

Regulatory Update

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Federal Reserve Board Releases Final Regulations to Implement the Durbin Provision of the Dodd-Frank Wall Street Reform Act

On June 29, 2011, the Federal Reserve Board released the highly-anticipated final regulations implementing Section 1075 (the Durbin amendment) of the Dodd-Frank Wall Street Reform Act.

Within the Act, the FRB was directed to establish regulations on several key components:

Debit Interchange Rates: debit card interchange rates must be reasonable and proportional to the cost of each debit transaction.

Circumvention of the Debit Interchange Rate: payment card networks may not use network fees to directly compensate debit card issuers and circumvent the interchange rate restrictions.

Fraud Standards: the FRB may adjust the debit interchange rate based on certain fraud prevention activities undertaken by a debit card issuer.

Network Exclusivity: debit card issuers may not enter into exclusive processing arrangements with one payment card network or two affiliated networks.

Merchant Routing: merchants will be allowed to direct the routing of debit card transactions.

On the following page, find a comparative summary of the proposed and final regulations for each of the above key provisions within Section 1075.

Executive summary of the proposed and final regulations for each of the above key provisions within Section 1075

PROVISION	PROPOSED REGULATIONS	FINAL REGULATIONS	EFFECTIVE DATE
DEBIT INTERCHANGE RATES	<p>The FRB proposed two alternatives – both apply only to card issuers with \$10B and above in assets:</p> <ul style="list-style-type: none"> <i>Alternative 1:</i> An issuer would be permitted to determine a maximum interchange fee by calculating the average variable cost for authorization, clearing and settlement of a debit transaction with a safe harbor for interchange rates up to \$.07 per transaction, not to exceed the interchange rate cap of \$.12 per transaction. <i>Alternative 2:</i> An issuer would be permitted to set the debit interchange rate not to exceed \$.12 per transaction. 	<p>The FRB adopted a modified version of proposed Alternative 2: a stand-alone cap of \$.21 per transaction with an ad valorem component of 5 basis points (to reflect each issuer's portion of fraud losses).</p>	October 1, 2011
CIRCUMVENTION OF DEBIT INTERCHANGE	<p>Debit card issuers may not receive net compensation from a network for debit card transactions that exceeds total fees that an issuer pays to a network. (Applies only to issuers with \$10B and above in assets)</p>	<p>The FRB will review circumvention/evasion of debit interchange regulations on a case-by-case basis. Net compensation from a network to an issuer (excluding interchange fee revenue + other specific types of revenue) is prohibited, although that may not be the only determining factor in a finding of circumvention/evasion.</p>	October 1, 2011
FRAUD STANDARDS	<p>The FRB did not propose an adjustment to the interchange rate based on fraud prevention activities. (Applies only to issuers with \$10B and above in assets)</p>	<p>The FRB issued an interim final rule for public comment that allows a fraud prevention adjustment to the debit interchange cap of \$.01 per transaction, provided an issuer meets general fraud prevention standards.</p>	October 1, 2011
NETWORK EXCLUSIVITY	<p>The FRB proposed two alternatives – both of which would apply to ALL financial institutions, regardless of asset size:</p> <ul style="list-style-type: none"> <i>Alternative 1:</i> Require debit card issuers to participate in two unaffiliated networks without regard to the authorization method (i.e., one signature network and one unaffiliated PIN network). <i>Alternative 2:</i> Require more than one unaffiliated network for each method of authorization (i.e., two unaffiliated signature networks and two unaffiliated PIN networks). 	<p>The FRB adopted Alternative 1, which requires each debit card issuer to participate in two unaffiliated networks without regard to the authentication method.</p>	<p>Networks may not have exclusive arrangements beginning October 1, 2011. Issuers must participate in 2 unaffiliated networks beginning April 1, 2012</p>
MERCHANT ROUTING	<p>Merchants will be allowed to control the routing of debit card transactions, but routing is limited to the payment card networks enabled on the debit card.</p>	<p>The FRB adopted the merchant routing provisions as outlined in the proposed rule.</p>	October 1, 2011

The full text of the regulations can be accessed through the below URL:
<http://www.federalreserve.gov/newsevents/press/bcreg/20110629a.htm>