IKEA

February 22, 2011

<u>BY EMAIL</u>
Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. R-1404 (Debit Card Interchange Fees and Routing)
RIN No. 7100 AD63

Dear Ms. Johnson,

On behalf of IKEA, we submit the following comments in response to the notice of proposed rulemaking published by the Federal Reserve Board ("Board") in the Federal Register on December 28, 2010. *Debit Card Interchange Fees and Routing*, 75 Fed. Reg. 81,722 (proposed Dec. 28, 2010) ("NPRM"). The NPRM requested comments in many areas, and IKEA, through its membership with the Retail Industry Leaders Association and its association with the Merchants Payment Coalition ("MPC"), has offered substantive comments to the open questions and practical, constructive suggestions on how to move forward in implementing the rule-making. IKEA's comments and suggestions have been comprehensively addressed in the MPC submission dated February 22, 2011. IKEA is fully supportive of the MPC submission but we wish to offer additional supplemental comments at this time to the Board.

At the outset, IKEA wishes to recognize and commend the Board on the work done so far on the proposed rulemaking and wishes to acknowledge the time and effort spent by the Board in formulating the NPRM.

IKEA believes it is vitally important that the implementation of the rule-making proceed according to the timeline established when the law was signed into effect last summer.

<u>Competition Must be Restored</u>

Contrary to what is being claimed by the debit networks and the issuing banks, today's debit interchange system is broken and dysfunctional. The market is not competitive, it is not open or transparent, and it allows networks and issuers to act in their own self-interest in ways that are harmful to merchants, but even more harmful to consumers. Interchange reform is needed now and the Board should not delay releasing final rules in April 2011. Completion of the rulemaking process and implementation of the rules according to the statutorily-mandated

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timeline will mean an earlier transition towards a more transparent, more open, and more competitive marketplace with benefits flowing to consumers sooner than if the rulemaking process is delayed or interrupted.

The claims by networks and issuers that 1) debit interchange today represents a fair economic transfer for the right to access a customer's demand deposit account ("DDA"); and 2) the institution of caps now will have adverse effects on their operations and consumers are completely disingenuous. These claims ignore past history and the hidden costs paid by all consumers up to this point.

PIN Debit Networks Removed Fee Caps to Further Exploit Merchants

Less than ten years ago, fixed transaction pricing was the common standard in the PIN debit industry. Visa-owned Interlink and STAR were among the first networks to introduce ad valorem pricing for debit interchange. With the competition for issuers, it was not too long before all networks moved to ad valorem pricing. At this point, all of the PIN debit networks operated with upper caps on their interchange fee calculations. Interchange revenue was based on an ad valorem formula, but the calculations also established a maximum fixed cost for the merchant. For each network, a 'break-even' transaction amount could be calculated, and once a transaction exceeded the 'break-even' amount, the cap would go into effect and no more interchange costs would be charged to the merchant for that transaction. Merchants would then realize some limited economies of scale for interchange costs, but only if their transaction values were high enough to exceed the 'break-even' amount. Due to the reality of a one-sided, non-competitive marketplace, the ad valorem rates and upper caps were still too high, but at least finite limits did exist on what a transaction would cost a merchant. In this setting, with self-imposed caps in place by the networks, PIN debit issuers thrived and prospered.

Over time, those caps were gradually increased, and then finally removed. The removal of the caps was a non-event for some retail sectors and little-noticed, but for merchants like IKEA who have high average PIN debit transaction values the removal of caps had a devastating impact on interchange fees. The Pulse network removed their caps in April 2007 followed by Visa-owned Interlink in April 2008. Once Interlink removed their caps, all of the other major PIN debit networks (including MasterCard's Maestro, NYCE and STAR) followed suit and did the same in an effort to remain "competitive" with issuers. By early 2010, debit interchange charged by the major PIN networks noted above had become a pure ad valorem cost burden on merchants that increased in direct proportion to increases in the transaction amount, limited only by the size of the transaction. Note that for merchants, competition drives prices lower, yet competition in the context of networks attracting issuers had the opposite effect, driving interchange upward.

As PIN debit caps were removed, IKEA's effective PIN debit acceptance costs (measured on a cost per transaction basis) skyrocketed. For IKEA, the removal of the upper caps represented overnight increases in the effective cost of debit acceptance for the same size transaction ranging from 28% to 100%, depending on the network. Since the removal of caps, the networks have continued to increase their nominal interchange rates as well. The combined impact of removing the caps along with the ongoing rate increases means that IKEA's effective PIN debit cost increases by the major networks have ranged from 68% to 155% since the removal of caps. These statistics are shown in Exhibit A and are attached as an appendix to this comment letter. The combined impact of the rate adjustments by all major PIN networks has resulted in the effective cost rate of PIN debit acceptance for IKEA doubling in just a 2 ½ year period, and increasing 195% over the last seven years. This increase is well beyond inflation and certainly beyond any reasonable cost increases for the debit networks.

IKEA is not the only merchant with a high average debit transaction value. Many other merchants have been similarly affected by the removal of the caps. Statements by Visa and other debit networks that the cost of debit interchange has remained fairly constant ignore the hidden and insidious impact of the removal of previously self-imposed caps. These disproportionate cost increases to IKEA and other merchants represent a hidden tax on consumers, which the networks and issuers will never admit but independent studies have consistently affirmed. In this context, current debit interchange is an excessive transfer of costs unfairly pushed upon merchants for the benefit of networks and issuers, with a negative impact on the consumer who ultimately bears the prices retailers must set to cover their costs.

Based on the example of IKEA and all other merchants similarly impacted by the ongoing rate increases and removal of caps, PIN debit interchange as it exists today is not economically justifiable. Arguments for the continuation of the status quo on the basis that bank services will now have to be cost-based ignore the reality that for too long, banks and issuers realized windfall profits, while merchants have subsidized the cost of bank services for which they received no direct or indirect benefit. It is only fair that the users of bank services should be the ones to pay for them, and merchants should not have to fund bank services that are of no benefit to them.

Retail Is Fiercely Competitive

Claims by the networks and issuers that retailers will pocket the savings are equally without merit. The U.S. retail market is the most competitive retail environment in the world and the home furnishings sector in which IKEA operates is extremely price-conscious and price-competitive. As a low-cost, low-price retailer, the need for IKEA to compete aggressively on price in a functioning retail market is vital.

The ongoing network increases and removal of the prior network caps cost IKEA millions of dollars in excess fees for which we received no fair value in service. The benefit to IKEA from the Board's proposed rule is that we will be able to direct money that is no longer spent on excess interchange fees towards the continuing realization of our business idea, which states:

> ***"At IKEA our vision is to create a better everyday life for the many people. Our business idea supports this vision by offering a wide range of well-designed, functional home furnishing products at prices so low that as many people as possible will be able to afford them (emphasis added)."***

The savings realized from interchange reform will allow IKEA to continue lowering our prices, which translates into a direct benefit to our customers.

Finally, we wish to emphasize to the Board the tremendous burden that excessive interchange fees have on companies like IKEA. Every dollar that IKEA pays in interchange fees is a dollar that we are not able to reinvest in our brand, diverting resources from making capital investments to our existing stores, the opening of new stores, hiring additional staff, and countless other productive uses which IKEA would like to invest in but is otherwise not able to do so because of the burdensome interchange fees we pay today. We respectfully submit that the Board must recognize that job creation and job growth would be an additional benefit for both consumers and the millions of merchants and other entities nationwide who accept debit cards if the Board's proposed rule is made final.

In closing, the NPRM represents a critical step towards establishing a more open, competitive debit marketplace, with clear benefits flowing to consumers and the economy with the rebalancing of the existing flawed interchange fee market. Moving away from today's one-sided market will allow merchants to pass on the benefits of lower costs to consumers in the form of lower prices and will stimulate overall economic development by making it easier for businesses to create and add jobs.

IKEA thanks the Board for the opportunity to offer comments at this time and for your consideration of them, and urges that the rulemakings be completed and made final according to the timeline outlined in the statute.

Yours sincerely,

John Robinson
Treasurer
IKEA

Exhibit A
The Cost Impact of Removing PIN Debit Network Caps on IKEA

Network	Date Caps Removed	Network Interchange Before Caps Removed	Network Interchange After Caps Removed	Overnight Interchange Increase Due to Cap Removal	Current Network Interchange @ 2/22/2011	Cumulative Interchange Increase Since Cap Removal
Pulse	4/1/2007					
Interchange Rate		(.65% + $.10)	(.65% + $.10)		(.85% + $.13)	
Interchange cap		$0.65	no max		no max	
Interchange fee on $113 sale (See Note 1)		$ 0.65	$ 0.83	28%	$ 1.09	68%
Interlink	4/5/2008					
Interchange Rate		(.75% + $.15)	(.75% + $.15)		(.95% + $.20)	
Interchange cap		$0.50	no max		no max	
Interchange fee on $113 sale (See Note 1)		$ 0.50	$ 1.00	100%	$ 1.27	155%
Maestro	11/1/2008					
Interchange Rate		(.75% + $.15)	(.75% + $.15)		(.90% + $.15)	
Interchange cap		$0.50	no max		no max	
Interchange fee on $113 sale (See Note 1)		$ 0.50	$ 1.00	100%	$ 1.17	133%
NYCE	1/1/2009					
Interchange Rate		(.75% + $.15)	(.75% + $.15)		(.90% + $.12)	
Interchange cap		$0.65	no max		no max	
Interchange fee on $113 sale (See Note 1)		$ 0.65	$ 1.00	53%	$ 1.14	75%
Star	3/1/2010					
Interchange Rate		(.75% + $.15)	(.80% + $.17)		(.80% + $.185)	
Interchange cap		$0.65	no max		no max	
Interchange fee on $113 sale (See Note 1)		$ 0.65	$ 1.07	65%	$ 1.09	68%

Note 1:
The $113 sale amount is based on IKEA's historical average debit transaction values during the time period caps were removed.
Note 2:
Cumulative increases noted in the table cover the following time periods, based on the $113 sale amount:

Pulse	4/1/2007 to 2/22/2011
Interlink	4/5/2008 to 2/22/2011
Maestro	11/1/2008 to 2/22/2011
NYCE	1/1/2009 to 2/22/2011
Star	3/1/2010 to 2/22/2011