

## ALERTS AND UPDATES

### U.S. Financial Reform: Consumer Financial Protection Act of 2010 Institutes First Federal Regulation of Debit Card Interchange Fees

August 24, 2010

The [Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010](#) ("the Act") begins sweeping reform for the U.S. financial system. It requires new and existing regulatory agencies to undertake more than 50 studies of the financial system and more than 250 instances of rulemaking. Duane Morris has issued further Alerts on many of the broad topics addressed by the Act, accessible at [www.duanemorris.com/FinancialReform](http://www.duanemorris.com/FinancialReform).

Section 1075 of Title X of the Act, is also known as the "Durbin amendment." With the Durbin amendment, Congress has instituted the first federal regulation of interchange fees (*i.e.*, fees charged by a cardholder's, or "issuing," bank to a merchant's, or "acquiring," bank) on debit card purchases. This part of the Act, which will become part of the existing Electronic Fund Transfer Act (EFTA), also represents the first direct federal regulation of agreements between merchants and payment card networks.

While the fee limits of the Durbin amendment apply only to debit cards, and not to credit cards, the new law is also aimed at indirectly regulating credit card interchange fees. By limiting interchange fees on debit card purchases (and, in turn, the amount of the merchant discount retained by banks) to rates that are "reasonable and proportional" to the actual costs incurred by issuing banks as well as restricting limits on merchants from providing discounts for cash, check or debit payments or imposing minimum amounts for purchase by credit card, the law is likely to encourage merchants to provide incentives to customers to use lower-cost payment methods. The full impact of the Durbin amendment is unlikely to be observed until the Board of Governors of the Federal Reserve System ("Board") promulgates regulations detailing the loosely outlined "reasonable and proportional" standard and other contemplated rules in the Act.

#### Limitations on Interchange Fees for Debit Card Issuers

Under the new law, interchange fees for purchases made by debit cards ("electronic debit transactions") are required to be "reasonable and proportional to the cost incurred by the issuer with respect to the transaction." The Board – the federal agency with jurisdiction under EFTA – is directed, within nine months of the enactment of the Act, to establish regulations setting forth the "reasonable and proportional" standard. In developing such standard, the law directs the Board to: (1) consider the extent to which electronic debit transactions are comparable with checking transactions that are required to clear without fees; (2) distinguish between actual costs incurred by a debit card issuer for a particular transaction and other costs incurred by the issuer not specific to a transaction; and (3) consult with other regulatory agencies.

Currently, many interchange fee agreements provide for higher fee rates on "card not present" (CNP) transactions, *i.e.*, electronic transactions where the magnetic card strip is not read, due to higher operational costs associated with handling fraud disputes on such transactions. The Act appears to allow the possibility of such rate differences for CNP transactions to continue, but that is likely to depend on the final rules promulgated by the Board. The Act provides that the Board "may allow for an adjustment" to an interchange fee rate if the issuer (1) can demonstrate such adjustment is reasonably necessary to cover costs incurred by the issuer in preventing fraud in electronic debit transactions, and (2) complies with certain fraud-reduction standards to be established by the Board.<sup>1</sup> Such fraud-reduction standards must "be designed to ensure that any

fraud-related adjustment of the issuer is limited to" actual costs incurred by the issuer and take into account any fraud-related reimbursements received by the issuer from consumers, merchants or payment card networks. In addition, the fraud-reduction standards must "require issuers to take effective steps" to reduce the occurrence of fraud in electronic debit transactions, including the development and implementation of cost-effective fraud technology.

The Act also grants the Board the power to obtain information from issuers and payment card networks regarding their costs incurred in processing electronic debit transactions and interchange fees received on such transactions in connection with the Board's promulgation and enforcement of the interchange fee standards. The Board is further directed to disclose a summary of such information to the public on a biannual basis.

In addition to the regulation of interchange fees, the law provides the Board with broad authority to regulate "network fees" (defined as "any fee charged and received by a payment card network"<sup>2</sup> in connection with an electronic debit transaction) to prevent such fees from being used as indirect compensation to an issuer for electronic debit transactions. This portion of the Act appears to grant the Board limited authority to regulate fees charged by credit card networks or other payment networks to prohibit indirect compensation for electronic debit transactions – although the effect of such grant will not be known until the Board promulgates the required regulations.

The Act exempts "small issuers" of debit cards (defined as an issuer that, together with its affiliates, has assets of less than \$10 billion). This provision was designed to exempt credit unions and community banks. Debit cards issued by government-administered payment programs and reloadable prepaid gift cards are also exempt, although the exemption will expire after a year for the latter if such prepaid cards impose overdraft fees or ATM withdrawal fees on consumers who use them.

### **Restrictions on "Exclusivity Arrangements," Prohibitions on Discriminating Between Payment Types, and Authorization of Minimum Charge Limits**

The second part of the Durbin amendment regulates agreements between payment card networks and merchants. Such agreements often impose a number of conditions on debit card and credit card transactions, including placing restrictions on which payment networks may be used; prohibiting merchants from offering discounts for cash or check payments; requiring merchants to accept all cards from a particular network (which may include cards with higher interchange fees); and prohibiting merchants from imposing "minimum purchase" amounts. The Act prohibits "exclusivity arrangements" with respect to debit cards, providing that a payment card network may not directly or indirectly: (1) restrict the number of payment card networks on which a electronic debit transaction may be processed, or (2) restrict merchants from routing electronic debit transactions over any payment card network that may process the transaction. This limitation is intended to allow merchants to select which financial routing method to use for electronic debit transactions (*e.g.*, Cirrus, NYCE, Interlink) based on cost.

Perhaps more significantly, the Act restricts payment card networks from prohibiting merchants from offering discounts or other incentives for payment by cash, check or debit card. Payment card networks typically prohibit merchants from imposing surcharges on consumers for the use of credit cards or cards with higher interchange fees, such as rewards cards.<sup>3</sup> In addition, 10 states have laws prohibiting such surcharges,<sup>4</sup> although a majority of those states do authorize discounts for cash, check or debit purchases as long as they are offered to all consumers.<sup>5</sup> The Durbin amendment provides that merchant discounts must comply with these state laws requiring equal availability of discounts to all customers. For the three states that prohibit surcharges but do not permit such discounts – Connecticut, New York and Texas – because such

state laws are inconsistent with the new requirements set forth in the Act, pursuant to existing section 919 of EFTA,<sup>6</sup> they likely will be found to be preempted by the Act.

In addition to authorizing discounts by merchants for purchases by cash, check or debit card, the Act also restricts payment card networks from prohibiting merchants from imposing minimum dollar amounts for credit card purchases. Such minimum dollar requirements may not exceed \$10; however, the Board may increase such amount by regulation.

Finally, the Act provides that enforcement of the new regulations will be pursuant to the administrative enforcement provisions of EFTA (section 917), rather than the criminal or civil enforcement provisions (sections 915 and 916). Thus, enforcement of the new regulations will be handled solely by the various federal agencies – including the Board – that oversee financial institutions, and not through private lawsuits or criminal actions by the U.S. Department of Justice.

## About Duane Morris

Duane Morris has an online **Financial Services Reform Center** – [www.duanemorris.com/FinancialReform](http://www.duanemorris.com/FinancialReform) – which includes videos and the firm's comprehensive series of *Alerts* analyzing the provisions of the Act and emerging policies, as well as links to relevant government websites. Duane Morris' attorneys will be monitoring the rules and regulations released under the Act, as well as the regulatory agencies' interpretive guidance. For [subsequent Alerts](#) on these and other topics, please revisit [www.duanemorris.com](http://www.duanemorris.com) and [www.duanemorris.com/FinancialReform](http://www.duanemorris.com/FinancialReform).

## For Further Information

If you have any questions about the Act or any of the topics described in this *Alert*, including how they may affect your company or its executives, please contact [A. Bruce Bowden](#), [Katherine Nichols](#), any [member](#) of the [Corporate Practice Group](#) or the attorney in the firm with whom you are most regularly in contact.

*As required by United States Treasury Regulations, you should be aware that this communication is not intended by the sender to be used, and it cannot be used, for the purpose of avoiding penalties under United States federal tax laws.*

## Notes

1. Specifically, the Act directs the Board to consider, in prescribing regulations pursuant to the Act, "the nature, type and occurrence of fraud in electronic debit transactions" and "the extent to which the occurrence of fraud depends on whether authorization" in such transactions "is based on signature, PIN or other means."
2. A "payment card network" is defined as "an entity that directly, or through licensed members, processors, or agents, provides the proprietary services, infrastructure, and software that route information and data to conduct debit card or credit card transaction authorization, clearance, and settlement, and that a person uses in order to accept as a form of payment a brand of debit card, credit card or other device that may be used to carry out debit or credit transactions." H.R. 4174, 111th Cong. §1075(c)(11).
3. U.S. Gen. Accounting Office, Report to Congressional Addressees, Credit Cards: Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges 38, GAO-10-45 (2009).
4. Those states are: California (Cal. Civ. Code § 1748.1(a)); Colorado (Colo. Rev. Stat. § 5-2-212(1)); Connecticut (Conn. Gen. Stat. Ann. §42-133ff(a)); Florida (Fla. Stat. Ann. § 501.0117(i)); Kansas (Kan. Stat. § 16a-2-403); Maine (Maine Rev. Stat. Ann. tit. 9-A § 8-303(2)); Massachusetts (Mass. Gen. Laws Ann. ch. 140D, § 28A(a)(2));

New York (N.Y. Gen. Bus. Law § 518); Oklahoma (Okla. Stat. Ann. tit. 14A §§ 2-211, -417); and Texas (Tex. Fin. Code Ann. § 339.001(a)).

5. See Cal. Civ. Code § 1748.1(a); Colo. Rev. Stat. § 5-2-212(2)); Fla. Stat. Ann. § 501.0117(i); Kan. Op. Atty. Gen. 86-115 (1986); Maine Rev. Stat. Ann. tit. 9-A § 8-303(3); Mass. Gen. Laws Ann. ch. 140D, § 28A(b); and Okla. Stat. Ann. tit. 14A §§ 1-301(7), (9), (19).
6. Section 919 provides that EFTA "annul[s], alter[s] and affect[s]" state law relating to electronic fund transfers, "to the extent that those laws are inconsistent with the provisions of" the Act. The Board is authorized to determine whether a state law is preempted, on its own motion or upon request by any financial institution, state or other interested party. 15 U.S.C. § 1693q; 12 C.F.R. § 205.12(b).