

Federal Reserve Releases Proposed Regulations Implementing Durbin Amendment

December 16, 2010

On December 16, 2010, the Board of Governors of the Federal Reserve released proposed regulations implementing the Durbin Amendment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The proposed regulations were proposed at a Board meeting, which was simultaneously webcast through the Federal Reserve Web site.

The Durbin Amendment provides that interchange rates for electronic debit transactions must be “reasonable and proportionate” to the actual processing costs incurred by the issuer, taking into account only the incremental costs of authorizing, clearing and settling electronic debit transactions, but not other costs incurred by an issuer that are not specific to a particular debit transaction. In addition, the Durbin Amendment prohibits “network exclusivity” for debit payments, so that merchants can utilize at least two networks to route debit payments.

With regard to the reasonableness and proportionality requirement for debit interchange fees, the staff has proposed two alternative rules. Under the first alternative, interchange fees would be set separately for each issuer according to its own incremental¹ clearing, authorization and settlement costs. Interchange fees under such an arrangement would be capped at 12 cents per transaction, with a safe harbor for fees set at 7 cents per transaction (the median cost per transaction for the issuers that the staff surveyed prior to proposing this rule). Under the second alternative, interchange fees would be capped at 12 cents per transaction for all issuers. The Board is soliciting comment from the public relating to both alternatives. Neither alternative would allow an issuer to recoup fixed or overhead costs relating to debit transactions, nor would it allow an issuer to recoup costs associated with reward programs or cardholder transaction inquiries.

The proposed interchange fee limitations do not currently reflect allowances for fraud, but the staff has proposed two alternatives with regard to fraud costs. First, an issuer may recover costs incurred with expenditures relating to industry-wide fraud losses. Second, an issuer may recoup costs for steps it takes toward implementing fraud prevention programs. Neither alternative specifies the types of fraud-prevention processes or technology that would qualify.

Under the network exclusivity and routing portion of the Durbin Amendment, the staff has proposed two alternatives. The first alternative provides that merchants have a choice of two unaffiliated networks available for debit transactions (e.g., Visa and MasterCard). These unaffiliated networks would consist of one network to route signature-based debit transactions and an unaffiliated network to route PIN-based debit transactions. The staff, however, considered that most merchants do not currently have PIN debit capability and rely exclusively on signature-based debit transactions, creating logistical difficulties relating to implementing this approach. The second alternative would require that a merchant has the choice of two unaffiliated networks for signature-based transactions and two unaffiliated networks for PIN-based

¹ Incremental costs are proposed by the staff as a calculation of average variable cost per transaction from a cost accounting perspective. The staff has proposed this approach in lieu of using a marginal cost of transaction approach, for simplicity of calculation and accounting.

transactions. This alternative would entail significant operational changes by issuers, networks, payment processors and merchants.

Open questions from the Board included discussion of whether a monetary cap per debit transaction is an appropriate means of regulating the industry, whether market forces would be sufficient to limit costs, and how the cap and safe harbor was determined. The Board will issue the proposed regulations for further comment by the public.

The proposed regulations are available at the following link:
<http://www.federalreserve.gov/newsevents/press/bcreg/20101216a.htm>.



If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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