August 11, 2021

Submitted electronically via regs.coments@federalreserve.gov.

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

Re: National Restaurant Association Comments on 12 CFR Part 235 [Regulation II; Docket No. R–1748, RIN 7100–AG15]

Dear Secretary Misback,

On behalf of the National Restaurant Association, thank you for the opportunity to comment on the Notice of Proposed Rulemaking (or "Proposed Rule") regarding Debit Card Interchange Fees and Routing issued by the Board of Governors of the Federal Reserve System ("Board") published in the Federal Register on May 13, 2021.[1] We strongly support the Board's proposed rule to clarify that card-not-present (CNP) transactions apply to the Regulation II requirement that merchants have the option to route debit card transactions between at least two unaffiliated payment card networks, and further urge the Board to expand its enforcement of the Regulation II routing competition provision as well as reduce the regulated debit rate.

Founded in 1919, the National Restaurant Association ("the Association") is the leading business association for the restaurant and foodservice industry, representing more than 15.6 million employees, nearly 10 percent of the nation's workforce. As the nation's second largest employer, with one million locations across the country, the restaurant industry is a vital part of the U.S. economy.

As you are aware, our industry has been completely upended due to the COVID-19 pandemic. More than 8 million restaurant employees were laid off or furloughed, and the industry lost $290 billion in sales due to mandated closures and capacity limits during the pandemic. Even as states continue to reopen this year, restaurants still have an incredibly long road to recovery as they continue to face labor shortages, supply chain disruptions and rising food costs.

While these challenges were ultimately insurmountable for tens of thousands of restaurants across the nation, those that managed to keep their doors open since March of last year have done so by finding new and innovative ways for their customers to order from the safety and comfort of their homes. In doing so, restaurants scrambled to adjust their business models to support remote dining by accepting orders made online, through mobile applications, third-party delivery services, or via contactless payments during curbside pickup, and the industry's ability to offer these services were only made possible through card-not-present (CNP) transactions.

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[1] 12 CFR Part 235 [Regulation II; Docket No. R–1748]

I. The Board Should Apply the Regulation II Competitive Debit Routing Requirement to Card-Not-Present (CNP) Transactions

Unsurprisingly, restaurants have seen CNP transaction volume skyrocket since the pandemic began and CNP is now the industry's primary source of payment method. In fact, according to a recent PYMTS study, a staggering sixty-seven percent of the average restaurant's revenue now comes from food orders placed either online or over the phone. The study, which surveyed 514 quick-service restaurant (QSR) and full-service restaurant managers across the country, found that remote food orders are even more critical for QSRs, who now on average generate as much as seventy-five percent of their sales from CNP transactions.[2]

It is critical to understand that even prior to the pandemic, consumers' preferred form of payment has consistently shifted toward the use of debit over the past decade. Combined with the emergence of innovative payment technologies, it only follows that CNP transactions were the primary driver of debit card growth in 2019, increasing over twenty-one percent year-over-year, or roughly 10 times faster than the growth rate of card-present (CP) transactions.[3] Looking forward, another study found that seventy-nine percent of consumers plan to maintain their new digital shopping habits after the pandemic is over. And since eighty-seven percent of debit cards are expected to be contactless by year-end 2022,[4] the Association anticipates that CNP and contactless debit transactions will continue to serve as an essential revenue driver for restaurants and other consumer-facing sectors across the U.S. economy.

Despite these dramatic shifts in market innovation and consumer spending preferences prior to and throughout the pandemic, restaurants and other merchants today are still required to pay significantly higher fees to accept CNP debit transactions compared to CP transactions. This is because issuers and the dominant card networks have for too long operated in the perceived "grey area" of Regulation II's ambiguity around online payments. For example, for an average retailer, a non-regulated Visa consumer debit transaction is 0.85% more expensive for card-not-present than card-present.[5] Additionally, on average, single-message networks are 10 cents less expensive per transaction than dual-message networks[6], a result of greater competition and churn within the single-message market. Statistics like these appear to be in part a result of the Board's recent finding that single-message networks collectively process a small share of card-not-present transactions compared with their share of card-present transactions.[7] These additional costs add up quickly and is clearly unfair to restaurants and other merchants who have embraced CNP transactions as a core aspect of their business.

In addition to higher fees invoked upon merchants in CNP environments, the average ticket size for these purchases is considerably larger than a transaction made with a card physically present. According to the PULSE® 2020 Debit Issuer Study, the average CNP transaction totaled $61.48 in 2019, while the average card-present purchase totaled $34.10.[8] This statistic further demonstrates how restaurants and other merchants paid more in fees, due to the percentage element of most fees, to facilitate CNP transactions despite both transaction types being made via the same debit card. Compound these numbers with the additional expenses issued to third-party delivery services like Uber Eats and DoorDash and you have

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[2] PYMTS Restaurant Readiness Index: July 2021
[3] "2020 Debit Issuer Study," PULSE®, August 2020
[4] Next-Gen Debit Tracker: April 2021
[5] Wells Fargo Payment Network Qualification Matrix, April 2021
[6] "2019 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions" May 2021
[7] "Board Memo: Proposed Amendments to Regulation II"
[8] "2020 Debit Issuer Study," PULSE®, August 2020

significant harm being done to the restaurant community, an already low-margin industry because of high competition.

For restaurant owners, accepting a form of payment that is not "cash only" is an absolute imperative in order to best serve their customers and keep their doors open. However, the Association believes that the aforementioned higher fees associated specifically with CNP debit transactions do not align with the Board's previous clarifications of Regulation II, which "does not limit the term 'electronic debit transaction' to transactions initiated at brick-and-mortar store locations; the term also includes purchases made online or by telephone or mail."[9] Additionally, the Board affirmed that "electronic debit transactions initiated over the Internet are within the scope" of the statute and Regulation II.[10] Finally, Regulation II also holds that neither an issuer nor a card network may direct the routing of a transaction to a particular network based on the way the cardholder presents the card.[11]

Ultimately, the Association agrees with the Board on its finding that, "merchants are not always able to choose from at least two unaffiliated networks when routing card-not-present transactions… because issuers have not consistently enabled single-message networks for card-not-present transactions."[12] Indeed, CNP transactions have played a crucial role for restaurants weathering the effects of the pandemic, yet merchants have not had the ability to choose between competing networks when routing CNP transactions, an issue that has become increasingly pronounced because of continued growth in online transactions, particularly in the COVID-19 environment.[13] For these reasons, the Association urges the Board to clarify that CNP transactions do in fact apply to the Regulation II requirement that debit-card issuers must enable at least two unaffiliated networks on each card for any debit card transaction. This necessary clarification would finally empower restaurants with the ability to choose how to route debit payments for the remote dining services customers so heavily utilize and enjoy today.

II. The Board Should More Robustly Enforce the Regulation II Competitive Debit Routing Requirement and Reduce the Regulated Rate

In addition to applying the Regulation II competitive routing requirement to CNP transactions, the Association further believes the time is now for the Board to more robustly enforce the competitive routing requirements set forth in Regulation II, which requires that there be at least two unaffiliated payment card networks enabled on a debit card to process debit card transactions.

For the restaurant industry, merchant service charges are often restaurants' third greatest operating expense behind labor and food costs. On each debit card payment, a restaurant owner pays a merchant service fee comprised of three separate payments: one for interchange fees, one for network fees, and one for processor margins. Interchange and network fees together are the largest portions of the merchant service charge and are non-negotiable, leaving the merchant with little control over costs. Fortunately, the restaurant industry has been able to save consumers millions of dollars since Regulation II took effect in 2011, but as the Board has acknowledged in its proposed clarification, both issuing banks and the global networks have yet to fully comply with the requirement that "…prohibits an issuer or payment card

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[9] Reg. II, 76 Fed. Reg. at 43410
[10] Reg. II, 76 Fed. Reg. at 43410
[11] Reg. II, 76 Fed. Reg. at 43453
[12] "Board Memo: Proposed Amendments to Regulation II"
[13] Press Release: Federal Reserve Board invites public comment on proposed changes to Regulation II…; May 7, 2021

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."[14]

The Board's acknowledgment here is especially concerning given how the pandemic has accelerated wide-scale changes to consumers' spending habits, with a growing number of Americans now choosing to pay via debit rather than credit. To this end, the PULSE® 2020 Debit Issuer Study reported that forty-one percent of consumers now prefer to pay with debit cards,[15] while fifty-five percent of U.S. consumers now count themselves as "debit-centric" users.[16] As such, the Association is concerned by the Board's finding that only six percent of online debit transactions are being processed by single-message networks. Indeed, these trends and recent findings robustly illustrate American consumers' growing preference for debit cards, making it more important than ever for the Board to take immediate action to enforce the law by requiring financial institutions to comply with the Regulation II competitive routing requirement for debit card transactions.

Finally, as the Board noted in its 2019 memo, U.S. merchants paid $24.38 billion in debit interchange fees in 2019, while the current regulated rate for covered issuers has remained unchanged over the past decade at $0.22 and $0.24 per transaction, plus five basis points with an additional penny for fraud adjustment.[17] Again, this merchant service cost is one of the top expenses for restaurants—even though average issuer costs, measured by average issuer authorization, clearing, and settlement (ACS) costs, have more than halved from 2009-2019 to $0.039 per transaction[18], leaving our industry and other merchants to continue shouldering an unfair share of the interchange fee burden. Therefore, the Association urges the Board to consider further reducing the regulated rate to bring it into alignment with the statutory requirement that it is both reasonable and proportional to the issuer costs in its final proposed rule. Lowering the regulated rate will deliver direct relief to the restaurant industry and generate billions in savings to debit-accepting merchants across the U.S.

Thank you again for the opportunity to comment on the Notice of Proposed Rulemaking, "Debit Card Interchange Fees and Routing." The National Restaurant Association strongly urges the Board to act expeditiously to apply Regulation II requirements to card-not-present transactions, expand enforcement of its competitive debit routing requirement, and reduce the regulated debit rate.

Sincerely,

Brennan Duckett
Director, Technology and Innovation Policy

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[14] 15 U.S.C. §1693o-2

[15] "2020 Debit Issuer Study," PULSE®, August 2020

[16] "Next-Gen Debit Tracker: January 2021"

[17] "Board Memo: Proposed Amendments to Regulation II"

[18] "2019 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions" May 2021