February 7, 2022

Ms. Anne E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Facts about Regulation II

Dear Ms. Misback:

We noted with interest the letter that some banking associations sent on February 1, 2022, regarding the recordkeeping and disclosure requirements of Regulation II. As you know, that letter does not really address recordkeeping and disclosure. Instead, it marshals a parade of falsehoods to attack Regulation II. This letter provides some relevant facts to ensure that those falsehoods are not inadvertently accepted as having a basis in reality.

Regulation II has been successful policy and requires vigilant enforcement by the Federal Reserve. We strongly support the proposal clarifying that competition among networks for the full range of debit transactions is required by law and respectfully request immediate finalization and enforcement of the law. Additionally, it is imperative for the Fed to update its limitation on how card networks can fix fees for debit transactions and bring it into alignment with the law requiring the rate to be both reasonable and proportional to issuers' costs. Reducing the debit rate will bring the regulation up to date and properly reflect the banks' ever-shrinking costs of handling the transactions, as documented in repeated Fed surveys.

Consumers have benefitted tremendously from Regulation II. In the first year following its implementation, consumers saved $6 billion and those savings supported 37,500 jobs due to the reduction in swipe fees.[1] Merchants have consistently shielded their customers from the cost increases since Regulation II came into effect. Those cost increases, reflected in the Producer Price Index for retail trade industries, rose 9.4 percent from the time Regulation II went into effect through the end of 2016, while price increases to consumers, reflected in the Consumer Price Index, increased only 4.5 percent.[2] That experience has held true even during the

[1] "The Costs and Benefits of Half a Loaf: The economic effects of recent regulation of debit card interchange fees," Robert Shapiro, Sonecon LLC (2013).

[2] Producer price index figures from the St. Louis Fed can be found here: https://fred.stlouisfed.org/series/PCUARETTRARETTR and consumer price index figures from the Minneapolis Fed can be found here: https://www.minneapolisfed.org/about-us/monetary-policy/inflation-calculator/consumer-

past year with increased inflation. During 2021, the Producer Price Index rose by 9.7 percent while the Consumer Price Index rose by 7 percent.[3] Merchants continue to use savings from Regulation II to keep prices low for U.S. consumers.

In addition, banking services have become more readily accessible to consumers since Regulation II came into effect – just the opposite of what the banking associations claimed in their letter. According to FDIC figures released in December 2021, the proportion of Americans who are unbanked is at its lowest level (5.4 percent of households) since the FDIC started collecting that data in 2009.[4] In fact, the data shows that the rate of unbanked Americans peaked at its highest level right *before* Regulation II became effective in 2011. The experience following Regulation II, then, has been one of more consumers, including low income consumers, gaining access to traditional banking services. To the extent there are factors getting in the way of that consumer access, they are ones erected by the banking industry on its own and completely unrelated to debit reforms. For example, the reason second-most cited by consumers for remaining unbanked at this point is not cost. Instead, those consumers say they remain unbanked because they "don't trust banks."[5] That is an unfortunate reality that may be reinforced by misstatements such as those included in the letter the banking associations sent you.

Despite the clear benefits of Regulation II, the fee levels that card networks centrally fix remain far too high. While an average debit transaction costs the card-issuing bank between 3 and 4 cents, the bank enjoys profit margins of more than 600 percent. Remarkably, in their letter, the bank associations raise concerns about so-called "mid-volume" issuers of debit cards that have costs of 10 cents per transaction and therefore have profit margins of about 140 percent. Merchants that regularly live on profit margins between 1 percent and 5 percent may have trouble empathizing with that particular plight. Regulation II has shown that limits on centrally fixed fees incentivize the majority of regulated banks (covering well over 90 percent of transaction volume) to have more cost-efficient operations. That is a good thing because it mimics the result of price competition in a functioning market. The low-volume issuers referenced by the bank associations are not affected by Regulation II's efficiency incentives because they offer very few debit cards, issuing them primarily as a convenience to

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[3] The U.S. Bureau of Labor Statistics' release on the producer price index can be found here: Producer Price Index News Release summary - 2021 M12 Results (bls.gov) and the 2021 increase in the consumer price index can be found here: CPI Home : U.S. Bureau of Labor Statistics (bls.gov).

[4] https://www.fdic.gov/analysis/household-survey/

[5] *Id*.

key customers. These outliers, who issue very few cards, should not artificially skew the regulated rate to the benefit of the major issuers.

It should also be noted that Regulation II has spurred fraud prevention. It was only after the rules ensured some level of competition among debit card networks that the dominant networks settled on plans for computer chips in cards and pushed for more encryption and tokenization technologies. Competition leads to such innovations because customers can differentiate among companies in the fight for market share. Prior to Regulation II, the card market in this country had failed to innovate on fraud prevention. And, while we still trail much of the world on fraud prevention, Regulation II has created incentives for U.S. financial institutions to catch up. By completing its rule clarification on debit network competition, the Fed can increase these fraud prevention incentives in ways that will benefit American consumers and the U.S. economy.

The fraud landscape has changed since adoption of Regulation II. The major card networks pushed fraud liability onto merchants with the adoption of chip cards. Merchants not only spent tens of billions of dollars upgrading their systems to use chip readers to accept cards, but also took on the majority of card fraud liability. None of those changes has been reflected in updates to Regulation II. Changes in fraud liability should lead the Fed to update Regulation II and reduce debit fees.

We hope that seeing the facts on these topics is helpful. We would be pleased to meet with the Fed staff at any time to talk through these issues and provide additional background to ensure that misinformation does not infect the Fed's deliberative process on these issues.

Sincerely,

FMI - The Food Industry Association
National Association of College Stores
National Association of Convenience Stores
National Grocers Association
National Restaurant Association
National Retail Federation
NATSO, Representing America's Travel Centers and Truckstops