 21 cents, which was 2.7 times higher than the 2009 average allowable cost of 7.7 cents. A fixed multiplier of 2.7 corresponds to a cost-recovery target of 95 percent of covered issuer transactions – a small fractional difference from the NPRM’s 98.5 percent target – but would produce a base component fee of 10.5 cents which reflects the fact that issuer costs have declined by approximately half since 2011. A base component rate of 10.5 cents would still provide covered issuers with almost triple the average per-transaction cost, but merchants and consumers would benefit from a reduced rate that reflects covered issuers’ actual cost decreases.

2. The *ad valorem* fee component should be reduced and the methodology for the *ad valorem* fee must be revised.

The grocery industry agrees that the *ad valorem* component must be reduced. As the NPRM notes, since 2011 “the issuer fraud losses on which the Board based the *ad valorem* component have fallen,” as has the median ratio of issuer fraud losses to transaction value.⁵ Those changes in the data alone warrant a reduction in the current *ad valorem* fee under the Board’s existing methodology, as the current five basis point fee is not reasonable and proportional to covered issuer fraud losses.

However, as FMI details in its filing on behalf of the industry, shortcomings in the methodology for the *ad valorem* component must also be addressed. Fraud on covered issuer debit transactions

¹ 88 Fed. Reg. 78105 (Nov. 14, 2023).

² *Id.*

³ *Id.* (emphasis added).

⁴ See Dec. 22, 2022, petition from FMI and NACS *supra* note 1 (“When the base component was set at \$0.21, it was 2.7 times higher than the average allowable costs of \$0.077 reflected in the 2009 issuer survey.”); see also Letter to Chairman Powell and Governors Brainard, Quarles, Bowman, and Clarida from FMI and other companies and trade associations, July 27, 2020, at p. 5, available at <https://www.federalreserve.gov/regreform/rr-commpublic/merchants-and-merchant-trade-associations-meeting-20200923.pdf> (“The Board should reset the base component of the interchange rate to be not more than the original multiple of 2.7 times average allowable costs.”)

⁵ 88 Fed. Reg. 78101.



A Helpful Smile In Every Aisle

has approximately doubled under Regulation II while fraud losses absorbed by covered issuers have plummeted.⁶ Our industry recommends that the Board revise its methodology of requiring merchants to compensate in advance all covered issuers for fraud losses through a uniform *ad valorem* fee, and that the Board instead provide the *ad valorem* fee component to covered issuers on an issuer-by-issuer basis in accordance with the following criteria: (1) to be eligible to receive any *ad valorem* fee component during an upcoming two-year rate period, the issuer must be determined by the Board to be in compliance with more robust fraud prevention standards that the Board should establish and enforce; and (2) to be eligible for the maximum *ad valorem* fee component during an upcoming two-year rate period, an issuer must demonstrate that the per-transaction rate of fraud losses on transactions involving the issuer's debit cards decreased in the most recent two-year rate period compared to the two-year rate period prior to the most recent period, regardless of which participants in the system absorbed the losses.

Such reforms to the Board's methodology would not be challenging to implement, as they would be largely based upon data the Board already collects every two years from each covered issuer, and the reforms would realign incentives in a way that would give covered issuers strong motivation to reduce fraud. The reforms would also correct the current unreasonable situation in which the Board allows covered issuers to essentially have their cake (a network-established *ad valorem* fee that forces merchants to pre-pay all covered issuers for fraud losses regardless of how effective any particular issuer is at reducing fraud), and eat it too (by charging back merchants or cardholders for a majority of fraud losses when they occur), and then get another helping of cake (the fraud prevention adjustment, which covered issuers appear to be currently receiving under Regulation II without demonstrating that they are effectively preventing fraud).

3. The fraud prevention adjustment must not be awarded to a covered issuer without actual confirmation that the issuer is taking effective fraud prevention steps.

The grocery industry supports the use of the fraud prevention adjustment as Congress intended: to reward only those covered issuers that are actually and demonstrably taking effective steps to reduce debit fraud. As noted by FMI in its filing, there is no awareness of any issuer being

deemed ineligible for the fraud prevention adjustment nor any awareness of the Board collecting any data from issuers that would demonstrate whether any fraud prevention step taken by an issuer was or was not effective in reducing fraud. The Board's Debit Card Issuer Survey (FR 3064a) simply asks issuers to check a box whether or not they engage in certain broad categories of fraud prevention activities (*e.g.*, "Data-security" and "PIN customization") with no further information requested or provided on what specific steps the issuer takes and how often those steps are used on the issuer's debit transactions.⁷

⁶ 88 Fed. Reg. 78118 ("With respect to covered issuer transactions, fraud losses to all parties as a share of transaction value increased from 9.0 basis points in 2009 to 17.5 basis points in 2021, and have displayed an upward trend since 2011.")

⁷ See Debit Card Issuer Survey, FR3064a, Survey Period: Calendar Year 2021, at p. 11, *available at* <https://www.federalreserve.gov/paymentsystems/files/2021DebitCardIssuersurvey.pdf>.



A Helpful Smile In Every Aisle

The NPRM would increase the fraud prevention adjustment amount from 1 cent to 1.3 cents per transaction based on a revised methodology for measuring those issuer costs,⁸ but the Board seeks to do so without proposing any change in its methodology to ensure that this interchange revenue is being used effectively to reduce fraud. As detailed in FMI's filing, a covered issuer should not be deemed eligible to receive the adjustment unless: (1) the issuer has first provided to the Board documents demonstrating the issuer's compliance with fraud prevention policies and procedures; and (2) the Board has verified that the issuer has met the statutory requirement that the issuer "take effective steps to reduce the occurrence of, and costs from, fraud in relation to electronic debit transactions." Further, the issuer should be deemed ineligible for the fraud prevention adjustment for subsequent rate periods if the issuer has reported increased per-transaction fraud losses on its debit cards for two two-year rate periods in a row and has not provided evidence demonstrating that it has changed its fraud prevention steps to more effectively reduce fraud.

This issuer-specific evaluation will not only realign issuer incentives to encourage and achieve actual reductions in debit fraud but will also give the Board greater insight into what fraud prevention activities are effectively working. The Board can then share aggregated information about the effectiveness of certain fraud prevention measures. This will benefit the overall debit system and help create a competitive dynamic between covered issuers by enabling issuers to demonstrate to consumers that they are taking actions to prevent fraud that the Board has found to be effective.

4. Future rate adjustments made every other year should be based upon revised methodologies for the fee components and the Board should implement oversight and auditing of reported data to ensure that issuer costs are not misrepresented or inflated.

The grocery industry supports the Board's proposal to update fee rates in Regulation II every other year, as the 12-year delay in updating these rates has exacerbated the degree to which the current rate is neither reasonable nor proportional to covered issuer costs. Regular and predictable updates to the regulated rate to reflect changes in costs would be beneficial to the overall debit system and its participants. However, the methodologies currently proposed in the NPRM should not be locked into place for future rate adjustments without modification. Our industry opposes codifying an arbitrary and excessive fixed multiplier of 3.7 into regulation and locking it into a formula going forward. Similarly, locking in an *ad valorem* component methodology that rewards all covered issuers regardless of their record on fraud, or a 1.3 cent fraud prevention adjustment that similarly is untethered to any assessment of whether specific

⁸ The Board proposes to modify the original methodology used to determine the fraud-prevention adjustment; whereas Regulation II in 2011 calculated the difference between the media per-transaction fraud-prevention costs aggregated with transaction-monitoring costs among covered issues and the median per-transaction transaction monitoring costs among covered issuers, rounded to the nearest cent, the Board now proposes to determine the fraud-prevention adjustment as the median per-transaction fraud-prevention costs among covered issuers rounded to the nearest tenth of one cent.



A Helpful Smile In Every Aisle

issuers are taking steps that are effective in reducing fraud, would entrench the wrong incentives for fraud prevention in perpetuity. The recommendations detailed in the industry comment letter filed by FMI would improve the methodologies for these fee components such that they could be credibly used for future rate adjustments.

Further, the grocery industry strongly supports oversight and enforcement by the Board. Neither the NPRM nor its proposed Appendix B to Part 235 indicate that the Board will audit or otherwise verify data provided by issuers using FR 3064a. Without oversight and periodic audits, issuers may inflate or misrepresent costs that they report to the Board or may attempt to include costs that the Board has not deemed allowable in their reported costs. Issuers and networks have attempted to circumvent the requirements of EFTA Section 920 and Regulation II before, which led to the Board's clarification of the card-not-present routing rule in 2022 and has prompted investigations by the Federal Trade Commission and the Department of Justice.⁹ Our industry urges that the final rule lay out a plan in Appendix B for verifying and periodically auditing data provided by issuers to ensure that the data is valid and accurate.

III. Conclusion

Thank you, again, for initiating the rulemaking to lower the debit regulated rate cap and establish an every-other-year cycle of updates under Regulation II. Hy-Vee and ultimately our customers have been paying a debit regulated interchange rate that significantly exceeds banks' costs for processing these transactions for far too long.

While the proposed rule is a step in the right direction, we request that the final rule include our suggested revisions to the rate's components and methodologies to reflect the law's requirement of being "reasonable and proportional."

Thank you for considering the recommendations noted above.

Sincerely,

A handwritten signature in black ink that reads "Andy Schreiner". The signature is written in a cursive, flowing style.

Andy Schreiner
Executive Vice President, Chief Financial Officer, Treasure

⁹ See, e.g., FTC closing letter to Visa, Nov. 22, 2016, *available at* https://www.ftc.gov/system/files/documents/closing_letters/nid/closing_letter_from_james_frost_to_visa_-_11-22-16.pdf; Reuters, "Visa, Mastercard draw FTC inquiry over debit card transactions," Nov. 13, 2019, *available at* <https://www.reuters.com/article/us-ftc-visa-mastercard-probe/visa-mastercard-draw-ftc-inquiry-over-debit-card-transactions-bloomberg-law-idUSKBN1XN291>; Reuters, "DOJ probing Visa on U.S. debit card practices, competition," Jan. 27, 2023, *available at* <https://www.reuters.com/business/finance/doj-probing-visa-us-debit-card-practices-competition-2023-01-27/>.