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A Further Look at the FRB's Debit Interchange Cap Proposal


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As we mentioned last week, the Federal Reserve Board ("FRB") announced proposed changes to Regulation II (Debit Card Interchange Fees and Routing), which is the implementing regulation of the Durbin Amendment to the Dodd-Frank Act that required the FRB to establish a cap on debit interchange fees that is reasonable and proportional to the cost incurred by the debit card issuer.

The Federal Reserve last touched on Regulation II in 2012, basing the calculation of the interchange fee caps upon numbers from 2009 and 2010. The proposal is based on expense numbers from 2021, and the FRB stated "that the costs incurred by covered issuers in connection with debit card transactions have changed significantly over time," with "transaction-processing costs on which the Board based the base component [having] nearly halved, the issuer fraud losses on which the Board based the ad valorem component [having] fallen, and the fraud-prevention costs on which the Board based the fraud prevention adjustment [having] risen."

Under the current rule, the interchange fee received by a covered debit card issuer (e.g., not subject to small institution exemption) for a debit card transaction (note, Reg. II does not apply to credit card transactions, but Sen. Durbin has introduced S. 1838 to require the FRB to issue rules on credit card transactions and competition amongst credit card networks) can be no more than the sum of: (i) 21 cents (the "base component"); (ii) 5 basis points multiplied by the value of the transaction (the "*ad valorem* component"; and (iii) for issuers that meet certain requirements, a fraud-prevention adjustment of one cent per transaction. As a result of those lower costs and expenses noted above, the FRB is proposing to adjust all three components of the interchange cap. The proposal lowers the base component from 21.0 cents to 14.4 cents, and the *ad valorem* component from 5 basis points to 4 basis points. But, the proposal would increase the fraud-prevention adjustment from 1.0 cent to 1.3 cents.

Not surprisingly, this Reg. II proposal looks to rekindle the same battle over interchange splits between banking trade groups and retailer trade groups that occurred back in 2012. The Bank Policy Institute, the Consumer Bankers Association and The Clearing House (together, the "Banking Trades") came out immediately with a statement in opposition to the proposal. The National Retail Federation argued for lowering the cap just at the announcement of the meeting. Governor Michelle Bowman was the only dissenting vote on issuing the Reg. II proposal. In her statement, Gov. Bowman noted some of the same themes of the Banking Trades in that the data does not seem to support the argument that retailers' cost savings are being passed on to consumers.

Comments on the proposal are due 90 days after publication in the Federal Register, which had not yet occurred as we went to press.