What to Do Next: A Post-Durbin Checklist for Financial Institutions

On June 29, 2011, the Federal Reserve Board (FRB) released the final regulations pertaining to Section 1075 (the Durbin Amendment) of the Dodd-Frank Wall Street Reform Act. Because most of the provisions take effect on October 1 of this year, financial institutions must act quickly to achieve compliance and take the necessary strategic steps to minimize any negative impact on their business and position themselves for the future.

The following are brief summaries of the key provisions of the new regulations, as well as recommendations for responding to them.
Debit Interchange Rates

**Effective Date:** October 1, 2011

**Final Regulations:** Debit interchange composed of a base component capped at $0.21 per transaction, plus an ad valorum component of 5 basis points on the total transaction value (to offset a portion of each issuer’s fraud losses).

**Applies to:** Financial institutions with assets greater than $10 billion

**Actions for Debit Issuers:**

- Prepare immediately for budgetary impact. The new interchange fee standard could result in a 30-40 percent reduction in interchange revenues for some issuers, so revenue forecasts and spending plans must be adjusted accordingly.
- Evaluate the economic feasibility of debit rewards programs. Determine whether programs must be restructured or eliminated. Explore the option of replacing or supplementing existing loyalty programs with merchant-funded debit rewards.
- Identify cost savings opportunities. Reduced debit transaction profit margins mean issuers must seek greater cost efficiency throughout their DDA and debit product portfolios. Consider outsourcing functions that may currently be handled in-house, such as processing, servicing, card production, and statements. Depending on an institution’s cost structure, it may make sense to encourage customers to use PIN debit instead of signature debit.
- Segment customers to better understand opportunities and options. Consider migrating some customers to credit/charge card products or general purpose reloadable prepaid (GPR) products. (However, each institution should examine the regulatory criteria associated with general purpose prepaid products to ensure clarity on exempted versus non-exempted prepaid products. In addition, each institution should carefully review the recent federal law (CARD Act) implementing regulations applicable to credit cards.) If an institution does not currently issue credit cards, it should re-assess the possibility of doing so.
- Pursue new revenue opportunities. According to the FDIC, 85 percent of DDA revenue comes from non-interchange sources. Seek to recoup lost interchange revenue through fee-based account services like personal financial management (PFM) tools and expedited bill payment.
- Conduct analyses on revenue sources, consumer transaction behavior, and sensitivity to fees across your customer base and within specific customer segments. Use the resulting insight to design new pricing strategies and guide revenue replacement efforts.
- Closely monitor the competition. Create a detailed competitive map to keep track of competitors’ pricing modifications, product introductions and marketing tactics in the aftermath of the new regulations. Identify new opportunities and threats based on changes in the marketplace.

Network Exclusivity

**Effective Date:** October 1, 2011 for networks and April 1, 2012 for issuers

**Final Regulations:** Debit card issuers must participate in two unaffiliated networks without regard to the authorization method (e.g., one signature network and one unaffiliated PIN network, two unaffiliated PIN or signature debit networks).

**Applies to:** All debit card issuers and general purpose reloadable prepaid issuers, regardless of asset size

**Actions for Debit Issuers:**

- Add another PIN debit network, if necessary. Institutions that currently work with a single debit network provider (i.e., Visa/Interlink or MasterCard/Maestro) need to add a second unaffiliated debit network to their existing arrangement. While the regulations do not stipulate the need to replace a network, institutions should consider the potentially significant economic benefits yielded by a network replacement strategy. Selecting a new PIN debit network is an important strategic decision that should take into account many considerations, including merchant acceptance, operational capacity and performance, fraud mitigation, and innovation capabilities and overall strategic value.
- Take action now. While issuers don’t have to comply with the multiple network requirement until April 1, 2012, networks will not be able to enforce existing exclusive arrangements or enter into new exclusive arrangements as of October 1. Further, the network contracting and implementation timeframes require ample lead-time to ensure timely compliance and management of customer and business risk. Take advantage of the extra time to fully research other networks’ product offerings and become a member this year to ensure everything is in place before the April 1, 2012 deadline. (see timeline on p. 3)
Fraud Standards

Effective Date: October 1, 2011

Interim Final Regulations: Proposes a fraud prevention adjustment to the debit interchange cap of $.01 per transaction if an issuer meets general fraud prevention standards. (Comments due September 30, 2011)

Applies to: Financial institutions with assets greater than $10 billion

Actions for Debit Issuers:

- Review the general fraud standards outlined in the interim final rule and develop policies and procedures to: identify and prevent fraudulent debit transactions; monitor the incidence of/reimbursements received for losses incurred from fraudulent debit transactions; respond appropriately to suspicious debit transactions to limit fraud losses; and secure debit card and cardholder data.

- Develop a process to ensure adherence to the fraud prevention standards on an on-going basis.

Merchant Routing

Effective Date: October 1, 2011

Final Regulations: Merchants allowed to control the routing of debit card transactions (limited to the payment card networks enabled on the debit card).

Applies to: Merchants

Actions for Debit Issuers:

- Issuers should seek out network partners that have strong relationships with merchants and that offer nationwide acceptance. Merchant relationships and acceptance will become increasingly important in the post-Durbin marketplace, so issuers should seek partners that have experience working with all industry stakeholders and a history of expanding PIN debit acceptance and utility (e.g., new verticals, new access methods).

Network Exclusivity Compliance Timeline

YOUR TIMELINE FOR STRATEGIC AND COMPLIANCE DECISION-MAKING AND IMPLEMENTATION

<table>
<thead>
<tr>
<th>FI Network Selection Process</th>
<th>Planning &amp; Implementation*</th>
<th>Prepared</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contracting &amp; Internal FI Approvals</td>
<td>Year-end Industry IT Freeze</td>
<td></td>
</tr>
<tr>
<td>July '11</td>
<td>Aug '11</td>
<td>Sept '11</td>
</tr>
</tbody>
</table>

Effective October 1, 2011:
- Interchange cap
- Circumvention of interchange
- Fraud adjustment to interchange cap
- Merchant routing
- End of network-imposed exclusivity arrangements

*Implementation Components:
- Detailed implementation planning
- FI debit volume projections
- Core banking processor readiness
- Telecom configuration & orders
- Debit processor capacity & readiness
- Debit network capacity & readiness

Effective April 1, 2012: Issuer compliance with network exclusivity

Network configurations differ and may impact your timetable