

August 10, 2021

Submitted via E-mail at: regs.coments@federalreserve.gov

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

**RE: Notice of Proposed Rulemaking, Debit Card Interchange Fees and Routing
[Docket No. R-1748, RIN 7100-AG15]**

Dear Ms. Misback:

This letter is submitted to the Board of Governors of the Federal Reserve (the "Board") on behalf of the National Grocers Association ("NGA"),¹ in response to the Notice of Proposed Rulemaking concerning Debit Card Interchange Fees and Routing issued by the Board on May 7, 2021 and published in the Federal Register on May 13, 2021 (the "Proposed Rule").²

NGA is proud to represent independent community grocers who feed and serve communities across the United States. Grocery, whether retail or wholesale, is a highly competitive industry with net profit margins ranging from 1-2% annually. Therefore, the costs of accepting debit cards have a direct effect on our members' operations and the viability of their businesses. For too long, our members have been prevented from exercising their routing choice when customers pay with a debit card.

The past year has forever changed not only grocery but retail writ large. From lockdowns to business closures, plexiglass to panic buying, Americans have had to learn to adjust to living in

¹ NGA is the national trade association representing the retail and wholesale grocers that comprise the independent sector of the food distribution industry. An independent community grocer is a privately owned or controlled food retail company operating a variety of formats. The independent grocery sector is accountable for more than 1 percent of the nation's overall economy and is responsible for generating more than \$250 billion in sales, 1.1 million jobs, \$39 billion in wages and \$36 billion in taxes. NGA members include retail and wholesale grocers, state grocers associations, as well as manufacturers and service suppliers.

² 86 FR 26189 (May 13, 2021).

a global public health crisis. Consumers have also shifted their shopping habits and payment preferences due to COVID-19, but many of these trends are likely to continue. The growth of e-commerce and online shopping, and the growth in card-not-present ("CNP") debit transactions have highlighted deficiencies in Regulation II enforcement and the need for the Board to act. NGA supports the Board's Proposed Rule, but we would also like to make the Board aware of additional issues that may further prevent merchants from exercising their routing choice and lead to de-facto exclusivity. NGA requests the Board also provide clarifications to address the following issues.

Authentication

Currently, there is no requirement in Regulation II that issuers must enable every authentication method that a payment card network has developed. While the Proposed Rule notes the historical issue of single-message versus dual-message functionality and seeks to resolve the de-facto exclusivity that has resulted from issuers not enabling single-message networks for CNP transactions,³ NGA requests that the Board go further and clarify that issuers must enable every authentication method made available by each unaffiliated network on their cards. In doing so, the Board would prevent issuers from using authentication-related enablement strategies to subvert prohibitions on network exclusivity.

For example, without additional clarification, issuers could choose to enable "Network 1" for signature, PIN, or transactions with no cardholder verification method (CVM), and enable "Network 2" solely for iris or fingerprint scans (even though "Network 2" can also process transactions authenticated by the methods provided by "Network 1"). With a majority of retailers not using biometric authentication technology, these merchants would be forced to route non-biometric-authenticated debit transactions exclusively through "Network 1" and lose their routing choice.

While the Board makes clear in its "Frequently Asked Questions"⁴ that issuers are prohibited from requiring a specific authentication technology or method available through only one enabled network, this clarification would prevent an issuer from using enablement of certain

³ "II. Background on Network Exclusivity Issues for Card-Not-Present Debit Card Transactions", 86 FR 26189 (May 13, 2021).

⁴ "Frequently Asked Questions About Regulation II (Debit Card Interchange Fees and Routing)", (November 2, 2016).

authentication technology or methods as a means to circumvent Section 235.7(b) requirements. This clarification would maximize routing options, regardless of current or future authentication technology or methods, while still providing networks an incentive to innovate.

Tokenization

The Proposed Rule provides much needed clarification regarding network enablement and mobile wallets and other "means of access", but the Proposed Rule should specifically address the application of Regulation II in instances of tokenization. Currently, one global network refuses to detokenize CNP transactions. The other, while not explicitly refusing to detokenize transactions, does not provide the necessary cryptogram or domain channel which leads to issuers rejecting these transactions on the basis that the issuer has not received all information. These actions by the global networks run afoul of the prohibition on merchant routing restrictions identified in Section 235.7(b). NGA requests that the Board explicitly clarify that tokenization cannot impede merchants' routing choice to preempt any future ambiguity.

Prioritization of Common AID & Customer Choice

When point-of-sale ("POS") terminals are programmed, EMVCo specifications allow for the issuer's highest priority application identifier ("AID") to be the default standard. Unfortunately for merchants, the global networks have instituted rules mandating issuers prioritize the Global AID, denying merchants their routing choice. Since the US Common Debit AID contains all the networks in the Global AID plus additional networks, there is no reason a merchant would desire the more restrictive Global AID to be selected when U.S. Common Debit is available. The Proposed Rule should clarify that U.S. Common Debit AID is the default -- or prioritized -- AID.

Furthermore, the global networks have previously attempted to circumvent merchants' debit routing choice by allowing customers to choose or confirm the network to route their transaction over, forcing the uninformed cardholder to make a selection. The Board clarified this issue as it pertained to EMV chip terminals in November 2016⁵ but the Proposed Rule should further clarify that any specifications that shift routing choice from the merchant to the customer are prohibited under Regulation II.

⁵ Ibid.

Third-Party Provider Relationships & Incentives

Over half of NGA's membership is comprised of single-store owner-operators. Like many merchants across industries, these small-business owners are primarily focused on serving their customers. As such, many smaller merchants do not have technical payments expertise and rely heavily on their acquirers, processors, or other third-party providers to ensure that their routing choices are best maximized to contain costs.

While Regulation II focuses primarily on issuers and networks, merchants' routing choice can be impaired or restricted by the actions of these payment "middlemen". For example, incentive-based agreements between issuers and processors can lead to routing conflicts-of-interest. With no way to ensure that merchants benefit from these issuer-processor "deals", these agreements could lead to processors inhibiting merchants' routing choice.

NGA requests that the Board further clarify Regulation II's rights and responsibilities as they pertain to processors, third-party providers, payment facilitators, and other transaction stakeholders. Any agreements between issuers or networks and these stakeholders must not prohibit merchants' routing choice.

Regulated Debit Interchange Fee Rate

Although the Proposed Rule does not address the regulated rate of interchange fees for debit card transactions, NGA asks the Board to take action posthaste to lower the regulated rate. In the most recent report of debit card issuers⁶ -- released in tandem with the Board's invitation for public comment on the Proposed Rule on May 7, 2021 -- the Board noted that the average interchange fee for covered transactions ranged from \$0.22 to \$0.24, for dual-message and single-message, respectively. In sharp contrast, the same report noted that the average per-transaction authorization, clearing, and settlement (ACS) cost for covered Issuers was \$0.039. Additionally, the report noted the base interchange fee standard exceeding the average per-transaction ACS costs, including issuer fraud losses, for 78.6 percent of covered issuers and 99.4 percent of covered transactions.⁷ With merchants being charged roughly five times the average cost incurred by issuers per debit card transaction, NGA asks the Board to move

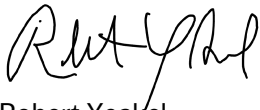
⁶ 2019 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions (May 2021).

⁷ Ibid.

quickly to decrease the regulated rate as the current fee standard is neither reasonable nor proportional.

Since the Board promulgated its final rule in July 2011 implementing the prohibitions on network exclusivity and routing restrictions, barriers continue to inhibit merchants' routing choice. While NGA thanks the Board for the opportunity to comment on the Proposed Rule, the Board is under no statutory obligation to request comment. We ask that the Board take swift action to finalize the Proposed Rule and uphold the entirety of Regulation II requirements for the benefit of U.S. consumers and merchants alike.

Sincerely,



Robert Yeakel
Director, Government Relations
National Grocers Association