Final Rules Published to Implement Dodd-Frank Requirements for Debit Card Interchange Fees and Routing

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On July 20, 2011, the Board of Governors of the Federal Reserve System (the “Board”) issued a final rule implementing its new Regulation II (12 CFR Part 235) with respect to debit card pricing and other requirements for debit card transactions and systems, as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Act”). At the same time, the Board issued an interim final rule, with a request for comment, on standards for receiving a fraud-prevention adjustment to interchange transaction fees.

Section 1075 of the Act amends the Electronic Fund Transfer Act by adding a new section regarding interchange transaction fees and rules for payment card transactions. Under the revised statute, an “interchange fee” or “interchange transaction fee” is any fee established, charged, or received by a payment card network for the purpose of compensating a card issuer for its involvement in an electronic transaction in which a consumer uses a debit card. Typical debit card transactions are withdrawals, transfers and other transactions using automated teller machines (“ATMs”), point of sale (“POS”) transactions whereby the purchase price for goods and services is automatically debited to the purchaser’s account using a card, and prepaid cards, whether or not reloadable, such as gift cards. In order to clear each of these transactions, one or more intermediate processors will be used to route the transaction from its origin (at an ATM or POS terminal, for example) to the cardholder’s deposit account.

Various fees (commonly referred to as “swipe fees”) are associated with this process. An interchange fee is determined by the operator of a network used in the clearing process and is paid to the card issuer by the person (called an “acquirer”) performing settlement services for the merchant accepting the card. Switch fees are charged by the network to acquirers and card issuers to compensate the network for its role in clearing the transaction. An acquirer will charge a merchant a "merchant discount," which is the face amount of all transactions in a particular period, such as a day, minus the amount of such transactions actually received by the merchant, the difference being the amount of the above types of fees and other acquirer costs. In addition to setting fees, card processing networks will establish procedural rules for the use of their networks, such as technical specifications for cards and rules regarding the proper acceptance of cards.

New Regulation II contains restrictions on interchange fees, requirements with respect to the operation of card networks, and reporting requirements for issuers and networks. Some of these requirements are as follows:

Caps on Interchange Fees. Issuers may only charge "interchange fees" (generally defined as set forth in Section 1075 of the Act) which are "reasonable and proportional to the cost incurred by the issuer." If the issuer charges an interchange fee of no more than the sum of (i) 21 cents, plus (ii) 5 basis points times the transaction amount, such fee will be deemed to be in compliance.

In a separate interim final rule and request for public comment, also published in the Federal Register on July 20, 2011 and effective October 1, 2011, the Board is allowing, an issuer to charge an additional 1 cent per transaction, so long as it develops, implements and updates policies and procedures reasonably designed to identify and prevent fraudulent electronic debit transactions. Comments on this interim rule must be submitted by September 20, 2011. Comments must be identified by Docket No. R-1404 and RIN No. 7100 AD 63, and may be sent to regs.comments@federalreserve.gov.

Prohibited Practices. The regulation prohibits the following practices by a card issuer:

- Directly or indirectly circumventing or evading the restrictions on interchange fees.
- Receiving payments or incentives from a card network (other than the pass-through of interchange fees) in excess of the amount of all fees paid by the issuer to that card network within a calendar year.

Limitations on Certain Restrictions. The regulation limits the following payment card restrictions by issuers and payment card networks:

- Directly or indirectly restricting the number of networks on which an electronic debit transaction may be processed to fewer than two unaffiliated networks. This provision is generally effective April 1, 2012, with later effective dates for certain types of cards, as set forth in the final rule.
- Inhibiting the ability of any person accepting a debit card to direct the routing of electronic debit transactions through a particular network.

Reporting Requirements. Unless exempted (see below), issuers must file a report with the Board setting forth, among other things, data regarding the costs associated with debit card transactions, interchange transaction fees, network fees, fraud-prevention costs, and transaction value, volume and type. Records of such information must be retained for at least 5 years.

Exemptions. The following are generally exempt from Regulation II:

- Issuers that (i) hold the account that is being debited and (ii) together with affiliates, have assets of less than $10 Billion.
- Certain Federal, state and local government-administered programs.
- Certain reloadable prepaid cards.

Except as set forth above, these requirements are effective October 1, 2011.

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