



# Banking Law

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## The Fed Settles the Debit Card Issue

Author: [Barrie VanBrackle](#)

**On June 29, 2011, the Federal Reserve published its final rule, known as Regulation II, Debit Card Interchange Fees and Routing (the “Rule”), which implements Section 1075 of the Dodd–Frank Wall Street Reform and Consumer Protection Act. The Rule differs in several respects from the proposed regulation that the Federal Reserve Board issued on December 16, 2010 (“Original Proposal”). Below are the key points:**

1. The Rule is effective October 1, 2011, except for Section 235.7(a), which is effective on April 1, 2012 (except for (i) payment card networks, for which this section is effective October 1, 2011 [which means that as of that date, a network may not enforce a rule that restricts the ability of an issuer to add a network to comply with the Rule]; (ii) issuers with respect to debit cards that use transaction qualification or substantiation systems, for which this section (235.7) is effective April 1, 2013; and (iii) April 1, 2013, for general-use prepaid cards sold and reloaded prior to April 1, 2013; but for a general-use card sold prior to April 1, 2013, and reloaded thereafter, the card must be compliant within 30 days of the reloading).
2. Issuers that, together with affiliates (which would include both U.S. and foreign affiliates), have assets less than \$10 billion and electronic debit transactions made using either debit cards under certain government-administered programs or certain reloadable prepaid cards are still exempted from the interchange fee restrictions as set forth in the Original Proposal (but not from the network exclusivity arrangements and

merchant routing restrictions). However, the interchange exemptions available for the reloadable cards and cards issued under a government program terminate after one (1) year from the effective date of the statute if either of the following fees may be charged: (i) a fee for an overdraft, or (ii) a fee imposed by the issuer for the first withdrawal per month from an ATM that is part of the issuer's designated ATM network.

3. An issuer may not receive or charge a debit interchange transaction fee in excess of the sum of a 21-cent base component and five (5) basis points of the transaction's value (which the Board believes is a reasonable limit on the highest amount of an interchange fee that an issuer may receive). An issuer may also charge an extra one-cent fee if it meets certain fraud-prevention criteria.

4. Debit transactions covered by the Rule include transactions that access business and consumer accounts (but excludes debit transactions from a bona fide trust account or accounts structured as bona fide trust arrangements, such as a health savings account).

The Board adopted a definition of "account" that restricts the term to those accounts located in the United States. The Rule defines "United States" as the states, territories, and possessions of the United States; the District of Columbia; the Commonwealth of Puerto Rico; and any political subdivision of any of the foregoing.

5. Under the Rule, ATM transactions are not subject to either the interchange fee standards or the network exclusivity and routing provisions. The Rule provides that a network providing only ATM services is not a payment card network (insofar as withdrawing money from one's own account is not a payment to the ATM operator "in exchange for goods or services, to satisfy an obligation, or for other purposes"). Three-party systems (in which a single payment entity is the issuer and acquirer) are excluded from the definition of "payment card network."

6. The final Rule "does not seek to set or establish the amount, type or level of network fees that a network may permissibly impose on any network participant for its services" (although the Rule prohibits circumvention or evasion of the interchange fee restrictions, a comment provides that increases in network fees charged to merchants or acquirers and decreases in network fees charged to issuers do not by themselves constitute circumvention or evasion of the interchange transaction fee standards; however, such actions may warrant supervisory scrutiny).

7. Section 235.7(a) requires a debit card subject to the Rule to be enabled on at least two (2) unaffiliated payment card networks, regardless of the method of authentication (i.e., an issuer could comply by enabling two (2) PIN debit networks per card, as long as such networks were unaffiliated as defined by the Rule). The comments specifically provide that an issuer COULD NOT comply with the network exclusivity provision by adding a second unaffiliated payment card network that is accepted in only a limited geographic region of the country. However, an issuer could comply if the debit card operates on one national network and multiple geographically limited networks that are unaffiliated with the first network and that, taken together, provide nationwide coverage.

8. The Rule does not require a debit card that operates on two or more different unaffiliated payment card networks to bear the brand, mark, or logo for each card network.

9. The Rule provides that merchants, not issuers or networks, can direct the routing of debit transactions to a payment card network that the issuer has enabled on the particular card (not to just any payment network). The comments provide that a payment card network could offer incentives to a merchant to route transactions to that network.

10. The definition of “debit card” in the Rule does not specifically exclude “an account number, when used to initiate an ACH transaction to debit a person’s account,” as provided in the Original Proposal. The comments provide that hybrid cards (for example, decoupled debit) that permit some transactions to be posted directly to an account as defined in the Rule are considered debit cards.