**Meeting Between Chair Powell and Staff of the Federal Reserve Board and Representatives of Multiple Merchant Trade Associations**
**May 7, 2024**

**Participants:** Chair Jerome H. Powell and Nancy Riley (Federal Reserve Board)

John Drechny (Merchant Advisory Group); Austen Jensen (Retail Industry Leaders Association); Douglas Kantor (National Association of Convenience Stores); Stephanie Martz (National Retail Federation); Daniel Swanson (collectively, the trade associations)

**Summary:** Chair Powell and staff of the Federal Reserve Board met with representatives of the trade associations to discuss the Board's notice of proposed rulemaking on Regulation II. The representatives expressed concerns with the proposal and suggested changes, including a tiered (rather than a uniform) rate structure, more robust requirements to qualify for the fraud prevention adjustment, and disallowing the inclusion of fraud losses in the ad valorem component.

Attachment

Merchants Payments
COALITION

# FEDERAL RESERVE MEETING

## APRIL 2024

PAT MORAN (INDUSTRY EXPERT/CONSULTANT)

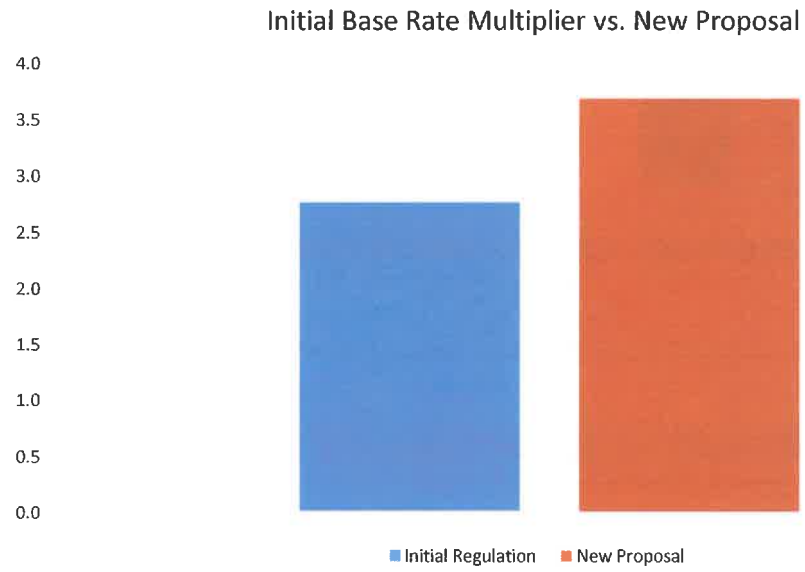
The information presented today is primarily derived from analysis using Federal Reserve published data & The Nilson Report

# AGENDA

- ❑ Debit Fee Base Rate
  - ❑ Multiplier concerns and potential remedies
  - ❑ Analysis
  - ❑ Other base rate concerns and potential remedies
- ❑ Future Adjustments to Base Rate
- ❑ Fraud Loss Adjustment
- ❑ Fraud Prevention Costs
- ❑ Dispute Resolution Process

# Base Rate Multiple

The Base Rate component of $0.144 is 3.7 times the transaction weighted ACS, while the original regulated rate was about 2.7 times actual 2009 costs




Source: Fed Table 9 and analysis



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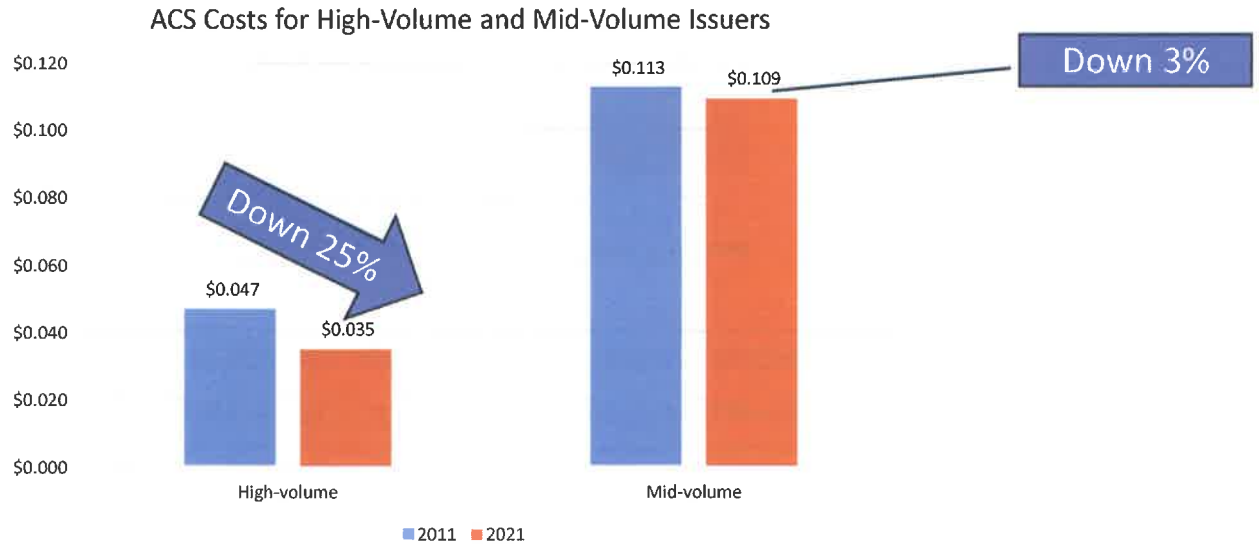
# Cost Efficiency of Issuers

The High-Volume Issuers have reduced their ACS costs significantly since 2011, while the Mid-Volume Issuers have not.




Sources: Fed table 13



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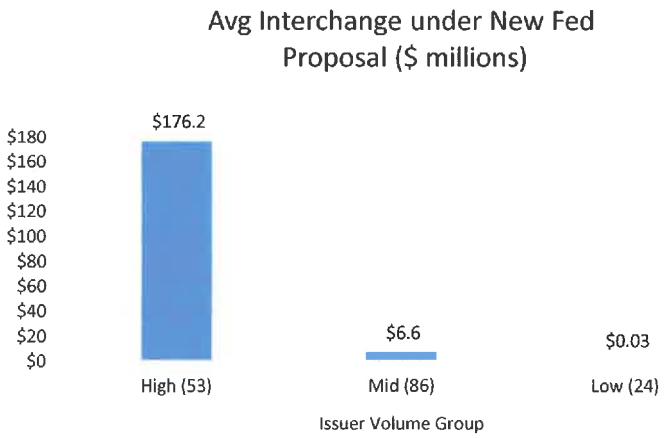
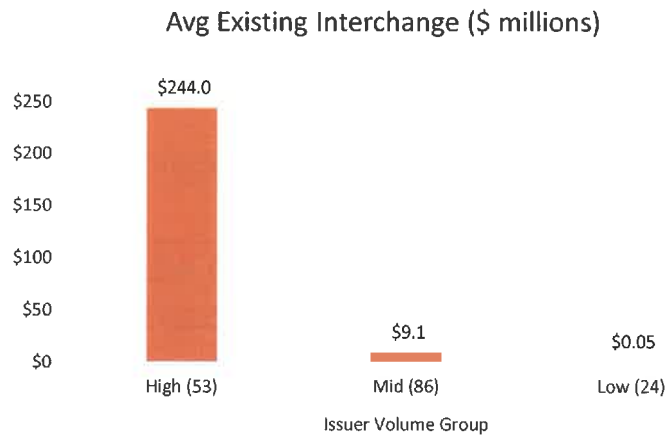
# Proposal and Existing Rule by Volume

The High-Volume Issuers are the only group that receives material interchange from existing regulated interchange and the new Fed proposal....




Sources: Fed table 12 was used to calculate average interchange within each group.



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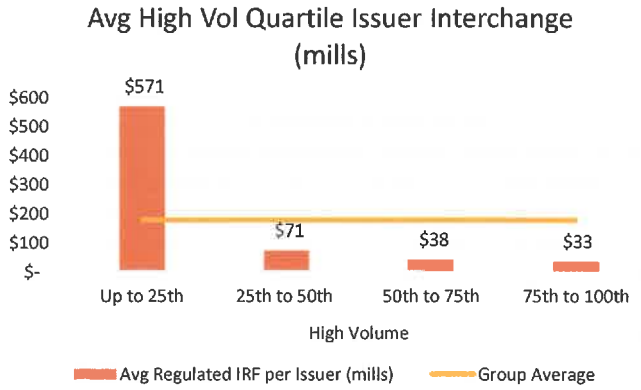
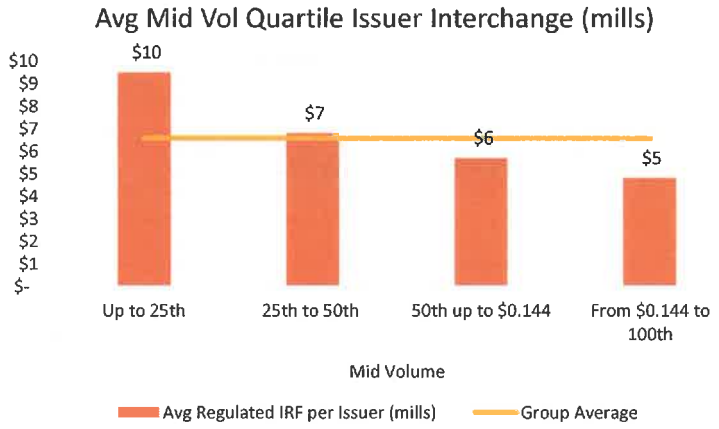
# Proposal Revenue by Volume Within Quartiles

... and quartile estimates help demonstrate how the 1st quartile of High-Volume Issuers overwhelms the others. By trying to support small Issuers where materiality is questionable the proposal provides large Issuers excess margin..




Sources: Fed table 12 was used for volume data within each group. Nilson data was used to estimate volumes within each quartile.



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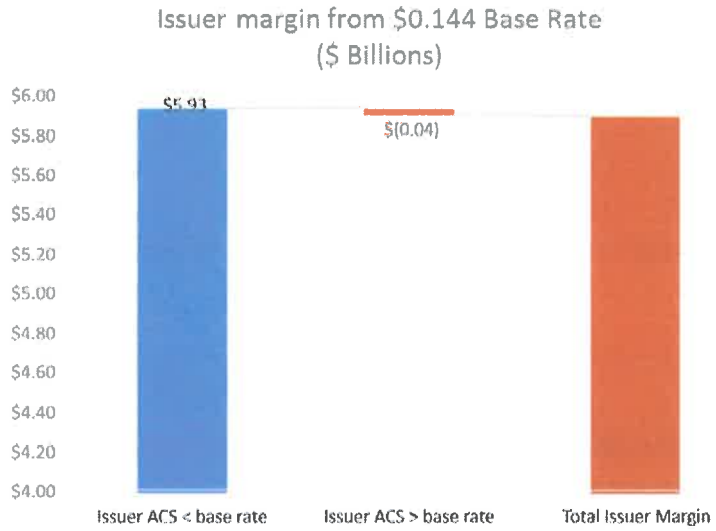
# Base Rate Proposal Margins

Issuers with ACS costs below the proposed $0.144 base rate generate about $5.9 Billion in margin, while those with ACS costs above the proposed base rate will have about $40 million in costs above the base rate revenue




Sources: Fed table 12 was used for volume data within each group. Nilson data was used to estimate volumes within each quartile. ACS margins estimated using Table 13.



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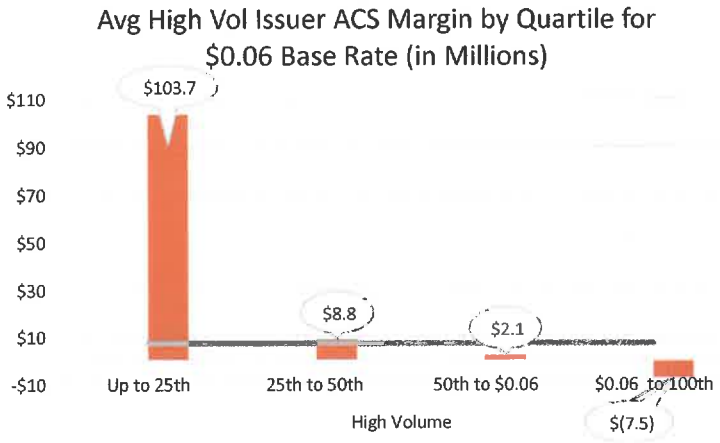
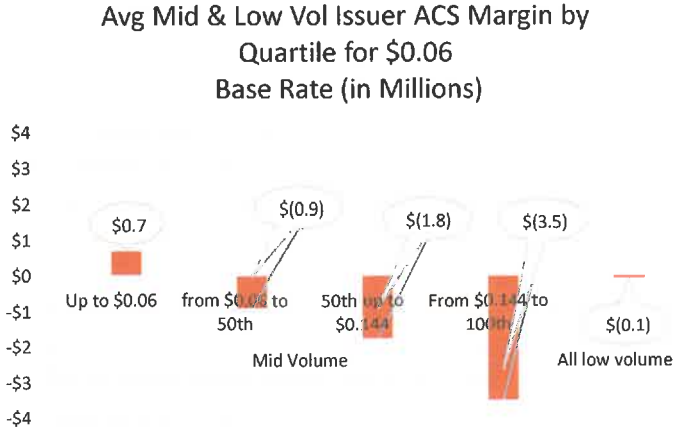
# Base Rate With 35% Margin is 6 Cents

Allowing an overall 35%* margin with a $0.06 base rate would be consistent with the reasonable and proportional standard




Sources: Fed table 12 was used for volume data within each group. Nilson data was used to estimate volumes within each quartile. ACS margins estimated using Table 13.
In his 5 January 2024 summary of various industry profit margins, Professor Aswath Damodaran of NYU's Stern School of Business indicates Money Center Bank net profit margin of 30.89% and Regional Bank profit margin of 29.67%. MacroTrends Financial Institution Pre-Tax Margin averaged 28.7% from 12/09 – 9/23



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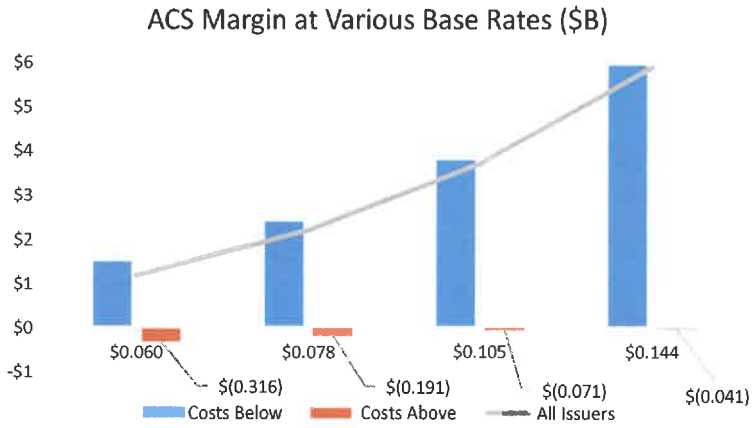
# Base Rate Impacts on Margins

The amount of margin received by Issuers with ACS costs below various base rates is much greater than the negative margin from issuers with ACS costs above various base rates.




Sources: Fed table 12 was used for volume data within each group. Nilson data was used to estimate volumes within each quartile. ACS margins estimated using Table 13.



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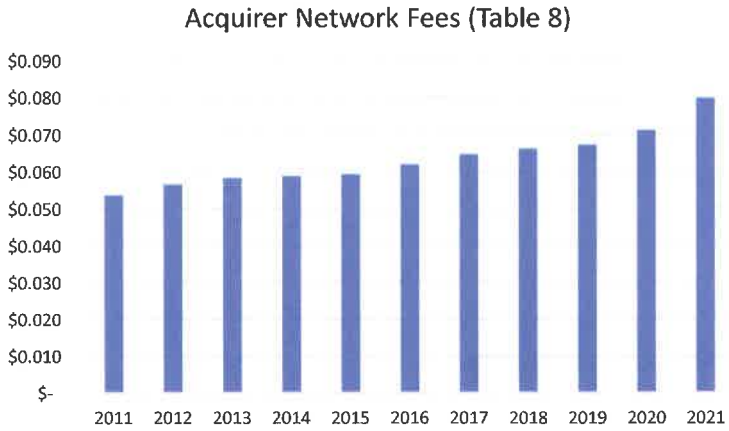
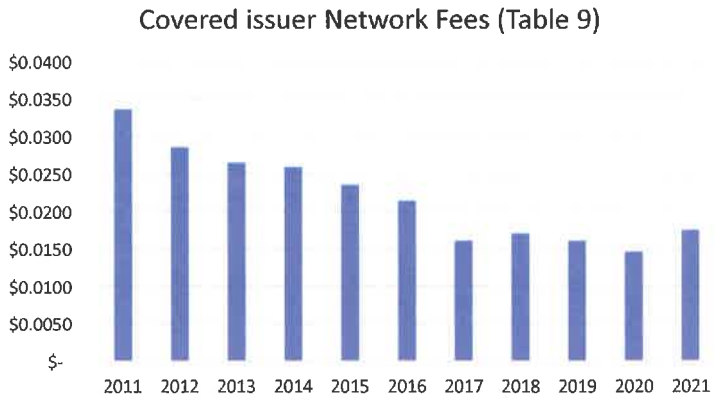
# Network Fee History

## Networks are potentially evading the intent of the regulation




### Using The Reported Data

- Since the initiation of the regulation, Acquirer Network Fees have increased at least 50% and we believe that the fees are under-reported
- Network Fees paid by Issuers have decreased materially, and the largest Issuers pay a small amount per transaction
- On its face, it appears that the Networks are circumventing the intent of the regulation by changing rules and fees to benefit Issuers



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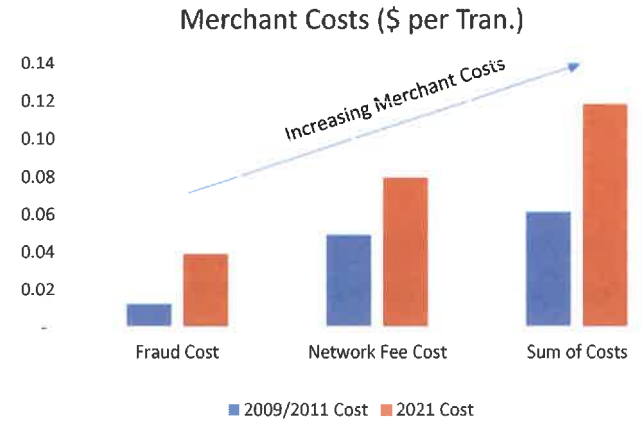
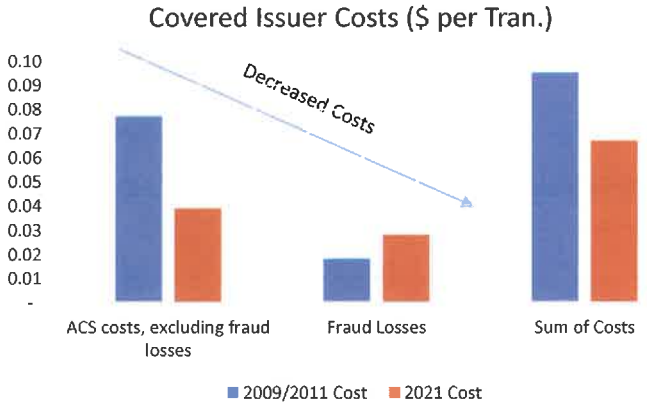
# Review of Costs Post Regulation




Note: 2011 was used for Fraud Costs as 2009 was unavailable

**Acquirer / Merchant Costs**

- Since the initiation of the regulation, Network Fees and Fraud Costs borne by Merchants have continually increased
- Network Fees, particularly dual message (V/MC), have increased in number and complexity
- Fraud Costs have nearly tripled which is frustrating since the bulk of EMV costs were absorbed by Merchants (EMV terminal cost is estimated at $30 billion*)

**Covered Issuer Profitability**

- Conversely, Issuers continued to improve profitability as Network Fees and Fraud Costs have shifted to Merchants
- The shift in economics has resulted in a $0.09 swing per transaction!
- This economic swing equates to approximately $5.4 billion per year in favor of Covered Issuers

*** NRF "EMV Chip Cards" available at https://nrf.com/emv-chip-cards.**



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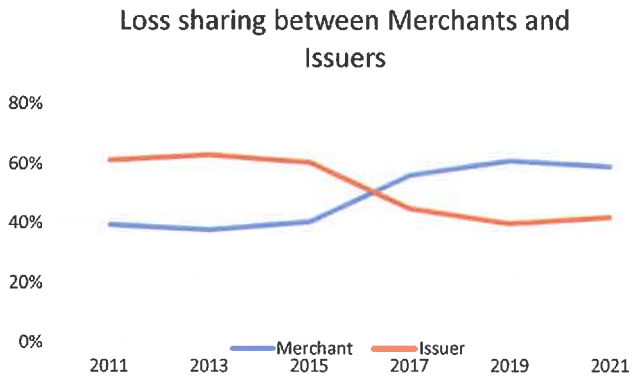
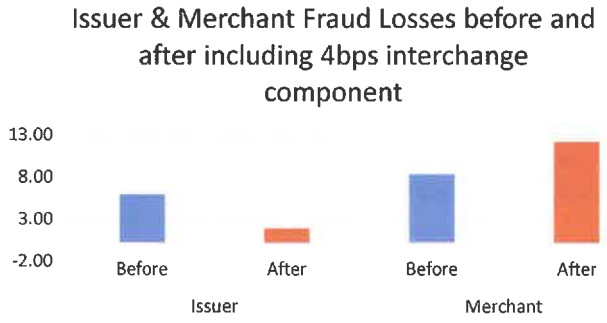
# Fraud Loss Component

***The 0.04% ad valorem component should be eliminated***

- Since 2017 Merchants have incurred more fraud losses than Issuers (Top chart)
- After considering the 4bps in interchange, merchants' fraud losses will exceed that of issuers over 6-fold (Bottom chart; over 12bps vs under 2bps)




Sources: Tables 11, 14 and analysis



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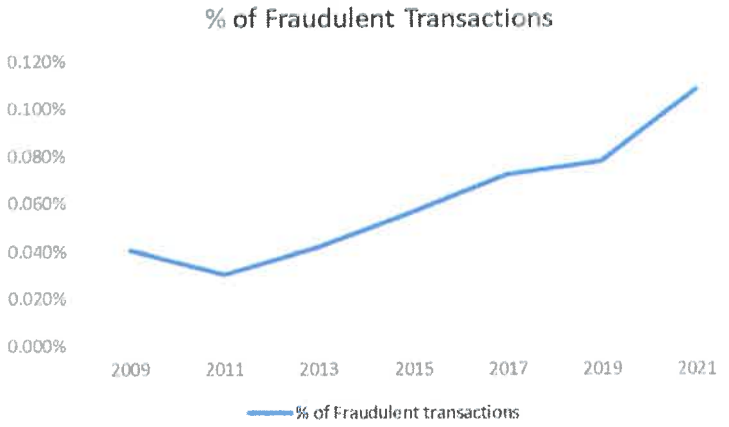
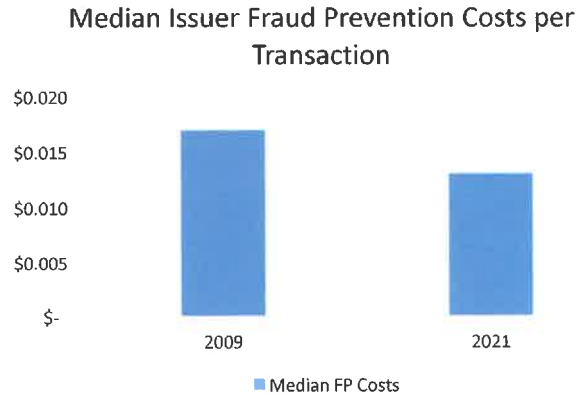
# Fraud Prevention Adjustment

***The Fraud Prevention Adjustment should not be increased***

Fraudulent transactions have increased steadily since regulation took effect, but median Issuer fraud prevention costs have decreased.




Sources: Tables 10,11, 14



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