August11, 2021

Via email to regs.comments@federalreserve.gov

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

Re: Comments on R-1748 (AG15): Debit Card Interchange Fees and Routing

Dear Ms. Misback:

Thank you for providing H-E-B, LP ("H-E-B") the opportunity to comment on the proposed rulemaking on Debit Card Interchange Fees and Routing. This issue is particularly important to us due to the significant cost of accepting debit cards as a payment method and the growing obstacles to accessing competitive networks, both of which negatively impact H-E-B and the customers we serve daily. With this in mind, we urge the Board of Governors of the Federal Reserve System (the "Board") to take the following actions that will bring much needed relief to retailers and customers and encourage competition in the debit market:

1. Take immediate action to enforce the 2010 Durbin amendment that requires a merchant to be given a choice among two or more unaffiliated networks when processing a debit transaction, regardless of whether such transaction is a card-present (e.g., in-store) or card-not-present (CNP) (e.g., online) transaction.

2. Take immediate action to reduce the regulated debit interchange rate to take into account the fact that issuers' costs have fallen by half since the original rate went into effect and the reality that merchants are shouldering most of the responsibility for fraud, especially online fraud.

It is H-E-B's promise to our customers and the 120,000 employees, whom we call Partners, that we will provide Texans with access to top-quality products at some of the lowest grocery prices in the nation. H-E-B is known for this commitment, and for investing in our communities to make Texas one of the best places to live for the families we serve. Beginning with just one grocery store built in Kerrville, Texas in 1905, today we operate over 390 stores throughout Texas and 58 stores south of the border in Northern Mexico, creating thousands of jobs annually. H-E-B is now one of the largest private companies in the nation and is owned entirely by family and employees.

Given our customer base and presence in Texas, the routing and interchange fee issue is significant to us. The 2010 Durbin amendment ensured that a merchant has a choice amongst debit networks when processing a transaction. The law does not limit that choice to only card present transactions, and the Board is correct to clarify that card-not-present, or CNP, including eCommerce transactions are covered under the law. As the Board notes, "…issuers that accounted for approximately 50 percent of all debit card transactions and approximately 50 percent of all card-not-present debit card transactions did not conduct any card-not-present transactions over single-message networks in 2019."[1] Unfortunately, this is clear evidence that some of the largest debit card issuers are not complying with the law and limiting merchant routing choice in eCommerce.

As a merchant, H-E-B relies on debit network routing options in-store and online to help contain network costs. Networks competing for both issuing banks and our business benefit all stakeholders in the chain, most importantly the consumer. The grocery industry is highly competitive, averaging less than a 2% profit margin a year. We leverage savings we receive to keep food prices low for our customers. The strains on our industry since early 2020 have been unprecedented and previously unimaginable. Almost overnight, we saw a seismic shift in our customers' needs, shopping habits and the way they pay for their groceries. Customers who traditionally shopped in-store and paid for groceries using a variety of tenders suddenly moved to shopping exclusively online with debit and credit cards. Online grocery sales remain historically high as consumers have changed their shopping behavior and shifted to some form of a new normal as state and local economies reopen across the country. A recent consumer survey found that two-thirds of U.S. consumers now buy groceries online, and the average consumer is allocating over 20% of their grocery spend online.

This shift in shopping habits, along with the significant investment our business has made to help keep our Partners and customers safe, have greatly increased our cost of doing business – placing further strains on our ability to keep food prices low.

In connection with these recent changes and increased cost of doing business, particularly during the pandemic, we believe that increased competition with respect to debit routing choices can assist with network costs. In the request for comment, the Board notes that Regulation II specifically "…prohibits an issuer or payment card network from directly or indirectly restricting the number of payment card networks on which an electronic debit transaction may be processed to fewer than two unaffiliated networks." Unfortunately, as the

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[1] 2019 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions, Board of Governors of the Federal Reserve System (May 2021)

Board notes, currently only 6% of online debit transactions are being processed by single-message networks – Visa's and Mastercard's competitors. This is a clear indicator that merchants are routinely not able to access a second debit network when a purchase occurs online, which has a negative effect on competition between card payment networks. We believe this practice goes against the intent of Regulation II and, as a result, that it is necessary and appropriate for the Board to take immediate action to both clarify and enforce the law, starting by passing the proposed rule.

Clarifying Regulation II would also spur issuers and PIN debit networks to continue developing eligible products that allow for routing different types of transactions (i.e., card-not-present or online transactions). Today, only a small percentage of the debit transactions made online at H-E-B are eligible for PINless routing as most issuers and PIN debit networks do not enable more than one payment card network, let alone an unaffiliated network, for their debit cards, nor is there an incentive to do so. Emphasizing in Regulation II that issuers must enable at least two unaffiliated payment card networks for these online transactions will help further promote innovation in this space.

While technology plays a part in such innovation, we acknowledge that certain technology (e.g., network tokens, EMV terminals that ask customers to choose networks) implemented by payment card networks may hinder debit routing choices. To that extent, we respectfully encourage the Board to clarify in the final rule that the use of technology, such as tokenization, should not prevent full compliance with the debit routing rules. Specifically, in today's environment, network tokenization enables merchants to protect the transaction from end-to-end and allow for credentials to be automatically updated. However, if a merchant were to utilize network tokens, the tokenization locks the transaction into the network and does not allow for routing to competing networks, forcing merchants to choose between security versus costs.

The proposed clarification also recognizes the innovation in the debit space since the initial rule was finalized almost a decade ago. Specifically, the growth in online sales and the investment by the debit networks to enable PINless transactions are two examples. H-E-B strongly supports the Board moving forward with enforcing the debit routing provisions to ensure that we can have access to at least two unaffiliated debit networks regardless of how or where the transaction occurs and is authenticated. Furthermore, we strongly encourage the Board to act quickly to finalize the clarification, so it is in full effect before the 2021 holiday shopping season. Not only is the clarification necessary to enforce federal law, primarily Section 920(b) of the Electronic Fund Transfer Act, but it will also bring immediate relief to H-E-B and other merchants and generally help merchants like us continue to provide the low prices and enhanced service customers expect and deserve.

Finally, as the Board noted, U.S. merchants, such as H-E-B, paid $24.38 billion in debit interchange fees in 2019. The current regulated rate for covered issuers is 21 cents plus five basis points with an additional penny for fraud adjustment. The rate has not been adjusted since it went into effect, even though issuer costs have reduced by half, and merchants are increasingly shouldering more of the losses from fraudulent transactions.[2] These facts are obvious indicators that the regulated rate should be reduced and done so immediately. The Board should act immediately to reduce the regulated rate to bring it into alignment with the statutory requirement that it be both reasonable and proportional to the issuer costs. Doing so will deliver direct relief to our business and further encourage competition in the debit market.

Thank you again for the opportunity to provide comments on the proposed clarification to protect merchants' rights. The Board did not have to provide a comment period to the clarification, and we appreciate the opportunity to share our thoughts. We strongly encourage the Board to act quickly on both enforcing the debit routing law and reducing the regulated debit rate.

Sincerely,

Martin Otto

Martin H. Otto
Chief Operating Officer

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[2] *See* Board of Governors of the Federal Reserve System, 2019 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions, pp. 4 (May 2021), https://www.federalreserve.gov/paymentsystems/files/debitfees_costs_2019.pdf.