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**Update Regarding “Swipe Fee” Regulations**

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In an article published last month (attached), we examined the details of the Dodd-Frank Wall Street Reform Act and related proposed regulations limiting the amount banks can charge for swipe fees on debit card transactions. Since the drafting of the article, the Federal Reserve published its final regulations, which differ in some respects from the proposed regulations published in December, 2010, and upon which the article focused. The final regulations take into account the over 11,000 comments received by the Fed regarding the proposed regulations, and also add additional proposed regulations on related issues. Specifically:

- The final regulations raised the minimum swipe fee charge from \$.12 per transaction to \$.21 per transaction with an *ad valorem* component of 5 basis points per transactions to reflect the issuer’s portion of fraud losses. This is still much less than the pre-regulation average of 1.14% to 1.53%. Rather than taking effect on July 21, 2011, these regulations will become effective on October 1, 2011.
- Interim final regulations were issued for public comment and would allow for a fraud prevention adjustment of the debit interchange cap of \$.01 per transaction provided that the issuer meets general fraud prevention standards. These interim regulations are also set to take effect on October 1, 2011.

*For more information, please contact the author, or any member of our Action Sports group.*

## Retailers to Catch a Break With New “Swipe Fee” Regulations



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Last spring, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act, one of the most comprehensive restructurings of the country's financial regulations since the Great Depression. The Act was passed in response to the financial crisis that erupted in early 2008, and is a comprehensive series of laws that touch virtually every aspect of the financial sector.

Perhaps the biggest impact the Act will have on retailers is the portion known as the Durbin Amendment. This amendment targets interchange fees, or “swipe fees,” for retail transactions made with debit cards. Interchange fees are the fees that the issuer of a customer's debit card charges for purchases made with the card. Interchange fees vary from bank to bank and the type of debit card used. For instance, fees charged for signature rewards cards are usually higher than those charged for non-rewards cards. The amendment does not apply to interchange fees for credit card transactions.

An example of how these interchange fees impact retailers would be if a customer purchased \$100 worth of goods using her Bank X debit card. In that transaction, Bank X would deduct the interchange fee (currently averaging 1.14% on all debit transactions and 1.53% for signature debit transactions) from the amount it pays to the retailer's merchant account provider (other fees are paid to the operator of the electronic-payment network, usually Visa or Master Card, and a smaller fee is collected by the retailer's merchant account provider). So on that \$100 debit card purchase, the retailer could receive as little as \$97.50.

The Durbin Amendment requires the Board of Governors of the Federal Reserve System to prescribe regulations to ensure that the interchange fees charged for debit card transactions are reasonable and proportional to the cost incurred by the issuing banks with respect to the transaction. The Fed responded to its charge on December 16, 2010, with proposed regulations that would cap the transaction fees at 12 cents per transaction. This is a reduction of almost 75 percent from the current average, which the Fed found to be 44 cents per transaction.

The proposed regulations provide an exemption from the 12 cent interchange fee limit to banks with less than \$10 billion in assets. These will generally be community banks and small credit unions. However, these smaller institutions have argued that retailers will discriminate against their higher-fee cards, which will force the smaller banks to charge the same, lower fee as large banks. Fed Chairman Ben Bernanke acknowledged that possibility, and testified before Congress that “it's possible merchants will reject cards from smaller banks.” But the amendment's namesake, Illinois Senator Dick Durbin, said that retail merchants would not discriminate between these two levels – “The credit card company rules are very strong on this. They cannot discriminate against credit cards, plus it would cost them business to do so.”

The proposed regulations also prohibit issuers of debit cards and payment card networks (e.g. Visa or Master Card) from inhibiting the ability of merchants to set minimum purchase amounts for credit card transactions not exceeding \$10. Further, while merchants are not permitted to add a surcharge to credit card transactions, the proposed regulations do prohibit issuers of debit cards and payment card networks from restraining the ability of merchants to offer an in-kind incentive for payment by debit cards. (Federal and State law usually require that such in-kind incentive payments be offered to all prospective customers and that they be displayed clearly and conspicuously.)

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The Durbin Amendment required the Fed to issue its final regulations by April 21, 2011. However, after receiving more than 11,000 comment letters, Fed Chairman Ben Bernanke said in a letter to leaders of the House Financial Services and the Senate Banking committees that Fed staffers need more time to review and consider issues raised by those letters before they can finish the rule-making process. Bernanke also said the Fed is committed to having regulations in place before July 21, when the debit-interchange-cap law takes effect.\*

An interesting side-note, a federal judge in South Dakota recently denied the U.S. government’s request to throw out a case filed by TCF National Bank challenging the constitutionality of the Durbin Amendment and the Fed’s proposed regulations. The bank in that case claimed that the proposed regulations would cost it \$6 million per month. The judge also denied the bank’s request to block the regulations, which allows the case to go forward while Congress debates the issue.

### So what does all of this mean for retailers?

Assuming the Fed’s final regulations are not materially different from the proposed regulations, retailers can expect more money in their pockets from debit card transactions. It was Congress’s desire that this money would be passed on to customers in the form of lower prices, but retailers are under no obligation to do so.

Moreover, retailers now have the freedom to set a minimum purchase price of up to \$10 for credit card transactions, and can offer in-kind incentives for payments with debit cards without worrying about being penalized by the banks issuing the cards or by Visa or Master Card. Both of these options should allow retailers to protect against the higher interchange fees on credit cards versus debit cards.

However, retailers should be careful not to discriminate between debit cards subject to the 12 cent limitation on interchange fees and those that are exempt (those issued by community banks and small credit unions), even though these exempt debit cards will likely be processed with much higher interchange fees, which means less money to the retailer per transaction.

*\* On June 8, 2011, the Senate voted against an amendment that would have delayed the implementation of the Fed’s regulations in order to allow further study of the potential implications of those regulations. Barring some extraordinary circumstance, there is nothing in the way of the Fed’s final regulations taking effect on July 21, 2011.*

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