

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

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**Date:** June 22, 2011  
**To:** Board of Governors  
**From:** Vice Chair Janet L. Yellen   
**Subject:** Final Rule on Debit Card Interchange Fees and Routing and Interim  
Final Rule on Fraud-Prevention Adjustment

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The Committee on Payments, Clearing, and Settlement has reviewed staff's recommendation that the Board approve a final rule implementing the requirements of Section 920 of the Electronic Fund Transfer Act as amended by Section 1075 of the Dodd Frank Act governing debit card interchange fees and routing and an interim final rule and request for public comment on a fraud-prevention adjustment to the interchange fee standard. As Chair of that Committee, I am forwarding to the Board for its consideration the attached staff memorandum; draft *Federal Register* notices; and draft report summarizing the survey data on debit card costs, interchange fees, and fraud losses.

Attachments

Date: June 22, 2011

TO: Board of Governors

SUBJECT: Final rule on debit card interchange fees and routing and interim final rule on fraud prevention adjustment

FROM: Staff<sup>1</sup>

**ACTION REQUESTED**

Staff requests Board approval of –

(1) the attached final rule (Regulation II) and related draft *Federal Register* notice implementing the requirements of Section 920 of the Electronic Fund Transfer Act (EFTA) as amended by Section 1075 of the Dodd Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) that require the Board to (a) establish standards for assessing whether the amount of any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit card transaction is reasonable and proportional to the cost incurred by the issuer with respect to the transaction, and (b) prohibit issuers and networks from restricting to one network or two or more affiliated networks the number of networks over which a debit card transaction may be routed, or inhibiting the ability of a merchant to direct the routing of a debit card transaction with certain conditions;

(2) the attached interim final rule, request for public comment, and draft *Federal Register* notice that provides for adjustments for fraud-prevention costs to the debit card interchange transaction fee limits described in paragraph (1); and

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<sup>1</sup> Division of Reserve Bank Operations and Payment Systems (Louise Roseman, Jeff Marquardt, David Mills), Division of Research and Statistics (Robin Prager, Elizabeth Kiser, Mark Manuszak), Legal Division (Scott Alvarez, Stephanie Martin, Chris Clubb, Dena Milligan), Division of Consumer and Community Affairs (Vivian Wong), and Julia Cheney (on detail to the Board from FRB Philadelphia).

(3) certain data collection efforts and publication of cost and interchange fee information and issuer lists, as discussed below.

Staff also requests authority to make technical and conforming changes to the attached draft *Federal Register* notices, if approved, prior to sending the notices to the *Federal Register* for publication.

## **BACKGROUND**

New section 920 of the EFTA, added by Section 1075 of the Dodd-Frank Act, directs the Board to issue rules relating to debit card interchange fees, network exclusivity, and transaction routing. EFTA Section 920 also provides that the Board may prescribe regulations to permit an issuer to receive an adjustment to the debit card interchange fee limits that is reasonably necessary to make allowance for costs incurred by the issuer in preventing fraud in electronic debit transactions if the issuer complies with fraud-related standards established by the Board.

In September 2010, the Board distributed three surveys to industry participants (an issuer survey, a network survey, and a merchant acquirer survey) designed to gather information to assist the Board in developing the rulemaking pursuant to EFTA Section 920. The data obtained through the surveys informed the development of the attached draft final rule and are referred to in the discussion below.

***Statutory framework for fee standards.*** EFTA Section 920(a)(2) contains the general requirement that “[t]he amount of any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction shall be reasonable and proportional to the cost incurred by the issuer with respect to the transaction.” EFTA Section 920(a)(3)(A) requires the Board to establish “standards for assessing whether the amount of any interchange transaction fee” is

“reasonable and proportional to the cost incurred by the issuer with respect to the transaction.”

In prescribing the regulations, EFTA Section 920(a)(4)(A) requires the Board to consider the “functional similarity” between “(i) electronic debit transactions; and (ii) checking transactions that are required within the Federal Reserve bank system to clear at par.” In addition, in establishing standards for assessing whether a fee is reasonable and proportional to costs, EFTA Section 920(a)(4)(B) requires the Board to distinguish between –

(i) the incremental cost incurred by an issuer for the role of the issuer in the authorization, clearance, or settlement of a particular electronic debit transaction, which cost shall be considered; and

(ii) other costs incurred by an issuer which are not specific to a particular electronic debit transaction, which costs shall not be considered.

A copy of EFTA Section 920 is attached as Appendix B.

#### **A. Proposed rule**

In December 2010, the Board invited public comment on a proposed rule to implement EFTA Section 920. The proposal had two main components:

(1) proposed rules establishing the interchange fee standards and a request for comment on standards for a fraud-prevention adjustment to those fees; and

(2) proposed rules prohibiting network exclusivity and routing restrictions. In brief, the proposed rule requested public comment on the following issues:

- *Interchange fee standard.* Two alternative frameworks for assessing whether debit card interchange transaction fees are “reasonable and proportional”: Alternative 1 was an issuer-specific approach that allowed recovery of certain allowable actual costs up to a cap of 12 cents per electronic debit transaction with a safe harbor at 7 cents per electronic debit transaction; and Alternative 2 was a stand-alone cap of 12 cents per electronic debit transaction.

- *Allowable costs.* Which costs should be allowed for purposes of determining whether the interchange transaction fees were reasonable and proportional to an issuer’s cost. The proposed rule limited “allowable costs” for the calculation of the interchange transaction fee restrictions to the costs that are both associated with authorization, clearance, and settlement of electronic debit transactions and that vary with the number of transactions within a calendar year (i.e., average variable costs). Network processing fees, fixed costs, and costs outside the authorization, clearance, and settlement process, such as overhead costs and account set-up costs, were excluded from allowable costs.
- *Fraud-prevention adjustment.* Two general approaches to determining a fraud-prevention adjustment to the interchange transaction fee provision: an approach requiring a showing of innovative technologies likely to reduce debit card fraud in a cost-effective manner, and an approach establishing more general standards for an effective fraud-prevention program, but without prescribing specific measures or technologies. The Board did not propose a specific fraud prevention adjustment.
- *Exemptions.* Provisions implementing statutory exemptions from the interchange fee limitations for small issuers (less than \$10 billion in consolidated assets including affiliates), government-administered payment programs, and certain reloadable prepaid cards.
- *Network exclusivity and routing.* Two alternative approaches to implementing the statutory requirement that issuers and payment card networks must permit at least two unaffiliated payment card networks to be available to carry an electronic debit transaction: Alternative A would require issuers to make two unaffiliated networks available for processing electronic debit transactions, without consideration as to the method of authentication (e.g., a network for signature and an unaffiliated network for PIN); and Alternative B would require more than one unaffiliated network for each method of authentication (e.g.,

two unaffiliated networks for each of signature and PIN). The proposed rule also invited comment on a proposed approach to the statute's prohibition on routing restrictions.

## **B. Public comments**

The Board received comments on the proposed rule from approximately 11,570 commenters, including issuers, merchants, consumers, national and regional payment card networks, acquirers, processors, trade groups, government agencies, and members of Congress.

Issuers, their trade groups, some consumers, and payment card networks generally opposed the Board's proposed rule for various reasons, including the substantial reduction in interchange revenue to issuers (which they asserted could result in increased cardholder fees or decreased availability of debit card services), and the possibility that reduced interchange fee revenue could stifle innovation in the payment system. Conversely, merchants and their trade groups overwhelmingly supported the Board's proposal, as did some consumers, because they believe the proposal would lower the current interchange fees, increase transparency in the system, and increase competition by prohibiting exclusivity arrangements and enabling merchant-routing choice.

Comments received on some of the specific provisions of the proposed rule are discussed in more detail below with respect to those provisions of the attached draft final rule and in the attached draft *Federal Register* notices. A detailed summary of the public comments is available in the Office of the Secretary.

## **DISCUSSION**

### **A. Final rule for interchange fee standard, and exclusivity and routing**

Based on an analysis of the comments, the data regarding interchange transaction fees and debit card processing costs available to the Board at this time,

and other relevant available information, staff recommends that the Board adopt a final rule with the following components:

- A modified version of the proposed Alternative 2 (stand-alone cap) for the interchange fee standard, with a cap composed of a base component of 21 cents and an ad valorem component of 5 basis points to reflect a portion of fraud losses.
  - The following issuer costs that are incurred to effect an electronic debit transaction were included in deriving the base component of the cap: network connectivity costs; costs of hardware, software, and labor used to effect electronic debit transactions; network processing fees; and transaction monitoring costs. As noted above, a portion of fraud losses incurred by issuers for particular electronic debit transactions are also included as an ad valorem component.
  - The following issuer costs were not included in deriving the cap: corporate overhead (such as executive compensation, support functions such as legal, human resources, and audit, and the issuer's branch network); costs of establishing the account; card production and delivery, marketing, and research and development; network membership fees; costs of rewards programs; and customer inquiries.
- With respect to network exclusivity, a requirement that an issuer enable two unaffiliated networks for electronic debit transactions (Alternative A in the original proposal); the prohibition on routing restrictions in the proposed rule, which prohibit an issuer or payment card network from inhibiting the ability of the merchant to direct the routing of electronic debit transactions for processing over any network that can process the transaction.

- A definition of “payment card network” that would exclude three-party systems (e.g., American Express) because they are not a “network” that “routes” transactions.
- An effective date of October 1, 2011, for the interchange fee standards (including, on an interim basis, the fraud-prevention adjustment) and the routing restrictions; an effective date of April 1, 2012, for the prohibition on network exclusivity as it applies to issuers and an effective date of October 1, 2011, as it applies to network enforcement of a rule that restricts the ability of an issuer to add a network to comply with the prohibition on network exclusivity.
- A delayed effective date of April 1, 2013, for certain cards with particular technological challenges, including certain health benefit cards, as well as certain prepaid cards.

With respect to the fraud-prevention adjustment to the interchange transaction fee, staff recommends that the Board adopt an interim final rule that allows a fraud-prevention adjustment of 1 cent per transaction conditioned upon the issuer adopting effective fraud prevention policies and procedures.

Key components of the draft final rule are discussed in more detail below. In addition, staff analysis of the effect of the draft final rule on various parties in electronic debit transactions is included as Appendix A to this memorandum.

***Reasonable and proportional interchange fees.*** Many issuers urged the Board to adopt a more flexible approach to the interchange fee standards than either of the proposed alternatives. These issuers often objected to the establishment of a cap, which would in effect prevent some covered issuers from recovering all costs through debit interchange fees. Numerous issuers, networks, depository institution trade organizations, and individuals objected to fee limits as inconsistent with the directive that the Board establish “standards for assessing” whether the amount of an interchange fee is reasonable and proportional to cost.

These commenters objected to the establishment of both the safe harbor and the cap because both involved numerical limits rather than subjective or flexible standards for assessing interchange transaction fees. Many of the commenters, including many that opposed a cap and/or safe harbor, however, recognized the administrative appeal of a cap or a safe harbor and stated that a pure issuer-specific standard would be difficult to implement operationally and difficult to enforce.

Merchants generally preferred a more issuer-specific approach because issuers would receive interchange fees tied to their actual respective costs. Merchants and one acquirer/processor acknowledged that having either a cap or a safe harbor would make the interchange fee structure more transparent and simpler for merchants to understand, which could aid compliance.

Between the two alternatives for the interchange fee standard in the proposed rule, merchants uniformly supported Alternative 1 as being the most consistent with the statute, but advocated a lower safe harbor. Some merchants suggested a safe harbor of 4 cents (the average per-transaction authorization, clearance, and settlement costs, across all transactions and issuers), arguing that a higher safe harbor would allow more covered issuers to receive interchange fees above their actual allowable costs. Merchants also generally supported a lower cap to discourage issuers from incurring and being compensated for excessive costs.

Although many issuers argued against both alternatives, a significant number of issuers preferred Alternative 2 over Alternative 1 due to the former's ease of compliance. However, many of these commenters suggested raising the cap value to reflect an expanded definition of allowable costs and to cover the costs of a larger percentage of covered issuers. Issuers that supported inclusion of a safe harbor suggested raising it to a level that permits a "substantial majority" of issuers to avail themselves of the safe harbor.

After consideration of the comments received, the language and purpose of the statute, the available data, and the practical results of various interpretations of the statute, staff recommends the Board adopt in the final rule an approach similar to the approach supporting Alternative 2 in the proposed rule, but with some modifications. Under the draft final rule, the maximum permissible interchange transaction fee would be the sum of a base component and an ad valorem component. Each issuer could receive interchange transaction fees that do not exceed this cap, without demonstrating that particular issuer's actual per-transaction allowable costs. The base amount per transaction is 21 cents, which corresponds to the average per-transaction allowable cost, excluding fraud losses, of the issuer at the 80<sup>th</sup> percentile, based on data collected by the Board in the survey of covered issuers referenced above. The ad valorem amount is 5 basis points per transaction, which corresponds to the average per-transaction fraud losses of the median issuer, based on data from the same survey.

As discussed in more detail on pages 138 to 142 in the attached draft *Federal Register* notice, this approach is consistent with the language in EFTA Section 920(a)(2). Section 920(a)(2) provides that “the amount of any interchange fee that an issuer may receive or charge with respect to an electronic debit transaction shall be reasonable and proportional to the cost incurred by the issuer with respect to the transaction.” Staff recommends that the Board interpret Section 920(a)(2) to refer to a representative issuer and a representative transaction, which, as explained in the draft notice, is a permissible and meaningful interpretation of the statutory provisions. This reading allows a standard to be set based on the average included costs of a representative issuer, and that ensures that interchange transaction fees are reasonable and are proportional to allowable costs without imposing undue compliance burdens on issuers or networks. This approach also provides transparency to issuers, networks, acquirers, merchants, and regulators

that will result in the most effective monitoring and enforcement of compliance with least burden.

It would be virtually impossible to implement the statute if it were interpreted to require a determination of an issuer's actual costs for each specific electronic debit transaction because that amount cannot be ascertained at or before the time the issuer receives or charges the interchange fee.<sup>2</sup> Some commenters urged adoption of an interpretation of Section 920(a)(2) that focuses on the costs incurred by a specific issuer in connection with a generic electronic debit transaction. This view, however, does not represent a consistent reading of the words of Section 920(a)(2). Moreover, establishing issuer-specific interchange fee standards would significantly increase the burden on supervisors to assess compliance and make it impossible for networks and merchants to know whether issuers were in compliance with the standards under EFTA Section 920.

Section 920(a)(2) also requires that the amount of any interchange transaction fee be "reasonable" and "proportional to the cost of the issuer" without defining either "reasonable" or "proportional." Instead, Section 920(a)(3) requires the Board to give meaning to those terms through its standards. As noted above, a number of commenters argued that a cap is not reasonable or proportional to costs. For the reasons explained more fully on pages 142 to 146 in the attached draft *Federal Register* notice, staff believes that the statute's use of the term "reasonable" implies that, above some amount, an interchange fee is not reasonable. The use of the term "proportional" requires a relationship between the interchange transaction fee and costs incurred; however, it does not require

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<sup>2</sup> For example, the cost of a transaction may vary based on the volume of transactions that the issuer processes through a given network. The issuer cannot precisely control or know the volume of transactions at any given moment when a particular transaction occurs because that volume depends largely on customer usage of the debit card and merchant routing decisions.

equality of fees and costs. For purposes of establishing standards for assessing whether the amount of any interchange fee is “reasonable” and “proportional” to cost, staff recommends that the Board establish a reasonable limit on the highest amount of an interchange fee that an issuer may receive and base that limit on the distribution of per-transaction included costs incurred by issuers with respect to electronic debit transactions. This represents a standard for both terms: a cap that delineates a separation between a “reasonable” fee and a fee that is not reasonable; and a requirement that the relationship between the interchange transaction fee that may be received by an issuer and the cost incurred by the issuer be set by reference only to certain issuer costs directly related to particular electronic debit transactions (as discussed below).

***Included costs.*** Under the proposed rule, allowable costs for purposes of measuring a reasonable and proportional fee would be the sum of those costs that are attributable to the issuer’s role in authorization, clearance, and settlement (“ACS”) of an electronic debit transaction and that vary with the number of transactions sent to the issuer within a calendar year (variable costs) divided by the number of electronic debit transactions on which the issuer received or charged an interchange transaction fee during that year (average variable cost). Merchants overwhelmingly supported the Board’s proposal to limit allowable costs to the incremental ACS costs for each transaction and supported the proposed measurement of those costs as average variable cost. In contrast, issuers and networks overwhelmingly supported including the costs of more debit card-related activities in allowable costs.

Issuer commenters noted that they incur substantial fixed investment costs in order to process electronic debit transactions. Merchants responded that they too incur fixed investment costs to process electronic debit transactions and that issuers have already been compensated for past investment through interchange fees.

Issuers also stated that they are required to pay processing fees to the network for every transaction an issuer authorizes, clears, and settles, and these network fees should be included in the interchange fee as a cost of authorization, clearance, and settlement. Merchants noted that they also pay processing fees to the networks and argued that, if the issuers' network processing fees are included in the interchange fee, merchants would pay all network processing fees for electronic debit transactions.

Issuers also commented that they incur various other costs associated with electronic debit transactions or operations. For example, issuers contended that they incur significant costs for receiving and addressing customer inquiries about particular transactions, as well as other costs, such as rewards or certain compliance costs, that are incurred, they argued, as part of particular transactions. Issuers also noted that they incur costs associated with account set-up and card production and delivery that are necessary to perform electronic debit transactions. Merchants universally opposed including such costs for purposes of the interchange fee standards, either because they would not be recouped by a check-writer's bank from the merchant's bank in a check transaction or because they are not specific to a particular transaction.

Issuer commenters also argued that the guarantee of payment in an electronic debit card transaction is a paramount difference between check and debit transactions, represents a benefit to the merchants, and should be included in the costs recovered through the interchange transaction fee. Issuers also contended that fraud losses are specific to a particular transaction and should be reflected in the interchange transaction fee. Merchants argued that the payment guarantee in an electronic debit transaction is not really a "guarantee," as they are frequently subject to chargebacks after the initial purchase transaction and, as a result, bear

fraud losses. In general, issuers and merchants disagreed about the portion of fraud losses borne by each party.

Merchants, as well as a few other commenters, supported the use of average variable costs (i.e., the average value of those costs that vary with the number of transactions sent to an issuer within a calendar year) in defining incremental costs. Issuers and networks generally opposed this interpretation of incremental cost of a particular transaction and suggested alternative interpretations that would generally encompass additional costs (e.g., fixed costs).

After consideration of the comments received on the scope of costs to include in the interchange fee standard, staff recommends that the Board revisit the interpretation of EFTA Section 920(a)(4)(B) used for the proposed rule. Section 920(a)(4)(B) is ambiguous and may be read in several ways. It requires the Board to distinguish between two types of costs when establishing standards for determining whether the amount of any interchange transaction fee is reasonable and proportional. In particular, Section 920(a)(4)(B) requires the Board to distinguish between “the incremental cost incurred by an issuer for the issuer’s role in authorization, clearance, or settlement of a particular electronic debit transaction,” which costs the statute requires the Board to consider, and “other costs incurred by an issuer which are not specific to a particular electronic debit transaction,” which the statute prohibits the Board from considering.

Staff recommends the Board focus on the clear prohibition in the statute. The statute’s direction that the Board not consider costs that “are not specific to a particular electronic debit transaction” may be read to expressly prohibit consideration of costs that are not incurred in the course of effecting an electronic debit transaction. All other costs may be considered, and some—the incremental costs incurred by the issuer for its role in authorization, clearance, and settlement—must be considered. As explained in more detail on page 157 to

page 158 in the *Federal Register* notice, staff believes the Board should consider costs that are incurred by an issuer to effect an electronic debit transaction to be “specific to a particular electronic debit transaction” for purposes of Section 920(a)(4). This reading retains focus on specific costs that are directly related to each electronic debit transaction. It excludes costs that would not be incurred in the course of effecting electronic debit transactions, without requiring identification of the cost to a given electronic debit transaction.

There are costs that are not encompassed in either the set of costs the Board must consider under Section 920(a)(4)(B)(i) or the costs the Board may not consider under Section 920(a)(4)(B)(ii). These are costs that are specific to a particular electronic debit transaction but that either are not incremental or are not related to the issuer’s role in authorization, clearance, and settlement. Although Section 920(a) does not specifically instruct the Board with regard to how these costs should be considered in establishing the debit interchange fee standard, the section does not prohibit their consideration. Indeed, the requirement that one set of costs be considered and another set of costs be excluded suggests that Congress left to the Board discretion to consider costs that fall into neither category to the extent necessary and appropriate to fulfill the purposes of the statute. Under this interpretation, all elements of the issuer’s costs (other than those expressly prohibited from consideration) incurred in effecting an electronic debit transaction for which the Board has reliable data would be considered, so that it would not be necessary to delineate between costs that are and are not “incremental” or between costs that are and are not incurred in connection with authorization, clearance, and settlement.

Costs that are not specific to a particular electronic debit transaction (and that would not be considered in establishing the interchange fee standard) include costs associated with corporate overhead (such as executive compensation; support

functions such as legal, human resources, and audit; and the issuer's branch network); establishing an account relationship; general debit card program costs (such as card production and delivery costs); marketing; research and development; and network membership fees. Other costs that are specific to particular electronic debit transactions and could be considered, but have not been included in the draft final rule for the interchange fee standard, include costs of reward programs, handling cardholder inquiries, and non-sufficient funds handling. Staff recommends not including these costs for various reasons as discussed on pages 158 to 165 of the draft *Federal Register* notice.

The draft final interchange fee standard would be based on costs incurred in effecting a transaction, including the variable authorization, clearance, and settlement costs the Board originally proposed to include as allowable costs. More broadly, costs that are incurred in effecting electronic debit transactions include costs for network connectivity, the software and hardware used for processing transactions, and the associated labor to operate the processing environment, because no electronic debit transaction can be effected without incurring these costs. In addition, network processing fees are specific to a particular transaction and incurred for the issuer's role in authorization, clearance, and settlement. Transactions monitoring (e.g., neural networks and fraud-risk scoring systems) also are included costs because such activity is integral to the authorization decision. These costs, and the basis for including them, are discussed on pages 152 to 158 and pages 165 to 170 of the attached draft *Federal Register* notice.

As explained on pages 170 to 173 of the attached draft *Federal Register* notice, the draft final rule would include a portion of fraud losses in the interchange fee standards through a maximum permissible ad valorem component of 5 basis points of the value of the transaction. For purposes of the draft final

rule, fraud losses are those losses incurred by the issuer after excluding costs that are recovered through chargebacks to the merchants or debits to or collections from customers. Fraud losses represent a cost to the issuer of effecting the particular electronic debit transaction and are a result of the authorization, clearance, and settlement of an apparently valid transaction that is later identified as fraudulent. Permitting issuers to recover at least some fraud losses through interchange transaction fees is reasonable because the party best positioned to address the fraud could be any participant in an electronic debit transaction and the exact source of fraud often is unknown. Payment card network rules allocate responsibility for fraudulent transactions, but this allocation does not necessarily result in the loss ending up with the party that was in the best position to prevent the fraud. For example, the loss may have occurred from a data breach at a merchant or acquirer not involved in the fraudulent transactions. At the same time, the issuer may be responsible for, or in the best position to prevent, certain fraud losses. Consequently, staff recommends setting the ad valorem component at a level (the median) at which many issuers will be required to cover some of the fraud loss expense, in order to provide incentives for both issuers and merchants to take steps to reduce fraud losses. Finally, the cost of fraud loss varies with the amount of the transaction and, therefore, fraud losses are best assessed through an ad valorem component in the interchange fee standards.

The costs that are included in the draft final rule interchange fee standards and that were not included in the proposed rule interchange fee standards are network processing fees; fixed electronic debit transaction processing costs; fraud prevention costs associated with authorization; and the allowance for fraud losses. These added costs account for the difference between the originally proposed cap of 12 cents and the recommended final rule cap of 21 cents plus a 5 bps ad valorem component.

*Exemptions.* Section 920(a)(6), as well as the proposed and draft final rules, provides an exemption from the interchange fees standards for any issuer that, together with affiliates, has assets of less than \$10 billion (i.e., the small issuer exemption). Most of the comments on the proposed exemptions were related to this exemption. Many issuers expressed concern that this exemption will not be effective because networks would not institute, or could not sustain, a two-tier fee structure. If two-tier fee structures are implemented, these issuers believed that merchants would discriminate against cards of small issuers in favor of cards with lower interchange fees. Moreover, several issuers contended that even if networks institute a two-tier fee structure, merchant routing choice and steering would put downward pressure on interchange fees over time, thereby eroding the ability of small issuers to recover their full costs through interchange transaction fees and ultimately reducing any difference in interchange fees for small issuers.

Reflecting these concerns, some issuers and other commenters suggested the Board require debit card networks to implement a two-tier fee structure. Other commenters suggested that the Board initially monitor, and report information about, implementation of two-tier fee structures. Some issuers and other commenters suggested that the Board exempt small issuers from the network exclusivity and routing portions of the rule even though no statutory exemption was provided to small issuers from these provisions.<sup>3</sup> Finally, some issuers requested that the Board implement rules to prohibit merchants from discriminating against exempt issuers.

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<sup>3</sup> Several commenters also suggested the Board invoke EFTA Section 904(c) to exempt small issuers from the network exclusivity and routing rules. The Board's authority pursuant to EFTA Section 904(c), however, is transferred on July 21, 2011, to the Consumer Financial Protection Bureau.

Merchants stated that they believed debit card networks would have incentives to offer a two-tier fee structure in order to compete for the debit card programs of small issuers. Merchants further suggested that existing network rules, merchant incentives to avoid alienating customers, and the impracticality of steering debit card customers to a lower-cost payment method would prevent merchants from discriminating against cards of small issuers.

The exemptions in the statute provide that electronic debit transactions made using certain cards or cards issued by certain issuers are not subject to the interchange fee standards in Section 920 or the Board's rules. The statute does not itself require networks to provide or merchants to pay a higher interchange transaction fee to exempt small issuers or issuers of exempt products. Furthermore, the statute does not authorize the Board to mandate that payment card networks institute two-tier fee structures.<sup>4</sup> Similarly, the statute does not exempt small issuers from the network exclusivity and routing provisions of the rule or provide the Board with exemptive authority regarding these provisions. Accordingly, the attached draft final rule does not include provisions that would require a two-tier interchange structure by networks or that would exempt small issuers from the other network exclusivity and routing portions of the rule.

Staff recommends, however, that the Board take several steps permitted by the statute to reinforce the exemption for small issuers. First, staff recommends that the Board publish annually lists of institutions that fall 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

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<sup>4</sup> Payment card networks that collectively process more than 80 percent of debit card volume have indicated that they plan to implement two-tier rate structures. These statements are not binding commitments, however, and networks (both those with and those without two-tier fee schedules) may revisit their decisions after implementation.

rule's interchange fee standards.<sup>5</sup> Second, as suggested by commenters, staff recommends that the Board survey payment card networks annually and publish annually a list of the average interchange transaction fee each network provides to its covered issuers and to its exempt issuers. This list should enable issuers, including small issuers, to more readily compare the interchange revenue they would receive from each network. This reporting will also allow exempt issuers, Congress, and others to monitor the effect of the statute and final rules to determine if they are having the desired policy result.

***Exclusivity and routing.*** Section 920(b) imposes limitations on the ability of issuers and networks to restrict the number of networks enabled on a debit card and the choice of merchants in routing electronic debit transactions over the available networks. Issuers and networks preferred implementing this section by requiring issuers and networks to permit at least two unaffiliated networks without regard to the method of authentication (Alternative A of the original proposal). Issuers and networks also emphasized that Alternative B, which would require at least two unaffiliated networks for each authentication method, would impose significant operational burdens and could stifle the development of new authentication technologies. Merchants preferred Alternative B because they believe that Alternative B is most consistent with the statutory language and provides the broadest merchant routing choice. Merchant commenters did not agree that substantial operational changes are necessary to implement Alternative B.

For the reasons discussed in detail on pages 231 to 234 of the attached draft *Federal Register* notice, the draft final rule adopts Alternative A with respect to the network exclusivity provisions. Alternative A is consistent with the statute, which

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<sup>5</sup> Staff anticipates that the initial lists would be posted on the Board's public website by mid-July.

prohibits the number of payment card networks on which an electronic debit transaction may be processed from being fewer than two unaffiliated payment card networks, and does not require that there be two unaffiliated payment card networks available to the merchant for each method of authentication. Alternative A would minimize the compliance burden on institutions, particularly small issuers, and would also present less logistical burden on the payment system overall. In addition, Alternative B's requirement for multiple unaffiliated payment card networks to be enabled on a debit card for each method of card authorization could potentially limit the development and introduction of new authentication methods.

Currently, merchants generally must route electronic debit transactions based on the card issuer's designated preferences, preventing merchants from applying their own preferences with respect to routing a particular electronic debit transaction to the network that will result in the lowest cost to the merchant. EFTA Section 920(b)(1)(B) requires the Board to prescribe regulations providing that an issuer or payment card network may not inhibit the ability of any person who accepts debit cards for payments to direct the routing of electronic debit transactions for processing over any payment card network that may process such transactions. The proposed rule essentially incorporated the statutory language with commentary that provided examples of prohibited practices. Issuers commented generally that the routing provisions would likely frustrate consumer choice and consumers' ability to receive cardholder benefits, such as zero liability and enhanced chargeback rights, which are unique to a particular network. In contrast, merchants strongly supported the proposed provision.

As explained in the attached draft *Federal Register* notice at pages 247 to 254, the draft final rule adopts the prohibition on routing restrictions as proposed, which follows the language in the statute.

***Reporting requirements.*** EFTA Section 920(a)(3)(B) authorizes the Board to require any debit card issuer or payment card network to provide the Board with such information as may be necessary to carry out the provisions of the statute. In addition, the statute requires the Board to disclose on at least a biannual basis such aggregate or summary information concerning the costs incurred, and interchange transaction fees received or charged, by issuers or payment card networks in connection with the authorization, clearance, or settlement of electronic debit transactions as the Board considers appropriate and in the public interest. The attached draft *Federal Register* notice at page 267 includes an illustrative list of data that may be required to be reported, such as data regarding costs incurred with respect to an electronic debit transaction, interchange transaction fees, network fees, fraud-prevention and data-security costs, fraud losses, and transaction value, volume, and type. Staff believes it would be useful to collect information from networks regarding their interchange fee structures on an annual basis and from covered issuers regarding their costs every two years. Staff anticipates presenting in the near future a data collection form to the Board for its review and publication for public comment.

#### **B. Interim final rule for fraud-prevention adjustment**

Section 920(a)(5) allows the Board to permit an adjustment to be made to the interchange transaction fee for costs incurred by the issuer in preventing fraud, if the issuer complies with the fraud-related standards established by the Board. When it requested comment on its interchange fee standards, the Board invited comments on two broad approaches to designing fraud-prevention standards

without proposing a specific fraud-prevention adjustment. One approach focused on general fraud-prevention costs; the other focused on recouping only costs related to new or substantially improved technologies for preventing fraud.

Although commenters did not uniformly favor either of the approaches that the Board presented in the proposal, commenters generally agreed that the Board should not mandate use of specific technologies. Merchant commenters generally favored a requirement that an issuer adopt technologies that would demonstrably decrease fraud in order for the issuer to be eligible for the adjustment. These commenters proposed that the fraud-prevention adjustment should permit issuers to recoup only costs of developing technologies that resulted in less fraud than existing technologies. In contrast, issuer and payment card network commenters preferred a non-prescriptive approach that would allow issuers the flexibility necessary to tailor their fraud-prevention activities to address most effectively the risks faced by the issuer associated with changing fraud patterns and to permit sufficient incentives to invest in new and potentially more effective authentication methods.

The dynamic nature of the debit card fraud environment requires standards that permit issuers to determine the best methods to detect, prevent, and mitigate fraud losses for the size and scope of their debit card program and in response to frequent changes in fraud patterns. The attached draft interim final rule bases eligibility for the fraud-prevention adjustment on general standards for an effective fraud-prevention program, rather than prescribing specific measures or technologies. The draft interim final rule would permit an issuer to receive or charge a fraud-prevention adjustment if the issuer develops and implements policies and procedures reasonably designed to (i) identify and prevent fraudulent electronic debit transactions; (ii) monitor the incidence of, reimbursements

received for, and losses incurred from, fraudulent electronic debit transactions; (iii) respond appropriately to suspicious electronic debit transactions so as to limit the fraud losses that may occur and prevent the occurrence of future fraudulent electronic debit transactions; and (iv) secure debit card and cardholder data. In order to maintain eligibility for the adjustment under the draft interim final rule, an issuer must review its fraud-prevention policies and procedures at least annually, and update them as necessary to address changes in the prevalence and nature of the fraud the issuer experiences in electronic debit transactions and available methods of detecting, preventing, and mitigating fraud. Finally, the issuer must certify to the payment card networks in which it participates, on an annual basis, its compliance with the Board's standards to the payment card networks in which the issuer participates in order to receive the fraud-prevention adjustment.

Some merchant commenters argued for a cap on the amount of the adjustment, while several issuers, networks, and other commenters opposed a cap on the basis that it would limit the recovery of costs that could be determined to be reasonably necessary to prevent fraud. In addition, some commenters noted that any cap might reduce incentives to invest in innovative fraud-prevention techniques. A few commenters supported a safe harbor to reduce compliance and supervisory burden and to encourage effective fraud prevention.

Both issuers and merchants make substantial investments in fraud prevention, and the statute does not require the Board to set an adjustment so that each (or any) issuer fully recovers its fraud prevention costs. As an interim measure, staff recommends that the Board permit a fraud-prevention adjustment of 1 cent per electronic debit transaction. This value is the fraud-prevention cost reported by the median issuer in response to the Board's recent survey of debit card issuers, minus those fraud-prevention costs that are already included in the

costs used as a basis to establish the interchange fee standards. An issuer that meets the Board's standards may receive the fraud-prevention adjustment, even if its fraud-prevention costs are below the median, and no issuer may receive more than the median, regardless of its fraud-prevention costs. The allowance helps to offset the costs of implementing activities that are effective at reducing fraud losses, while placing cost discipline on issuers to ensure that those fraud-prevention activities are also cost effective. The Board could review the amount of the adjustment over time.

Finally, there was a general consensus across issuer, network, and merchant commenters that the fraud-prevention adjustment should be effective at the same time as the interchange fee standard. Accordingly, staff recommends that the rule establishing the fraud-prevention adjustment be effective on an interim basis, while public comment is invited on the rule, concurrent with the interchange fee standard on October 1, 2011. Issuers must comply with the Board's fraud-prevention standards by that date in order to receive or charge the fraud-prevention adjustment to the interchange transaction fee. The draft interim final rule requests comment on various aspects of the rule; comments would be due by September 30. There is good cause to conclude under the Administrative Procedure Act that providing notice and an opportunity to comment before issuing the interim final rule would be contrary to the public interest. Implementation of the fraud prevention adjustment is an integral part of implementation of the interchange fee standards, which will occur no later than October 1, 2011. Delay in implementing the fraud-prevention adjustment would deny issuers the opportunity to collect an allowance for costs incurred preventing fraud, and could thereby undermine the public policy goal of fraud prevention. Finally, the Board can take into account comments on the standards for implementing fraud-prevention policies and procedures and

adjust its rules in light of those comments following implementation of the fraud-prevention adjustment without disruption.

*Effective dates.* As explained on pages 270 to 272 of the draft *Federal Register* notice (except as noted), the provisions of the draft final rule would have the following effective dates:

- October 1, 2011 would be the effective date for the interchange fee standards (including, on an interim basis, the fraud-prevention adjustment), as well as the routing restrictions, see pages 270 to 272.
- The network exclusivity rules would be generally effective and compliance would be mandatory on April 1, 2012 with respect to issuers. With respect to payment card networks, however, the draft final rule makes these provisions effective on October 1, 2011, see pages 255 to 258.
- The effective date for the network exclusivity rules would be delayed until April 1, 2013 for certain health and other benefit cards that are subject to certain Internal Revenue Service (IRS) rules, see pages 258 to 260.
- The effective date for the network exclusivity rules would be April 1, 2013 for non-reloadable general-use prepaid cards, see pages 261 to 262.
- The effective date for the network exclusivity rules would be April 1, 2013 for reloadable general-use prepaid cards, so reloadable general-use prepaid cards sold after April 1, 2013 would have to comply with the rule; reloadable prepaid cards sold before April 1, 2013 would not be subject to the rule unless and until they were reloaded, and then the effective date for such cards would be May 1, 2013 (if reloaded

prior to April 1, 2013) or 30 days after the date the cards were reloaded (if reloaded after April 1, 2013), see pages 262 to 263.

### **C. Publication of financial data**

As noted above, EFTA Section 920(a)(3) requires the Board to publish such aggregate or summary information concerning the costs incurred, and interchange transaction fees charged or received, by issuers or payment card networks in connection with the authorization, clearance, or settlement of electronic debit transactions as the Board considers appropriate and in the public interest. Data based on the information received from the September 2010 survey is attached for publication with the final rule.

In addition, staff seeks the Board's approval to publish, as discussed above, (i) lists of institutions that fall 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; and (ii) a list of the average interchange transaction fee each network provides to its covered issuers and to its exempt issuers in order to enable issuers, including small issuers, to more readily compare the interchange revenue they would receive from each network.

Staff recommends that the Board delegate authority to the director of the Division of Reserve Bank Operations and Payment Systems (RBOPS), in consultation with the Director of the Division of Banking Supervision and Regulation and the General Counsel, to approve the publication of future lists of institutions that fall above and below the small issuer exemption asset threshold.

Attachments

## Appendix A

### Effects on various parties

The Board received numerous comments regarding the effects of EFTA Section 920 and the Board's implementing rules on various parties. The effect of the draft final rule on issuers, merchants, and consumers is subject to many market factors and, therefore, is difficult to predict. Staff analysis of the effect of the draft final rule on various parties is set out below.

*Issuers.* Revenue received by covered issuers from debit interchange fees is likely to decline by more than 40 percent under the draft final rule and interim final rule. It is not clear how covered issuers will respond to this reduction in revenue. Covered issuers may be able to offset lost interchange fee revenues by raising other fees, promoting the use of other payment methods that are exempt from fee restrictions, and reducing costs. Competitive forces, however, may limit their practical ability to fully recoup this revenue loss.

Similarly, it is difficult to determine the market response to the rule and, thus, the likely overall effect of the rule on exempt issuers. As noted above, networks that collectively process more than 80 percent of debit card volume have indicated that they plan to establish two-tier interchange pricing, though it is unclear whether the tier for exempt issuers and transactions will remain at current interchange fee levels.

The network exclusivity and routing provisions, which apply to issuers even if they are exempt from the interchange fee standards, may lead to higher costs for some issuers, including some exempt issuers. Moreover, these provisions could put some downward pressure on interchange fees overall as merchants are able to route transactions over lower-cost networks. The ultimate extent of any downward pressure on interchange fees due to the network exclusivity and routing provisions

cannot be predicted and depends on the industry and consumer response once those provisions are in effect. Thus, it is possible, even with two-tier interchange fee schedules, that some issuers that are exempt from the interchange fee standard may receive less interchange revenue than they would have absent the rule.

***Merchants.*** Interchange fees that are ultimately paid by merchants through the merchant discount will decline significantly under the draft final rule. Whether these cost savings are retained by the merchants depends on various factors. Merchants that operate in highly competitive markets with low margins may pass on most or all of the interchange cost savings to their customers in the form of lower prices or improved service. In contrast, merchants that operate in less competitive markets may retain a greater portion of the interchange fee savings.

The merchant acquiring business, broadly speaking, is competitive; therefore, staff believes that acquirers would pass on the savings from lower interchange fees to their merchant customers, including small and medium-sized customers.<sup>6</sup> Although it is possible that merchants with a large proportion of small-ticket transactions could experience an increase in total interchange fees, there is nothing in the rule that would require networks to alter the interchange fees for small-value transactions.

***Consumers.*** It is difficult to predict the overall effect of the draft final rule on consumers. Card issuers are likely to implement some changes in response to the reduction in interchange fee revenue resulting from the rule. They may seek alternative sources of revenue, including higher fees from debit card users or deposit account customers more generally, or may encourage customers to use credit cards (which have higher interchange fees) rather than debit cards. In

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<sup>6</sup> Certain small and medium-sized merchants that have entered into long term contracts with independent resellers of payment card services may experience some delay before realizing lower transaction costs.

addition, card issuers may look for opportunities to lower their costs, which could involve reducing benefits associated with deposit accounts or debit cards.

At the same time, a reduction in interchange fees would likely lead to a decrease in merchants' costs of debit card acceptance, which could be passed on to consumers in the form of lower retail prices to all consumers, regardless of the payment methods they use. Merchants have the ability to use incentives or other methods to encourage or "steer" their customers to use debit, and therefore may be able to benefit from lower debit interchange fees. As noted above, the extent to which merchants pass on savings to their customers will depend on the particular merchant's competitive environment. If, however, consumers shift from debit cards to payment methods that may be more costly to merchants (e.g., credit cards), overall merchant costs could rise, despite a reduction in the cost of accepting debit cards, and these higher costs could offset savings from lowered debit interchange fees or could be passed on to consumers. If merchants continue their current practice of not varying their prices with the form of payment, and are not able to steer their customers to choose debit, any benefits associated with price reductions, or costs associated with price increases, would likely accrue to all consumers, regardless of whether or not they use debit cards.

Thus, the effect of the rule on any individual consumer will depend on a variety of factors, including the consumer's current payment behavior (e.g., cash user or debit card user), changes in the consumer's payment behavior, the competitiveness of the merchants from which the consumer makes purchases, changes in merchant payment method acceptance, and changes in the behavior of banks. Staff believes that it is unclear whether consumers in aggregate will benefit from or be harmed by the draft final rule.

**Section 920 of the Electronic Fund Transfer Act**

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(b) REPORT AND RECOMMENDATIONS.—Not later than January 31, 2011, the Secretary of the Treasury shall submit the report and recommendations required under subsection (a) to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

**SEC. 1075. REASONABLE FEES AND RULES FOR PAYMENT CARD TRANSACTIONS.**

(a) IN GENERAL.—The Electronic Fund Transfer Act (15 U.S.C. 1693 et seq.) is amended—

15 USC 1693p,  
1693q.

(1) by redesignating sections 920 and 921 as sections 921 and 922, respectively; and

(2) by inserting after section 919 the following:

15 USC 1693o-2.

**“SEC. 920. REASONABLE FEES AND RULES FOR PAYMENT CARD TRANSACTIONS.**

**“(a) REASONABLE INTERCHANGE TRANSACTION FEES FOR ELECTRONIC DEBIT TRANSACTIONS.—**

**“(1) REGULATORY AUTHORITY OVER INTERCHANGE TRANSACTION FEES.—**The Board may prescribe regulations, pursuant to section 553 of title 5, United States Code, regarding any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction, to implement this subsection (including related definitions), and to prevent circumvention or evasion of this subsection.

**“(2) REASONABLE INTERCHANGE TRANSACTION FEES.—**The amount of any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction shall be reasonable and proportional to the cost incurred by the issuer with respect to the transaction.

**“(3) RULEMAKING REQUIRED.—**

Deadline.  
Standards.

**“(A) IN GENERAL.—**The Board shall prescribe regulations in final form not later than 9 months after the date of enactment of the Consumer Financial Protection Act of 2010, to establish standards for assessing whether the amount of any interchange transaction fee described in paragraph (2) is reasonable and proportional to the cost incurred by the issuer with respect to the transaction.

**“(B) INFORMATION COLLECTION.—**The Board may require any issuer (or agent of an issuer) or payment card network to provide the Board with such information as may be necessary to carry out the provisions of this subsection and the Board, in issuing rules under subparagraph (A) and on at least a bi-annual basis thereafter, shall disclose such aggregate or summary information concerning the costs incurred, and interchange transaction fees charged or received, by issuers or payment card networks in connection with the authorization, clearance or settlement of electronic debit transactions as the Board considers appropriate and in the public interest.

**“(4) CONSIDERATIONS; CONSULTATION.—**In prescribing regulations under paragraph (3)(A), the Board shall—

**“(A) consider the functional similarity between—**

**“(i) electronic debit transactions; and**

**“(ii) checking transactions that are required within the Federal Reserve bank system to clear at par;**

**“(B) distinguish between—**

“(i) the incremental cost incurred by an issuer for the role of the issuer in the authorization, clearance, or settlement of a particular electronic debit transaction, which cost shall be considered under paragraph (2); and

“(ii) other costs incurred by an issuer which are not specific to a particular electronic debit transaction, which costs shall not be considered under paragraph (2); and

“(C) consult, as appropriate, with the Comptroller of the Currency, the Board of Directors of the Federal Deposit Insurance Corporation, the Director of the Office of Thrift Supervision, the National Credit Union Administration Board, the Administrator of the Small Business Administration, and the Director of the Bureau of Consumer Financial Protection.

“(5) ADJUSTMENTS TO INTERCHANGE TRANSACTION FEES FOR FRAUD PREVENTION COSTS.—

“(A) ADJUSTMENTS.—The Board may allow for an adjustment to the fee amount received or charged by an issuer under paragraph (2), if—

“(i) such adjustment is reasonably necessary to make allowance for costs incurred by the issuer in preventing fraud in relation to electronic debit transactions involving that issuer; and

“(ii) the issuer complies with the fraud-related standards established by the Board under subparagraph (B), which standards shall—

“(I) be designed to ensure that any fraud-related adjustment of the issuer is limited to the amount described in clause (i) and takes into account any fraud-related reimbursements (including amounts from charge-backs) received from consumers, merchants, or payment card networks in relation to electronic debit transactions involving the issuer; and

“(II) require issuers to take effective steps to reduce the occurrence of, and costs from, fraud in relation to electronic debit transactions, including through the development and implementation of cost-effective fraud prevention technology.

“(B) RULEMAKING REQUIRED.—

“(i) IN GENERAL.—The Board shall prescribe regulations in final form not later than 9 months after the date of enactment of the Consumer Financial Protection Act of 2010, to establish standards for making adjustments under this paragraph.

Deadline.  
Standards.

“(ii) FACTORS FOR CONSIDERATION.—In issuing the standards and prescribing regulations under this paragraph, the Board shall consider—

“(I) the nature, type, and occurrence of fraud in electronic debit transactions;

“(II) the extent to which the occurrence of fraud depends on whether authorization in an electronic debit transaction is based on signature, PIN, or other means;

“(III) the available and economical means by which fraud on electronic debit transactions may be reduced;

“(IV) the fraud prevention and data security costs expended by each party involved in electronic debit transactions (including consumers, persons who accept debit cards as a form of payment, financial institutions, retailers and payment card networks);

“(V) the costs of fraudulent transactions absorbed by each party involved in such transactions (including consumers, persons who accept debit cards as a form of payment, financial institutions, retailers and payment card networks);

“(VI) the extent to which interchange transaction fees have in the past reduced or increased incentives for parties involved in electronic debit transactions to reduce fraud on such transactions; and

“(VII) such other factors as the Board considers appropriate.

“(6) EXEMPTION FOR SMALL ISSUERS.—

“(A) IN GENERAL.—This subsection shall not apply to any issuer that, together with its affiliates, has assets of less than \$10,000,000,000, and the Board shall exempt such issuers from regulations prescribed under paragraph (3)(A).

“(B) DEFINITION.—For purposes of this paragraph, the term “issuer” shall be limited to the person holding the asset account that is debited through an electronic debit transaction.

“(7) EXEMPTION FOR GOVERNMENT-ADMINISTERED PAYMENT PROGRAMS AND RELOADABLE PREPAID CARDS.—

“(A) IN GENERAL.—This subsection shall not apply to an interchange transaction fee charged or received with respect to an electronic debit transaction in which a person uses—

“(i) a debit card or general-use prepaid card that has been provided to a person pursuant to a Federal, State or local government-administered payment program, in which the person may only use the debit card or general-use prepaid card to transfer or debit funds, monetary value, or other assets that have been provided pursuant to such program; or

“(ii) a plastic card, payment code, or device that is—

“(I) linked to funds, monetary value, or assets which are purchased or loaded on a prepaid basis;

“(II) not issued or approved for use to access or debit any account held by or for the benefit of the card holder (other than a subaccount or other method of recording or tracking funds purchased or loaded on the card on a prepaid basis);

“(III) redeemable at multiple, unaffiliated merchants or service providers, or automated teller machines;

“(IV) used to transfer or debit funds, monetary value, or other assets; and

“(V) reloadable and not marketed or labeled as a gift card or gift certificate.

“(B) EXCEPTION.—Notwithstanding subparagraph (A), after the end of the 1-year period beginning on the effective date provided in paragraph (9), this subsection shall apply to an interchange transaction fee charged or received with respect to an electronic debit transaction described in subparagraph (A)(i) in which a person uses a general-use prepaid card, or an electronic debit transaction described in subparagraph (A)(ii), if any of the following fees may be charged to a person with respect to the card:

Applicability.

“(i) A fee for an overdraft, including a shortage of funds or a transaction processed for an amount exceeding the account balance.

“(ii) A fee imposed by the issuer for the first withdrawal per month from an automated teller machine that is part of the issuer’s designated automated teller machine network.

“(C) DEFINITION.—For purposes of subparagraph (B), the term ‘designated automated teller machine network’ means either—

“(i) all automated teller machines identified in the name of the issuer; or

“(ii) any network of automated teller machines identified by the issuer that provides reasonable and convenient access to the issuer’s customers.

“(D) REPORTING.—Beginning 12 months after the date of enactment of the Consumer Financial Protection Act of 2010, the Board shall annually provide a report to the Congress regarding —

Effective date.

“(i) the prevalence of the use of general-use prepaid cards in Federal, State or local government-administered payment programs; and

“(ii) the interchange transaction fees and cardholder fees charged with respect to the use of such general-use prepaid cards.

“(8) REGULATORY AUTHORITY OVER NETWORK FEES.—

“(A) IN GENERAL.—The Board may prescribe regulations, pursuant to section 553 of title 5, United States Code, regarding any network fee.

“(B) LIMITATION.—The authority under subparagraph (A) to prescribe regulations shall be limited to regulations to ensure that—

“(i) a network fee is not used to directly or indirectly compensate an issuer with respect to an electronic debit transaction; and

“(ii) a network fee is not used to circumvent or evade the restrictions of this subsection and regulations prescribed under such subsection.

“(C) RULEMAKING REQUIRED.—The Board shall prescribe regulations in final form before the end of the 9-month period beginning on the date of the enactment of the Consumer Financial Protection Act of 2010, to carry out the authorities provided under subparagraph (A).

Deadline.

“(9) EFFECTIVE DATE.—This subsection shall take effect at the end of the 12-month period beginning on the date of the enactment of the Consumer Financial Protection Act of 2010.

Deadlines.

“(b) LIMITATION ON PAYMENT CARD NETWORK RESTRICTIONS.—

“(1) PROHIBITIONS AGAINST EXCLUSIVITY ARRANGEMENTS.—

“(A) NO EXCLUSIVE NETWORK.—The Board shall, before the end of the 1-year period beginning on the date of the enactment of the Consumer Financial Protection Act of 2010, prescribe regulations providing that an issuer or payment card network shall not directly or through any agent, processor, or licensed member of a payment card network, by contract, requirement, condition, penalty, or otherwise, restrict the number of payment card networks on which an electronic debit transaction may be processed to—

“(i) 1 such network; or

“(ii) 2 or more such networks which are owned, controlled, or otherwise operated by —

“(I) affiliated persons; or

“(II) networks affiliated with such issuer.

“(B) NO ROUTING RESTRICTIONS.—The Board shall, before the end of the 1-year period beginning on the date of the enactment of the Consumer Financial Protection Act of 2010, prescribe regulations providing that an issuer or payment card network shall not, directly or through any agent, processor, or licensed member of the network, by contract, requirement, condition, penalty, or otherwise, inhibit the ability of any person who accepts debit cards for payments to direct the routing of electronic debit transactions for processing over any payment card network that may process such transactions.

“(2) LIMITATION ON RESTRICTIONS ON OFFERING DISCOUNTS FOR USE OF A FORM OF PAYMENT.—

“(A) IN GENERAL.—A payment card network shall not, directly or through any agent, processor, or licensed member of the network, by contract, requirement, condition, penalty, or otherwise, inhibit the ability of any person to provide a discount or in-kind incentive for payment by the use of cash, checks, debit cards, or credit cards to the extent that—

“(i) in the case of a discount or in-kind incentive for payment by the use of debit cards, the discount or in-kind incentive does not differentiate on the basis of the issuer or the payment card network;

“(ii) in the case of a discount or in-kind incentive for payment by the use of credit cards, the discount or in-kind incentive does not differentiate on the basis of the issuer or the payment card network; and

“(iii) to the extent required by Federal law and applicable State law, such discount or in-kind incentive is offered to all prospective buyers and disclosed clearly and conspicuously.

“(B) LAWFUL DISCOUNTS.—For purposes of this paragraph, the network may not penalize any person for the providing of a discount that is in compliance with Federal law and applicable State law.

“(3) LIMITATION ON RESTRICTIONS ON SETTING TRANSACTION MINIMUMS OR MAXIMUMS.—

“(A) IN GENERAL.—A payment card network shall not, directly or through any agent, processor, or licensed member of the network, by contract, requirement, condition, penalty, or otherwise, inhibit the ability—

“(i) of any person to set a minimum dollar value for the acceptance by that person of credit cards, to the extent that —

“(I) such minimum dollar value does not differentiate between issuers or between payment card networks; and

“(II) such minimum dollar value does not exceed \$10.00; or

“(ii) of any Federal agency or institution of higher education to set a maximum dollar value for the acceptance by that Federal agency or institution of higher education of credit cards, to the extent that such maximum dollar value does not differentiate between issuers or between payment card networks.

“(B) INCREASE IN MINIMUM DOLLAR AMOUNT.—The Board may, by regulation prescribed pursuant to section 553 of title 5, United States Code, increase the amount of the dollar value listed in subparagraph (A)(i)(II).

“(4) RULE OF CONSTRUCTION.—No provision of this subsection shall be construed to authorize any person—

“(A) to discriminate between debit cards within a payment card network on the basis of the issuer that issued the debit card; or

“(B) to discriminate between credit cards within a payment card network on the basis of the issuer that issued the credit card.

“(c) DEFINITIONS.—For purposes of this section, the following definitions shall apply:

“(1) AFFILIATE.—The term ‘affiliate’ means any company that controls, is controlled by, or is under common control with another company.

“(2) DEBIT CARD.—The term ‘debit card’—

“(A) means any card, or other payment code or device, issued or approved for use through a payment card network to debit an asset account (regardless of the purpose for which the account is established), whether authorization is based on signature, PIN, or other means;

“(B) includes a general-use prepaid card, as that term is defined in section 915(a)(2)(A); and

“(C) does not include paper checks.

“(3) CREDIT CARD.—The term ‘credit card’ has the same meaning as in section 103 of the Truth in Lending Act.

“(4) DISCOUNT.—The term ‘discount’—

“(A) means a reduction made from the price that customers are informed is the regular price; and

“(B) does not include any means of increasing the price that customers are informed is the regular price.

“(5) ELECTRONIC DEBIT TRANSACTION.—The term ‘electronic debit transaction’ means a transaction in which a person uses a debit card.

“(6) FEDERAL AGENCY.—The term ‘Federal agency’ means—

“(A) an agency (as defined in section 101 of title 31, United States Code); and

“(B) a Government corporation (as defined in section 103 of title 5, United States Code).

“(7) INSTITUTION OF HIGHER EDUCATION.—The term ‘institution of higher education’ has the same meaning as in 101 and 102 of the Higher Education Act of 1965 (20 U.S.C. 1001, 1002).

“(8) INTERCHANGE TRANSACTION FEE.—The term ‘interchange transaction fee’ means any fee established, charged or received by a payment card network for the purpose of compensating an issuer for its involvement in an electronic debit transaction.

“(9) ISSUER.—The term ‘issuer’ means any person who issues a debit card, or credit card, or the agent of such person with respect to such card.

“(10) NETWORK FEE.—The term ‘network fee’ means any fee charged and received by a payment card network with respect to an electronic debit transaction, other than an interchange transaction fee.

“(11) PAYMENT CARD NETWORK.—The term ‘payment card network’ means 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.

“(d) ENFORCEMENT.—

“(1) IN GENERAL.—Compliance with the requirements imposed under this section shall be enforced under section 918.

“(2) EXCEPTION.—Sections 916 and 917 shall not apply with respect to this section or the requirements imposed pursuant to this section.”

(b) AMENDMENT TO THE FOOD AND NUTRITION ACT OF 2008.—Section 7(h)(10) of the Food and Nutrition Act of 2008 (7 U.S.C. 2016(h)(10)) is amended to read as follows:

“(10) FEDERAL LAW NOT APPLICABLE.—Section 920 of the Electronic Fund Transfer Act shall not apply to electronic benefit transfer or reimbursement systems under this Act.”

(c) AMENDMENT TO THE FARM SECURITY AND RURAL INVESTMENT ACT OF 2002.—Section 4402 of the Farm Security and Rural Investment Act of 2002 (7 U.S.C. 3007) is amended by adding at the end the following new subsection:

“(f) FEDERAL LAW NOT APPLICABLE.—Section 920 of the Electronic Fund Transfer Act shall not apply to electronic benefit transfer systems established under this section.”

(d) AMENDMENT TO THE CHILD NUTRITION ACT OF 1966.—Section 11 of the Child Nutrition Act of 1966 (42 U.S.C. 1780) is amended by adding at the end the following:

“(c) FEDERAL LAW NOT APPLICABLE.—Section 920 of the Electronic Fund Transfer Act shall not apply to electronic benefit transfer systems established under this Act or the Richard B. Russell National School Lunch Act (42 U.S.C. 1751 et seq.).”