



THE KROGER CO.

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**VIA E-MAIL AT** [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)

Ann E. Misback, Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue NW  
Washington, DC 20511

**Re: Docket No. R-1748, RIN 7100-AG15 – Debit Card Interchange Fees and Routing NPRM**

Dear Ms. Misback:

We appreciate the opportunity to submit these comments to the Board of Governors of the Federal Reserve System (the “Board”) on behalf of The Kroger Co. and its affiliates (individually and collectively, “Kroger”) in response to the Board’s request for comment on the proposed clarifications to Regulation II published in the Federal Register on May 13, 2021. Debit Card Interchange and Routing, 86 Fed. Reg. 26,189 (proposed May 13, 2021) (“Proposal”).

Kroger is dedicated to our Purpose: to Feed the Human Spirit™. To that end, Kroger serves America through food inspiration and uplift, and works to create #ZeroHungerZeroWaste communities by 2025. Across our family of companies, Kroger includes nearly half a million associates who serve over nine million customers daily through a seamless digital shopping experience and 2,800 retail food stores under a variety of banner names.

In the years leading up to the enactment of Reg II in 2011, the debit market had become broken. Evidence of the dysfunction abounds in Kroger’s experience. First, the card brands had merchant operating rules that tied the acceptance of their credit cards to Kroger’s acceptance of their much less used branded debit cards, including PIN and signature debit cards. Second, the brands’ interchange rates and network fees for merchants’ acceptance and processing of debit card transactions increased at alarming rates. Third, card brands and issuers had limited or impaired Kroger’s routing options by entering exclusive routing deals that prevented Kroger from creating an acceptance environment that incentivized the networks to compete on price for the processing of Kroger’s (and other merchants’) debit card volume. In particular, Kroger processed hundreds of millions of debit card transactions annually. Yet despite that sizeable volume, it could not get the brands to charge lower prices for processing debit cards even though their cost to transmit transactions electronically continued to decline due to technology advances. This was the environment for debit card present transactions before Reg II, EFTA section 920(b)(1)(A) and (B) required every debit card to have two unaffiliated networks enabled for processing – thus at least nominally providing a mechanism for some network competition to process Kroger debit transactions.



The rules enacted in Reg II did not expressly state that card not present (“CNP”) debit card transactions were excluded from Reg II. The rules also did not explicitly exclude debit transactions that came from a mobile wallet, digital or any other means of authentication. In fact, Reg II stated that these rules applied to *all* debit card transactions. The Board’s own findings stated that “...covered debit card issuers, issuers that accounted for approximately 50 percent of all debit card transactions and approximately 50 percent of all card-not-present debit cards transactions did not conduct any card-not-present transactions over single-message networks in 2019.”

In the years after the enactment of Reg II and its rules, networks that had primarily provided PIN debit transaction processing and routing created new technology to support debit card transactions without a PIN. The advancement of this technology was timely as businesses, including Kroger, began to develop on-line shopping and payment from personal computers. As part of this new business model, mobile apps allowed customers to shop from their mobile devices. The additional routing choice for Kroger in the CNP environment was a welcome opportunity to try to inject competition on price and liability for processing these new transactions. More recently, with the impact of COVID-19, many customers have shopped more frequently on-line, thus increasing Kroger’s volume of CNP debit cards transactions over 150% since 2019. Kroger processed all of these new transactions over the card brands’ networks.

Fraud is another area that Kroger has addressed for CNP debit card transactions. To combat the potential fraud that accompanies CNP transactions, Kroger has developed multiple layers of fraud detection -- some internal and some with external third parties at a cost to Kroger for protection. The reason for these multiple layers of protection is that with a CNP transaction, Kroger, and not the card brand or network, often has the liability for the transaction.

With the foregoing background in mind, we turn to the Board’s decision to interpret the language of EFTA section 920(b) as *not* requiring issuers to enable unaffiliated networks for each cardholder authentication method that may be used for a debit transaction. Kroger requests that the Board re-examine its decision, starting with the language in the regulation itself. As set forth in 12 CFR 235 Regulation II; Docket No. R-1748 RIN 7100-AG15: “*Specifically, the statute directs the Board to prescribe regulations that forbid issuers and payment card networks from directly or indirectly inhibiting any person that accepts debit cards for payment from directing the routing of an electronic debit transaction over any network that may process that transaction.*” Kroger believes that this language is clear and applicable to the events occurring today that restrict routing options for CNP transactions. We are concerned that adding language ostensibly meant to be clarifying that requires routing options for each “type of merchant” and “type of transaction” may, in fact, fail to solve the current restrictions and create new opportunities for card brands and issuers to further disregard the regulation, thereby by continuing to limit Kroger’s routing options for CNP debit card transactions.

One Board action that would help prevent routing restrictions by card brands and issuers is to address the language in the regulation regarding authentication. Cardholder authentication methods should not be used to continue to restrict Kroger's routing choices. Consider, for example, PINless authentication. In 2015, Kroger implemented PINless processing for in-store card present debit transactions through third party networks. Once again, despite Kroger's substantial debit card volume, and the large and growing debit card volume of the merchant community, the number of issuers supporting PINless debit transactions has *declined* since implementing this process in 2015. When an issuer does not enable all available cardholder authentication methods, this denies the transacting merchants routing choices provided in the regulation. The Board should not allow this type of noncompliance to continue for card present debit transactions, and it should require issuers to enable PINless processing for CNP debit transactions as well.

The Board can accomplish compliance with the regulation by requiring the two unaffiliated networks to be enabled for every method of cardholder authentication supported by that network. In addition, the Board should not allow cardholder authentication to be used as a loophole for restricting the routing rights of Kroger when the issuer states one authorization method is more difficult to support for one network over another.

The Board is also proposing changing the language of "form factor" with "means of access" as a way to better align with current industry terminology. Kroger supports this change by adding language that includes "*the media or technology used today or developed in the future to send the cardholder's debit payment credentials through the merchant to the issuer*", to address the multiple ways consumers use their debit cards for shopping in-store and on-line and the authentication methods for these various ways. Consumers use multiple digitally enabled devices such as, mobile phone, TV, car, fob and other mobile devices to initiate a payment. Payment technology has changed substantially over the past 10 years and continues to change rapidly. Many of these uses do not include a PIN or biometric but use no cardholder verification method as authentication. Under the current practices of the card brands and issuers, these debit transactions would most likely all be routed only through the card brands to the issuer, limiting Kroger's choice of routing options. The way payment credentials are presented to the issuer should not be a limiting factor. Without clear wording from the Board, issuers are likely to create different authentication methods by unaffiliated network for certain types of transactions. The Board needs to state clear language that *every debit transaction is required to have two unaffiliated networks available for merchant's choice of routing regardless of the authentication method and the media or technology used today or developed in the future to send debit card credentials from the merchant to the issuer*.

In addition to addressing the "means of access", the Board should look at the network tokenization services provided by the card brands and used by issuers and some mobile wallet providers for any limitations they enable. Kroger supports the protection of cardholder data including the primary account number ("PAN") and along with many other organizations,

Kroger uses a tokenization process that protects the PAN but does not limit any of the data used by the issuer in the authorization process. Kroger recommends the Board adopt language for debit transactions processed with a network token and are used by issuers or other third parties to not allow the network token or process of the decryption of the network token be or create a technical or business barrier that limits routing options.

In the 10 years since the passage of the Durbin Amendment and implementation of Reg II, the Board had conducted the required surveys, received data from required issuers and compiled the data regarding the cost associated with authorization, clearing and settlement ("ACS") costs. Each survey from these issuers has provided the Board with data showing a decline in the ACS cost. Yet, the Board has not made any changes to the rate set 10 years ago. The other component of the regulated rate addresses fraud costs incurred by the issuer. The Board acknowledges data has shown fraud losses have shifted significantly from the issuers to the merchants. Kroger recommends the Board immediately eliminate the fraud prevention and fraud reimbursement fees along with lowering the regulated debit interchange rate to the amount reported in the 2019 survey. The original regulated debit interchange rate has become the minimum the issuers will accept, eliminating the ability to create a competitive environment to lower costs. Kroger urges the Board to make these changes immediately. These changes would meet the requirements set forth in the Durbin Amendment for the rate of debit transaction to be *reasonable and proportional to the cost incurred by the issuer with respect to the transaction*.

Kroger urges the Board to take immediate action to correct the card brands and issuers ongoing actions in the debit market as described in this letter, and to enable Kroger (and all merchants) to have full routing choices as set forth in Reg II.

Kroger appreciates the Board's efforts to address these important issues that are limiting or impairing its ability to route debit card transactions in the card present and CNP space. We remain available to discuss our comments and future inquiries with the Board.

Respectfully,

Kathy Hanna, Sr Director Enterprise Payments

The Kroger Co.