

|  | Who the Rules Cover   | Exemptions  | Debit Interchange Rules   | Limitations on Payment Card Network Restrictions   |   |
|--|---|---|---|--|---|
| <b>Final Rules Announced by Fed on 6/29/11</b>         | <ul style="list-style-type: none"> <li>Generally the same as initially proposed described below</li> <li>Definition of payment card network excludes three-party systems (e.g., American Express) because they are not a network that routes transactions</li> </ul>  | <ul style="list-style-type: none"> <li>Same as initially proposed described below</li> </ul>  | <ul style="list-style-type: none"> <li><b>Final Rule:</b> Modified version of Alternative #2 described below: \$0.21 fee cap (base component) with additional allowance of 5 basis points of transaction value (ad valorem) to account for fraud costs                             <ul style="list-style-type: none"> <li>Additional ‘allowable costs’ described below includes fraud costs and transaction monitoring costs</li> <li>Includes circumvention standards described below</li> <li>Effective date of 10/1/11</li> </ul> </li> <li><b>Interim proposed rule:</b> allows banks to charge an additional 1 cent per transaction if they meet certain fraud prevention standards established by the Fed. Currently open for comment; comments are due by Sept. 30.</li> </ul>   | <ul style="list-style-type: none"> <li><b>Final Rule:</b> Modified version of Alternative A                             <ul style="list-style-type: none"> <li>Effective date as it applies to issuers as well as certain cards with particular technological challenges, including certain health benefit cards, as well as certain prepaid cards: 4/1/12</li> <li>Effective date as it applies to network enforcement that restricts the ability of an issuer to add a network: 10/1/11</li> </ul> </li> </ul>   | <ul style="list-style-type: none"> <li><b>Final Rule:</b> Same as described below                             <ul style="list-style-type: none"> <li>Effective date: 10/1/11</li> </ul> </li> </ul>   |
| <b>Initial Recommendations Made by Fed on 12/16/10</b> | <ul style="list-style-type: none"> <li><b>Issuers:</b> anyone who issues debit cards to card holders</li> <li><b>Debit cards:</b> a card (or account number to access an account) issued to debit an account. The debit card definition includes general use prepaid cards. (Excluded from the ‘debit card’ definition are gift cards that can be used at only a single merchant or at an affiliated group of merchants.)</li> <li><b>General use prepaid cards:</b> network branded prepaid card</li> <li><b>Payment card networks:</b> The entities that establishes the rules that govern both issuers <i>and</i> acquirers involved in the processing of debit card transactions (ex. Visa/ MasterCard; generally excludes processors and acquirers)</li> </ul> | <ul style="list-style-type: none"> <li>Debit interchange fee rules <i>only</i> do not apply to:                             <ul style="list-style-type: none"> <li>Small issuers (less than \$10 billion in assets)</li> <li>Government administered programs</li> <li>Reloadable, general use prepaid cards <i>not</i> marketed as gift cards</li> </ul> </li> <li>ATM Transactions and Closed loop transactions are technically covered by the initial proposed rules but the Fed is looking for comments due to difficulties of applying rules to these types of transactions</li> </ul> | <ul style="list-style-type: none"> <li>To set issuer debit interchange fees by mandating that they are ‘reasonable and proportional’ to costs incurred by the issuer; costs were categorized to define ‘reasonable and proportional’:                             <ul style="list-style-type: none"> <li><b>Allowable costs:</b> Incremental costs to issuer and include authorization, clearing, and settlement</li> <li><b>Other costs:</b> Costs not specific to authorization, clearing, and settlement</li> </ul> </li> <li><b>Alternative #1:</b> Permits issuer to calculate its variable/allowable costs and charge maximum fee (\$0.12 cap) or use safe harbor (\$0.07); cap is \$0.12 even if allowable costs are above \$0.12</li> <li><b>Alternative #2:</b> \$0.12 cap with no calculation of allowable costs and no safe harbor</li> <li><b>Prohibition on circumvention or evasion</b> <ul style="list-style-type: none"> <li>only fee regulated is interchange fee; does not set network fees, discounts, and incentives; expressly prohibits incentives paid to issuers by networks with respect to debit card transactions</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li><b>Network exclusivity:</b> Neither an issuer nor a payment card network may restrict the number of networks on which an electronic debit transaction may be processed                             <ul style="list-style-type: none"> <li><b>Alternative A:</b> Every debit transaction (card) has to be able to be processed on at least two unaffiliated networks of <i>any</i> authorization method; example issuer compliance by having one network for signature and one unaffiliated for PIN (10/1/11 effective date)</li> <li><b>Alternative B:</b> Every debit transaction (card) has to be able to be processed on at least two unaffiliated networks for <i>each</i> authorization method; example issuer compliance by having two PIN and two signature networks on each card (1/1/13 effective date)</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li><b>Merchant routing restrictions:</b> Neither an issuer nor a payment card network may restrict the ability of a merchant to route debit transactions over any “network that may process such transactions”                             <ul style="list-style-type: none"> <li>Merchant selects authorization network</li> <li>Merchant directs routing in advance with acquirer</li> <li>Networks may not prohibit steering (not able to set defaults for PIN or signature)</li> </ul> </li> <li><b>Self Executing Provisions</b> <ul style="list-style-type: none"> <li>Networks can’t prevent merchants from offering discounts for paying by another method (cash)</li> <li>For <i>credit</i> transactions, networks can’t prevent from choosing not to accept less than \$10 and set maximum amount limits</li> </ul> </li> </ul> |

## Perspective/Impact of Durbin Rules on Payments Industry

### ***A New Normal?***

- With regulation comes uncertainty; payments industry players are unsure if this is just the start and credit card regulation is next. Merchant advocates for change are organized and able to utilize consumer mobilization strategies.
- Impact on Debit Networks is substantial (First Data, Visa, FIS, Discover) – this will come from increased competition as a result of adding a second bug and the ability to simplify their pricing so they become the low cost provider.
- Most analysts are predicting that debit growth will continue because of consumers possessive affinity for debit electronic payment methods.
- Alternative payment methods along with changes in credit policies will be impacted and felt in the market.

### ***Short-Term Gains***

- The rules regulate debit interchange, not discount, which is the bundle of costs that most merchants pay.
- The merchant timing of the benefit is dependent upon their current pricing agreement with their acquirer.
  - Portion of merchants will receive reduced fees on the effective date 10/01/11.
  - The remaining merchant population is at the mercy of their acquirer pricing strategy on the timing and the amount of reduced fees.
  - Many acquirers will have a revenue and profit windfall until the competitive market corrects it (3 - 5 years).

### ***Winners & Losers***

- Issuing banks are still the ‘biggest losers’ but not as much as previously feared.
- Merchants remain the winners through interchange expense decreases; very unlikely that these savings will be passed on to consumers.
- Debit Networks can win with a the appropriate strategy based on pricing, partnerships and value added benefits.
- Issuers may impose debit card transaction limits.
- Unclear as to impact on Alternate payment methods largely based on ACH models, which have gained some momentum in C-store due to a cost advantage. May be non-favorable to such programs.

### ***Planning Considerations: Banks & Merchant Acquirers***

- This affects ALL of your debit business (PIN & Signature)
- Value proposition reality check
- Portfolio pricing: What is the revenue change due to the new cap? What is the possible impact to a portfolio?
- Banks and Merchant Acquirers – Questions to ask yourself about the rules:
  - Provide you a sustainable competitive advantage?
  - Are you priced appropriately to take advantage of the new marketplace (bundled/PIN/etc.)?
  - Deliver technical advantages and dependencies?
  - Will these help you maintain margin and increase retention?
  - Is it time to implement new revenue producing ‘fee income’ products?

#### **Contact Information**

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