

# **Understanding the Durbin Amendment**

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## Proposed Regulation II Debit Card Interchange Fees and Routing

- Establish standards for determining whether a debit card interchange fee is “reasonable and proportional” to the cost to authorize, clear, and settle the transaction.

## The Durbin Amendment

- Regulatory Timeline
- Interchange Regulation
  - Small Issuer Exemption and Impact
- Network Exclusivity and Merchant Routing
- Fraud Prevention
- Merchant Response

## Regulatory Timeline

- **Federal Reserve Board (FRB) meeting and proposal**
  - December 16, 2010
- **Comments on proposal due**
  - February 22, 2011
- **Final interchange fee rule due**
  - April 21, 2011
  - Federal Reserve Chairman Ben Bernanke reported to the House Financial Services Committee on March 29, 2011. The “extraordinary volume” of public comments (more than 11,000 comments have been submitted) coupled with the complexities raised, will make it impossible for the central bank to finish the rules by the deadlines set in the Dodd-Frank financial reform law.

## Regulatory Timeline

- **Effective date of interchange statutory provisions**
  - July 21, 2011
    - Issuers and payment card networks may have as little as three months to prepare and comply with the final interchange rule.
    - Effective dates of other provisions could vary.
    - The statute directs the FRB to issue rules regarding exclusivity and routing by July 21, 2011.

## Interchange Regulation

- Important Notes
  - These rates apply to both signature and PIN POS transactions.
  - There is no interchange differential between PIN and signature.
  - It is unclear how or if these proposed rules will affect ATM transactions.
  - Everyone here is exempt (technically)???

## Interchange Regulation

- Cost Components
  - Based on average variable costs for authorization, clearing, and settlement only.
  - Exclude network fees charged to issuers.
  - Exclude any coverage of fixed costs or other costs related to debit card program management.
  - Exclude any consideration of fraud-prevention costs
- Exemptions
  - An issuer, together with its affiliates, with assets of less than \$10 billion as of the end of the previous calendar year
  - Government-administered programs
  - Reloadable prepaid cards, not marketed as gift cards

## Interchange Regulation

### Alternative 1

- Each covered issuer would be permitted to determine its maximum allowable fee based on its average variable costs to process the transaction, with a safe harbor of \$0.07 per transaction.
- Covered issuers may receive more than \$0.07 per transaction up to a cap of \$0.12 per transaction if they can certify that their eligible costs per transaction are higher.

### Alternative 2

- Caps the fee at \$0.12 per transaction and applies to all covered issuers regardless of costs.

## Small Issuer Exemption and Impact

- Federal Reserve Chairman Ben Bernanke
  - It may not be the case that in practice they are exempt, but I don't know for sure, of course
- FDIC Chairman Shelia Bair
  - An exemption for institutions with less than \$10billion in assets won't work in the market
- Acting Comptroller of the Currency John Walsh
  - The proposal takes an unnecessarily narrow approach to the recovery of costs and has long-term safety and soundness consequences for banks of all sizes that are not required by statute

## Small Issuer Exemption and Impact

- **Independent Community Bankers of America (ICBA)**
  - A so-called “carve-out” from small issuers included in the law simply won’t work. Over time, not only will small issuers be drawn into the price controls called for in the rule, they will be disadvantaged relative to large issues. The Federal Reserve’s proposed rule, if implemented, will further industry consolidation and lead to higher fees and fewer choices for consumers.
- **American Bankers Association (ABA)**
  - The exemption for banks under \$10 billion is illusory and will not be a “safe harbor” for community banks.

## Small Issuer Exemption and Impact

- **Potential Impact**
  - Even though issuers with less than \$10 billion in assets are exempt from the interchange portion of Regulation II, the realities of market acceptance are that retailers may refuse a two-tier interchange rate structure.
  - This could negatively impact smaller community financial institutions.
  - The level of that impact is currently unknown and will be unknown until certain market factors are determined.

## Examples of Small Issuer Impact

Asset Size	Current Interchange	Interchange if Capped at \$0.12	Amount lost per month	Amount lost per year
50 Million	\$4,000	\$1,000	(\$3,000)	(\$36,000)
100 Million	\$10,000	\$3,200	(\$6,800)	(\$81,600)
150 Million	\$14,000	\$5,000	(\$9,000)	(\$108,000)
200 Million	\$18,000	\$6,300	(\$11,700)	(\$140,400)

## Network Exclusivity and Routing: Prohibition on Network Exclusivity

- **Alternative A**
  - Issuer must provide at least two unaffiliated networks
- **Alternative B**
  - Issuer must provide at least two unaffiliated networks for each type of authentication method it enables
- **Under Both**
  - Networks must be national broad-based networks
  - Prohibits limitations by rule, by requirement, by contract
  - Requirements on exclusivity and routing apply even if debit interchange exemption applies (small issuer, reloadable program, government programs)

## Network Exclusivity and Routing: Merchant Routing Control

- Merchant Makes Decision On Routing - But Only Among Networks Enabled By The Issuer
- Neither Issuers Nor Networks May Limit Routing In Any Way
- Neither Issuers Nor Networks May Inhibit Merchant From Blocking Authentication Altogether, e.g., By Signature

## Fraud Prevention

- The statute allows the FRB to issue a rule to allow an adjustment for an issuer's cost in "preventing fraud" in connection with electronic debit transactions.
  - The adjustment would require the issuer to comply with the FRB fraud-related standards.
- The FRB did not propose language to implement the statute's fraud-adjustment provision.
- The FRB is considering three issues in connection with developing a fraud-adjustment framework.
  - How the adjustment should be implemented.
  - What fraud-prevention costs should be included.
  - What fraud standards issuers should be required to comply with in order to receive a fraud adjustment.

# Fraud Prevention

## Alternative 1

- Technology-specific approach – The (FRB) would identify technologies that would reduce debit card fraud in a cost-effective manner. An adjustment would be set to reimburse the issuer for some or all of the costs associated with implementing the new technology, perhaps up to a cap.

# Fraud-Prevention Costs

## Alternative 2

- Non-prescriptive approach, meaning there would be a general standard that an issuer must meet to be eligible to receive an adjustment for fraud-prevention costs. Such a standard could require issuers to take steps reasonably necessary to maintain an effective fraud-prevention program, but not prescribe specific technologies that must be employed as part of the program. With this approach, an adjustment would be set to reimburse the issuer for some or all of the costs of its current fraud-prevention and data-security activities and research and development for new fraud-prevention techniques, perhaps up to a cap.

## Merchant Response

- Interchange
  - Alternative 1 (Safe Harbor with a Cap)
  - Should be much lower than \$0.12
- Network Exclusivity
  - Alternative B (2 networks per authorization method)
- Merchant Routing Control is Crucial
- Implementation
  - As soon as possible

## H.R. 1081, the Consumers Payment System Protection Act

- Delay Durbin for one year
- The Fed, FDIC, OCC and the NCUA would have eight months to conduct a study that would analyze all costs associated with debit transactions. It also, among other things, would examine the proposed Fed rule's effect on consumers, debit card issuers and merchants.
- The regulators then would provide Congress with an analysis of the results, and recommend whether the statute or the rule needed revision. A rewrite of the rule would be automatically triggered if two regulators reached any of the following conclusions:
  - The Durbin amendment or the proposed rule does not encompass all costs and investments associated with debit-card transactions;
  - Consumers will be adversely affected;
  - And the small-issuer exemption doesn't work.

## S.575, the Debit Interchange Fee Study Act of 2011

- Void the proposed rules and extend the deadline for implementing the Durbin Amendment for two years after the bill's enactment.
- Fed, FDIC, OCC and the NCUA to jointly submit a report to the Senate Banking Committee and the House of Financial Services Committee on the impact of regulating debit interchange transaction fees and related issues not later than one year after the bill's enactment.
- Examine the costs, such as anti-fraud efforts, data breach, financial liability and payment guarantees, and benefits of debit card transactions and alternative forms of payment for consumers, merchants, issuers and debit card networks. They must also look at whether it is possible to treat small debit card issuers differently.

# Questions?