The Durbin Amendment and the Prepaid Card Industry

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Durbin Amendment: Implementing Law and Regulation; Litigation

- Part of Dodd-Frank Wall St Reform and Consumer Protection Act (May 2010), with two major areas of impact:
  - Limitations on interchange fees for certain debit (including prepaid) card transactions
  - Network routing requirements for all debit/prepaid cards
- Fed Issues Regulation II to implement Durbin Amendment:
  - Final Rule issued June 29, 2011; effective Oct. 1, 2011. Certain provisions effective 4-1-12 and 4-1-13
  - Fraud-Prevention Adjustment: Final Rule issued July 27, 2012; effective October 1, 2012
  - FAQs Issued 9-14-11 and expanded/revised 10-24-11; 3-13-13; 5-30-13
Limitations on Interchange Fees

Maximum interchange fee on debit card transactions is:

• 21 ¢; plus

• 5 bps of the transaction value (5¢ per $100); plus

• Possible 1¢ fraud prevention adjustment

*But* see Slides 20-23 re the Durbin litigation
Fraud Prevention Adjustment

To obtain the 1¢ fraud prevention adjustment, an issuer must do the following:

1. Implement policies/procedures reasonably designed to:
   
   • Identify and prevent fraudulent debit transactions
   • Monitor frequency of, losses from, and reimbursements for debit transactions
   • Respond to suspicious transactions to limit losses and prevent future fraud
   • Secure debit card and cardholder data
To obtain the 1¢ fraud prevention adjustment, an issuer must also:

Review its fraud-prevention policies and procedures at least annually, and update them as necessary in light of: (i) their efficacy in reducing fraud; (ii) their cost-effectiveness; and (iii) changes in types, methods, and ways to detect/prevent fraud

Notify payment card networks annually of its compliance
Exemptions From Limitations on Interchange Fees

“Small Issuer” Exemption

Exemption for Certain Government Administered Programs

GPR Card Exemption
Small Issuer Exemption: Requirements

Issuer of the debit card must hold account being debited ("decoupled" debit cards cannot qualify for the small issuer exemption)

Issuer, together with affiliates, must have assets of less than $10 billion as of the end of the preceding calendar year
Small Issuer Exemption: Issues

- $10BB is worldwide, but does \textit{not} include trust assets

- Networks may rely on Federal Reserve Board publications re issuer assets

- If a small issuer grows so that assets exceed the $10BB threshold, institution must comply by July 1 of the next year

- If large institution acquires small institution and acquired entity ceases to exist, acquirer becomes “issuer” of the debit card and has 30 days to comply with the interchange limitations (FAQ)
Exemption for Certain Government-Administered Programs: Requirements

1. Card must be provided to a consumer pursuant to a federal, state, or local government-administered payment program.

2. The cardholder may use the debit card only to transfer or debit assets provided pursuant to such program.

3. Effective for interchange fees charged or received on or after July 21, 2012, the card account also meets certain requirements regarding overdraft fees and ATM withdrawals (Slide 16)
Exemption for Certain Government-Administered Programs: Issues

• Payment program must be administered by a governmental agency or by a service provider acting on behalf of a governmental agency, but the governmental agency does not need to be the source of the funds. Thus, the following sorts of payment programs would qualify for the exemption:
  o Child- or spousal-support payments through government agency (Commentary)
  o Student loan proceeds from federally-administered programs (FAQ)
  o Electronic benefit transfers or reimbursement systems established under the Food and Nutrition Act of 2008, the Farm Security and Rural Investment Act of 2002, and the Child Nutrition Act of 1966 (Statute)

• FSA, HSA, and HRA programs likely would not qualify (unless administered by or on behalf of a government employer).
GPR Card Exemption: Requirements

Funds underlying the prepaid card must be in an omnibus account in the name of an agent or custodian. The card may not be issued or approved for use to access or debit any account held by or for the benefit of the cardholder (a sub-account or other method of tracking funds is permissible).

Card must be reloadable (temporary non-reloadable cards are permissible) and must not marketed or labeled as a gift card or gift certificate (identical to CARD Act requirements).

Card (including card number) must be the **only** means of access to the underlying funds, **except** when all remaining funds are provided to the cardholder in a single transaction [e.g., cash or a check (including even a convenience check) for the remaining balance in the account].

Effective for interchange fees charged or received on or after July 21, 2012, the card account also meets certain requirements regarding overdraft fees and ATM withdrawals (Slide 16).
GPR Card Exemption: Issues (cont.)
Bill Payment

- Payment (one-time or recurring) on a merchant website using “information from the card” (e.g., card number and expiry date) is considered to be access using the card and will not cause loss of the exemption (FAQ).

- **But**, a “bill-pay” feature could disqualify a card from receiving the GPR exemption. Authorizing an issuer to make EFT (or check) payments to third parties is *not* considered to be access via the card (FAQ)

- If an issuer provides the cardholder with a method to authorize transfers to the account (e.g., a routing number and pseudo-DDA), the issuer must take steps to make sure the cardholder does not authorize access to the funds via ACH or other non-card means. The issuer may disclose that such use is prohibited, but if the cardholder engages in it anyway, the issuer must take further action to prevent it in order for the card to maintain its eligibility for the exemption (FAQ)
GPR Card Exemption: Other Issues

• Generally, no restrictions on methods of transferring money into the prepaid card account (other than no circumvention)

• Payroll cards: Non-card means to access wages in order to satisfy state labor statutes will not cause loss of exemption (FAQ).

• FSAs: Non-card means of accessing money in the account (i.e., via submitting paper or electronic claims to the administrator) will cause the card to lose the exemption (FAQ).

• If the issuer can settle transactions made with the card by debiting another account of the cardholder (instead of reducing the balance in the card account), the exemption is lost (FAQ)

• If the issuer can reload the prepaid account by making debit transactions from another account under standing instructions from the customer (i.e., reload whenever the balance falls below a certain amount), the exemption is lost (FAQ)
Overdraft / ATM Fee Limitations: Requirements

Effective for interchange fees charged or received on or after July 21, 2012, in order to qualify for the Government-Administered Program or GPR Card Exemptions:

No fee may be charged for an overdraft (including a shortage of funds or a transaction processed for an amount exceeding the account balance), except for a fee for transferring funds from another account to cover a shortfall in the account accessed by the consumer (such a transaction is not considered an “overdraft”)

No fee may be imposed by the issuer for the first withdrawal per calendar month from an ATM that is part of the issuer’s “designated ATM network.”
Overdraft / ATM Fee Limitations: Issues

• “Designated ATM Network” means either: (i) all ATMs in the issuer’s name or (ii) a network of ATMs identified by the issuer that provides “reasonable and convenient access to the issuer’s customers.”

• Whether a network provides “reasonable and convenient access” is a fact-based determination.

• Imposing a fee and later providing an offsetting credit will not meet the requirement not to charge a fee.

• Accidentally charging an overdraft or ATM fee that would violate this provision will not cause loss of exemption, so long as policies/procedures established to prevent charging such fees (FAQ).
Prohibition on Circumvention, Evasion, and Net Compensation

- Circumvention or evasion of the restrictions on interchange fees is prohibited (evaluated on a case-by-case basis)

- 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.

- “Net compensation” occurs when the total amount of payments/incentives paid by a payment network to the card issuer (excluding interchange) exceeds the total amount of fees paid by the issuer to the network.
Network Routing Requirements:
In General

- Neither issuer nor payment network may restrict the number of payment networks on which a debit transaction may be processed to less than two unaffiliated networks.

- Neither issuer nor payment network may inhibit a merchant’s ability to route a debit transaction for processing over any payment card network that may process such transactions.

- Exemptions for cards issued by small financial institutions, government benefits cards, and GPR cards do not apply.
Debit cards must be enabled on at least two unaffiliated payment card networks:

• May be two signature networks, two PIN networks, or one of each, so long as two networks are not affiliated (but see Slides 20-23 re Durbin litigation)

• May have more than two networks (including affiliated networks), so long as at least two unaffiliated networks

• The two unaffiliated networks must be able to process the transactions reasonably expected to be routed to them and must not be limited to specific type of transaction or geographic area
Network Routing
Two Unaffiliated Networks
When is a PIN Network “Enabled”? 

• For a PIN network to be “enabled,” the issuer must provide a PIN to the cardholder or have the cardholder select a PIN before or at the time a merchant first prompts the cardholder to enter a PIN (revised FAQ)

• Examples (Revised FAQ):
  o Provide (or have cardholder select) PIN at time of sale (e.g., on or in package)
  o Require activation after purchase and provide (or have customer select) PIN when cardholder activates card
  o Have cardholder select PIN the first time a merchant prompts them to enter one
  o If prepaid card is mailed, PIN may be mailed separately, but if so, PIN must be sent so that it would normally be received within 2 business days of the card.
Litigation
NACS v Board of Governors of Federal Reserve System
2013 WL 3943489 (D.D.C.)

- Plaintiffs (merchant trade associations and two individual retailers) alleged that the Fed had overstepped its authority and disregarded the intent of Congress in developing the interchange fee limitations and network exclusivity requirements in Reg. II.

- Court agreed with plaintiffs; granted their motion for summary judgment; and vacated the interchange fee limitation and network exclusivity provisions of the Regulation.

- Board appealed:
  - DC Cir. Ct. App. granted an expedited briefing and appeal schedule (all briefing must be filed by Dec. 4, 2013)
  - District Court stayed its order vacating portions of Reg. II pending the appeal (thus, the current provisions remain in effect for now)
• Statute instructs the Board that:
  o the incremental cost incurred by an issuer for the role of the issuer in the authorization, clearance, or settlement [\(\text{\textit{``ACS Costs''}}\)] of a particular electronic debit transaction shall be considered [in setting the permissible interchange fee]
  o other costs incurred by an issuer which are not specific to a particular electronic debit transaction, shall not be considered [in setting the permissible interchange fee]

• Plaintiffs: Argued there are only two categories (insert a comma after “issuer”). No costs other than ACS costs are specific to a particular transaction.
Litigation
District Court Opinion
Interchange Fee Limitations

• Board:
  o In its NPRM (7-12 cent interchange fee cap) the Board essentially adopted the plaintiffs’ view and proposed excluding all non-ACS costs as “fixed.”
  o In the final Rule, the Board took a more expansive view of “incremental” costs. The Board noted that for many non-ACS costs, it is impossible to determine whether and to what extent they are incurred as a result of one transaction vs. another and thus interpreted “which are not specific to a particular electronic debit transaction” to mean those costs that are not incurred in the course of effecting any electronic debit transaction.
  o Therefore, in the Final Rule, the Board concluded there was a third category – costs specific to a particular transaction but that are not ACS costs – on which the statute is silent. That meant the Board could include costs such as transaction processing, network processing fees, transactions monitoring, and fraud losses (over and above the one cent allowance) when setting the permissible interchange fee.

• Court agreed with plaintiffs
Litigation
District Court Opinion
Routing Exclusivity

• Plaintiffs: Not requiring two unaffiliated networks for each method of authentication is “restricting the number of payment networks on which a debit transaction may be processed to less than two unaffiliated networks”

• Board: Plain language of the statute does not require that there be two unaffiliated payment card networks available to the merchant for each method of authentication.
  
  o When a consumer selects an authentication method, it is the consumer, not the issuer or the payment network, that has limited the selection of payment networks.
  
  o When a merchant elects not to process PIN transactions (car rentals, hotels), it is the merchant, not the issuer or the payment network, that has limited the selection.

• Court agreed with plaintiff’s argument
Network Routing
Prohibitions on Network Exclusivity

• Networks may not limit or specify the other payment networks that may be enabled on a debit card

• Networks may not limit or restrict the display of other payment networks’ logos on debit cards

• Debit cards do not need to display logos of all networks that are enabled (no requirement to put multiple logos on card)
Network Routing
Prohibitions on Merchant Restrictions

• Networks may not prevent a merchant from directing a transaction to any enabled network

• Merchant may encourage/discourage use of preferred/non-preferred method of authorization (signature vs. PIN)

• Routing priorities prohibited, except as default if merchant, acquirer, or processor does not designate

• May not specify a network based on the type of access device issued or the manner in which it is used
• Merchants may offer non-discriminatory discounts or in-kind incentives to use preferred payment type (e.g., debit, credit, cash)

• Merchants may impose up to a $10 minimum for credit card transactions

• Federal agencies and higher education institutions may place a cap on credit card transaction amounts

• ATM transactions are not covered by the Regulation
QUESTIONS AND COMMENTS?