

The Durbin Amendment: What Does Regulation II – The Final Ruling -- Mean for Prepaid?

**A discussion of the Final Interchange Regulations Under the
Dodd Frank Act, Effective October 1, 2011**

August 2, 2011

Presented by:

Judie Rinearson, New York City

Linda Odom, Washington, D.C.

Courtney Stolz, Washington, D.C.

Agenda

- **Introduction – Judie Rinearson**
 - Where are we today?
 - Brief Update on new FinCEN regulations released July 26, 2011
- **Interchange: Definitions and Fees – Courtney Stolz**
- **Interchange: Exemptions – Judith Rinearson**
- **Routing, Exclusivity and Next Steps– Linda Odom**
- **Question and Answer Session – Judith Rinearson**

Background: What's happening now?

- Law has passed – Dodd Frank Wall St Reform and Consumer Protection Act – May 2010
- First Regulations Issued December 16, 2010
- 11,000+ Comment letters and complaints – extremely controversial
- “Durbin Delay” legislation failed June 8, 2011
- Regulation II issued June 29, 2011

Results: Could've been much worse – but could've been better...

- Interchange fees increased somewhat and fraud adjustment added
- Wherever there was a choice of alternatives, the banking industry choices were generally adopted
- Effective dates have been delayed to October 2011 (interchange) and later to 2012 – 2013 (routing)
- ***But still many concerns – including the applicability and enforcement of exemptions***
- ***Network Branded Prepaid Card Association (NBPCA) has submitted 5 questions to the Fed for further clarification...***

30 days later - Still considerable uncertainty

But first... a brief Note on FinCEN's **Prepaid Access Final Rule**

- Published in Federal Register July 29th.
- Some important changes since NPRM -
 - Prepaid Providers can be designated by contract ([Q: problematic?](#)).
 - Retailers do not have to collect and verify ID for cards that are exempt or that cannot be used until after ID is verified.
 - Cards that can only have \$1000 or less in value, no international usage, no P2P transfers and *no loads other than at depository institutions* exempt.
 - Cards that provide government funds only, or FSA/HRA programs exempt
 - Closed loop cards under \$2000 exempt even if usable outside the US.
- Providers & Sellers must report Suspicious Transactions involving \$2000 or more
- Sellers of prepaid access must establish procedures to obtain and verify ID on persons who obtain prepaid access of more than \$10,000 during any one day,
- The final rule becomes effective September 27, 2011 but MSB registration for providers is not required until January 29, 2011.

ID at reload of active cards? MORE TO COME....

Interchange Provisions - Definitions

§ 235.2 Definitions

Account

- Means a transaction, savings, or other asset account (other than an occasional or incidental credit balance in a credit plan) established **for any purpose** and that is located in the United States; and
- Does not include an account held under a *bona fide* trust agreement that is excluded by section 903(2) of the Electronic Fund Transfer Act and rules prescribed under the applicable state law or the Internal Revenue Code.

Interchange Provisions - Definitions

Debit card

- Means “any card, or other payment code or device, issued or approved for use through a payment card network to debit an account, regardless of whether authorization is based on signature, personal identification number (PIN), or other means, and regardless of whether the issuer holds the account” and any general-use prepaid card.
- The term does **not** include (i) cards redeemable at a single merchant or affiliated group of merchants for goods or services, or (ii) checks, drafts or similar paper instruments (or electronic representations thereof).

Note: *the proposed exclusion for “an account number, when used to initiate an ACH transaction to debit a person’s account” was **not** adopted. But Deferred Debit, Decoupled Debit ARE included as “debit”. “Hybrid” Cards and Mobile Wallets – Depending on the circumstances.*

Interchange Provisions – Definitions

Electronic debit transaction

- Means “the use of a **debit card** by a person as a form of payment in the United States to initiate a debit to an **account**.”

The term does not include “transactions initiated at an ATM, including cash withdrawals and balance transfers initiated at an ATM.” Also does not include purchases made outside the US.

Does include online purchases, and cash-back at the POS.

Interchange Provisions – Definitions

General-use prepaid card

- Means “a card, or other payment code or device, that is— (1) Issued on a prepaid basis in a specified amount, whether or not that amount may be increased or reloaded, in exchange for payment; and (2) Redeemable upon presentation at multiple, unaffiliated merchants for goods or services.”

Note: Reference to “use at ATMs” deleted

Reward Cards, Phone Cards, Paper-only products, HSA Cards included (but may be excluded elsewhere). Also, Selective Authorization (University cards; Mall cards) included.

Interchange Provisions – Definitions

Issuer

- Means “any person that authorizes the use of a debit card to perform an electronic debit transaction”

BIN Sponsored Cards -

- Sponsored debit card model: a payment network member bank sponsors debit cards for a Community Bank or Credit Union - - issuer is the Community Bank or Credit Union
- Prepaid Card Model: a payment network member bank sponsors prepaid cards for a program manager – issuer is the member bank who sponsors the prepaid card.

Interchange Provisions – Definitions

Payment card network

- Means “an entity that— (1) Directly or indirectly provides the proprietary services, infrastructure, and software that route information and data to an issuer from an acquirer to conduct the authorization, clearance, and settlement of electronic debit transactions; and (2) A merchant uses in order to accept as a form of payment a brand of debit card or other device that may be used to carry out electronic debit transactions.”

Excludes Three Party Systems. Excludes ATMs and ACH.

Interchange Provisions – Amount of Interchange (§235.3)

- “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 electronic debit transaction.”
- Each such fee may be no more than the sum of 21 cents plus 5 basis points (.05%) multiplied by the value of the transaction.
- \$50 = 23.5¢ [21¢ + 2.5¢ ($\$50 \times .05 / 100$)]
- \$500 = 46¢ [21 ¢ + 25¢ ($\$500 \times .05 / 100$)]
Plus a potential Fraud Adjustment

Interchange Provisions – Amount of Interchange (§235.3)

- Based on total transaction processing costs, network processing fees, transaction monitoring and fraud losses
- Median per-transaction processing costs for *all* types of debit transactions: 11¢.
 - Signature 13¢; PIN 8¢; Prepaid 61¢
- 80th Percentile of per-transaction processing costs for *all* types of debit transactions: 19¢
 - Signature 21¢; PIN 14¢; Prepaid \$1.52.

No guarantee that Consumers will benefit. “Hard to predict effect on Consumers”

The Interchange Provisions – Fraud Prevention Adjustment (§235.4)

- **How much?**
“an additional amount of no more than **1 cent** per transaction”
- **Who’s eligible?**
An issuer who has **(1)** developed and implemented 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; **AND**

Interchange Provisions – Fraud Adjustment

- **(2)** Who reviews its fraud-prevention policies and procedures at least annually, and updates them as necessary to address changes in prevalence and nature of fraudulent electronic debit transactions and available methods of detecting, preventing, and mitigating fraud.”
- In order to be eligible for this fraud-prevention adjustment, issuers must annually certify compliance to their payment card networks.
- Previous example - \$50 transaction = 24.5 cents

An “Interim Final Rule” - Comments Due September 30, 2011

Interchange Provisions – 3 Exemptions (§235.5) -- #1

Exempt if the issuer together with its affiliates have assets of less than \$10 billion

Issuer: Must hold the asset account that is debited through an electronic debit transaction.

Affiliate: To be an “affiliate,” an institution must control, be controlled by or be under common control with the issuer; hence, a small issuer that provides prepaid issuance services for large entities is excluded, unless the large entities are under common control with the issuer.

Foreign Affiliates are Included in the calculation.

Exclusion for interchange ONLY – not for routing/exclusivity

July 12th - Fed issued a list of exempt and non-exempt. Issuance is Key.

IMPORTANT – Full exemption – no need to worry about GPR issues.

Exemptions are most frequently asked questions.

Interchange Provisions – Exemption #1

- Decoupled Debit? The issuer (the entity that authorizes the cardholder to use the card) must ALSO “hold the account” from which with the transaction is debited. “An issuer of a decoupled debit card is not exempt under § 235.5(a), even if, together with its affiliates, it has assets of less than \$10 billion, because it is not the entity holding the account to be debited. “
- Will Payment Networks establish a two-tier system for large vs small issuers? **Yes.**
- When will we know impact on prepaid programs? **Uncertain.**
 - Networks are seeking self-certification, probably on a BIN Basis
 - Likely timing for certification: August 31st
 - Banks working on communications to program managers and clients now.
- Long-term: Board will survey and publish list of average interchange fees for both exempt and non-exempt entities “to monitor the effectiveness” of the exemption for small issuers.

A lot is happening. There will be notices provided soon.

Interchange Provisions – Exemption #2

Exempt if it is a debit or prepaid card provided to a person pursuant to a federal, state or local government administered payment program **where the holder can ONLY access funds from such program.**

- *no exclusion for network routing provisions*
- *Includes child support; unemployment; Jury duty*
- *Tribal governments would be included as a “local” government program*
- Higher Education issues: Funds from student loans, government grants? Commingled with other funds? in a separate “bucket”?
- *Depends on whether institution is administering on behalf of the government or on its own behalf. “Just because it’s Gov’t funds doesn’t mean it’s Gov’t “administered”.*

Sole means of access” rule doesn’t apply here.

Interchange Provisions – Exemption #2

Exclusion can be lost if:

- one year after the effective date a fee for an overdraft (including a fee assessed for a shortage of funds or for a transaction processed for an amount exceeding the account balance) **may be charged**; or a fee imposed by the issuer for the first ATM withdrawal per month from an ATM that is part of the issuer's designated ATM network **may be charged**

Interchange Provisions – Exemption #3

- (3) Exempt if it is a **reloadable general use prepaid card**
- (i) Not issued or approved for use to access or debit any account held by or for the benefit of the cardholder (other than a subaccount or other method of recording or tracking funds purchased or loaded on the card on a prepaid basis)
 - (i) Reloadable and not marketed or labeled as a gift card or gift certificate (**open loop gift cards issued by large banks ARE covered – no exemption**); and
 - (ii) ***The card is the only means of access to the underlying funds, except when all remaining funds are provided to the cardholder in a single transaction.*** **NO** convenience checks, bill pay or remittance via ACH, “because certain reloadable prepaid cards are virtually identical in function to debit cards”
- *Subaccount is an “account within an account” opened for benefit of two or more cardholders, where transactions are tracked in such subaccounts. An account opened for one cardholder is NOT a subaccount.*

Interchange Provisions – Exemption #3

- **Sole Means of Access Restriction: Why added in the Final Rule?**
- Focus is more on the means of Cardholder access – not the settlement at the end of the day.
- Does not impact LOADS onto cards, but how funds are accessed.
- Presenting the card at a bank teller to receive cash from the card is *still using the card as a sole means of access*. But going into a bank with the routing & transit number, filling out a draw check, and requesting funds *is NOT*.
- ACH Bill Pay? *If Cardholder is not empowered to instruct an ACH from his or her card funds, seems it should be okay. But uncertain.*
- Convenience checks obtain with the card and paid from a 3rd party's account – not the card account? *Also Uncertain.*
- Can convenience checks that can be used each month solely to cash-out the entire balance on the card be acceptable? Under the text of the statute: yes – “all remaining funds in a single transaction”; but explanatory text says “one-time” cash-out. *Also uncertain.*
- Card to Card transfers? Depending on structure, could be okay.

Interchange Provisions – Exemption #3

As with Government Administered Programs-- -

Exclusion can be lost if: one year after the effective date a fee for an **overdraft** (including a fee assessed for a shortage of funds or for a transaction processed for an amount exceeding the account balance) **may be** charged; or a fee imposed by the issuer for the **first ATM withdrawal** per calendar month from an ATM that is part of the issuer's designated ATM network **may be** charged

Keep in mind: Small issuers (less than \$10 Billion) not subject to these limitations as well.

Interchange Provisions

- **§ 235.6 Prohibition on circumvention, evasion, and net compensation**
- Circumvention or evasion of the interchange transaction fee restrictions in §§ 235.3 and 235.4 is prohibited.
- An issuer “may not receive net compensation from a payment card network with respect to electronic debit transactions or debit card-related activities within a calendar year.”
- Replacing a debit card with a prepaid card is not per se circumvention “but warrants additional supervisory scrutiny”

[**Net Compensation:** When incentives paid by a payment network to the card issuer exceeds the fees paid by the issuer to the network]

Interchange Provisions – Practical Implications

- Clock is ticking. Will we have enough time? October 1st deadline for most interchange transactions.
- Reg E – 21 days prior notice for change in terms
- Fed response at least a week away – likely longer.
- Networks and banks are all scrambling to get procedures in place.

Routing and Exclusivity (§235.7)

- **Alternative A:** An issuer or payment card network is prohibited from restricting the number of payment card networks to less than two unaffiliated networks PER CARD. (PIN or Signature or Combination)
- Each of the unaffiliated payment card networks must not, by rule or policy, restrict the operation of the network to a limited geographic area, merchant, or type of transaction and each of which has taken steps reasonably designed to enable the network to process the electronic debit transactions that the network would reasonably expect will be routed to it, based on expected transaction volume

Routing and Exclusivity

Impact?

- Many debit and reloadable prepaid cards already have two unaffiliated networks
- Does not prohibit 2 affiliated networks on one card so long as there is at least one other unaffiliated network

Issue: Non-reloadable Open Loop Gift Cards

- Difficulty: Only one signature network per card
 - No PIN network, no addresses for sending PINs
 - Board urged to exempt such cards entirely
- Decision: No exemption. Instead, more time to figure it out
 - April 1, 2013
- *Several questions submitted on this issue.*

Routing and Exclusivity

Subsequent affiliation

- If unaffiliated payment card networks become affiliated (as a result of a merger or acquisition), the affected issuer must add an unaffiliated payment card network within 6 months

Prohibited exclusivity arrangements by networks.

- A payment card network “may not restrict or otherwise limit an issuer’s ability to contract with any other payment card network that may process an electronic debit transaction involving the issuer’s debit cards.”

Voluntary exclusive arrangements - -

- Prohibited even if there is no contractual rule or restriction.

Routing and Exclusivity

- Applies to ALL debit and general-use prepaid cards (Interchange exemptions don't apply here)
- Other “form factors”? Mobile phones? Fobs?
 - Routing restrictions still apply
 - Supplemental access device connected with a card - must also comply.
- Not Covered:
 - Three-party systems, ATMs

Routing and Exclusivity

- Displaying payment network logos
 - Contractual requirements or rules that only that network's brand, mark, or logo may be displayed on a particular debit card or that otherwise limit the ability of other brands, marks, or logos to appear are *Prohibited*
 - But a debit card is *not required* to display the brand, mark, or logo of each payment card network over which an electronic debit transaction may be processed
- Incentives permitted
 - Merchants cannot be prohibited or discouraged from using a particular network or authorization process
 - But payment networks CAN offer payments or incentives to Merchants to encourage specific routing.

Effective Dates

- Interchange requirements – October 1, 2011
- Contractual Routing and Exclusivity Restrictions generally for Issuers and Payment Networks - October 1, 2011
- Changes to Cards for Routing and Exclusivity generally for issuers - April 1, 2012
- Routing and Exclusivity for HSA / FSA / HRA cards (those using transaction substantiation systems) – April 1, 2013
- Special Rules for Prepaid Card issuers – generally April 1, 2013
 - Non-reloadable sold before April 1, 2013 exempt
 - For reloadable cards sold and reloaded prior to April 1, 2013, the effective date for routing rules is May 1, 2013;
 - For reloadable cards sold prior to April 1, 2013 and reloaded on or April 1, 2013, the effective date for routing rules is 30 days after the date of reloading

Q & A – Other questions

- Closed loop cards
- Three party systems
- What positive opportunities exist? B2B debit?
- How will it impact consumers over time? Change of procedures at the POS?
- Long term – can small banks really retain their higher interchange?
- Future of debit rewards?
- What will happen if non-reloadable gift cards have to add a PIN-based network to the cards?

Thanks! Contact:



Judie Rinearson, *Partner*, New York
judith.rinearson@bryancave.com



Linda Odom, *Counsel*, Washington
linda.odom@bryancave.com



Courtney Stolz, *Contract Lawyer*, Washington
courtney.stolz@bryancave.com