

**Meeting Between Staff of the Federal Reserve Board and Representatives and Members of
Merchant Trade Associations
June 1, 2023**

Participants: Elena Falcettoni, Cody Gaffney, Karen Juszczak, Mark Manuszak, Andrew Ruben, Benjamin Snodgrass, Evan Winerman, and Krzysztof Wozniak (Federal Reserve Board)

Molly Allen (7-Eleven); Patti Fletcher (Ahold Delhaize US); Teresa Turner (Aldi); Connor Crowley and Joseph Vasterling (Best Buy); Elizabeth Garner, Christian Johnson, and Alexandra Shertzer (CMSPI); Christine Pollack (FMI – The Food Industry Association); Abel Martinez (H.E.B.); Scott Anderson and Brett Layson (Home Depot); Ken Brumfield (JC Penney); Kathy Hanna and Adrian Swann (Kroger); Madison Carney, Robert Curis, and Jay Waters (Lowe's); John Drechny and Josh Pynn (Merchant Advisory Group); Doug Kantor (NACS); John Richard (National Grocers Association); Stephanie Badger (Nickels Group); Brennan Duckett (National Restaurant Association); Dylan Jeon and Stephanize Martz (National Retail Federation); Crystal Dodd (Publix); Kallie Brown, Michael Hanson, and Austen Jensen (Retail Industry Leaders Association); Perry Star and Susan Smith (Target); Ken Grogan (Wakefern); Wes Martin and Katie Smith (Walgreens); Trent Addington, Mario Dearmas, Kelly Haren, and Hannah Walker (Walmart)

Summary: Staff of the Federal Reserve Board met with representatives and members of merchant trade associations to discuss topics related to Regulation II's interchange fee cap. Merchant participants expressed their views on the costs incurred by covered debit card issuers in connection with debit card transactions, as well as merchant and issuer fraud losses as they relate to the interchange fee standards and the fraud-prevention adjustment in Regulation II.

Attachment

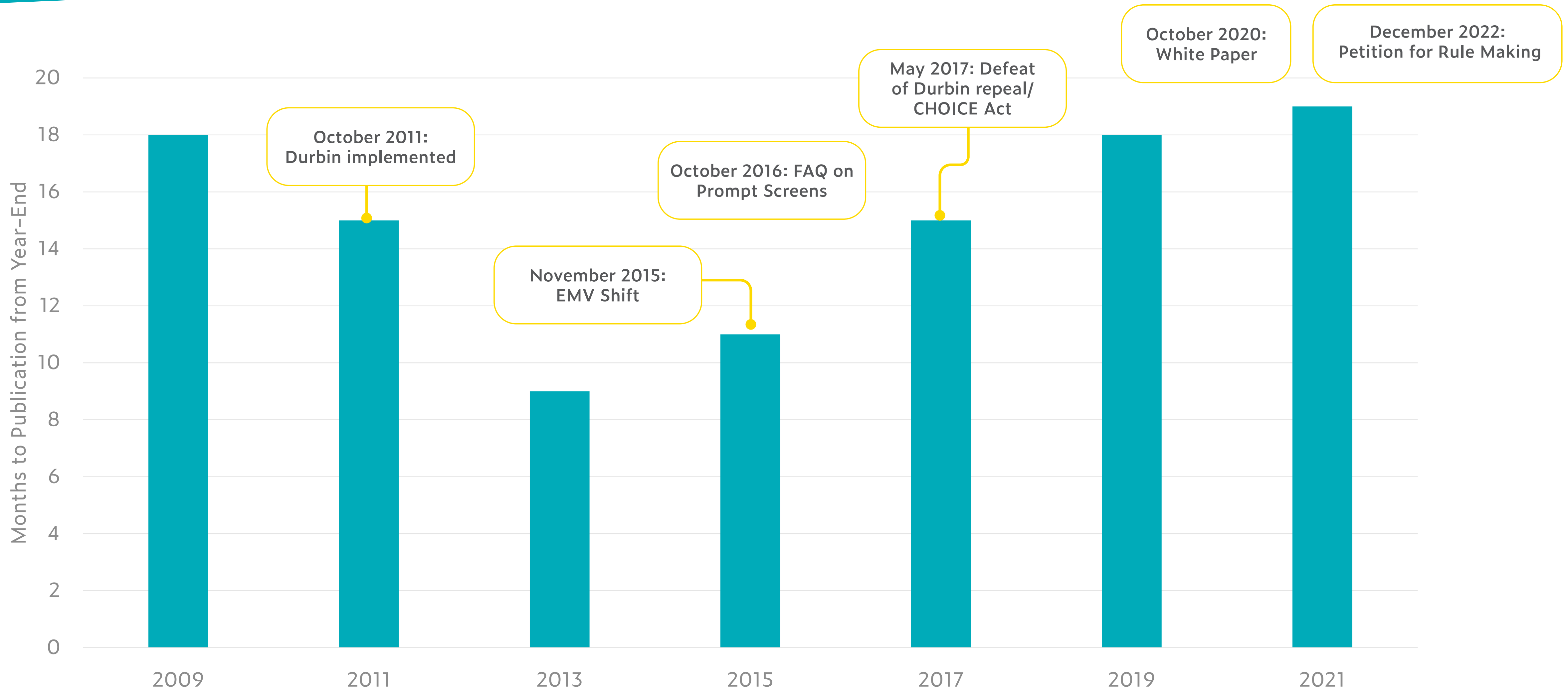


REGULATION II REGULATED RATE

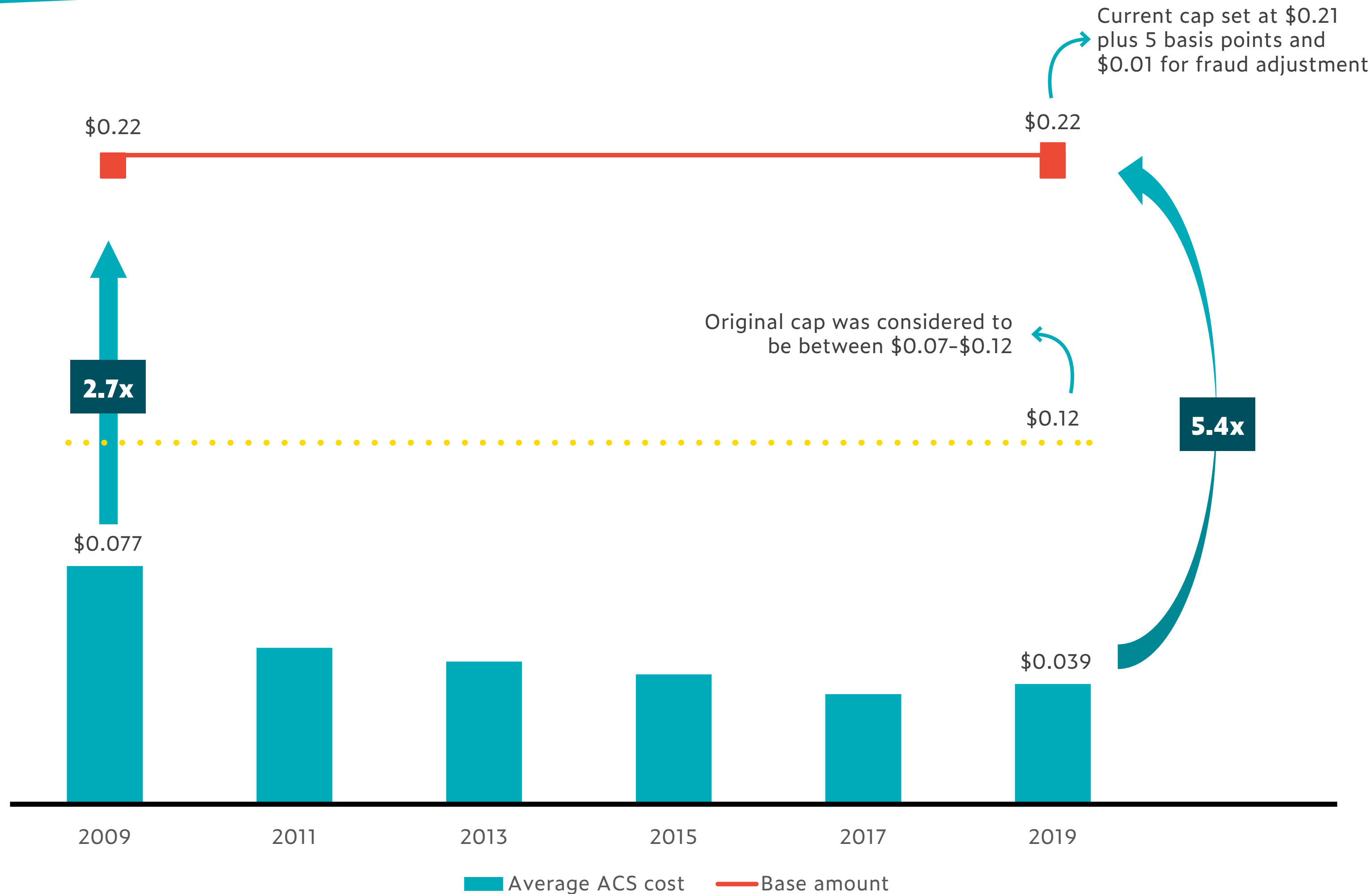
MAY 2023



Timeline of Reg II Reports and Key Milestones



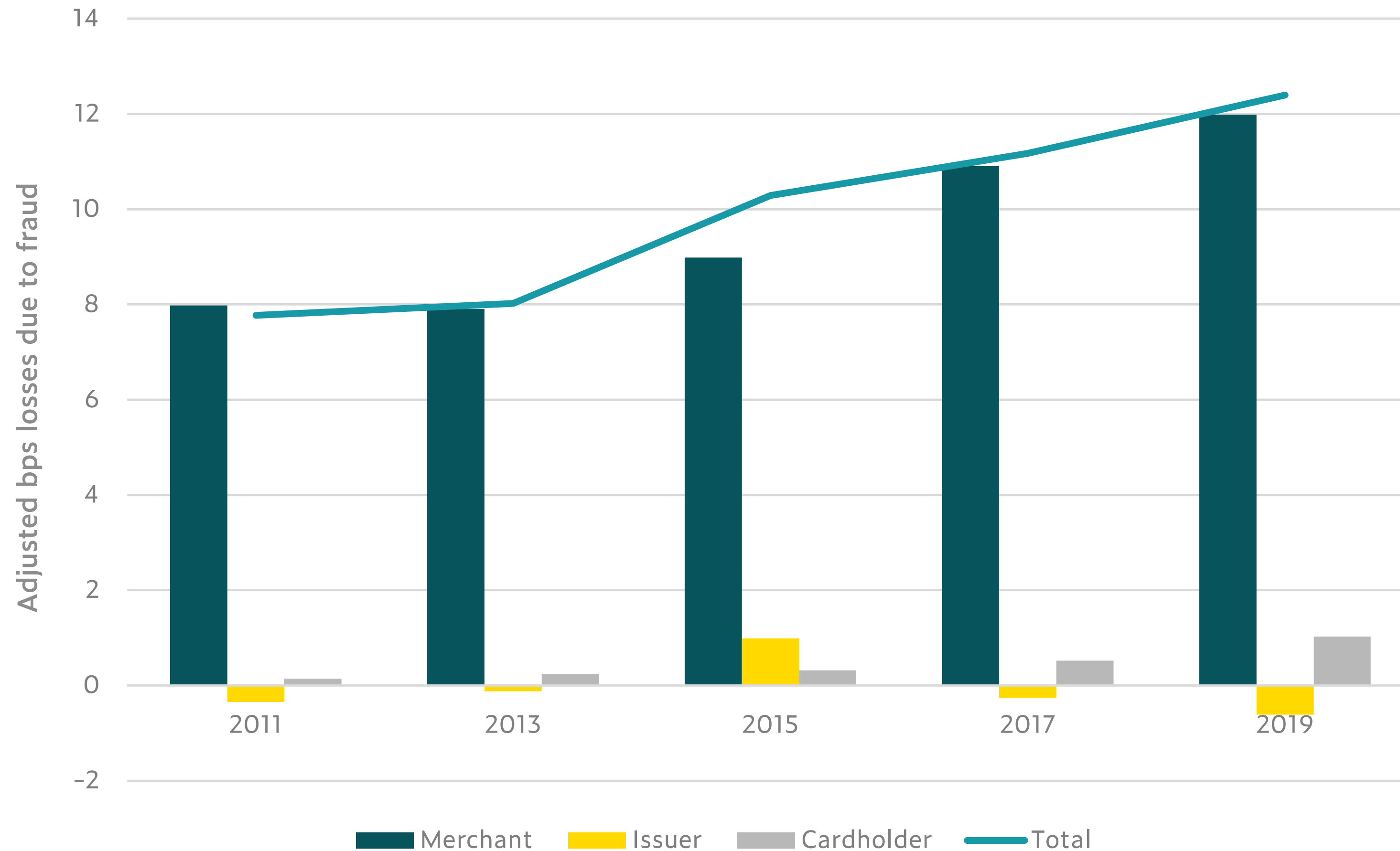
Issuer ACS Costs



Source: Federal Reserve Reg ii Report (2019)

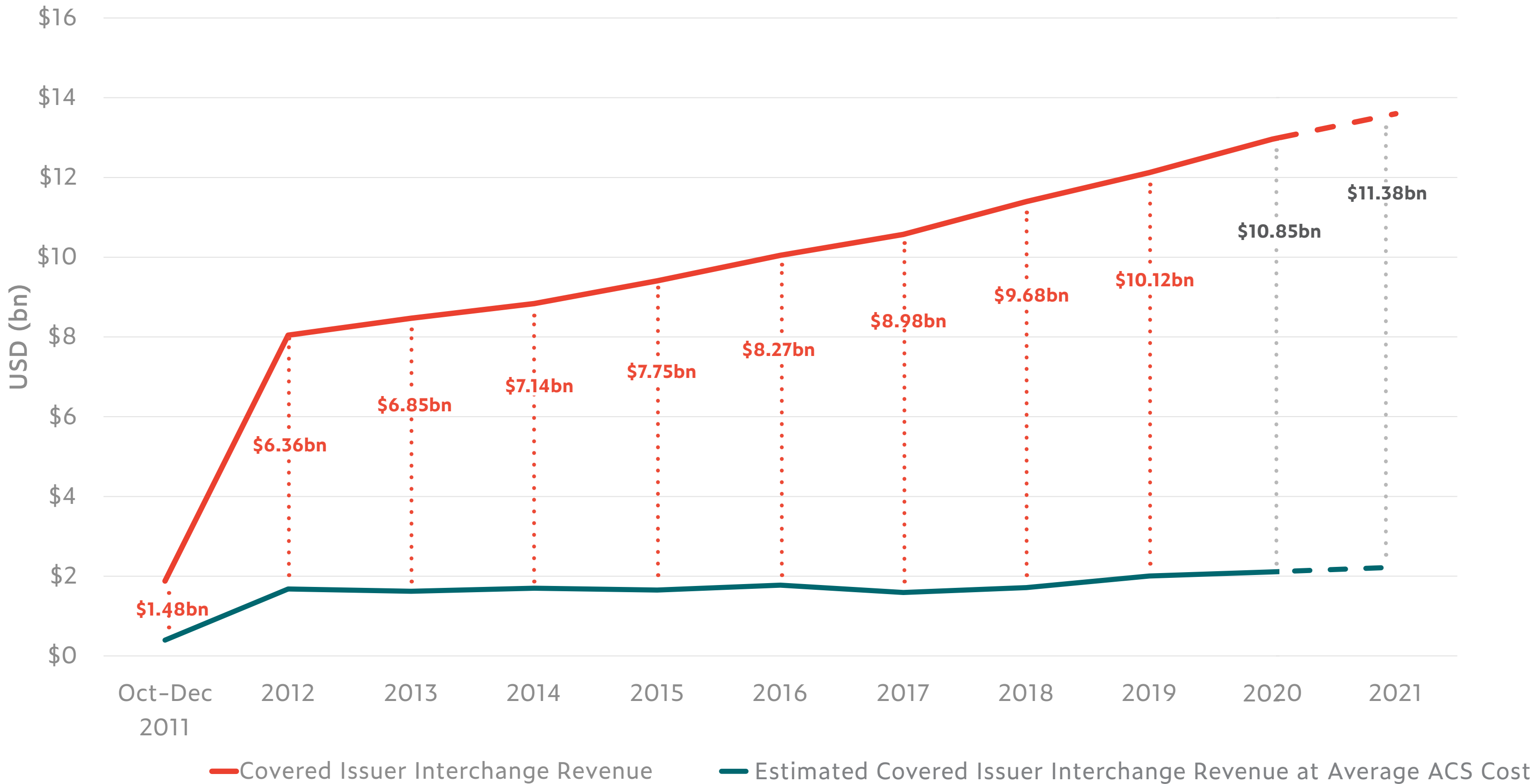
- The transaction weighted average cost for ACS for all covered issuers fell from **\$0.077** per transaction in 2009 to **\$0.039** per transaction in 2019
- In 2019, regulated banks accounted for **63%** of debit transactions
- 99.4% of covered transactions in 2019 were on cards from issuers with average ACS costs, including fraud losses, and fraud prevention costs less than \$0.22 plus 5 basis points
- Data beyond 2019 is unavailable because Reg II report is historically late

Fraud Loss as Share of Transaction Value



- From 2011 to 2019, issuer fraud losses per dollar have fallen 6%, while merchant fraud losses have risen 134%
- Total fraud losses per dollar have risen nearly 60% from 2011 to 2019
- Issuers are regularly profiting from the 5bps netted against fraud losses
- Profits from the 5bps calculated at an average \$53mn in 2019, and is estimated to have grown to \$66mn in 2021

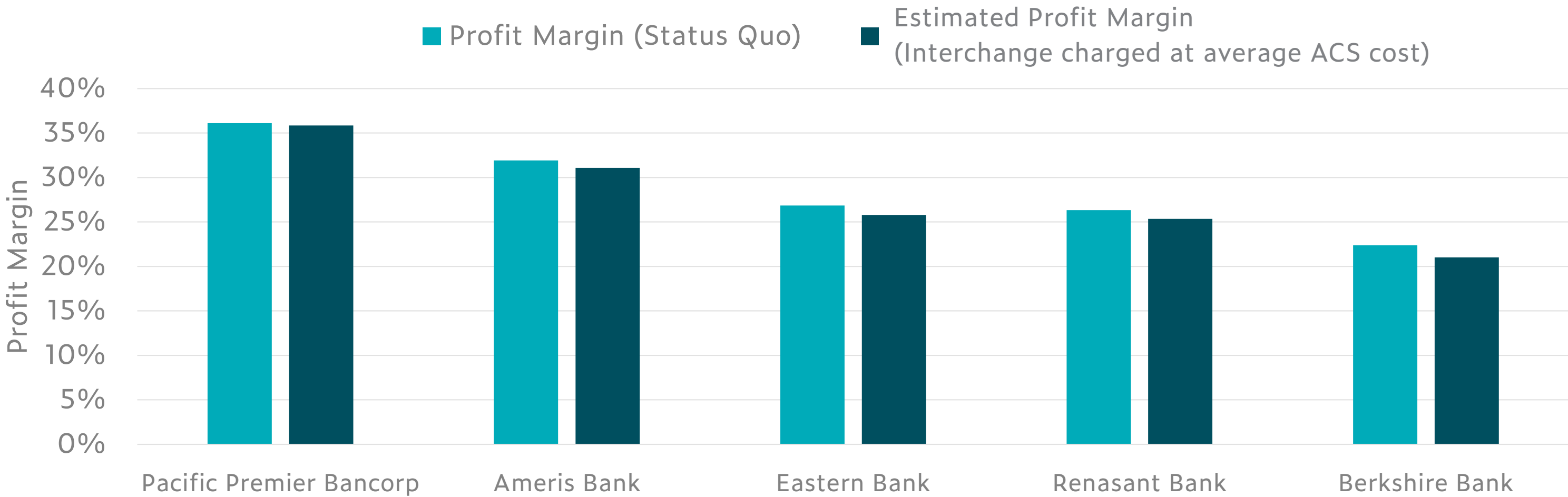
Covered Issuer Average Profits by Year



- From 2012-2019, covered issuer IC revenue rose by **50%** while average ACS costs for covered issuers fell by **23%**
- Because the interchange caps exceed average ACS costs and fraud is a profit center for issuers, covered banks have been allowed to overcharge an estimated **\$11.4bn annually**
- Annual overcharges sum to nearly \$90bn from 2011 to 2021

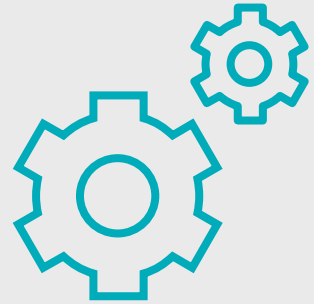
Source: Federal Reserve Reg ii Report (2019)

Regional Bank Analysis



Source: Financial Institution 10-Ks

Methodology for analyzing impact to smaller regulated banks:



- From a review of 70 banks with cumulative assets ranging \$10-30bn, five report gross debit interchange revenues
- Assuming gross debit interchange revenues achieve 100% profit, presented is a model estimating the impact of reducing interchange to average ACS costs on bank profit margins
- Across these five banks, gross debit interchange makes up 2.1% of revenue or less, and the impact of reducing the cap to average ACS is estimated to reduce profit margin by 1.4 percentage points at most

Key Takeaways



Since the inception of the cap, the per item element nor the fraud component have been adjusted.



Debit fees are no longer reasonable and proportional to the cost incurred by issuers



Neither the cap nor the fraud component are supportable by the data



THANK YOU

