



FAQ's About The Durbin Amendment – January 2011

BACKGROUND:

On December 16th, the Fed published a proposal on the regulation of interchange amounts financial institutions can receive from merchants.

Under the new proposed restrictions, institutions would have a **seven-to-12-cent-per-transaction cap** on interchange fees.

The Fed has asked for comments on two possible scenarios. The Fed is taking comments for 60 days and will reconvene, summarize and provide **answers by February 22, 2011.**

Final rulings are expected to be issued by the Federal Reserve on **April 21, 2011.** The central bank also has until **July 21, 2011** to produce new rules on the routing of transactions on payment card networks. Here are the two possible scenarios:

- **Scenario One:** Under this plan, debit card issuers could use a formula to determine the maximum amount on the interchange fee that it would collect based on certain processing costs. The Fed would set a 'safe harbor' standard at seven centers per transaction. If they chose not to accept the seven cents, it could recover any costs in excess of the safe-harbor level up to the 12-cents-per-transaction cap.
- **Scenario Two:** The second scenario would set a cap of 12-cents-per transaction without a 'safe harbor' in place. The Fed would re-evaluate the cap every two years, based on issuers' costs.

The proposed changes seem to take into consideration only a portion of the transaction costs, such as authorization, clearing/settlement.

- However, many costs were not taken into consideration in their calculations (i.e. – cost of cards, distribution of cards, call center, error resolution costs, etc.).
- In addition, the fraud adjustment provision is likely not enough to cover fraud losses and prevention.

BREAKING NEWS JAN 11, 2011:

Visa has announced they will support a two-tiered debit interchange system.

"We will support a two-tiered debit interchange structure, a Visa spokesman said. We expect to have a separate rate schedule for exempted institutions and products at the time of implementation of the Fed's new restrictions. Analysts said the change could give credit unions and community banks an edge over major financial institutions."

[U.S. Banker](#) (1/2011)

Visa held an informational Durbin webinar on January 6, 2011 presented by Bill Sheedy, President for the Americas. In the commentary, Mr. Sheedy indicated Visa expects to generally maintain the existing interchange structure for the under \$10 billion institutions, while implementing the new rates for institutions over the \$10 billion threshold.

This is exceptional news for the institutions – not only will Visa support a two-tiered debit interchange structure, but they expect the rates to be similar to existing rates.

This announcement shows that NOW is the time for institutions under \$10 billion to implement loyalty programs. The interchange economics will allow the smaller institutions to offer a feature-rich, relevant rewards program, while their larger competitors will be facing a possible reduction in revenue and cardholder benefits.

<http://www.americanbanker.com/bulletins/-1031142-1.html>



FAQ's ABOUT DURBIN & INTERCHANGE

Q. What are interchange fees?

Interchange fees are the means by which merchants pay card issuers (FI's) fees to cover the costs associated with card-based transactions. The retailers are receiving guaranteed payments, streamlined processing, faster transaction time, and receiving the funds immediately. The issuers have costs involved in processing the transactions, collecting the funds, marketing the services, data security and possible fraud.

Q. Who will set interchange?

The card associations (Visa and MasterCard) and debit networks will continue to set the exact interchange rates, under the overall guidance and requirements from the Federal Reserve Board.

Q. How will this change affect the FI's customer/member?

There is no direct effect to end consumers from this legislation. However, FI's over \$10 billion in assets may need to replace lost revenue by implementing fees or altering program rules.

Q. What are the new interchange rates?

On January 6, 2011, Visa announced they will support a two-tiered rate debit interchange rate system. Institutions under \$10 billion will likely remain at or around the same rates as they have today.

For institutions above \$10 billion, it is unknown what the changes to the interchange rates will be other than the preliminary guidance as outlined above.

Q. My institution is UNDER \$10 billion in assets, how am I affected?

The legislation specifically provides an exception for financial institutions under \$10 billion in assets. Visa has publically stated they will support a two-tiered interchange structure. Your revenue will not be impacted. This is a great opportunity for your institution to launch and maintain a feature-rich loyalty program. As large issuers determine how to recoup lost revenue, your institution could benefit by acquiring new customers who are seeking meaningful rewards programs.

An example of a large issuer who may make drastic changes to loyalty offerings include JP Morgan Chase: [JP Morgan Chase - Ending Debit Rewards](#) (*click link to view this article*).

Loyalty programs create market share for Financial Institutions, regardless of size.

It's absolutely critical not to let the threat of tightening financial regulation 'scare' a bank or credit union into doing nothing. The financial services marketplace continues to be highly competitive – once an FI gains a customer or member...an FI's objective should be 'how do I keep that customer'? Loyalty programs, additional products and services (outside of the sphere of debit) can be part of the equation of success. RNI offers programs that are built on a model that works (ERN), but can be fitted and shaped to fit a specific FI's objectives and business goals.

Q. What is the impact on credit card programs?

The Durbin Amendment specifically addresses debit card interchange. There is no direct effect on credit card interchange rates; however, retailers can now set minimum and maximum transaction amounts for credit card purchases.



Q. Are the card associations really able to structure multi-tier interchange rates?

Yes, absolutely. In fact, Visa announced their intentions to support the two-tiered structure in reaction to the Durbin regulations.

In addition, it's important to note that the card associations currently have multi-tier structures in place today. In a transaction today, the interchange fee is often varied where the only differentiating aspect is the card BIN (first 6 to 9 digits on a card that designate the FI issuer). That would be the case in the under \$10 billion exception as well. The current multi-tier structure also has many different rates based on various (what is going on with spacing here) factors including, but are not limited to: type of retailer, method of the transaction (in person, internet, etc), or the type of card (consumer or commercial). Instituting a multi-tier structure to accommodate the Durbin legislation should be easily accommodated.

Q. Could my customers be negatively affected due to merchants discriminating against my issued cards.

The legislation specifically prohibits such discrimination.

Q. How does my institution recoup any potential loss of income from lower interchange rates?

Any change to interchange fees will mean institutions will need to recoup that income from other sources or methods. It may mean a return of fee-based checking products or implementation of various pricing strategies by consumer segment.

In the loyalty space, merchant-funded reward programs, such as ShoppingFLING, can be an additional source of revenue for the card program.

Q. What will happen to loyalty programs?

RewardsNOW believes that loyalty programs will become more important than ever. NOW is the time to act. Loyalty should be focused on the customer's total product set and profitability, not solely on cards. The full relationship should be considered in the program, as demonstrated in our *Extended Rewards Network* (ERN) model.

In addition, consumer's demands for loyalty programs will not diminish; in fact studies show that consumer demand for programs is on the rise.

In November 2010, RewardsNOW launched our merchant-funded rewards program, ShoppingFLING. This is a no-cost program enhancement that awards additional points for shopping at in-network retailers. This is a new source of revenue for FI's since the retailers are paying for the cost of points up-front. If those points are not redeemed, the breakage is held by the financial institution. Therefore, this no-risk program brings benefits to both you and your customer.

Lastly, RNI provides clients with many options for customizing the program parameters, which will allow you to increase the earn rate &/or increase the redemption threshold requirements, as needed.

Q. My institution has greater than \$10 billion in assets, why do I need a loyalty program?

With a possible reduction in interchange revenue, the FI will need to recoup that revenue through other means. Loyalty programs are needed in order to attract, maintain and grow your customer relationships – both with existing customers and new customers. Enterprise-wide loyalty programs are a primary method for increasing the customer's full relationship with your institution. Your loyalty strategy should be built around the entire product set, not solely based on card products.



Q. What are my options with loyalty programs?

Many options are available to expand the loyalty program away from a focus on simply card programs and encompass the entire relationship.

In addition, RNI provides clients with many options for customizing the program parameters, which will allow you to increase the earn rate &/or increase the redemption threshold requirements, as needed.

Q. What is the timeline for the implementation of the Durbin Amendment?

At the present time, the Federal Reserve Board has published their initial comments on the legislation. The Board is asking for commentary by February 2011. The Fed has solicited input from financial institutions and retailer-sponsored groups, in order to gain the complete set of facts and effects on each group.

The card associations will then decipher the requirements and determine the overall change to interchange rates.

The final changes are scheduled to be in place in July 2011, although the timeline may vary.

Q. What about the lawsuit by TCF Bank?

On 10/12/10, TCF Bank filed an anti-trust lawsuit against the Federal Reserve over a provision that limits how much banks can charge retailers for debit card transactions.

The bank is arguing that the Durbin Amendment violates the Equal Protection clause in the U.S. Constitution's 14th Amendment because it only applies to banks such as TCF that have more than \$10 billion in assets...

TCF is also arguing that by taking away a source of revenue, the law is confiscating its property without just compensation. It plans to file an injunction blocking enforcement of the Durbin Amendment while the case proceeds.

No further action or responses have yet been provided by the Fed. The viability of the suit progressing is unknown at this time, but it does point out the larger bank's recognition that institutions under \$10 billion in assets will have a great opportunity for competition in the space.

[CNN Article - TCF Lawsuit](#) *(click link to view this article)*



Q. What sources can I review for additional information?

A general Google website searches will result in many links for the topic of Durbin and interchange. A few resources include:

Click links to view articles:

<http://www.americanbanker.com/bulletins/-1031142-1.html>

<http://durbin.senate.gov/showRelease.cfm?releaseId=325810>
[CardHub: Study On The Effects of Durbin](#)

Note this important quote from the CardHub study:

Small banks' exclusion from this legislation makes it likely that their interchange fees will rise overtime, thus allowing them to have more competitive products than bigger banks. These banks currently hold a relatively small market share of 15 percent, which will allow the gradual increase of their interchange fees to go unnoticed. As the fees continue to rise, so will the appeal of their offers, and in turn their market share is likely to grow.

[Best Business - Effects of Durbin's Interchange Amendment](#)
[JP Morgan Chase - Ending Debit Rewards](#)



Why Loyalty Now?

1. Interchange rates for financial institutions under \$10 billion is not affected. Visa has publically announced they will support a multi-tier debit interchange structure. NOW is the time to act by implementing a feature-rich, enterprise wide loyalty program.
2. Today's consumer is savvier. They expect to be rewarded for being loyal to a brand or financial institution.
3. As an offset to potential fluctuations in revenue. When you improve relationships with your customer/member, you deepen those relationships. A Loyalty Program helps to predispose your current audience to new products and services that can drive new, ongoing revenue.
4. As financial institutions offer a broader range of products and services to keep consumers happy, it allows you to build a loyalty program that fosters a larger, enterprise-wide relationship that your customer has to your institution.
5. If you are an institution with under \$10 billion in assets, the Durbin Amendment will not impact your institution. It is a prime opportunity to increase your customer base and revenue by offering a feature-rich loyalty program.
6. It even gives you an opportunity to promote your own branded products and services as redemption items.
7. Consumers are especially interested in retail bargains and deals – attract them with merchant-funded rewards enhancements, such as ShoppingFLING – which provides a new source of revenue to your program. It gives participants bonus points while the retailer is paying YOU, the financial institution, for the cost of those points.
 - a. ShoppingFLING is a FREE enhancement to RewardsNOW loyalty programs.
8. Credit card issuers also have a great opportunity to target consumers who had primarily used their debit card as a form of payment.
 - a. The Durbin amendment does not apply to credit card interchange rates, and those credit card issuers should seize this opportunity to market and expand their offerings.

FOR MORE INFORMATION ON HOW RewardsNOW CAN HELP, CALL 1-855-793-7669 OR EMAIL info@rewardsnow.com