

May 21, 2010

Interchange Fee Regulation Included in Wall Street Reform Bill Passed by Senate

On May 20, 2010, the Senate approved (59-39) the Restoring American Financial Stability Act of 2010 (the "Wall Street Reform Bill," or the "Bill"), containing significant reforms to the financial system and including Senator Dick Durbin's (D-IL) Amendment 3989 (the "Amendment"). The Amendment sets forth two key areas of debit and credit card regulation that are relevant to merchant processors and card issuers.

First, the Amendment both grants authority to and mandates the Federal Reserve to set debit interchange rates that are "reasonable and proportionate" to the actual processing costs within nine months after passage of the Consumer Financial Protection Act of 2010 (which is part of the Wall Street Reform Bill). Interchange rates are percentage-based fees charged to merchants for the acceptance of payment cards and are paid to card issuers to cover processing and payment settlement costs. In setting these rates, the Federal Reserve is to consider the actual cost of authorization and settlement of debit transactions but is not to consider the other processing costs (for example, card network registration, back office processing costs, or data security compliance) that are not associated with a particular debit transaction.

Second, the Amendment prohibits a card processor from inhibiting the merchant's authority to (1) discount purchases associated with particular card networks, (2) discount purchases made among different payment forms (for example, a discount for paying cash rather than with a credit card), and (3) establish minimum and maximum purchase requirements for credit or debit card transactions.

Conspicuously absent from the Bill is Senator Tom Harkin's (D-Iowa) proposal to limit the ATM surcharge fees charged to consumers to 50 cents per transaction. Prior to a final vote on Senator Harkin's proposed amendment, the Senate voted 60-40 late yesterday afternoon to discontinue further debate or amendments to the Bill.

Notably, debit card issuers that have assets below \$10 billion are exempted from the debit interchange rate regulation. Industry experts suggest that debit cards issued by exempted community banks will become among the most expensive payment forms for merchants to accept. Credit union associations, which had been in favor of the Wall Street Reform Bill prior to the Amendment, are now generally opposed to the Bill, based in part on concerns over downward pricing pressure resulting from regulation of interchange rates at larger financial institutions.

Retailers generally are in favor of the Amendment, likening debit cards to the functional equivalent of paper checks that carry no processing fees. They reason that because the debit card holder's payment clears immediately from his or her bank account, card issuers do not need to charge a substantial debit interchange fee to offset the card issuer's risk of non-payment from the card holder.

By contrast, card issuers generally opposed the Amendment, believing that they cannot make up the revenue on reduced interchange fees because the debit card holder currently pays no fees for most debit transactions. In addition, even if debit interchange fees were reduced, payment processors often

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negotiate discount rates with merchants that would not require the payment processor to pass-through the entire reduction in debit interchange fees to merchants.

Payment networks Visa and MasterCard also denounced the Amendment as largely anti-consumer and asserted that the Amendment will have negative unintended consequences, such as consumers being penalized for choosing particular payment cards, and merchants realizing reduced debit interchange fees but not passing on the savings to consumers. In the future, debit card issuers may have to charge additional debit card fees to consumers to offset the reduced revenue from merchants.

The House and Senate conference committee meet to reconcile the House version (passed by the House in December of last year) and Senate version of the Bill. Lobbying by financial industry groups can be expected to continue while the two versions are reconciled. It is unknown whether the Amendment will remain in the final, bicameral version of the Bill, however some industry experts have noted that Representative Barney Frank (D-MA, Chairman of the House Financial Services Committee) has opposed interchange regulation in the past and may do so again. If the Amendment remains in the final version of the Bill, it could set the stage for additional regulation of card processing and interchange in the future.



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