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Debit Card Interchange Fees and Routing; Final Rule

exemption would not be effective in practice.<sup>146</sup> Many issuer commenters stated that they did not believe that payment card networks would implement two-tier fee structures (*i.e.*, different fee structures for covered issuers and exempt issuers). Other issuer commenters stated that although networks may attempt to implement two-tier fee structures, market forces and merchant routing choice will erode the differences between the two fee structures until there is only one interchange fee that all issuers may charge or very little variation between the two fees. Some of these commenters expressed concern that if small issuers were required to accept the same interchange fees as covered issuers, small issuers' debit card programs might not be sustainable and that these issuers could be forced to severely limit or abolish these programs.

Many issuer commenters also requested that the Board mandate that payment card networks implement two-tier fee structures. Several issuer commenters stated that even if payment card networks were to institute two-tier fee structures, they believe merchants would pressure customers or steer customers through discounts to use another form of payment or refuse exempt cards or cards issued by exempt issuers.

By contrast, merchant commenters also noted that they believe networks have an incentive to institute two-tier fee structures to attract and retain the business of exempt issuers and issuers of exempt products. In addition, merchant commenters, some consumer group commenters, and a member of Congress stated that they do not believe merchants would risk alienating customers by refusing to accept certain cards or discriminating against the use of certain cards through, for example, the use of differential pricing.

The Board's final rule provides exemptions from the interchange fee standards in accordance with EFTA Sections 920(a)(6) and (7). The EFTA does not provide the Board with specific authority to require networks to implement these exemptions in any particular way. The Board notes, however, that payment card networks that collectively process more than 80 percent of debit card volume have indicated that they plan to implement two-tier fee structures.

<sup>146</sup> Although these comments focused on the effectiveness of the small issuer exemption, the other exemptions (*i.e.*, debit cards issued pursuant to certain government payment programs and certain general-use prepaid cards) raise similar concerns.

The Board is taking several steps, including using the data collection authority provided in EFTA Section 920(a)(3)(B), to allow the Board to monitor and report to Congress on the effectiveness of the exemption for small issuers. First, the Board plans to publish annually lists of institutions above and below the small issuer exemption asset threshold to assist payment card networks in determining which of the issuers participating in their networks are subject to the rule's interchange fee standards.<sup>147</sup> Second, the Board plans to survey payment card networks annually and publish annually a list of the average interchange fees each network provides to its covered issuers and to its exempt issuers. This list should enable issuers, including small issuers, and Congress to more readily understand whether the provisions of EFTA Section 920 and the implementing rule, including the small issuer exemption, are having a meaningful effect.

With respect to comments on discrimination by merchants, Section 920(b)(2) prohibits payment card networks from inhibiting the ability of any person to provide a discount or in-kind incentive for payment by the use of debit cards to the extent that the discount or in-kind incentive does not differentiate on the basis of the issuer or the payment card network. Section 920(b)(4)(A) further provides that no provision of Section 920(b) shall be construed to authorize any person to discriminate between debit cards within a payment card network on the basis of the issuer of the debit card.

Moreover, the Board understands that many payment card networks have rules that require merchants to accept all cards of that payment product type within that network, regardless of issuer. Merchants also would likely face negative consequences by refusing to accept a particular issuer's debit card. Unlike credit cards, where customers may have cards from more than one issuer, customers are more likely to have only one debit card. A merchant refusing a customer's particular debit card could cause the customer to use a credit card, a potentially more expensive form of payment for the merchant. Alternatively, the merchant may lose the sale if the customer does not have enough cash or another payment method that would be acceptable to the merchant.

The Board also received several other comments on this exemption. Some issuer commenters and a financial regulatory agency urged the Board to

<sup>147</sup> The lists will be posted on the Board's public Web site.

extend the exemption for small issuers to the network exclusivity and routing provisions of § 235.7. Although EFTA Section 920(a)(6) provides that small issuers are exempt from the provisions of EFTA Section 920(a) concerning the interchange fee standards, the statute does not extend the exemption to the network exclusivity and routing provisions of EFTA Section 920(b). Some commenters urged the Board to use the exception authority under EFTA Section 904(c) to extend the exemption. The Dodd Frank Act removes this authority from the Board as of July 21, 2011, however.

A payment card network suggested that in assessing whether an issuer qualifies for the exemption in § 235.5(a), only U.S. assets should be considered. EFTA Section 920(a)(6) does not specify that the exemption should be based on U.S. assets only and nothing in the purpose or structure of EFTA Section 920 or in practical operation indicates that the provision should not apply to issuers with large foreign operations that also operate in the U.S. Indeed, applying the statute to apply to worldwide assets would be consistent with the principle of national treatment of foreign firms operating in the U.S. Therefore, the Board believes that this measurement should be based on worldwide assets.

The final rule also clarifies whether trust assets should be considered in determining whether an issuer's assets fall below the \$10 billion exemption threshold. Trust assets under management are not considered assets of the issuer or its affiliates, and are not reflected on the issuer's or affiliate's balance sheet. Therefore, comment 5(a)-1 states that an issuer qualifies for the small issuer exemption if its total worldwide banking and nonbanking assets, including assets of affiliates, other than trust assets under management, are less than \$10 billion.

In the supplementary information to its proposed rule, the Board noted that to the extent payment card networks plan to permit issuers meeting the small issuer exemption to receive higher interchange fees than allowed under §§ 235.3 and 235.4, such networks should establish a process to identify small issuers and to provide information to acquirers and merchant processors to enable them to determine what interchange fee applies to each issuer. The Board requested comment on whether the rule should establish a certification process and reporting period for an issuer to notify a payment card network and other parties that the issuer qualifies for the small issuer exemption.

net compensation to the issuer. In the example, an issuer receives an additional incentive payment from the network as a result of increased debit card transaction volume over the network during a particular calendar year. During the same period, however, the total network fees the issuer pays to the payment card network with respect to electronic debit transactions also increase so that the total amount of fees paid by the issuer to the network continues to exceed the total amount of incentive payments received by the issuer from the network during that calendar year. Under these circumstances, the issuer does not receive net compensation from the network for electronic debit transactions. *See* comment 6(b)–4.i.

A few large issuers and a payment card network commented that the prohibition against circumventing or evading the interchange transaction fee standards should apply only to contractual arrangements between a payment card network and an issuer that are entered into on or after the date of enactment of the Dodd-Frank Act, July 21, 2010. The Board does not believe that such arrangements should be grandfathered, but the date on which such arrangements are entered into would be included in the facts and circumstances analysis for circumvention or evasion. Such arrangements would, however, be subject to the prohibition against net compensation.

#### *D. Additional Uses of Circumvention or Evasion Authority*

As discussed above under § 235.5, trade associations representing small issuers, including credit unions, and one federal banking agency urged the Board to use its circumvention or evasion authority to ensure that the small issuer exemption in EFTA Section 920(a)(6) from the interchange transaction fee standards is given effect by the networks. In particular, these commenters were concerned that absent an express requirement on networks to adopt higher tiers of interchange fees for exempt issuers, such issuers would experience a significant reduction in interchange fee revenue, notwithstanding the exemption.

The Board notes that Section 920(a) imposes restrictions on the interchange fees that issuers may charge or receive and requires the Board to set standards regarding those fees—it does not confer authority on the Board to regulate the activities of networks (other than regarding the use of network fees to compensate issuers or to circumvent the interchange fee standards) or to require

merchants to pay any particular level of fees. Moreover, although the statute provides an exemption from the interchange transaction fee standards for issuers with less than \$10 billion in consolidated assets, the statute neither imposes an affirmative duty on networks to implement different interchange transaction fee rates for covered and non-covered issuers, nor requires merchants to pay a particular level of interchange fee revenue that may be collected by an exempt issuer. Thus, the Board does not believe that the circumvention or evasion authority confers authority on the Board to require networks to take specific actions to implement the small issuer exception (which do not involve the use of network fees) or merchants to pay higher interchange fees to small issuers.

As discussed above, however, the final rule relies on specific authority granted in Section 920(a)(3)(B) to collect and publish information from issuers and networks to separately require networks to report to the Board the interchange revenue and related debit card volumes for exempt and covered issuers. The Board intends to publish on an annual basis the average interchange revenue received by covered and exempt issuers by network. The Board anticipates that greater transparency regarding network interchange policies will facilitate issuers' ability to more easily choose the networks that best serve their individual requirements, including the level of interchange transaction fees that apply to issuers on the network.

#### **VI. Section 235.7 Limitations on Payment Card Restrictions**

EFTA Section 920(b)(1) directs the Board to prescribe regulations with respect to two limitations set out in the statute regarding transaction processing. First, the Board must prescribe regulations prohibiting an issuer or payment card network from restricting the number of payment card networks on which an electronic debit transaction may be processed to fewer than two unaffiliated networks (network exclusivity restrictions).<sup>157</sup> Second, the Board must prescribe regulations that prohibit an issuer or payment card network from directly or indirectly inhibiting any person that accepts debit cards for payment from directing the routing of an electronic debit transaction through any network that may process that transaction (merchant routing restrictions).<sup>158</sup> Section 235.7

implements these limitations on payment card network restrictions.

EFTA Sections 920(b)(2) and (3) impose certain limits on the ability of payment card networks to restrict merchants and other persons in establishing the terms and conditions under which they may accept payment cards. Specifically, EFTA Section 920(b)(2) prohibits a payment card network from establishing rules that prevent merchants from offering discounts or in-kind incentives based on the method of payment tendered to the extent that such discounts or incentives do not differentiate on the basis of the issuer or payment card network. In addition, EFTA Section 920(b)(3) prohibits a payment card network from establishing rules that prevent merchants from setting minimum transaction amounts for accepting credit cards to the extent that such minimums do not differentiate between issuers and payment card networks. These two statutory provisions are self-executing and are not subject to the Board's rulemaking authority.<sup>159</sup>

EFTA Section 920(b) does not provide a statutory exemption for small issuers, government-administered payment cards, or covered reloadable prepaid cards. Thus, the exemptions in section 235.5 of the rule do not extend to the prohibitions on network exclusivity arrangements and merchant routing restrictions under EFTA Section 920(b) implemented in § 235.7. *See* comment 7–1. As discussed below, however, the final rule provides a delayed effective date for certain types of debit cards to allow issuers to address significant technological or operational impediments to an issuer's ability to comply with the network exclusivity and routing provisions of the rule.

#### *A. Section 235.7(a) Prohibition on Network Exclusivity*

EFTA Section 920(b)(1)(A) directs the Board to prescribe rules prohibiting an issuer or a payment card network from directly, or indirectly through any agent, processor, or licensed member of a payment card network, restricting the number of payment card networks on which an electronic debit transaction may be processed to fewer than two unaffiliated payment card networks. Section 235.7(a) implements the new requirement and prohibits an issuer or payment card network from restricting the number of payment card networks on which an electronic debit transaction

<sup>157</sup> *See* EFTA Section 920(b)(1)(A).

<sup>158</sup> *See* EFTA Section 920(b)(1)(B).

<sup>159</sup> The Board may, however, increase from \$10 the minimum value amount that a merchant may set for credit card acceptance. EFTA Section 920(b)(3)(B).