



The Durbin Amendment Battle

DODD- FRANK

Section 1075

"The Durbin Amendment"

SEC. 1075. REASONABLE FEES AND RULES FOR PAYMENT CARD TRANSACTIONS.

(a) IN GENERAL.—The Electronic Fund Transfer Act (15 U.S.C. 1693 et seq.) is amended—

(1) by redesignating sections 920 and 921 as sections 921 and 922, respectively; and

(2) by inserting after section 919 the following:

"SEC. 920. REASONABLE FEES AND RULES FOR PAYMENT CARD TRANSACTIONS.

"(a) REASONABLE INTERCHANGE TRANSACTION FEES FOR ELECTRONIC DEBIT TRANSACTIONS.—

"(1) REGULATORY AUTHORITY OVER INTERCHANGE TRANSACTION FEES.—The Board may prescribe regulations, pursuant to section 553 of title 5, United States Code, regarding any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction, to implement this subsection (including related definitions), and to prevent circumvention or evasion of this subsection.

"(2) REASONABLE INTERCHANGE TRANSACTION FEES.—the amount of any interchange transaction fee that a consumer may receive or charge with respect to an elec

The Durbin Amendment Battleground

by
Glen P. Trudel
Connolly Bove Lodge & Hutz LLP



Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), better known as the “Durbin Amendment”, has engendered a battleground of controversy, pitting the forces of the consumer banking industry against the merchant/retail establishment in a time-sensitive conflict, as they struggle to wrest the political will of the U. S. Congress to reverse/delay, or to maintain, the current state and course of the new law and proposed regulation of debit interchange fees and routing requirements. To the victors will go the spoils—by all accounts multi-billion dollar revenues and costs savings. For some institutions and credit unions, this represents a “life-and-death” struggle for the survival of their fee-free debit card programs, and in some cases, their continued ability to offer debit card products at all, or other free or cost-subsidized checking and other deposit programs to their customers and members. Legislation has been proposed to provide time to seek a more generally-acceptable outcome, but at present time is running out, at least for the consumer banking industry.

The Federal Reserve's Response to the Durbin Amendment Requirements

The Durbin Amendment created a new Section 920 to the Electronic Fund Transfer Act ("EFTA"). Under this new law, interchange transaction fees that debit card issuers receive for electronic debit transactions must be "reasonable and proportional" to the issuer's costs relating to that transaction.

In response, the Board of Governors of the Federal Reserve System (the "Fed") published proposed rulemaking regarding debit interchange fees and routing requirements. The Fed's proposal would regulate what the "reasonable and proportional" standard would mean, at least for debit card issuers subject to the regulation. It also covers, or reserves decision on, other significant areas slated for regulation under Section 920 of the EFTA, such as: (i) preventing circumvention or evasion of interchange transaction fee restrictions; (ii) determining whether and how interchange transaction fees may be adjusted to reflect an issuer's fraud prevention costs; (iii) prohibiting issuers and payment card networks from imposing certain exclusivity restrictions on the number of networks on which a merchant might process an electronic debit transaction; and (iv) prohibiting issuers and networks from interfering with debit card-accepting merchants' ability to route those transactions over any network that can process transactions using that card.

The Fed is further required to establish interchange fee standards and rules regarding circumvention or evasion by April 21, 2011—a very short time frame. Interchange transaction fee rules must be made effective by July 21, 2011. While network exclusivity prohibitions and debit card transaction routing restriction prohibitions are due by July 21, 2011, there is no pre-mandated final effective date for such provisions.

The Fed proposed two alternatives for assessing whether interchange transaction fees are "reasonable and proportional" to the costs incurred by covered issuers. Pursuant to "Alternative 1", covered issuers may receive or charge interchange transaction fees at either (i) a safe harbor rate of \$0.07 per transaction, or (ii) based upon a calculation of certain total "allowable costs" divided by the number of electronic debit transactions for which the issuer received or charged an interchange fee that year, up to a cap of \$0.12 per transaction. The problem is, such "allowable costs" only cover certain variable costs attributable to receiving and processing requests for authorization, presentments and representments of electronic debit transactions; initiating, receiving and processing chargebacks, adjustments and similar transactions; and transmitting and receiving settlement funds and posting electronic debit transactions to the issuer's cardholders' accounts (all of which costs are defined in proposed commentary). Allowable costs do not include fees

such as those charged by payment card networks, or fraud prevention costs. "Alternative 2" imposes a straight \$0.12 per transaction rate --issuers who do not receive or charge interchange transaction fees above that rate would be deemed compliant with this interchange fee standard.

Issuers that, with their affiliates, have assets of less than \$10 billion would not be officially subject to the interchange fee restrictions. Nor would certain government program debit cards and certain reloadable general use prepaid cards be required to comply, under certain circumstances.

As noted above, fraud prevention costs are not presently included in the above-described calculations. The Fed has, for now, reserved proposing a specific adjustment to account for such issuer costs, but has suggested two different approaches for comment. The first approach focuses on implementation of specific technologies, which issuers would have to adopt in order to be eligible for the fraud costs adjustment, which would in turn defray implementation costs. The second approach does not require specific technologies, but instead would generally require an issuer to maintain an effective fraud-prevention program, and issuers would seek the cost adjustment in reimbursement for current fraud prevention activities, and for researching and developing new fraud prevention techniques. Either way, the Fed may still impose caps on the permissible amount of fraud adjustments.

In response to the Durbin Amendment requirement for rulemaking prohibiting network exclusivity, the Fed again proposed two alternatives. An issuer or network could not restrict the number of networks over which a debit transaction could be carried to less than two unaffiliated networks, under the first alternative. These two or more unaffiliated networks would be generally available for use for a debit card electronic transaction, regardless of whether the signature and/or PIN method was being employed for each such network. The second alternative proposed by the Fed would require at least two unaffiliated networks for each method of authorization a given debit card can support, so that issuers whose debit card product allows for signature and PIN would need to have two unaffiliated networks for each such authorization method.

The Battle is Joined - Reactions to the Proposed Rules

The public comment period for the Fed's proposal ended on February 22nd, but not before the Fed received nearly ten thousand comment letters (including some 8,336 letters determined by the Fed to be "form" letters). The comments came from individuals, credit unions, community banks, large institutions and trade groups, and they illustrate the ideological clash of the two sides of this debate, in their efforts to support

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or criticize several different concerns with the Fed's effort, and the likely effects of the proposed regulation (if finalized) on consumers, merchants and on small and large issuers of debit cards.

Some commenters opined that the rules are an ill-conceived and/or overly hasty attempt to artificially regulate rates and pricing, which until now have been governed by market forces. Others reject the concept of governmental price-fixing as antithetical to the appropriate functioning of a capitalist market system, or as a failed concept, or, more specifically to this industry, as an ill-advised or unnecessary intrusion by government into the marketplace. Alternatively, some commenters welcomed the rollback of what they considered unnecessarily high pricing imposed by a powerful, organized financial industry on small merchants, and still others questioned why debit card interchange, but not credit card interchange rates, should be targeted for federal regulation.

A further contested belief is that, notwithstanding that the debit interchange regulation provisions were touted as pro-consumer at the time of their passage, in fact consumers will be very unlikely to see real cost savings from the resulting shift of revenue from the relevant issuers to the merchants, who will benefit from the reduction in their interchange fees. Representatives of the retail industry disagree, citing the highly cost-competitive nature of their various industries as a compelling reason why such savings will be passed down to consumers.

Many institutions and banking industry proponents, especially credit union and smaller institutions, expressed their concern that issuers will have to look elsewhere to make up the revenue shortfalls that will occur if interchange rates are limited as contemplated, with many predicting the demise of free checking and other free transactional accounts, the advent of annual or monthly fees for debit card accounts or account usage fees, and/or the loss of other programs or benefits which at present are subsidized by interchange income. Also foreseen was that these additional or higher fees will result in the migration from the banking system of consumers who otherwise will become unbanked—a certainly unintended result for a regulation intended to be pro-consumer in its effects. Opponents of this view counter that the interchange fees have been rising at an accelerated pace in recent years, beyond the perceived real increase in costs to financial institutions for providing this service.

Another prime concern with the regulation focused on the consideration that while the proposed rule exempts issuers with consolidated assets of less than \$10 billion, there is no

guarantee that this freedom from the pricing restrictions will be sustainable in the marketplace. Many commenters argue that smaller issues may have to accept the seriously reduced debit interchange fees to remain in the business, even assuming the major payment networks are willing to establish dual systems for debit card interchange. Their concern is heightened by the proposed rules permitting merchants to select upon which network of those available for a given transaction it will route the transaction—presumably, merchants will seek to route to the network with the lowest costs to the merchant, of which interchange fees are a part.

On the topic of “allowable costs” and their calculation, there was strong support among the credit unions and banks for inclusion of all costs of issuers in the calculation (including in particular, fraud costs), not just the subset of costs included in the proposed regulation. Others argued that “reasonable and proportional” standard should be interpreted to include a reasonable profit for issuers, and not just a direct, limited costs analysis.

New Fronts in the Battle.

Proposed legislation has been introduced in both the United States Senate (S. 575—the Debit Interchange Fee Study Act of 2011) and the House of Representatives (H.R. 1081—the Consumers Payment System Protection Act), which reflect a shifting stage of the battle to preserve vs. delay or repeal, the Durbin Amendment and the Fed's proposed regulation.

The Senate bill would require the withdrawal of the current Fed proposal, and delay the effectiveness and mandated effective dates for the Durbin Amendment generally by two years from the enactment of such legislation. It would further require that a twelve month comprehensive study and report to Congress be undertaken by the Fed, OCC, FDIC and NCUA. The study would cover a wide range of topics directly relating to the impact of regulating debit interchange transaction fees, essentially seeking to analyze and determine the validity of the various main positions advanced by each side of this controversy.

The House bill imposes a one year period for the commencement of effectiveness of any final rule issued pursuant to authority granted under the Durbin Amendment. It also calls for the conduct of a survey of a “cross section of all market participants”, as part of an eight-month regulators' study of many areas similar to those contemplated by the Senate bill. It further mandates that the Fed will thereafter have four months to make changes to its proposed or final rule if at least two of: (i) the Fed's Board of Governors, (ii) the Chairperson of the FDIC, (iii) the Chairperson of the NCUA, and (iv) the Comptroller of the Currency determine in the report that any one of the following are true:

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- (a) the new section 920 of the EFTA or the Fed's proposed rule does not encompass all costs and investments associated with debit card transactions;
- (b) Consumers will be adversely affected by either such section or the proposed rule; or
- (c) The exemption for small financial institutions (i.e., less than \$10 billion in assets) as provided in the Durbin Amendment, or as carried out by the proposed rule, is not effective in practice.

Given the pronouncements and concerns already voiced publicly by certain federal regulators regarding this topic, the requisite findings would, at least at present, seem likely to be arrived at by those regulators.

One thing is certain—neither side of this issue is surrendering without a major fight to the finish. As currently enacted, the Durbin Amendment tilts the field in favor of those who wish the Fed's rules to take effect along currently mandated timelines (such as merchants), and at least for now, time is on their side—this is especially true considering that affected debit card issuers should already be contemplating how their debit and other related programs will need to change to reflect the potential new realities in the marketplace that could be here in just a few short months.



Glen P. Trudel is a Partner in Connolly Bove Lodge & Hutz LLP's Business Law Group. He represents clients in areas such as financial institution product, operations and corporate regulation, commercial and consumer secured and unsecured lending transactions, payments systems, general corporate/alternative entity creation, counseling and governance, and in a wide variety of business finance and other transactions. Prior to joining the firm, Glen was a Senior Vice President and Counsel with MBNA America Bank, N.A. (now part of Bank of America). Over his 14 years with MBNA, Glen advised on an extensive variety of credit card/unsecured lending, deposit and other bank regulatory matters, and represented the bank in the negotiation, structuring, creation and administration of joint marketing, affinity/co-brand and enhancement agreements and account portfolio acquisitions. He advised on regulatory and operational matters attendant to the international expansion efforts of MBNA for several years. Prior to joining MBNA, Glen was an associate with another Delaware firm for over four years, during which he provided advice, drafting and counsel in connection with financial institution regulatory matters, alternative entity and corporate formation and opinion matters, and commercial lending and other commercial transactions.

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