



Executive Summary

Food Marketing Institute Debit Card Swipe Fee Litigation Backgrounder

Why is FMI filing the lawsuit?

The U.S. Federal Reserve Board's final swipe fee rule ignores the clear statutory language of the Durbin Amendment. If not challenged, it will result in significant increased costs for food retailers and consumers.

What is the average supermarket debit interchange fee?

The average supermarket debit interchange fee prior to the reform ranged from 20 to 30 cents and was a bit higher than that range for smaller grocers. In order to accept cards, merchants pay network fees, processing fees, and interchange fees, which are the most significant fees.

Interchange Fees	→	Card Issuer (i.e., Bank of America, Citi)	→	roughly 85% of cost
Network Fees	→	Network (i.e., Visa, MasterCard, STAR)	→	roughly 10% of cost
Processing Fees	→	Merchant Processor (i.e., First Data)	→	roughly 5% of cost

How are interchange fees set?

Card networks set interchange fee revenue for the banks that issue credit and debit cards. The interchange revenue flows to the bank, even though they are not the entity setting the fee, resulting in significant anti-competitive impacts.

What are historical interchange rates?

Some merchants were paid interchange to accept debit cards in the early 1990's.ⁱ This directional flow shifted shortly thereafter, and the rates merchants pay to accept credit and debit cards have been rising ever since. In the grocery industry, PIN debit rates ranged from roughly 17- to-35 cents in 2010.

Why does the industry care about interchange fees?

Total fees paid by the supermarket industry to accept credit and debit cards in 2010 were roughly \$5.68 Billion, 1.01 percent of sales in 2010, greater than the 0.98 percent average net industry after tax profit margin in 2010.ⁱⁱ The card networks refuse to negotiate swipe fees, which impacts food retailers' ability to keep prices low for their customers and hire new workers.

What does the statutory language require regarding debit fees and routing?

Section 1075 of the Dodd Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203)ⁱⁱⁱ requires the Federal Reserve Board of Governors to prescribe rules regarding: 1) Reasonable

interchange transaction fees on debit; and 2) Limitations on payment card network routing restrictions. The statutory language is explicit as to which costs can and cannot be included in the reasonable and proportional standard.

What did the Federal Reserve Board's proposed rule say?

In their proposed rule^{iv} issued in December 2010, the Federal Reserve considered two approaches on reasonable and proportional debit card fees and merchant network routing choice:

- A) Reasonable and proportional: 1) Seven cents safe harbor with a 12-cent cap and 2) a 12-cent cap.
- B) Merchant routing choice: 1) Two unaffiliated networks on a card; 2) Two unaffiliated networks on a card for each debit authorization type (i.e. Signature vs. PIN).

What did the Federal Reserve Board's final rule say?

The Federal Reserve adopted a modified version of the stand-alone cap approach of 21 cents + a five-basis-point ad valorem fee. The revised base cap number included a number of new costs - network connectivity; software, hardware, equipment, and associated labor; network processing fees; and transaction monitoring - that were left out of their proposed rule. The final rule adopted a network exclusivity approach that only required two unaffiliated networks per card.^v

What are the actual costs of processing a transaction?

The Federal Reserve found that the average weighted debit transaction cost was around 4 cents per transaction.^{vi}

What does the final rule mean for supermarket rates?

The final rule means that savings to merchants and consumers from reduced debit card fees will be less than anticipated based on the proposed rule. On some transactions, debit card fees will increase for our industry because the networks pushed all rates up to the Federal Reserve's cap.

What is the impact of the five-basis-point ad valorem fee that was added to the reasonable and proportional standard?

The five-basis-point ad valorem to cover fraud losses is highly inappropriate since the statutory language specifically addresses fraud prevention activities separately. It will also lead to higher rates than some grocers are currently paying on PIN debit transactions, which are significantly more secure than signature. Supermarket sales account for 39 percent of PIN debit transactions in the United States.^{vii}

Why merchant routing choice is important?

Visa and MasterCard combined have excessive market share in both the credit and debit card space. Recently, both networks have offered financial institutions exclusive deals with their networks.

What is the impact of reforms on grocery shoppers?

Currently, the industry is still analyzing the impact of reforms. As noted, for some grocers, savings will be very limited or non-existent. Still, supermarkets compete heavily on price, so if there are savings to be passed to the consumer, price is one area where savings could be realized. In the Food Marketing Institute's 2011 consumer trends survey, 37 percent of consumers cited a retailer's low prices as the top consideration in deciding a primary grocery store.

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Food Marketing Institute (FMI) conducts programs in public affairs, food safety, research, education and industry relations on behalf of its 1,500 member companies — food retailers and wholesalers — in the United States and around the world. FMI's U.S. members operate approximately 26,000 retail food stores and 14,000 pharmacies. Their combined annual sales volume of \$680 billion represents three-quarters of all retail food store sales in the United States. FMI's retail membership is composed of large multi-store chains, regional firms and independent supermarkets. Its international membership includes 200 companies from more than 50 countries. FMI's associate members include the supplier partners of its retail and wholesale members. www.fmi.org

ⁱ **Federal Register** / Vol. 75, No. 248 / Tuesday, December 28, 2010 / Proposed Rules at **81724**
<http://edocket.access.gpo.gov/2010/pdf/2010-32061.pdf>.

ⁱⁱ FMI 2011 Annual Financial Review; 2011 Food Retailing Industry Speaks. Pg. 82.

ⁱⁱⁱ DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT. Public Law 111-203. 111th Congress.
<http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/html/PLAW-111publ203.htm> at [Page 124 STAT. 2068] and [Page 124 STAT. 2072].

^{iv} **Federal Register** / Vol. 75, No. 248 / Tuesday, December 28, 2010 / Proposed Rules at **81726 and 81727**
<http://www.federalreserve.gov/newsevents/press/bcreg/20101216a.htm>

^v **Federal Register** / Vol. 76, No. 139 / Wednesday, July 20, 2011 / Rules and Regulations at **43404**
<http://www.gpo.gov/fdsys/pkg/FR-2011-07-20/pdf/2011-16861.pdf>

^{vi} Federal Reserve Board of Governors Open Meeting December 16, 2010. Minutes 39:00 to 43:00.
<http://youtu.be/laJqZMfqXNY>

^{vii} 2010 Pulse Debit Issuer Study Executive Summary.