



Government Relations Newsletter

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FAQS: What You Need to Know about Regulation II, the Fed’s Proposed Rule, and the Impact on Interchange

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The Federal Reserve Board has proposed to amend Regulation II to clarify, among other things, that debit card issuers and payment card networks must enable each debit card transaction to be processed on at least two unaffiliated payment card networks for card-not-present transactions. In this FAQ, we break down the facts about this issue, starting with its roots in the Dodd-Frank Act.

What is meant by the Dodd-Frank Act?

Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (“[Dodd-Frank](#)”) in 2010 to reform financial services regulation in the aftermath of the Great Recession (2007-2009). Among many other changes to financial services regulation, Dodd-Frank amended the Electronic Funds Transfer Act (“EFTA”).

What is the EFTA?

Congress enacted the EFTA to protect consumers engaging in electronic funds transfers. The EFTA establishes the respective rights and liabilities of each party involved in an electronic funds transfer initiated by a consumer.

What Were the Amendments to the EFTA under Dodd-Frank?

Dodd-Frank amended the EFTA by adding Section 920 to the EFTA, which contains several provisions related to debit cards and electronic debit transactions and delegated the authority to administer Section 920 of the EFTA to the Federal Reserve Board (“FRB”).

As discussed further below, the purpose of Section 920 of the EFTA is to reduce the interchange transaction fees merchants must pay to “large bank” issuers (banks with over \$10 billion in assets). The bill also aimed to restrict anti-competitive practices and encourage competition, and included provisions which allow retailers to refuse to use credit cards for small purchases and offer incentives for using cash or another type of card. An interchange transaction fee is a fee the issuers of debit cards receive from the merchant to compensate such issuers for processing a transaction initiated by a consumer’s use of the issuer’s debit card. Debit card networks typically assess and collect interchange transaction fees and remit them to the issuer of the debit card.

What is Regulation II?

The FRB’s [Regulation II](#) (“Reg II”) implements Section 920 of the Electronic Fund Transfer Act and, among other requirements, requires “large bank” issuers of debit cards to receive and charge reasonable and proportional interchange transaction fees for electronic debit transactions. Under Regulation II, an interchange transaction fee is reasonable and proportional only if it is no more than the sum of (i) 21 cents; and (ii) 5 basis points multiplied by the value of the transaction. Subject to certain conditions, Reg II permits issuers of debit cards to charge or receive a fraud-prevention adjustment fee of no more than 1% in addition to an interchange transaction fee.

Reg II also prohibits issuers and payment card networks from restricting (i) the number of payment card networks on which an electronic debit transaction may be processed to less than two unaffiliated networks (known as the “prohibition on network exclusivity”); and (ii) the ability of any merchant to direct the routing of electronic debit transactions for processing over any payment card network that may process such transactions (known as the “prohibition on routing restrictions”). Unlike the interchange restrictions, the foregoing requirements pertain to all issuers (regardless of size).

The requirements established under Reg II apply only to debit card transactions (subject to certain exemptions) and not to credit card transactions.

What is the FRB’s Proposed Rule?

The FRB issued a notice of proposed rulemaking (“NPR”) on May 13, 2021 seeking public comment on a proposed rule to amend Reg II (comments were due on August 11, 2021). The FRB is proposing to amend Reg II to clarify (i) that debit card issuers and payment card networks must permit each debit card transaction to be processed on at

least two unaffiliated payment card networks for card-not-present transactions (i.e., to extend the “prohibition on network exclusivity” to card-not-present transactions); (ii) debit card issuers’ obligation to ensure that at least two unaffiliated payment card networks have been enabled for debit card transactions (i.e., to ensure compliance with the prohibition on network exclusivity); and (iii) standardize and clarify the use of certain terminology in Reg II.

Is Interchange Regulation Affected by the FRB’s Proposed Rule?

The FRB’s proposed rule does not affect interchange regulation under Reg II. The FRB’s proposed rule affects only the prohibition on network exclusivity under Reg II, as discussed above.

Why is the FRB Proposing These Amendments to Reg II?

The FRB is proposing these amendments to Reg II because it believes the Reg II prohibition on network exclusivity should apply to card-not-present transactions (i.e., transactions where the consumer does not present a card for payment but rather submits the card information to the merchant, such as for an online purchase). If the FRB adopts this amendment to Reg II (i.e., meaning the prohibition on network exclusivity applies to card-not-present transactions), then debit card issuers would need to enable at least two unaffiliated networks for card-not-present debit card transactions, and debit card issuers and networks would need to permit merchants to route transactions over such networks.

The FRB did not propose these amendments when Reg II was adopted in 2011 because at that time merchants could not route card-not-present transactions over multiple networks. The market had not yet developed solutions to enable such routing. Since the adoption of Reg II, many networks have introduced solutions to process card-not-present transactions, and card-not-present transactions have become a significant portion of all debit card transactions.

Accordingly, the FRB is proposing this amendment to Reg II because it believes (i) it is currently practical for debit card issuers and networks to enable and permit routing over multiple networks; (ii) card-not-present transactions play a major role in e-commerce; and (iii) it would promote competition in the online payment processing market and therefore reduce payment processing costs for merchants (and ultimately reduce the costs of goods and services for consumers).

Any Significant Comments Submitted to the FRB in Connection with the NPR?

Industry stakeholders have submitted nearly 2,300 [comments](#) to the FRB in connection with the NPR. Among other stakeholders, debit card issuing banks, card networks, merchants, and related trade associations have submitted comments to the FRB in connection with the NPR. Debit card issuing banks (particularly community banks) have submitted comments objecting to the proposed rule because they believe the proposed rule will increase their compliance burdens and costs as well as fraud in the payments ecosystem, among other reasons. Many comments submitted by merchants (i) support the proposed rule because of its potential to increase competition among debit card networks and result in lower cost and higher quality routing options for card-not-present transactions, among other reasons; and (ii) request reductions to the interchange fee limit in Reg II, which is outside the scope of this proposed rule (and therefore the FRB will likely not take such comments into consideration in its deliberations related to the proposed rule).

The [Department of Justice](#) (“DOJ”) and [Federal Trade Commission](#) (“FTC”) submitted comments to the FRB in connection with the NPR, which are among the most significant comments submitted. The DOJ and FTC are the primary federal antitrust regulators, and their comments highlight their belief that there currently is a significant lack of competition and significant barriers to entry in the online debit payment processing market. In fact, the DOJ and FTC support the FRB’s proposed rule because each believes clarifying the applicability of the Reg II prohibition on network exclusivity to card-not-present transactions may ultimately give merchants a real choice of networks and enable alternative debit card networks to grow and compete with the incumbent networks.

What is the Current Status of the FRB’s Proposed Rule?

The FRB is currently reviewing the comments submitted on or prior to the NPR comment deadline (August 11, 2021). The FRB has not issued any further notices relevant to the proposed rule since the comment deadline or any information regarding when it will issue a final rule, an amended proposed rule, or request for information.

Any Potential Impact on Credit Interchange?

The FRB’s proposed rule does not impact credit interchange fees (or debit interchange fees). As discussed above, the FRB’s proposed rule affects only the prohibition on network exclusivity under Reg II (note that Reg II applies only to debit transactions).

However, given the number of comments it has received, there has certainly been speculation regarding the interchange limits, and whether they will be revisited.



MAC Virtual Regional

Please join your fellow MAC members for an intimate day of sessions on Tuesday, Nov. 9, starting at 11 AM EST. With smaller 'micro' sessions centered on hot topics and larger panel discussions covering a range of sub-topics, attendees will be able to get vital information impacting the payments ecosystem.

This is a *complimentary event* for MAC members. To view the full agenda, please [click here](#).

Get Involved with MAC

As MAC approaches its 25th year we are hard at work continuously meet the needs of our members and partners more effectively. We have many exciting things planned based on member feedback, and we need your help to accelerate our delivery of new benefits and value.

This open call for volunteers offers an opportunity for members and nonmembers to support the implementation of our plan to CREATE the next level of impact at MAC.

As a MAC volunteer, you will be part of a passionate group of professionals dedicated to preserving the integrity of the payments ecosystem. While all volunteers are welcome, we are especially seeking individuals interested in collaborating with us in the following areas:

- Developing and launching new initiatives related to our Diversity, Equity, and Inclusion objectives.

- Crafting content, direction, and member engagement opportunities for our Social Impact initiatives.
- Teaming up with peers to elevate our Educational Programs and guide the development of new resources that keep members informed and support career growth.
- Communicating our messages to current and future members and partners to maintain our high levels of member satisfaction and ensure we keep evolving to meet their changing needs.
- Creating compelling new value for MAC members by contributing to content generation.
- Establishing stronger volunteer recognition programs and continuing to bring more fun into the MAC volunteer experience.

If you would like information, please visit our [Volunteer Resources](#) or [contact us directly](#).