

FEDERAL RESERVE SYSTEM

12 CFR Part 235

Regulation II; Docket No. R - [●]

RIN 7100-AF [●]

Debit Card Interchange Fees and Routing

AGENCY: Board of Governors of the Federal Reserve System (Board).

ACTION: Notice of Proposed Rulemaking.

SUMMARY: Regulation II implements a provision of the Dodd-Frank Act that requires the Board to establish standards for assessing whether the amount of any interchange fee received by a debit card issuer is reasonable and proportional to the cost incurred by the issuer with respect to the transaction. Under the current rule, for a debit card transaction that does not qualify for a statutory exemption, the interchange fee can be no more than the sum of a base component of 21 cents, an *ad valorem* component of 5 basis points multiplied by the value of the transaction, and a fraud-prevention adjustment of 1 cent if the issuer meets certain fraud-prevention standards. The Board developed the current interchange fee cap in 2011 using data voluntarily reported to the Board by large debit card issuers concerning transactions performed in 2009. Since that time, data collected by the Board every other year on a mandatory basis from large debit card issuers show that certain costs incurred by these issuers have declined significantly; however, the interchange fee cap has remained the same. For this reason, the Board proposes to update all three components of the interchange fee cap based on the latest data reported to the Board by large debit card issuers. Further, the Board proposes to update the interchange fee cap every other year going forward by directly linking the interchange fee cap to data from the Board's biennial survey of large debit card issuers. Initially, under the proposal, the base component would be 14.4 cents, the *ad valorem* component would be 4.0 basis points (multiplied by the value of the transaction), and the fraud-prevention adjustment would be 1.3 cents for debit card transactions performed from the effective date of the final rule to June 30, 2025. The Board also proposes a set of technical revisions to Regulation II.

DATES: Comments must be received on or before [INSERT DATE 90 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit comments, identified by Docket No. R-[], RIN 7100-AF [], by any of the following methods:

- *Agency Web Site:* <http://www.federalreserve.gov>. Follow the instructions for submitting comments at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.
- **Federal eRulemaking Portal:** <https://www.regulations.gov>. Follow the instructions for submitting comments.
- *E-mail:* regs.comments@federalreserve.gov. Include docket number in the subject line of the message.
- *Fax:* (202) 452-3819 or (202) 452-3102.
- *Mail:* Ann E. Misback, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW, Washington, DC 20551.

All public comments are available from the Board's website at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm> as submitted, and will not be modified to remove confidential, contact or any identifiable information. Public comments may also be viewed electronically or in paper in Room M-4365A, 2001 C St. NW Washington, DC 20551, between 9 a.m. and 5 p.m. during Federal business weekdays.

FOR FURTHER INFORMATION CONTACT: Benjamin Snodgrass, Senior Counsel (202-263-4877) or Cody Gaffney, Senior Attorney (202-452-2674), Legal Division; or Krzysztof Wozniak, Section Chief (202-452-3878) or Elena Falcettoni, Senior Economist (202-452-2528),

Division of Reserve Bank Operations and Payment Systems. For users of TTY–TRS, please call 711 from any telephone, anywhere in the United States or (202) 263-4869.

SUPPLEMENTARY INFORMATION:

I. Overview

A. Summary of Proposal

A section of the Dodd-Frank Wall Street Reform and Consumer Protection Act known as the Durbin Amendment requires the Board to establish standards for assessing whether the amount of any interchange fee received by a debit card issuer is reasonable and proportional to the cost incurred by the issuer with respect to the debit card transaction.¹ The Durbin Amendment also authorizes the Board to allow for an adjustment to such interchange fee in an amount that is reasonably necessary to make allowance for costs incurred by the debit card issuer in preventing fraud in relation to debit card transactions involving that issuer.

The Board implemented these and other provisions of the Durbin Amendment in 2011 and 2012 when the Board adopted Regulation II (Debit Card Interchange Fees and Routing).² Under the current rule, each interchange fee received by a debit card issuer for a debit card transaction that does not qualify for a statutory exemption 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 a debit card issuer that meets certain fraud-prevention standards, a “fraud-prevention adjustment” of 1 cent per transaction. Together, the base component and *ad valorem* component comprise the “interchange fee standards”; the base

¹ Public Law 110-203, section 1075, 124 Stat. 1376, 2068 (codified at 15 U.S.C. 1693o-2).

² 12 CFR part 235.

component, *ad valorem* component, and fraud-prevention adjustment comprise the “interchange fee cap.”

The Board developed the current interchange fee cap using data reported to the Board by large debit card issuers on a voluntary survey that the Board conducted during the original Regulation II rulemaking. As such, the current base component, *ad valorem* component, and fraud-prevention adjustment are based on the costs incurred by large debit card issuers in connection with debit card transactions performed in 2009. Since that time, the Board has collected data from large debit card issuers on a mandatory basis every other year, as required by the Durbin Amendment.

When the Board established the interchange fee standards in current Regulation II, the Board stated that it would, over time, adjust the interchange fee standards based on reported costs, if appropriate. Similarly, with respect to the fraud-prevention adjustment, the Board stated that it would take into account data reported by large debit card issuers in the future when considering any future revisions to the fraud-prevention adjustment. The Board also noted that lower costs should result in a lower interchange fee cap as issuers become more efficient.

The data collected by the Board from large debit card issuers since the original Regulation II rulemaking show that the costs incurred by large debit card issuers in connection with debit card transactions have changed significantly over time. In particular, the costs on which the Board based the base component have nearly halved, the issuer fraud losses on which the Board based the *ad valorem* component have fallen, and the fraud-prevention costs on which the Board based the fraud-prevention adjustment have risen, according to key metrics of those

costs.³ As a result, the Board believes that the current interchange fee standards may no longer be effective for assessing whether, for a debit card transaction subject to the standards, the amount of any interchange fee received by a debit card issuer is reasonable and proportional to the cost incurred by the issuer with respect to the transaction. Further, the Board believes that the current fraud-prevention adjustment may not reflect an amount that is reasonably necessary to make allowance for costs incurred by the debit card issuer in preventing fraud in relation to debit card transactions involving that issuer.

For these reasons, the Board proposes to update all three components of the interchange fee cap based on the latest data reported to the Board by large debit card issuers concerning transactions performed in 2021. Under the proposal, the base component would decrease from 21.0 cents to 14.4 cents, the *ad valorem* component would decrease from 5.0 basis points (multiplied by the value of the transaction) to 4.0 basis points (multiplied by the value of the transaction), and the fraud-prevention adjustment would increase from 1.0 cents to 1.3 cents. The Board determined the proposed base component using a new methodology that is informed by the cumulative data reported to the Board every other year since the original Regulation II rulemaking. This methodology targets full cost recovery over time for a significant majority of transactions across large debit card issuers through a formula that relates the base component to a key metric of issuer costs. By contrast, the Board determined the proposed *ad valorem* component and proposed fraud-prevention adjustment using generally the same methodologies used in the original rulemaking.

³ As described in section III.A, *infra*, the costs on which the Board based the base component include transaction-processing and transaction-monitoring costs.

In addition to updating the interchange fee cap for the first time since the original rulemaking, the proposed revisions would codify in Regulation II an approach for updating the three components of the interchange fee cap every other year going forward based on the latest data reported to the Board by large debit card issuers. By directly linking the interchange fee cap to data collected by the Board from large debit card issuers every other year, the proposed approach should ensure that the interchange fee cap will reflect changes in the costs incurred by debit card issuers. As a result, the Board believes that the proposal would ensure that, to the extent practicable, (i) the interchange fee standards will be effective going forward for assessing whether, for a transaction subject to the interchange fee standards, the amount of any interchange fee received by a debit card issuer is reasonable and proportional to the cost incurred by the issuer with respect to the transaction, and (ii) the fraud-prevention adjustment will continue to reflect an amount that is reasonably necessary to make allowance for costs incurred by the debit card issuer in preventing fraud in relation to debit card transactions involving that issuer. These future updates to the interchange fee cap would be implemented in accordance with the proposed methodology and would be published without inviting public comment.

The Board has reviewed its construction of the Durbin Amendment and original analysis regarding the costs incurred by debit card issuers that the Board may consider in establishing the interchange fee standards, and believes that this prior analysis remains sound. As such, the Board does not propose any changes to the costs considered for purposes of determining the base component or the issuer fraud losses considered for purposes of determining the *ad valorem* component. The Board also does not propose to modify the fraud-prevention costs considered for purposes of determining the fraud-prevention adjustment, or the fraud-prevention standards that large debit card issuers must meet to receive the fraud-prevention adjustment.

B. *Outline of this Notice*

This notice is divided into eight sections, including this overview section I. Section II provides additional legal background for the proposal, including a detailed description of the Durbin Amendment and current Regulation II.

Section III discusses the proposed revisions to the interchange fee standards in § 235.3. The Board proposes to determine the base component and *ad valorem* component every other year based on the latest data reported to the Board by debit card issuers with consolidated assets of \$10 billion or more – referred to in this notice as “covered issuers” – on the Board’s biennial Debit Card Issuer Survey. The base component would be determined using a new methodology that is informed by the cumulative data reported to the Board every other year since the original Regulation II rulemaking. Specifically, the base component would be the product of (i) the transaction-weighted average of per-transaction allowable costs (excluding fraud losses) across covered issuers based on the latest data reported to the Board, and (ii) a fixed multiplier codified in Regulation II.⁴ The Board proposes a fixed multiplier of 3.7, which targets full cost recovery for 98.5 percent of covered issuer transactions over time based on the cumulative data reported to the Board by covered issuers since the initial Debit Card Issuer Survey.⁵ The *ad valorem* component would be the median ratio of issuer fraud losses to transaction value among covered issuers (multiplied by the value of the debit card transaction), which is the same methodology the

⁴ As described in section III.A, *infra*, the costs on which the Board based the base component include transaction-processing and transaction-monitoring costs. These costs may also be referred to as “allowable costs (excluding fraud losses)” or “base component costs.”

⁵ In this notice, the term “covered issuer transactions” refers to debit card transactions performed with debit cards issued by covered issuers. By targeting full cost recovery for 98.5 percent of covered issuer transactions, the Board expects that, over time, the per-transaction allowable costs (excluding fraud losses) of around 98.5 percent of covered issuer transactions will be less than or equal to the base component. As discussed in section III.B, *infra*, the proposed approach would not guarantee that covered issuers will fully recover their allowable costs for the target percentage of covered issuer transactions in any particular year.

Board used to determine the *ad valorem* component during the original Regulation II rulemaking.

Initially, under the proposal, the base component would be 14.4 cents and the *ad valorem* component would be 4.0 basis points (multiplied by the value of the transaction) for debit card transactions performed from the effective date of the final rule to June 30, 2025. Going forward, the Board would determine the base component and the *ad valorem* component for debit card transactions performed during the two-year period beginning July 1, 2025, based on the data reported to the Board by covered issuers on the Board's next Debit Card Issuer Survey, and would thereafter determine these amounts for each succeeding two-year period based on data reported to the Board on future Debit Card Issuer Surveys.

Section IV discusses the proposed revisions to the fraud-prevention adjustment in § 235.4. As with the interchange fee standards, the Board proposes to determine the fraud-prevention adjustment every other year based on the latest data reported to the Board by covered issuers on the biennial Debit Card Issuer Survey. The fraud-prevention adjustment would be the median per-transaction fraud-prevention costs among covered issuers, which is generally the same methodology the Board used to determine the fraud-prevention adjustment in 2012.

Initially, under the proposal, the fraud-prevention adjustment would be 1.3 cents for debit card transactions performed from the effective date of the final rule to June 30, 2025. Going forward, the Board would determine the fraud-prevention adjustment for debit card transactions performed during the two-year period beginning July 1, 2025, based on the data reported to the Board by covered issuers on the Board's next Debit Card Issuer Survey, and would thereafter determine the fraud-prevention adjustment for each succeeding two-year period based on data reported to the Board on future Debit Card Issuer Surveys.

Section V discusses the proposed technical revisions to Regulation II, which are generally intended to make Regulation II clearer. For example, the Board proposes to add “covered issuer” as a defined term in Regulation II and use this term throughout the regulation and the Official Board Commentary on Regulation II to refer to debit card issuers with consolidated assets of \$10 billion or more.

Section VI discusses the proposed effective date for the revisions. The Board proposes that the revisions would, if adopted, take effect on the first day of the next calendar quarter that begins at least 60 days after the final rule is published in the *Federal Register*.

Section VII sets forth the Board’s general request for comment, as well as specific questions for feedback.

Section VIII sets forth certain regulatory analyses that the Board is required to complete under the Durbin Amendment and certain other statutes, such as the Regulatory Flexibility Act and the Paperwork Reduction Act.

II. Legal Background

A. Statutory Authority

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) was enacted on July 21, 2010.⁶ Section 1075 of the Dodd-Frank Act amended the Electronic Fund Transfer Act (EFTA) (15 U.S.C. 1693 *et seq.*) to add a new section 920 regarding interchange fees for debit card transactions and rules for debit card and credit card transactions.⁷

⁶ See Public Law 111-203, 124 Stat. 1376 (2010).

⁷ EFTA section 920 is codified at 15 U.S.C. 1693o-2. EFTA section 920(c)(2) defines “debit card” to mean any card (including a general-use prepaid card), or other payment code or device, issued or approved for use through a payment card network to debit an asset account, regardless of the purpose for which the account is established, and regardless of whether authorization is based on signature, PIN, or other means. Most of EFTA section 920’s requirements relate to debit card transactions – referred to in the statute and in Regulation II as “electronic debit transactions” – which are defined in EFTA section 920(c)(5) as transactions in which a person uses a debit card. This notice uses the term “debit

EFTA section 920(a)(2) provides that the amount of any interchange fee that an issuer may receive or charge with respect to a debit card transaction shall be reasonable and proportional to the cost incurred by the issuer with respect to the transaction.⁸ EFTA section 920(a)(3) requires the Board to establish standards for assessing whether the amount of any interchange fee is reasonable and proportional to the cost incurred by the issuer with respect to the transaction. EFTA section 920(a)(4) sets forth various considerations that the Board must take into account when establishing these interchange fee standards. Specifically, the Board must consider the functional similarity between debit card transactions and checking transactions that are required within the Federal Reserve bank system to clear at par. The Board must also distinguish between (i) the incremental cost incurred by an issuer for the role of the issuer in the authorization, clearance, or settlement of a particular debit card transaction, which cost shall be considered by the Board; and (ii) other costs incurred by an issuer which are not specific to a particular debit card transaction, which costs shall not be considered by the Board.

Under EFTA section 920(a)(5)(A), the Board may allow for an adjustment to the interchange fee received or charged by an issuer under the interchange fee standards if such adjustment is reasonably necessary to make allowance for costs incurred by the issuer in preventing fraud in relation to debit card transactions involving the issuer, provided that the issuer complies with fraud-related standards established by the Board. The Board's fraud-related standards must, among other things, require issuers to take effective steps to reduce the

card transaction" interchangeably with "electronic debit transaction." Similarly, this notice uses the term "interchange fee" interchangeably with the statutory term "interchange transaction fee." EFTA section 905(c)(8) defines "interchange transaction fee" as any fee established, charged, or received by a payment card network for the purpose of compensating an issuer for its involvement in an electronic debit transaction. For an overview of the debit card industry, *see* 76 FR 43393, 43395–96 (July 20, 2011).

⁸ "Issuer" is defined in EFTA section 920(c)(9) to mean any person who issues a debit card, or credit card, or the agent of such person with respect to such card.

occurrence of, and costs from, fraud in relation to debit card transactions, including through the development and implementation of cost-effective fraud prevention technology.

Certain issuers and debit card transactions are exempt from the interchange fee standards. EFTA section 920(a)(6) exempts any issuer that, together with its affiliates, has assets of less than \$10 billion.⁹ EFTA section 920(a)(7)(A)(i) exempts an interchange fee charged or received with respect to a debit card transaction in which a person uses a debit card or general-use prepaid card that has been provided to a person pursuant to a Federal, State, or local government-administered payment program, in which the person may only use the debit card or general-use prepaid card to transfer or debit funds, monetary value, or other assets that have been provided pursuant to such program. EFTA section 920(a)(7)(A)(ii) exempts an interchange fee charged or received with respect to a debit card transaction in which a person uses certain general-use prepaid cards.¹⁰

EFTA section 920(a)(3)(B) authorizes the Board to require any issuer or payment card network to provide the Board with such information as may be necessary to carry out the provisions of EFTA section 920(a). This provision additionally requires the Board, in issuing rules under EFTA section 920(a) and on at least a biannual basis thereafter, to disclose such aggregate or summary information concerning the costs incurred, and interchange fees charged or received, by issuers or payment card networks in connection with the authorization, clearance,

⁹ For purposes of this exemption, EFTA section 920(a)(6) provides that the term “issuer” shall be limited to the person holding the asset account that is debited through a debit card transaction.

¹⁰ Specifically, EFTA section 920(a)(7)(A)(ii) exempts an interchange fee charged or received with respect to a debit card transaction in which a person uses a plastic card, payment code, or device that is (i) linked to funds, monetary value, or assets purchased or loaded on a prepaid basis; (ii) not issued or approved for use to access or debit any account held by or for the benefit of the cardholder (other than a subaccount or other method of recording or tracking funds purchased or loaded on the card on a prepaid basis); (iii) redeemable at multiple, unaffiliated merchants or service providers, or automated teller machines; (iv) used to transfer or debit funds, monetary value, or other assets; and (v) reloadable and not marketed or labeled as a gift card or gift certificate.

or settlement of debit card transactions as the Board considers appropriate and in the public interest.¹¹

B. *Regulation II*

The Board adopted a final rule implementing the interchange fee standards and an interim final rule implementing the fraud-prevention adjustment in July 2011.¹² In August 2012, the Board adopted a final rule amending its interim final rule regarding the fraud-prevention adjustment.¹³ These rules were codified as Regulation II.

Section 235.3(a) of Regulation II implements EFTA section 920(a)(2) by providing that the amount of any interchange fee that an issuer may receive or charge with respect to a debit card transaction shall be reasonable and proportional to the cost incurred by the issuer with respect to the transaction. Section 235.3(b) implements EFTA section 920(a)(3) by providing that an issuer complies with the requirements of § 235.3(a) only if each interchange fee received or charged by the issuer for a debit card transaction is no more than the sum of (i) 21 cents and (ii) 5 basis points multiplied by the value of the transaction.¹⁴ These amounts, together with any fraud-prevention adjustment permitted under § 235.4, comprise the interchange fee cap.

Section 235.4 implements the fraud-prevention adjustment permitted by EFTA section 920(a)(5). Specifically, § 235.4(a) allows an issuer that meets the fraud-prevention standards

¹¹ EFTA section 920 contains various other provisions, but the proposed revisions to Regulation II discussed in this notice would not substantively amend the provisions of Regulation II that implement these other statutory provisions. Specifically, EFTA section 920(a)(1) authorizes the Board to prescribe regulations to prevent circumvention or evasion of EFTA section 920(a). EFTA section 920(a)(8) confers upon the Board additional authority to prescribe regulations concerning network fees. EFTA section 920(b) requires the Board to prescribe regulations related to the routing of debit card transactions.

¹² Regulation II, Debit Card Interchange Fees and Routing, codified at 12 CFR part 235. *See* 76 FR 43393 (July 20, 2011) (final rule); 76 FR 43477 (July 20, 2011) (interim final rule).

¹³ *See* 77 FR 46258 (Aug. 3, 2012).

¹⁴ The Official Board Commentary on Regulation II, found in Appendix A to part 235, refers to these amounts as the “base component” and the “*ad valorem* component,” respectively.

enumerated in § 235.4(b) to receive or charge an amount of no more than 1 cent per transaction in addition to any interchange fee it receives or charges in accordance with § 235.3.

Section 235.4(b) provides that to be eligible to receive or charge the fraud-prevention adjustment, an issuer must develop, implement, and periodically review fraud-related policies and procedures meeting certain requirements. Section 235.4(c) provides that to be eligible to receive or charge a fraud-prevention adjustment, an issuer must annually notify its payment card networks that it complies with the fraud-prevention standards in § 235.4(b). Section 235.4(d) sets forth rules for when an issuer, or the appropriate agency, determines that the issuer is not eligible to receive or charge a fraud-prevention adjustment.¹⁵

Section 235.5 implements the statutory exemptions from the interchange fee standards. Section 235.5(a) generally provides that the interchange fee standards do not apply to an interchange fee received or charged by an issuer with respect to a debit card transaction if the issuer, together with its affiliates, has assets of less than \$10 billion as of the end of the calendar year preceding the date of the transaction and holds the account that is debited. Section 235.5(b) implements the statutory exemption for government-administered payment programs. Section 235.5(c) implements the statutory exemption for certain reloadable prepaid cards.

Section 235.8 implements the data collection provisions in EFTA section 920(a)(3)(B). Specifically, § 235.8(a) provides that each issuer that is not otherwise exempt from the requirements of this part under § 235.5(a) and each payment card network shall file a report with

¹⁵ The appropriate agency for a particular entity is determined pursuant to § 235.9 and EFTA section 918 (15 U.S.C. 1693o). For example, the Board is the appropriate agency with respect to member banks of the Federal Reserve System (other than national banks), branches and agencies of foreign banks (other than federal branches, federal Agencies, and insured state branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act.

the Board.¹⁶ Section 235.8(b) provides that each entity required to file a report with the Board shall submit data in a form prescribed by the Board for that entity. Pursuant to this authority, the Board collects information from debit card issuers with consolidated assets of \$10 billion or more every other year through the Debit Card Issuer Survey.¹⁷ The Board also collects information from payment card networks every year through the Payment Card Network Survey.¹⁸ The Board has published a summary of findings from these two surveys on a biennial basis since 2013, consistent with EFTA section 920(a)(3)(B).¹⁹ The Board's most recent biennial report was published concurrently with this notice.²⁰

Appendix A to part 235 is the Official Board Commentary on Regulation II. In general, the commentary provides background material to explain the Board's intent in adopting a particular part of the regulation and examples to aid in understanding how a particular requirement is to work.²¹

¹⁶ The reference to “the requirements of this part” in § 235.8(a) is erroneous, as debit card issuers that qualify for the exemption in § 235.5(a) are *not* exempt from the requirements of § 235.7 (network exclusivity and debit card transaction routing) or § 235.8(c) (record retention). As described in section V, *infra*, the Board proposes a technical correction to fix this error.

¹⁷ See FR 3064a.

¹⁸ See FR 3064b.

¹⁹ See Board of Governors of the Federal Reserve System, *2011 Interchange Fee Revenue, Covered Issuers Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions* (Mar. 5, 2013), https://www.federalreserve.gov/paymentsystems/files/debitfees_costs_2011.pdf.

²⁰ The Board's reports may be found on the Board's website. See Board of Governors of the Federal Reserve System, *Regulation II (Debit Card Interchange Fees and Routing): Reports and Data Collections*, <https://www.federalreserve.gov/paymentsystems/regii-data-collections.htm>. Additionally, on an annual basis, the Board publishes average interchange fees by network. See Board of Governors of the Federal Reserve System, *Regulation II (Debit Card Interchange Fees and Routing): Average Debit Card Interchange Fee by Payment Card Network*, <https://www.federalreserve.gov/paymentsystems/regii-average-interchange-fee.htm>.

²¹ Other provisions of Regulation II implement provisions of EFTA section 920 that are not directly relevant to the proposed revisions discussed in this notice. Specifically, § 235.6 prohibits circumvention or evasion of the interchange fee restrictions in Regulation II and prohibits an issuer from receiving net compensation from a payment card network within a calendar year. Section 235.7 sets forth rules related to network exclusivity and the routing of debit card transactions. To address certain issues related to the routing of card-not-present debit card transactions, the Board recently revised § 235.7 and the commentary thereto, with an effective date of July 1, 2023. See 87 FR 61217 (Oct. 11, 2022).

III. Proposed Revisions to the Interchange Fee Standards (§ 235.3)

A. Background

As described above, EFTA section 920(a)(3) directs the Board to establish standards for assessing whether the amount of any interchange fee is reasonable and proportional to the cost incurred by the issuer with respect to the transaction. To fulfill this statutory mandate, the Board (i) defined the costs incurred by debit card issuers that the Board considers, consistent with the statute (referred to herein as “allowable costs”), and (ii) established standards for assessing interchange fees relative to allowable costs. A brief overview of how the Board developed the interchange fee standards in current § 235.3 follows.

1. Allowable Costs

EFTA section 920(a)(4)(B) requires the Board, in establishing interchange fee standards, to distinguish between (i) the incremental cost incurred by an issuer for the role of the issuer in the authorization, clearance, or settlement of a particular debit card transaction, which cost shall be considered by the Board; and (ii) other costs incurred by an issuer which are not specific to a particular debit card transaction, which costs shall not be considered by the Board.²² When the Board adopted current § 235.3 in 2011, the Board identified a third category of costs that the Board is permitted, but not required, to consider: costs incurred by an issuer that are specific to a particular debit card transaction but are not incremental costs related to a debit card issuer’s role in authorization, clearance, and settlement.²³

²² EFTA section 920(a)(4)(a) also requires the Board to consider the functional similarity between debit card transactions and checking transactions that are required within the Federal Reserve bank system to clear at par. For a discussion of this requirement, see section VIII.B, *infra*.

²³ The Board observed in 2011 that EFTA does not define “other costs incurred by an issuer which are not specific to a particular electronic debit transaction,” which the Board is prohibited from considering. *See* 76 FR 43393, 43426 (July 20, 2011). In 2010, the Board initially proposed to exclude costs that could not be attributed to any identified debit card transaction (referred to as “fixed costs” in the proposal), even if those costs were specific to

Using this framework, the Board defined the allowable costs that the Board considered in establishing the interchange fee standards set forth in § 235.3. For reasons explained in the notice accompanying the 2011 final rule, allowable costs comprise (i) transaction-processing costs, including fixed and variable authorization, clearance, and settlement costs, network processing fees (*e.g.*, switch fees), and the costs of processing chargebacks and other non-routine transactions; (ii) transaction-monitoring costs; and (iii) issuer fraud losses.²⁴ Allowable costs do not include other costs incurred by debit card issuers in connection with their debit card programs, such as corporate overhead and account-relationship costs, general debit card program costs (*e.g.*, card production and delivery costs, marketing costs, and research and development costs), or costs of non-sufficient funds handling, cardholder rewards, and cardholder inquiries.²⁵

The Board has reviewed its construction of the statute and prior analysis regarding the allowable costs that the Board considered in establishing the interchange fee standards, and believes that this prior analysis remains sound. As such, the Board does not propose any changes to the allowable costs considered for purposes of the interchange fee standards.

As described below, the Board established the base component based on transaction-processing and transaction-monitoring costs, but separately assessed issuer fraud losses through

effecting debit card transactions as a whole. *See* 75 FR 81721, 81735–36 (Dec. 28, 2010). After considering public comments, the Board at the final rule stage interpreted the category of prohibited costs to include only those costs that are not incurred in the course of effecting any debit card transaction. *See* 76 FR at 43426. Further, the Board noted that the statute is silent on those costs that are not incremental costs related to a debit card issuer’s role in authorization, clearance, and settlement, but that are specific to a particular debit card transaction. *See id.* The Board determined that EFTA section 920(a)(4)(B) did not specifically instruct the Board to consider this third category of costs but did not prohibit their consideration. *See id.* The Board’s interpretation of the statute was upheld by the U.S. Court of Appeals for the District of Columbia Circuit. *See NACS v. Board of Governors of the Federal Reserve System*, 746 F.3d 474, 488–89 (D.C. Cir. 2014). *See also* 80 FR 48684 (Aug. 14, 2015) (clarifying the treatment of transaction-monitoring costs, as required by the D.C. Circuit).

²⁴ *See* 76 FR at 43429–31.

²⁵ *See* 76 FR at 43427–29.

the *ad valorem* component. Transaction-processing and transaction-monitoring costs are collectively referred to in this notice as “base component costs.”

2. Interchange Fee Standards

For reasons explained in the notice accompanying the 2011 final rule, the Board adopted a uniform, transaction-level standard that, subject to any fraud-prevention adjustment that a covered issuer may be permitted to receive or charge under § 235.4, establishes the maximum permissible interchange fee that a covered issuer may receive for a debit card transaction subject to the interchange fee standards.²⁶ This maximum interchange fee is the sum of a base component and an *ad valorem* component.

To determine the base component, the Board referred to the data that the Board had collected shortly after the Dodd-Frank Act was signed into law via a voluntary survey of covered issuers concerning debit card transactions performed in the 2009 calendar year.²⁷ Based on these data, the Board computed the per-transaction base component costs of each covered issuer that reported such costs by summing the base component costs reported by the covered issuer and dividing this sum by the total number of debit card transactions reported by the covered issuer.

²⁶ See 76 FR at 43431–35.

²⁷ See Board of Governors of the Federal Reserve System, *2009 Debit Card Issuer Survey* (Sep. 13, 2010), https://www.federalreserve.gov/paymentsystems/files/payment_card_network_survey_20100920.pdf. The survey respondents included 66 covered issuers, representing about 57 percent of total debit card transactions by volume and 60 percent of total debit card transactions by value in 2009. However, because some covered issuers did not respond to the voluntary survey, the proportion of total debit card transactions performed in 2009 that are attributable to covered issuers (including respondents and non-respondents) was greater than 57 percent (by volume) and 60 percent (by value). The Board discussed preliminary summary findings from this survey in its 2010 proposal to establish interchange fee standards. See 75 FR at 81724–26. The Board subsequently published a report summarizing the data collected from the survey. See Board of Governors of the Federal Reserve System, *2009 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions* (June 2011), https://www.federalreserve.gov/paymentsystems/files/debitfees_costs.pdf.

The Board then arranged these per-transaction costs in ascending order from lowest- to highest-cost covered issuer.²⁸

The Board observed that this distribution of per-transaction base component costs across covered issuers was quite skewed. These costs ranged from 3 cents to 66 cents per transaction, with a considerable majority of covered issuers concentrated in the range of costs below 21 cents, and a scattered set of covered issuers having significantly higher costs above 21 cents. Further, below 21 cents, the difference between the per-transaction base component costs of adjacently ranked covered issuers was small, but at around 21 cents, the distribution showed a marked discontinuity, with base component costs varying more significantly across these higher-cost covered issuers.

The Board concluded that establishing interchange fee standards to accommodate these higher-cost covered issuers would not be reasonable or proportional to the overall cost experience of the substantial majority of covered issuers.²⁹ For that reason, the Board adopted a base component of 21 cents per transaction. Had that base component been in effect in 2009, approximately 80 percent of covered issuers that responded to the Board's voluntary survey would have fully recovered their base component costs.³⁰

The Board recognized that issuer fraud losses are distinct from the other types of allowable costs in that the amount of a fraud loss varies with the amount of the transaction.³¹ For

²⁸ See 76 FR at 43433.

²⁹ See *id.*

³⁰ In other words, for approximately 80 percent of covered issuers that responded to the Board's voluntary survey, the covered issuer's base component costs in 2009 were less than or equal to the product of 21 cents and the number of transactions involving that issuer's debit cards in 2009. However, the Board did not indicate that the Board was adopting any particular cost-recovery target across covered issuers (*i.e.*, that 80 percent of covered issuers should fully recover their base component costs) or across covered issuer transactions.

³¹ See 76 FR at 43431.

this reason, the Board determined that these fraud losses were best assessed through a separate *ad valorem* component. To determine the *ad valorem* component, the Board computed the ratio of issuer fraud losses to transaction value for each covered issuer that reported such costs in response to the voluntary survey.³² Specifically, for each such issuer, the Board divided (i) the issuer fraud losses by (ii) the total value of the issuer's debit card transactions. The Board then sorted these ratios, expressed in basis points, in ascending order from lowest to highest.

The resulting distribution showed that the ratio of issuer fraud losses to transaction value varied considerably among covered issuers, ranging from 0.9 to 19.6 basis points, but the distribution was not skewed like that of per-transaction base component costs. For the reasons explained in the notice accompanying the 2011 final rule, the Board adopted an *ad valorem* component of 5 basis points of the transaction value, which corresponded to the median ratio of issuer fraud losses to transaction value among covered issuers, rounded to the nearest basis point, based on the Board's voluntary survey.³³

The Board described the foregoing methodologies for determining the base component and *ad valorem* component in the notice accompanying the 2011 final rule. The Board did not, however, codify these methodologies in § 235.3. Rather, § 235.3(b) simply provides that each interchange fee received or charged by a debit card issuer for a debit card transaction shall be no more than the sum of 21 cents and 5 basis points multiplied by the value of the transaction.

B. *Rationale for Proposal*

³² In the notice accompanying the 2011 final rule, the Board used the term "per-transaction fraud losses" for this metric, but the Board now believes that "ratio of issuer fraud losses to transaction value" is a more accurate description.

³³ See 76 FR at 43434.

When the Board established the interchange fee standards in current § 235.3, the Board stated that it would regularly collect data on the costs incurred by covered issuers in connection with debit card transactions and, over time, would adjust the interchange fee standards based on reported costs, if appropriate. The Board also noted that lower costs should result in a lower interchange fee cap as issuers become more efficient.³⁴ To date, the Board has not proposed or finalized any adjustments to the interchange fee standards in § 235.3.³⁵

Consistent with EFTA section 920(a)(3)(B), the Board has surveyed covered issuers on a mandatory basis every other year since the reporting requirements in § 235.8 of Regulation II were adopted. Through these biennial surveys, the Board has collected data from covered issuers concerning the costs incurred by those issuers in connection with debit card transactions performed in calendar years 2011, 2013, 2015, 2017, 2019, and 2021. The Board has reviewed the interchange fee standards in § 235.3 in light of both the most recently collected data from 2021 and the cumulative data collected from covered issuers since the original Regulation II rulemaking. As a result of this analysis, and as described below, the Board believes that revisions to the current interchange fee standards are appropriate at this time.

While the interchange fee standards have remained the same since § 235.3 was adopted, several data points show that the allowable costs incurred by covered issuers have fallen significantly since the original Regulation II rulemaking. In particular, the Board monitors one especially important metric that approximates the base component costs of the average covered

³⁴ See 76 FR at 43432.

³⁵ In December 2022, two trade associations representing merchants submitted a rulemaking petition to the Board regarding the interchange fee standards in Regulation II. Specifically, the petitioners requested that the Board initiate a rulemaking to lower the base component from 21 cents to 9.7 cents, and eliminate or substantially reduce the *ad valorem* component and the fraud-prevention adjustment. The Board views the rulemaking petition as an additional consideration related to the proposal; however, the Board's rationale for the proposal is discussed in this section III.B.

issuer transaction: the transaction-weighted average of per-transaction base component costs across covered issuers.³⁶ That metric was 3.9 cents in 2021, which represents a decline of nearly 50 percent since 2009 (7.7 cents) and over 23 percent since 2011 (5.1 cents), the first year for which the Board collected data on a mandatory basis.

The Board also monitors issuer fraud losses, on which the Board based the *ad valorem* component. The median ratio of issuer fraud losses to transaction value among covered issuers declined by around 15 percent from 2011 (4.7 basis points, or 5.0 basis points if rounded to the nearest basis point) to 2021 (4.0 basis points).

Taken together, these declines in base component costs and issuer fraud losses have resulted in a substantial increase in the percentage of covered issuers that fully recovered their allowable costs from 2011 (61.1 percent) to 2021 (77.4 percent).³⁷

³⁶ The Board computes the transaction-weighted average of per-transaction base component costs across covered issuers by (i) summing base component costs across covered issuers that reported these costs; and (ii) dividing this sum by the sum of the total number of debit card transactions across covered issuers that reported base component costs. The transaction-weighted average of per-transaction base component costs across covered issuers can be viewed as a broad measure of whether covered issuers collectively are becoming more or less efficient at processing debit card transactions. Specifically, this metric corresponds to the average base component costs of a debit card transaction for covered issuers as a whole. The Board believes that, for skewed distributions like the distribution of per-transaction base component costs, the transaction-weighted average is preferable to alternative metrics, such as the unweighted average across covered issuers, or a given percentile across covered issuers. In particular, the transaction-weighted average is less affected than these alternative metrics by outliers, including covered issuers with low transaction volumes but per-transaction base component costs considerably greater than the vast majority of covered issuers. Further, for skewed distributions like the distribution of per-transaction base component costs, the transaction-weighted average is preferable to the median because, unlike that metric, its value depends on all covered issuers' per-transaction base component costs, rather than only on whether such values fall above or below the median. For example, a reduction in the per-transaction base component costs of the less efficient 50 percent of covered issuers (*e.g.*, due to the adoption of a new transaction-processing technology by these issuers) would cause a decline in the transaction-weighted average but may not affect the median.

³⁷ A covered issuer is considered to have fully recovered its allowable costs if the covered issuer's allowable costs in a particular year were less than or equal to the aggregate amount of interchange fees permitted under the interchange fee cap for transactions involving that issuer's debit cards in the particular year. In contrast to the increase in the percentage of covered issuers that fully recovered their allowable costs from 2011 to 2021, the percentage of covered issuer transactions for which covered issuers fully recovered their allowable costs was the same in 2021 as it was in 2011 (99.5 percent).

As a result of the significant decline in the allowable costs incurred by covered issuers since 2009, the Board believes that the current interchange fee standards in § 235.3 may no longer be effective for assessing whether, for a debit card transaction subject to the interchange fee standards, the amount of any interchange fee received or charged by a debit card issuer is reasonable and proportional to the cost incurred by the issuer with respect to the transaction, as required by EFTA section 920(a)(2). As such, the Board believes it is necessary to revise the interchange fee standards to reflect the decline since 2009 in base component costs and the decline over time in the ratio of issuer fraud losses to transaction value for covered issuers.

Furthermore, the Board believes that, as much as practicable, the base component and *ad valorem* component should be updated regularly and predictably to reflect changes in the allowable costs incurred by covered issuers as those changes occur. Such an approach would avoid long periods during which the interchange fee standards may not be effective for assessing whether, for a debit card transaction subject to the interchange fee standards, the amount of any interchange fee received or charged by a debit card issuer is reasonable and proportional to the cost incurred by the issuer with respect to the transaction. In addition, directly linking the interchange fee standards to the data reported to the Board by covered issuers on the Board's biennial survey would capture changes in allowable costs as quickly as practicable. Further, the Board believes that the patterns observed in the cumulative data collected by the Board since the original rulemaking, described further below, are consistent over time and thus support the establishment at this time of a repeatable process that directly links the interchange fee standards to the data reported on the Debit Card Issuer Survey. Finally, this approach would create predictability for the debit card industry regarding how and when updates to the interchange fee cap would occur.

For these reasons, and as described below, the Board proposes to determine the base component and *ad valorem* component in § 235.3 every other year based on the latest data reported to the Board by covered issuers. The Board believes that, under this approach, the interchange fee standards in § 235.3 will be effective going forward for assessing whether, for a debit card transaction subject to the interchange fee standards, the amount of any interchange fee received or charged by a debit card issuer is reasonable and proportional to the cost incurred by the issuer with respect to the transaction.³⁸

The Board also proposes a new methodology for determining the base component. As described above, in 2011, the Board adopted a base component of 21 cents per transaction. The Board selected 21 cents because that value was the site of a clear discontinuity in the distribution of per-transaction base component costs across covered issuers, arranged from lowest- to highest-cost covered issuer, for debit card transactions performed in 2009.³⁹ The Board has reviewed the distribution of per-transaction base component costs across covered issuers, arranged from lowest- to highest-cost covered issuer, from each biennial survey of covered issuers conducted since Regulation II was adopted. In some survey years, the distribution contained no clear discontinuity; in other survey years, there were multiple apparent

³⁸ In lieu of directly linking the interchange fee standards to data from the Board's biennial survey of covered issuers going forward, the Board could consider adopting a one-time update to the base component and *ad valorem* component in § 235.3. Following such an approach, the Board would continue to monitor changes in the allowable costs incurred by covered issuers and would propose further updates to the base component and *ad valorem* component in the future, if appropriate. However, such ad hoc updates to the base component and *ad valorem* component would not be predictable, and they could result in periods during which the interchange fee standards may not be effective for assessing whether, for a debit card transaction subject to the interchange fee standards, the amount of any interchange fee received or charged by a debit card issuer is reasonable and proportional to the cost incurred by the issuer with respect to the transaction.

³⁹ As described above, the Board noted that, had the current base component been in effect in 2009, approximately 80 percent of covered issuers would have fully recovered their base component costs through the base component. However, the Board did *not* indicate that the Board was selecting a cost-recovery target of 80 percent of covered issuers (or any other cost-recovery target across covered issuers or covered issuer transactions) and did not codify in Regulation II an approach for updating the base component to reflect any particular cost-recovery target.

discontinuities. In addition, in some cases, the amount corresponding to a particular discontinuity did not reflect the overall trend in the transaction-weighted average of per-transaction base component costs across covered issuers. For these reasons, the Board believes that the original methodology that the Board used to determine the base component by reference to a clear discontinuity in the distribution of per-transaction base component costs across covered issuers, arranged from lowest- to highest-cost covered issuer, is not appropriate for determining the base component at this time and, going forward, would not facilitate the regular and predictable updates to the interchange fee standards that the Board proposes.

Instead, as described below, the Board proposes to determine the base component as a function of the transaction-weighted average of per-transaction base component costs across covered issuers. Under this methodology, any change in the base component costs of the average covered issuer transaction would result in a *proportional* change to the base component. As such, this methodology will ensure that the maximum interchange fee that a covered issuer may receive will be proportional to the base component costs incurred by covered issuers with respect to the average covered issuer transaction, consistent with the Durbin Amendment. Combined with the Board's proposal to determine the base component every other year based on the latest data reported to the Board by covered issuers, this approach is designed to ensure that, to the extent practicable, any interchange fee that a covered issuer receives or charges will remain proportional to the costs incurred by covered issuers with respect to the average debit card transaction over time.⁴⁰

⁴⁰ In 2011, the Board rejected a mathematical interpretation of the word "proportional" that would have *required* a constant proportion between allowable costs and interchange fees. *See* 76 FR 43393, 43423 (July 20, 2011). The Board continues to believe that the statute requires only that the interchange fees must have a relationship to allowable costs, as the Board stated in 2011. *See id.* Determining the base component as a fixed multiple of the transaction-weighted average of per-transaction base component costs across covered issuers is thus consistent with

More specifically, the Board proposes to determine the base component as the product of a fixed multiplier and the transaction-weighted average of per-transaction base component costs across covered issuers. Under this formula, the fixed multiplier would be codified in Regulation II and would remain constant. The fixed multiplier would correspond to a target selected by the Board for a *reasonable* percentage of covered issuer transactions for which covered issuers should fully recover their base component costs over time, consistent with the Durbin Amendment.

Consistent patterns that the Board has observed in the data collected from covered issuers since 2009 related to per-transaction base component costs make it possible to derive such a formula. Specifically, while the transaction-weighted average of per-transaction base component costs across covered issuers has declined significantly since the original Regulation II rulemaking, the shape of the distribution of per-transaction costs across covered issuer transactions has not changed markedly between the data collections.⁴¹ Importantly, this particular shape can be well-characterized by a probability distribution with a key property: the value of per-transaction base component costs at a target percentile across covered issuer transactions is a multiple of the transaction-weighted average of per-transaction base component costs across covered issuers.⁴² The stability of the shape of the distribution over time means that the Board

the statute, and is desirable because it will enable the Board, going forward, to determine the base component based on the latest data reported to the Board by covered issuers.

⁴¹ The Board generates the distribution of per-transaction base component costs across covered issuer transactions as follows. For each covered issuer that reported base component costs, the Board first determines the per-transaction base component costs of the covered issuer by (i) summing the base component costs reported by the covered issuer and (ii) dividing this sum by the total number of debit card transactions reported by the covered issuer. The Board then assigns this result to each of the covered issuer's transactions. Finally, the Board arranges the per-transaction base component costs of all covered issuer transactions in ascending order from lowest- to highest-cost covered issuer transaction.

⁴² In particular, the data on per-transaction base component costs across covered issuer transactions, arranged from lowest- to highest-cost covered issuer transaction, for each year closely approximates the Weibull distribution. The Weibull distribution, commonly used in social sciences and engineering, has the property that the value of the

can identify a fixed multiplier that, when multiplied by the transaction-weighted average of per-transaction base component costs in each year, should yield full cost recovery for the target percentage of covered issuer transactions over time.⁴³

The stability of the shape of the distribution observed in data collected from covered issuers since 2009 suggests that there are features inherent to the covered issuer segment of the debit card market that persist over time. For this reason, the Board believes that, in future data collections, the distribution of per-transaction base component costs across covered issuer transactions will continue to exhibit a similar shape. Thus, the fixed multiplier derived from the cumulative data collected by the Board since 2009 should continue to yield full cost recovery over time for the target percentage of covered issuer transactions going forward.

Although the proposed fixed multiplier would correspond to a target percentage of covered issuer transactions for which covered issuers should fully recover their base component costs over time, the proposed approach would not guarantee this precise level of cost recovery in any particular year. Rather, in some years, covered issuers may fully recover their base component costs for more than the target percentage of covered issuer transactions; in other years, covered issuers may fully recover their base component costs for less than the target percentage of covered issuer transactions. Over time, however, the Board expects the actual cost

distribution at a particular percentile is a fixed multiple of the average value of the distribution. The Weibull distribution captures a number of key features of the data on covered issuer transactions, including the existence of a small number of high-cost transactions associated with relatively low-volume, high-cost covered issuers.

⁴³ A particular Weibull distribution is described by two parameters: (i) its scale, which determines the magnitude of the values along the distribution; and (ii) its shape, which determines the degree to which the distribution is skewed to one side. The Board's analysis determined that the consistent patterns in the distribution of per-transaction base component costs across covered issuer transactions for each set of survey data collected since 2009 can be best captured using the Weibull distribution with (i) a scale parameter that is proportional to the transaction-weighted average of per-transaction base component costs across covered issuers for each year, and (ii) a shape parameter that is stable over time. The Board's analysis did not find a statistically significant improvement in the fit of the Weibull distribution to the data when the shape parameter is allowed to differ across years.

recovery of covered issuer transactions to be close to the Board's cost-recovery target.⁴⁴ The Board intends to monitor over time the actual cost recovery of covered issuer transactions relative to the Board's cost-recovery target, and in the future may seek comment on potential adjustments to improve the proposed methodology for determining the base component, if appropriate. For example, adjustments to the proposed methodology may be appropriate in the event of fundamental changes to the debit card industry that significantly change the shape of the distribution of per-transaction base component costs across covered issuer transactions relative to the consistent patterns the Board has observed in the cumulative data collected from covered issuers since 2009.

To ensure that, for a debit card transaction subject to the interchange fee standards, the amount of any interchange fee received or charged by a debit card issuer is reasonable, the Board proposes a cost-recovery target of 98.5 percent of covered issuer transactions, which corresponds to a fixed multiplier of 3.7 based on the cumulative data collected from covered issuers since 2009. The Board believes that this cost-recovery target, and the base component that would

⁴⁴ The Board assesses how close actual cost recovery is to the cost-recovery target for a particular fixed multiplier by evaluating, for each year, the extent to which actual cost recovery would have diverged from the target had the relevant base component been in effect, and then considering the average deviation over time resulting from these calculations. Specifically, the Board first calculates the difference between the cost-recovery target and the percentage of covered issuer transactions performed in 2009 for which covered issuers would have fully recovered their base component costs if, in 2009, the base component had been the product of (i) the transaction-weighted average of per-transaction base component costs across covered issuers in 2009, and (ii) the fixed multiplier. Second, the Board performs the same calculation for transactions performed in 2011. The Board then takes the simple average of the differences calculated for each year (*i.e.*, for 2009 and 2011). Third, the Board repeats this process for transactions performed in 2013, 2015, 2017, 2019, and 2021, in each case taking the average of the differences calculated for each year so far. These averages represent the extent to which actual cost recovery would have diverged over time from the target had the relevant base components been in effect.

For the fixed multiplier that the Board proposes (*i.e.*, 3.7, as described below), using the measure of closeness described above, the Board found that the actual cost-recovery rate drew nearer to the target cost-recovery rate with each subsequent data collection that was incorporated into the Board's analysis. In other words, the simple average of the differences for 2009–13 transactions improved on that for 2009–11 transactions, which improved on the difference for 2009, and so on. This result suggests that, while for a particular data collection the actual cost-recovery rate may diverge from the target cost-recovery rate, over time actual cost recovery is likely to be close to the cost-recovery target.

result from multiplying this fixed multiplier and the transaction-weighted average of per-transaction base component costs, is reasonable because it would allow covered issuers to fully recover their base component costs over time for a significant majority of covered issuer transactions. At the same time, this target acknowledges that full cost recovery for the highest-cost covered issuer transactions would not be reasonable.⁴⁵

A useful measure of the difference between covered issuer transactions above the target percentile (for which the Board believes full cost recovery would be unreasonable) and covered issuer transactions below the target percentile (for which the Board believes full cost recovery would be reasonable) is the efficiency gap with respect to transaction processing between covered issuers whose transactions are above and below the target percentile. This efficiency gap may be represented by the ratio of the transaction-weighted average of per-transaction base component costs for covered issuers whose transactions are above the target percentile to that for covered issuers whose transactions are below the target percentile. The Board computed this ratio for a range of potential cost-recovery targets using each set of data collected from covered issuers since 2009.⁴⁶ For the proposed cost-recovery target of 98.5 percent of covered issuer transactions, the average value of this ratio across these data collections is approximately 5.2, meaning that covered issuers whose transactions are above the 98.5 percentile are, on average, more than five times less efficient than covered issuers whose transactions are below the 98.5

⁴⁵ In 2011, the Board stated that the term “reasonable” implies that, above some amount, an interchange fee is not reasonable, and noted that common definitions of the term “reasonable” include “fair, proper, or moderate” and “not excessive.” *See* 76 FR at 43423. The Board also noted that the Board did not believe that it was consistent with the statutory purpose to permit networks to set interchange fees in order to accommodate 100 percent of the average per-transaction costs of the highest-cost issuers. *See* 76 FR at 43433.

⁴⁶ *See* section VII, *infra*, for the average value of this ratio across these data collections for a range of potential cost-recovery targets.

percentile. Accordingly, the Board believes that targeting full cost recovery over time for 98.5 percent of covered issuers transactions is reasonable.

Although the proposed new methodology for determining the base component would ultimately rely on a simple formula (*i.e.*, the transaction-weighted average of per-transaction base component costs across covered issuers multiplied by 3.7), the Board appreciates that the underlying statistical analysis is complex. The Board considered other methodologies for determining the base component. For example, the Board considered setting the base component equal to the transaction-weighted average of per-transaction base component costs across covered issuers (*i.e.*, effectively with a fixed multiplier of 1.0), but determined that this methodology would result in an unreasonably low percentage of covered issuers fully recovering their costs.⁴⁷ The Board also considered determining the base component by reference to a target percentile in (i) the distribution of per-transaction base component costs, arranged from lowest- to highest-cost covered issuer, or (ii) the distribution of per-transaction base component costs across covered issuer transactions. In both cases, however, the Board determined that these methodologies could result in a base component that does not reflect changes over time in the transaction-weighted average of per-transaction base component costs across covered issuers due to the sensitivity of these alternative methodologies to low-volume, high-cost covered issuers. Finally, the Board considered adopting a tiered approach that would establish different base components for high-volume, low-cost covered issuers and low-volume, high-cost covered issuers. However, the Board determined that such an approach would create numerous practical challenges for both the Board and debit card industry participants and could disincentivize

⁴⁷ Specifically, setting the base component equal to the transaction-weighted average of per-transaction base component costs across covered issuers would have resulted in only around 15 percent of covered issuers, on average across the biennial data collections, fully recovering their base component costs. Such a methodology would, however, permit covered issuers as a whole to recover their aggregate base component costs.

covered issuers in the tier with the higher base component from growing their debit card programs.⁴⁸

Whereas the Board proposes a new methodology to determine the base component, the Board does not propose to revise the original methodology that the Board used to determine the *ad valorem* component (*i.e.*, the median ratio of issuer fraud losses to transaction value among covered issuers, multiplied by the value of the transaction). Since the Board adopted the interchange fee standards in 2011, the Board has observed an overall increase in fraud losses to all parties related to covered issuer transactions, but the share of such fraud losses absorbed by covered issuers (*i.e.*, issuer fraud losses) has declined during that time. Accordingly, as noted above, the median ratio of issuer fraud losses to transaction value among covered issuers has declined from 2011 to 2021, despite the overall increase in fraud losses to all parties.⁴⁹ The Board originally determined the *ad valorem* component using only those fraud losses absorbed by covered issuers, and analysis of the data collected by the Board since the original Regulation II rulemaking shows that, despite these changes in the fraud environment, the median ratio of issuer fraud losses to transaction value among covered issuers remains a representative metric of the cost of fraud incurred by covered issuers. Therefore, for the reasons explained in the notice accompanying the 2011 final rule, the Board believes that the original methodology continues to be appropriate for determining the *ad valorem* component.⁵⁰

⁴⁸ For example, a tiered base component approach would require the Board to demarcate different tiers of issuers, and the Board's demarcations would likely need to be adjusted over time. In addition, networks would need to track covered issuers by tier to ensure that the interchange fees received by each covered issuer do not exceed the interchange fee standards.

⁴⁹ For additional information regarding fraud losses with respect to covered issuer transactions, see section VIII.C, *infra*.

⁵⁰ See 76 FR at 43431 and 43434. The Board recognizes that some aspects of the fraud environment have changed with, for example, the introduction of increased security for in-person card payments through the issuance of chip-based EMV cards and the growth of ecommerce and remote fraud. As discussed in section VIII.C, *infra*, covered issuers now absorb a smaller percentage of fraud losses from covered issuer transactions than they did in 2009, with

C. Description of Proposal

The Board proposes to determine, for every two-year period, the base component and the *ad valorem* component using the latest data reported to the Board by covered issuers on the Debit Card Issuer Survey. Further, the Board proposes a new methodology for determining the base component. Initially, under the proposed approach, the base component would be 14.4 cents and the *ad valorem* component would be 4.0 basis points (multiplied by the value of the transaction) for debit card transactions performed from the effective date of the final rule to June 30, 2025. The Board does not propose to modify the allowable costs considered for purposes of determining the base component and the *ad valorem* component, or the original methodology used to determine the *ad valorem* component.

Proposed § 235.3(b)(1) would provide that the current base component of 21.0 cents and the current *ad valorem* component of 5.0 basis points (multiplied by the value of the transaction) would continue to apply for debit card transactions performed from October 1, 2011 (the original effective date of § 235.3) until the calendar day prior to the effective date of the final rule. Proposed § 235.3(b)(2) would establish the base component and the *ad valorem* component that would apply for debit card transactions performed from the effective date of the final rule to June 30, 2025. Specifically, for these transactions, the base component would be 14.4 cents, and the *ad valorem* component would be 4.0 basis points (multiplied by the value of the transaction). As described in section III.B, *supra*, the proposed base component of 14.4 cents is the transaction-weighted average of per-transaction allowable costs (excluding fraud losses) across covered

both cardholders and merchants absorbing larger proportions of such losses over time. Notwithstanding these changes, the Board believes that its conclusions with respect to the *ad valorem* component remain sound. Furthermore, because the methodology for determining the *ad valorem* component is based on actual fraud losses absorbed by covered issuers, any future decrease or increase in the median ratio of issuer fraud losses to transaction value among covered issuers would, pursuant to the Board's proposed methodology, result in a corresponding future reduction or increase to the *ad valorem* component.

issuers based on the data reported on the 2021 Debit Card Issuer Survey (3.9 cents) multiplied by the fixed multiplier of 3.7 and rounded to the nearest tenth of one cent. The proposed *ad valorem* component of 4.0 basis points (multiplied by the value of the transaction) is the median ratio of issuer fraud losses to transaction value among covered issuers based on the data reported on the 2021 Debit Card Issuer Survey, rounded to the nearest quarter of one basis point.⁵¹

The Board proposes a set of conforming revisions to comments 235.3(b)-2 and 235.3(b)-3 of the Official Commentary to make clear that the base component and the *ad valorem* component for a particular transaction depend on the date on which the transaction is performed. Proposed new comment 235.3(b)-4 would provide that, for this purpose, a debit card transaction is considered to be performed on the date on which the transaction is settled on an interbank basis.

Proposed new paragraph (c) to § 235.3 would set forth the basis for determining the amounts in proposed § 235.3(b). Specifically, proposed § 235.3(c) would provide that, for every two-year period, beginning with the period from July 1, 2025, to June 30, 2027, the Board will determine the base component and the *ad valorem* component using the approach described in a new proposed Appendix B to Regulation II. Paragraph (a) to proposed Appendix B would similarly state that the Board will determine the base component and the *ad valorem* component for each “applicable period” (*i.e.*, every two-year period beginning with the period from July 1, 2025, to June 30, 2027) using the approach described in proposed Appendix B.

⁵¹ The Board proposes to round the *ad valorem* component to the nearest quarter of one basis point to achieve a similar degree of accuracy as for the base component, which the Board proposes to round to the nearest tenth of one cent. Specifically, for a \$50 debit card transaction subject to the interchange fee standards, a change in the *ad valorem* component of one quarter of one basis point would result in a change of around one tenth of one cent to the maximum interchange fee permitted under the interchange fee standards.

Paragraph (b) of proposed Appendix B would set forth the data that the Board would use to determine the base component and *ad valorem* component for each applicable period – namely, the latest data reported to the Board by covered issuers on the Debit Card Issuer Survey. Specifically, paragraph (b) would provide that the Board will determine the base component and the *ad valorem* component for each applicable period using the data reported to the Board by covered issuers pursuant to § 235.8 concerning transactions performed during the calendar year that is two years prior to the year in which that applicable period begins. For example, in the case of the applicable period beginning July 1, 2025, the Board would use the data reported to the Board by covered issuers on the Debit Card Issuer Survey concerning debit card transactions performed in calendar year 2023, which the Board will collect in 2024.

Paragraph (c)(1) of proposed Appendix B would establish the formula that the Board would use to determine the base component for each applicable period. Specifically, for each applicable period, the base component would be the product of the transaction-weighted average of per-transaction allowable costs (excluding fraud losses) across covered issuers and 3.7, rounded to the nearest tenth of one cent.⁵² Paragraph (c)(2) would define “allowable costs (excluding fraud losses)” – which is synonymous with the term “base component costs” used elsewhere in this notice – as the sum of the costs of authorization, clearance, and settlement, as reported on the Debit Card Issuer Survey,⁵³ and transaction-monitoring costs tied to authorization, as reported on the Debit Card Issuer Survey.⁵⁴ Paragraph (c)(3) would set forth how the Board calculates the transaction-weighted average of per-transaction allowable costs

⁵² Section III.B, *supra*, describes the Board’s rationale for proposing 3.7 as the fixed multiplier for determining the base component.

⁵³ These costs are reported on line 3a of section II of the Debit Card Issuer Survey as “costs of authorization, clearance, and settlement.” *See* FR 3064a.

⁵⁴ These costs are reported on line 5a.1 of section II of the Debit Card Issuer Survey as “transactions monitoring costs tied to authorization.” *See id.*

(excluding fraud losses) across issuers. Specifically, using the latest data reported to the Board by covered issuers, the Board would (i) sum allowable costs (excluding fraud losses) across covered issuers that reported allowable costs (excluding fraud losses); (ii) divide this sum by the sum of the total number of debit card transactions across covered issuers that reported allowable costs (excluding fraud losses); and (iii) round this result to the nearest tenth of one cent.⁵⁵

Paragraph (d)(1) of proposed Appendix B would establish the metric that the Board would use to determine the *ad valorem* component for each applicable period. Specifically, for each applicable period, the *ad valorem* component for a particular debit card transaction would be the median ratio of issuer fraud losses to transaction value among covered issuers, rounded to the nearest quarter of one basis point, multiplied by the value of the debit card transaction.

Paragraph (d)(2) would define “ratio of issuer fraud losses to transaction value” as the value of fraud losses incurred by the covered issuer, as reported on the Debit Card Issuer Survey,⁵⁶ divided by the total value of debit card transactions, as reported on the Debit Card Issuer Survey.⁵⁷ Paragraph (d)(3) would set forth how the Board calculates the median ratio of issuer fraud losses to transaction value among covered issuers. Specifically, using the latest data reported to the Board by covered issuers, the Board would (i) determine the ratio of issuer fraud losses to transaction value for each covered issuer that reported issuer fraud losses, (ii) sort these

⁵⁵ The total number of debit card transactions attributable to a covered issuer is reported on line 1a of section II of the Debit Card Issuer Survey as the volume of “settled purchase transactions (excluding pre-authorizations, denials, adjustments, returns, and cash back amounts).” *See id.*

⁵⁶ These costs are reported on line 8b of section II of the Debit Card Issuer Survey as “losses incurred by issuer” (*i.e.*, gross value of fraudulent transactions, less fraud-related chargebacks to acquirers net of representments, and less losses absorbed by cardholders). *See id.*

⁵⁷ The total value of debit card transactions attributable to a covered issuer is reported on line 1a of section II of the Debit Card Issuer Survey as the value of “settled purchase transactions (excluding pre-authorizations, denials, adjustments, returns, and cash back amounts).” *See id.*

ratios in ascending order, and (iii) select the ratio in the middle (if the number of ratios is odd) or calculate the simple average of the two ratios in the middle (if the number of ratios is even).

Paragraph (f) of proposed Appendix B would establish the timing of the publication of the base component and *ad valorem* component for an applicable period. Specifically, the Board would publish these amounts in the *Federal Register* no later than March 31 of the calendar year in which the applicable period begins. Because the Board would determine these amounts by applying the approach described in proposed Appendix B and using the latest data reported to the Board by covered issuers, the Board would not intend to seek public comment on future updates to these amounts.⁵⁸

IV. Proposed Revisions to Fraud Prevention Adjustment (§ 235.4)

A. Background

As described above, under EFTA section 920(a)(5)(A), the Board may allow for an adjustment to the interchange fee received or charged by an issuer under the interchange fee standards if such adjustment is reasonably necessary to make allowance for costs incurred by the issuer in preventing fraud in relation to debit card transactions involving the issuer, provided that the issuer complies with fraud-related standards established by the Board. The Board's fraud-related standards must (i) be designed to ensure that any fraud-prevention adjustment is limited to the amount that is reasonably necessary to make allowance for costs incurred by the issuer in preventing fraud in relation to debit card transactions involving the issuer and takes into account

⁵⁸ See, e.g., 5 U.S.C. 553(b)(3)(B) (exempting agencies from notice and comment rulemaking when the agency for good cause finds that such procedures are impracticable, unnecessary, or contrary to the public interest). The Board believes that future determinations of the base component and the *ad valorem* component should qualify for the good cause exemption from notice and comment rulemaking because such determinations would involve the ministerial application of the approach described in proposed Appendix B, and the Board would not be exercising any discretion in connection with such determinations. The Board would seek public comment on any future substantive changes to the proposed approach.

any fraud-related reimbursements (including amounts from chargebacks) received from consumers, merchants, or payment card networks in relation to debit card transactions involving the issuer; and (ii) require issuers to take effective steps to reduce the occurrence of, and costs from, fraud in relation to debit card transactions, including through the development and implementation of cost-effective fraud prevention technology.⁵⁹ EFTA section 920(a)(5)(B) requires the Board to prescribe regulations to establish standards for making any such fraud-prevention adjustment.⁶⁰

The Board adopted a fraud-prevention adjustment and fraud-prevention standards in § 235.4 of Regulation II.⁶¹ In adopting the fraud-prevention adjustment, the Board (i) defined the fraud-prevention costs that issuers incur and (ii) structured the fraud-prevention adjustment to

⁵⁹ EFTA section 920(a)(5)(A)(ii). The Board does not propose revisions to the current fraud-prevention standards in § 235.4(b). For the reasons explained in the notice accompanying the 2012 final rule, the Board adopted a non-prescriptive approach to these standards. *See* 77 FR 46258, 46268–75 (Aug. 3, 2012). The fraud-prevention standards require issuers to develop and implement policies and procedures reasonably designed to take effective steps to reduce the occurrence of, and costs to all parties from, fraudulent debit card transactions, including through the development and implementation of cost-effective fraud-prevention technology. *See* § 235.4(b)(1). Specifically, an issuer's policies and procedures must address: (i) methods to identify and prevent fraudulent debit card transactions; (ii) monitoring of the volume and value of its fraudulent debit card transactions; (iii) appropriate responses to suspicious debit card transactions in a manner designed to limit the costs to all parties from and prevent the occurrence of future fraudulent debit card transactions; (iv) methods to secure debit card and cardholder data; and (v) such other factors as the issuer considers appropriate. *See* § 235.4(b)(2). An issuer must review, at least annually, its fraud-prevention policies and procedures, and their implementation, and update them as necessary in light of: (i) their effectiveness in reducing the occurrence of, and costs to all parties from, fraudulent debit card transactions involving the issuer; (ii) their cost-effectiveness; and (iii) changes in the types of fraud, methods used to commit fraud, and available methods for detecting and preventing fraudulent debit card transactions that the issuer identifies from (A) its own experience or information, (B) information provided to the issuer by its payment card networks, law enforcement agencies, and fraud-monitoring groups in which the issuer participates, and (C) applicable supervisory guidance. *See* § 235.4(b)(3). In order to charge or receive the fraud-prevention adjustment, an issuer must annually notify its payment card networks that it complies with the Board's fraud-prevention standards, and must notify its payment card networks if it is no longer eligible to receive or charge the fraud-prevention adjustment. *See* § 235.4(c)–(d).

⁶⁰ In issuing regulations to implement any fraud-prevention adjustment, the Board must consider certain factors set forth in EFTA section 920(a)(5)(B)(ii), which are discussed in section VIII.C, *infra*.

⁶¹ Section 235.4 was initially adopted via an interim final rule in July 2011. *See* 76 FR 43477 (July 20, 2011). The Board subsequently issued a final rule that made various amendments to the interim final rule. *See* 77 FR 46258 (Aug. 3, 2012).

allow issuers to recover a portion of these costs. A brief overview of how the Board developed the fraud-prevention adjustment in current § 235.4 follows.

1. Fraud-Prevention Costs

EFTA section 920 does not specify types of fraud-prevention costs incurred by issuers that the Board may or may not consider in determining the fraud-prevention adjustment. When the Board adopted current § 235.4, the Board explained that fraud prevention involves a broad range of activities in which an issuer may engage before, during, or after a debit card transaction.⁶² Accordingly, and for reasons explained in the notice accompanying the 2012 final rule, the Board considered costs incurred by debit card issuers associated with a variety of activities that contribute to preventing fraud, including research and development of new fraud-prevention technologies, card reissuance due to fraudulent activity, data security, card activation, and merchant blocking. However, the Board did not consider transaction-monitoring costs to be a fraud-prevention cost for purposes of determining the fraud-prevention adjustment because the Board included transaction-monitoring costs in allowable costs for purposes of the interchange fee standards.⁶³ The Board also did not consider costs incurred to prevent fraud to a cardholder's transaction account through means other than debit card transactions, or costs incurred to prevent fraud in connection with other payment methods such as credit cards. Additionally, fraud losses, lost revenue attributable to cardholders waiting for replacement cards, fraud-loss insurance, and recovering losses were not included in fraud-prevention costs.⁶⁴

⁶² 77 FR 46258, 46264 (Aug. 3, 2012).

⁶³ *See id.*; *see also* 76 FR 43393, 43431 (July 20, 2011) (noting that the types of fraud-prevention activities considered in connection with the fraud-prevention adjustment are those activities that prevent fraud with respect to debit card transactions at times other than when the issuer is effecting the transaction); 80 FR 48684, 48685 (Aug. 14, 2015) (same).

⁶⁴ 77 FR at 46264.

2. Fraud-Prevention Adjustment

When the Board adopted the fraud-prevention adjustment as an interim final rule in 2011, the Board noted that the statute does not specify what amount, or range of amounts, is reasonably necessary to make allowance for an issuer's fraud-prevention costs. The Board concluded that an amount that makes allowance for an issuer's fraud-prevention costs is one that gives consideration to those costs and allows a reasonable recovery of those costs based on the considerations set forth in EFTA section 920(a)(5)(B)(ii).⁶⁵

For the reasons explained in the notice accompanying the 2012 final rule, the Board adopted a fraud-prevention adjustment of 1 cent per transaction.⁶⁶ This amount corresponded to the difference, rounded to the nearest whole cent, between the median per-transaction fraud-prevention costs aggregated with transaction-monitoring costs among covered issuers (1.8 cents) and the median per-transaction transaction-monitoring costs among covered issuers (0.7 cents), based on the data collected on the Board's voluntary survey.⁶⁷

The Board described the foregoing methodology for determining the fraud-prevention adjustment in the notice accompanying the 2012 final rule. The Board did not, however, codify this methodology in § 235.4. Rather, § 235.4(a) simply provides that, subject to compliance with the Board's fraud-prevention standards, an issuer may receive or charge an amount of no more than 1.0 cent per transaction in addition to any interchange fee it receives or charges in accordance with § 235.3.

⁶⁵ 76 FR at 43482. The Board rejected an interpretation that would require a direct connection between the fraud-prevention adjustment and actual issuer costs. The Board also did not interpret the statute to require the fraud-prevention adjustment to permit each (or any) issuer to fully recover its fraud-prevention costs. *See id.*

⁶⁶ 77 FR at 46265–66.

⁶⁷ 77 FR at 46263.

B. *Rationale for Proposal*

When the Board adopted the fraud-prevention adjustment in current § 235.4, the Board stated that it would take into account data from future Debit Card Issuer Surveys when considering any future revisions to the fraud-prevention adjustment.⁶⁸ Consistent with EFTA section 920(a)(3)(B), the Board has surveyed covered issuers on a mandatory basis every other year since the reporting requirements in § 235.8 of Regulation II were adopted. Through these biennial surveys, the Board has collected data from covered issuers concerning the costs incurred by covered issuers in connection with debit card transactions performed in calendar years 2011, 2013, 2015, 2017, 2019, and 2021. These data show that fraud-prevention costs have risen since 2009. Specifically, the median per-transaction fraud-prevention costs among covered issuers was 1.3 cents in 2021.⁶⁹

Given this development, the Board believes it is necessary to revise the fraud-prevention adjustment to reflect the increase since 2009 in fraud-prevention costs. In addition – and for the reasons explained in section III.B, *supra*, in connection with the interchange fee standards – the Board believes that, as much as practicable, the fraud-prevention adjustment should be updated regularly and predictably to reflect changes in the fraud-prevention costs incurred by covered issuers as those changes occur. Accordingly, the Board proposes to determine the fraud-prevention adjustment in § 235.4 every other year based on the latest data reported to the Board by covered issuers. The Board believes that, under this approach, the fraud-prevention adjustment in § 235.4 will continue over time to reflect an amount that is reasonably necessary to

⁶⁸ 77 FR at 46266.

⁶⁹ The Board computes the median per-transaction fraud-prevention among covered issuers by (i) for each covered issuer that reported fraud-prevention costs, dividing the covered issuer's fraud-prevention costs by the total number of debit card transactions reported by the covered issuer; (ii) sorting these values in ascending order; and (iii) selecting the value in the middle (if the number of values is odd) or calculating the simple average of the two values in the middle (if the number of values is even).

make allowance for costs incurred by an issuer in preventing fraud in relation to debit card transactions involving that issuer.

The Board also proposes to modify the original methodology used to determine the fraud-prevention adjustment. When the Board adopted current § 235.4, the Board's objective was to determine the fraud-prevention adjustment as the median per-transaction fraud-prevention costs among covered issuers. However, due to limitations in the data reported to the Board by covered issuers on the Board's voluntary survey, the Board did not directly calculate this metric, but rather approximated it by calculating the difference between (i) the median per-transaction fraud-prevention costs aggregated with transaction-monitoring costs among covered issuers, and (ii) the median per-transaction transaction-monitoring costs among covered issuers, rounded to the nearest cent.⁷⁰ However, these limitations no longer persist in the data collected since the reporting requirements in § 235.8 of Regulation II were adopted.⁷¹ As a result, the Board is now able to directly calculate this metric. Therefore, as described below, the Board proposes to determine the fraud-prevention adjustment as the median per-transaction fraud-prevention costs among covered issuers, rounded to the nearest tenth of one cent.

The Board believes that the original methodology, with the proposed modification, continues to be an appropriate methodology for determining the fraud-prevention adjustment,

⁷⁰ Specifically, the Board's voluntary survey asked covered issuers to report (i) their fraud-prevention costs aggregated with transaction-monitoring costs, and also to break out, if possible, (ii) their transaction-monitoring costs. Some covered issuers reported the first figure but not the second. Instead of directly calculating the median per-transaction fraud-prevention costs among covered issuers – which would have required the Board to rely on a smaller data set comprised only of those covered issuers that reported both figures – the Board approximated this metric by calculating the difference between (i) the median per-transaction fraud-prevention costs aggregated with transaction-monitoring costs among covered issuers that reported their fraud prevention costs aggregated with transaction-monitoring costs, and (ii) the median per-transaction transaction-monitoring costs among covered issuers that broke out their transaction-monitoring costs.

⁷¹ Specifically, beginning with the first mandatory Debit Card Issuer Survey, a more representative number of covered issuers have reported their fraud-prevention costs disaggregated from their transaction-monitoring costs.

both for the reasons explained in the notice accompanying the 2012 final rule, and in light of the factors set forth in EFTA section 920(a)(5)(B)(ii), which are discussed in section VIII.C, *infra*.

C. Description of Proposal

The Board proposes to determine, for every two-year period, the fraud-prevention adjustment based on the latest data reported to the Board by covered issuers on the Debit Card Issuer Survey. Further, the Board proposes to modify the original methodology used to determine the fraud-prevention adjustment. The Board does not propose to modify the fraud-prevention costs considered for purposes of determining the fraud-prevention adjustment, or the fraud-prevention standards that covered issuers must meet to receive the fraud-prevention adjustment.

Proposed § 235.4(a)(1) would provide that the fraud-prevention adjustment of 1.0 cents would continue to apply for debit card transactions performed from October 1, 2011 (the original effective date of § 235.4) until the calendar day prior to the effective date of the final rule.

Proposed § 235.4(a)(2) would establish the fraud-prevention adjustment (1.3 cents) that would apply for debit card transactions performed from the effective date of the final rule to June 30, 2025. Proposed new comment 235.4(a)-1 would provide that, for purposes of § 235.4(a), a debit card transaction is considered to be performed on the date on which the transaction is settled on an interbank basis.

Proposed new paragraph (b) to § 235.4 would set forth the basis for determining the fraud-prevention adjustment in proposed § 235.4(a). Specifically, proposed § 235.4(b) would provide that, for every two-year period, beginning with the period from July 1, 2025, to June 30, 2027, the Board will determine the fraud-prevention adjustment using the approach described in proposed Appendix B to Regulation II. Paragraph (a) to proposed Appendix B similarly would

state that the Board will determine the fraud-prevention adjustment for each “applicable period” (*i.e.*, every two-year period beginning with the period from July 1, 2025, to June 30, 2027) using the approach described in proposed Appendix B.

Paragraph (b) of proposed Appendix B would set forth the data that the Board would use to determine the fraud-prevention adjustment for each applicable period – namely, the latest data reported to the Board by covered issuers on the Debit Card Issuer Survey. Specifically, paragraph (b) would provide that the Board will determine the fraud-prevention adjustment for each applicable period using the data reported to the Board by covered issuers pursuant to § 235.8 concerning transactions performed during the calendar year that is two years prior to the year in which that applicable period begins. For example, in the case of the applicable period beginning July 1, 2025, the Board would use the data reported to the Board by covered issuers on the Debit Card Issuer Survey concerning debit card transactions performed in calendar year 2023, which the Board will collect in 2024.

Paragraph (e)(1) of proposed Appendix B would establish the metric that the Board would use to determine the fraud-prevention adjustment for each applicable period. Specifically, for each applicable period, the fraud-prevention adjustment would be the median per-transaction fraud-prevention costs among covered issuers, rounded to the nearest tenth of one cent. Paragraph (e)(2) would define “per-transaction fraud-prevention costs” as fraud-prevention costs, as reported on the Debit Card Issuer Survey,⁷² divided by the total number of debit card transactions, as reported on the Debit Card Issuer Survey.⁷³ Paragraph (e)(3) would set forth how

⁷² Fraud-prevention costs are (i) “total fraud-prevention and data-security costs,” as reported on line 5a of section II of the Debit Card Issuer Survey, minus (ii) “transactions monitoring costs tied to authorization,” as reported on line 5a.1 of section II of the Debit Card Issuer Survey. *See* FR 3064a.

⁷³ The total number of debit card transactions attributable to a covered issuer is reported on line 1a of section II of the Debit Card Issuer Survey as the volume of “settled purchase transactions (excluding pre-authorizations, denials, adjustments, returns, and cash back amounts).” *See id.*

the Board calculates the median per-transaction fraud-prevention costs among covered issuers. Specifically, using the latest data reported to the Board by covered issuers, the Board would (i) determine the per-transaction fraud-prevention costs for each covered issuer that reported fraud-prevention costs, (ii) sort these values in ascending order, and (iii) select the value in the middle (if the number of values is odd) or calculate the simple average of the two values in the middle (if the number of values is even).

Paragraph (f) of proposed Appendix B would set forth the timing of the publication of the fraud-prevention adjustment for an applicable period. Specifically, the Board would publish the fraud-prevention adjustment in the *Federal Register* no later than March 31 of the calendar year in which the applicable period begins. Because the Board would determine the fraud-prevention adjustment by applying the methodology described in proposed Appendix B and using the latest data reported to the Board by covered issuers, the Board would not intend to seek public comment on future updates to the fraud-prevention adjustment.⁷⁴

V. Other Proposed Revisions

In addition to the proposed revisions to the interchange fee standards in § 235.3 and the fraud-prevention adjustment in § 235.4, the Board proposes a set of technical revisions to Regulation II. In general, these proposed revisions are intended to make Regulation II clearer. Additionally, some of the proposed revisions are intended to ensure the text of the regulation directly incorporates the Board's current construction of the rule.

First, to improve the readability of Regulation II, the Board proposes to add “covered issuer” as a defined term in § 235.2. Under the proposal, “covered issuer” would mean, for a

⁷⁴ As with future determinations of the base component and the *ad valorem* component, the Board believes that future determinations of the fraud-prevention adjustment should qualify for the good cause exemption from notice and comment rulemaking. *See supra* note 58.

particular calendar year, an issuer that, together with its affiliates, has assets of \$10 billion or more as of the end of the preceding calendar year.⁷⁵ Further, the Board proposes certain conforming revisions to the regulation to reflect the addition of “covered issuer” as a defined term. For example, the Board proposes to move current comment 235.5(a)-1, which describes which assets do and do not count toward the \$10 billion threshold, to the commentary under § 235.2. In addition, the Board proposes to incorporate the defined term “covered issuer” where relevant in other sections of Regulation II, particularly in § 235.5(a) (the small issuer exemption) and § 235.8(a) (reporting requirements) and the commentary thereto. The Board does not intend the addition and incorporation of the defined term “covered issuer” to be a substantive change.

Second, the Board identified three sentences in the commentary to current § 235.2(k) (definition of “issuer”) that relate to an issuer’s eligibility for the small issuer exemption in § 235.5(a). The Board proposes to move the substance of these sentences into the commentary to § 235.5(a). The Board does not intend this proposed revision to modify the definition of “issuer” or alter any issuer’s eligibility for the small issuer exemption.

Third, the Board proposes minor revisions to add specificity to § 235.8 (reporting requirements and record retention) and the commentary thereto. Specifically, the Board proposes to specify in § 235.8(a) that each covered issuer must file a report with the Board on a biennial basis, and that each payment card network must file a report with the Board on an annual basis, consistent with the Board’s survey practices since 2011. Further, the Board proposes to add new comment 235.8(a)-1 to specify that the reports referred to in proposed § 235.8(a) are the Board’s biennial Debit Card Issuer Survey and annual Payment Card Network Survey, and that each survey collects information concerning debit card transactions performed during the previous

⁷⁵ The proposed definition is derived from current § 235.5(a)(1)(ii).

calendar year. In addition, the Board proposes to add new comment 235.8(a)-2 to specify that newly covered issuers are exempt from the Debit Card Issuer Survey, consistent with the current instructions to that survey.⁷⁶ The Board believes that these proposed revisions are helpful in light of the significance of the data collected on the Debit Card Issuer Survey to the proposed approach for determining the base component, the *ad valorem* component, and the fraud-prevention adjustment.

Fourth, the Board proposes to delete § 235.7(c), the commentary to § 235.7(c), and § 235.10 of Regulation II. These sections of the regulation specify the original effective date of Regulation II (October 1, 2011) and give debit card issuers and networks additional time to comply with the requirements in § 235.7(a) for certain types of debit cards, such as general-use prepaid cards and debit cards that use point-of-sale transaction qualification or substantiation systems for verifying the eligibility of purchased goods or services. Both the original effective date of Regulation II and these extended compliance dates have long since passed. As such, the Board believes that these provisions of Regulation II are no longer necessary.⁷⁷ In addition, deleting these provisions would avoid the potential for confusion regarding the effective date of any future revisions to the requirements in § 235.7(a).⁷⁸

⁷⁶ The General Instructions to the Debit Card Issuer Survey currently provide that “[i]f an issuer that is covered by the interchange fee standards in Regulation II at the time of this data collection was not also covered in [the previous calendar year], it does not need to file a report” See FR 3064a.

⁷⁷ For the same reason, the Board proposes to delete § 235.5(a)(4), which temporarily modified the application of the small issuer exemption due the COVID-19 pandemic. See 85 FR 77345 (Dec. 2, 2020). Because the last debit card transactions to which § 235.5(a)(4) applied were performed on December 31, 2021, the Board proposes to delete § 235.5(a)(4) with an effective date of January 1, 2027, which is after the five-year record retention requirement prescribed in § 235.8(c)(1) will have elapsed with respect to these transactions. The effective date of the other proposed revisions described in this notice is discussed in section VI, *infra*.

⁷⁸ The Board does not anticipate any future revisions to § 235.7(a) at this time. However, questions regarding the effective date arose in connection with the Board’s recent revisions to § 235.7(a) and the commentary thereto. See 87 FR 61217 (Oct. 11, 2022).

Fifth, the Board proposes minor revisions to § 235.4 (in addition to those described in section IV.C, *supra*) and the commentary to § 235.3(b) (in addition to those described in section III.C, *supra*) to clarify the relationship between the interchange fee standards in § 235.3 and the fraud-prevention adjustment in § 235.4. Specifically, the Board proposes to modify the first sentence of § 235.4(a) to clarify that the fraud-prevention adjustment is in addition to any interchange fee an issuer receives or charges in accordance with § 235.3. Further, the Board proposes to add a sentence in both comments 235.3(b)-1 and 235.3(b)-3 stating that, in addition to the base component and *ad valorem* component, an issuer may be permitted to receive a fraud-prevention adjustment under § 235.4. Although the Board does not believe that debit card industry participants currently misunderstand the relationship between the interchange fee standards in § 235.3 and the fraud-prevention adjustment in § 235.4, the proposed revisions would eliminate any doubt that the maximum permissible interchange fee amount that a covered issuer may receive for a transaction subject to the interchange fee standards is the sum of the base component, the *ad valorem* component, and, if the covered issuer is eligible, the fraud-prevention adjustment.

Finally, the Board proposes to delete the first clause of § 235.5(a)(1), which cross-references § 235.5(a)(3) (transition period for newly covered issuers) and characterizes the latter paragraph as an exception to the small issuer exemption in § 235.5(a)(1). The Board believes that characterizing § 235.5(a)(3) as an exception to § 235.5(a)(1) is potentially confusing, as § 235.5(a)(3) adds to, rather than subtracts from, the relief provided in § 235.5(a)(1) by providing additional, temporary relief to newly covered issuers that would not otherwise qualify for the relief provided in § 235.5(a)(1). The proposed revision would clarify the relationship

between these two paragraphs in § 235.5(a) but is not intended to alter any issuer's eligibility for the small issuer exemption.

VI. Effective Date of Proposed Revisions

With one exception,⁷⁹ the Board proposes that the revisions would, if adopted, take effect on the first day of the next calendar quarter that begins at least 60 days after the final rule is published in the *Federal Register*.⁸⁰ Such an implementation period would be similar to the implementation period of the current interchange fee standards, which the Board published on July 20, 2011, and became effective on October 1, 2011.⁸¹

Once the proposed revisions are effective, and as described in sections III.C and IV.C, *supra*, the proposed base component (14.4 cents), *ad valorem* component (4.0 basis points multiplied by the value of the transaction), and fraud-prevention adjustment (1.3 cents) would be in effect through June 30, 2025. On July 1, 2025, a new base component, *ad valorem* component, and fraud-prevention adjustment would take effect. The Board would determine these amounts using the approach described in proposed Appendix B based on the data reported to the Board by covered issuers on the Debit Card Issuer Survey in 2024 (concerning debit card transactions

⁷⁹ Unlike the other proposed revisions described in this notice, the proposed deletion of § 235.5(a)(4) would, if adopted, take effect on January 1, 2027. *See supra* note 77.

⁸⁰ Section 302 of the Riegle Community Development and Regulatory Improvement Act, Pub. L. 103-325, requires that amendments to regulations prescribed by a federal banking agency that impose additional requirements on insured depository institutions must take effect on the first day of a calendar quarter that begins on or after the date of publication in the *Federal Register*. *See* 12 U.S.C. 4802.

⁸¹ The Board notes that, compared with the original rulemaking in which the Board adopted current § 235.3, the proposed revisions would represent a significantly smaller reduction in the amount of interchange fees that covered issuers may receive for transactions subject to the interchange fee standards. In addition, at the time of the original rulemaking, there was significant uncertainty as to whether payment card networks would implement different interchange fee schedules for transactions subject to and exempt from the interchange fee cap. Since that time, all networks have established different interchange fee schedules for transactions subject to and exempt from the interchange fee cap.

performed in calendar year 2023), and would publish these values in the *Federal Register* no later than March 31, 2025.

VII. Request for Comment

The Board invites comment on all aspects of the proposed revisions.⁸² In addition, the Board invites feedback on the following specific questions related to the proposal:

1. As stated in paragraph (a) of proposed Appendix B to Regulation II, the Board would determine the base component, *ad valorem* component, and fraud-prevention adjustment for every two-year period, beginning with the period from July 1, 2025, to June 30, 2027. Is the proposed two-year cadence appropriate, or should the Board determine these amounts more or less frequently?
2. As described in paragraph (c)(1) of proposed Appendix B to Regulation II, the Board would determine the base component as a fixed multiple of the transaction-weighted average of per-transaction base component costs (*i.e.*, allowable costs (excluding fraud losses)) across covered issuers. As described in section III.B, *supra*, the fixed multiplier corresponds to the percentage of covered issuer transactions for which the Board believes covered issuers should fully recover their base component costs over time. Should the Board select an alternative cost-recovery target from among the possibilities below, or another cost-recovery target not included below? If so, why?

⁸² As noted in section III.A, *supra*, the Board has reviewed its construction of the statute and prior analysis regarding the allowable costs that the Board considered in establishing the interchange fee standards, and believes that this prior analysis remains sound. As such, the Board is not inviting comments on the allowable costs considered for purposes of the interchange fee standards.

Cost-recovery target (percentage of covered issuer transactions)	Fixed multiplier	Base component (based on 2021 data) ⁸³	Decline in base component relative to current (based on 2021 data)	Efficiency gap with respect to transaction processing between covered issuers whose transactions are above and below the cost-recovery target (based on 2021 data) ⁸⁴	Percentage of covered issuers that would have fully recovered their base component costs in 2021 had the relevant base component been in effect in 2021 (based on 2021 data)
Current	-	21.0¢	-	-	77%
99.5%	4.5	17.6¢	16%	7.7	76%
99.0%	4.0	15.6¢	26%	5.8	71%
98.5% (proposal)	3.7	14.4¢	31%	5.2	66%
98.0%	3.5	13.7¢	35%	4.7	63%
95.0%	2.7	10.5¢	50%	3.8	52%

3. As described in paragraph (d)(1) of proposed Appendix B to Regulation II, the Board would determine the *ad valorem* component, for a particular debit card transaction, as the median ratio of issuer fraud losses to transaction value among covered issuers, multiplied by the value of the transaction. Should the Board adopt an alternative methodology for determining the *ad valorem* component? If so, why?
4. As described in paragraph (e)(1) of proposed Appendix B to Regulation II, the Board would determine the fraud-prevention adjustment as the median per-transaction fraud-prevention costs among covered issuers. Should the Board adopt an alternative methodology for determining the fraud-prevention adjustment? If so, why?

⁸³ The transaction-weighted average of per-transaction base component costs across covered issuers, rounded to the nearest tenth of one cent, for transactions performed in 2021 was 3.9 cents. For purposes of comparison, the same average for transactions performed in 2009 and 2011 was 7.7 cents and 5.1 cents, respectively. The base component values listed are the product of 3.9 cents and the relevant fixed multiplier.

⁸⁴ As described in section III.B, *supra*, this efficiency gap is represented by the ratio of the transaction-weighted average of per-transaction base component costs for covered issuers whose transactions are above the target percentile to that for covered issuers whose transactions are below the target percentile.

5. As described in paragraphs (c)(1), (d)(1), and (e)(1) of proposed Appendix B to Regulation II, respectively, the Board proposes to round the base component to the nearest tenth of one cent, the *ad valorem* component to the nearest quarter of one basis point, and the fraud-prevention adjustment to the nearest tenth of one cent. Further, as described in paragraph (c)(3) of proposed Appendix B to Regulation II, in determining the base component, the Board proposes to round the transaction-weighted average of per-transaction allowable costs (excluding fraud losses) across covered issuers to the nearest tenth of one cent. Do these rounding conventions provide an appropriate degree of precision? If not, what alternative rounding conventions should the Board adopt?
6. As described in paragraphs (c)–(e) of proposed Appendix B to Regulation II, the Board would determine the base component, *ad valorem* component, and fraud-prevention adjustment for an applicable period using data reported on lines 1a, 3a, 5a, 5a.1, and 8b of the Debit Card Issuer Survey (FR 3064a).
 - a. Are there any reporting challenges or data quality issues associated with these line items of which the Board should be aware? If so, how could the Board address these challenges or issues?
 - b. Should the Board amend § 235.8 of Regulation II to specify that a covered issuer is required to retain records supporting the data that the covered issuer reports on the Debit Card Issuer Survey? Would this record retention requirement be duplicative of any existing recordkeeping requirements for covered issuers? If not, what would be the estimated additional annual burden of this requirement, in terms of hours and cost, for covered issuers?

7. As described in section VI, with one exception, the Board proposes that the revisions would take effect on the first day of the next calendar quarter that begins at least 60 days after the final rule is published in the *Federal Register*. Would this proposed effective date provide sufficient notice to covered issuers, payment card networks, and other industry stakeholders to prepare for the initial changes to the base component, *ad valorem* component, and fraud-prevention adjustment?
8. As stated in paragraph (f) of proposed Appendix B to Regulation II, going forward, the Board would publish the base component, *ad valorem* component, and fraud-prevention adjustment in the *Federal Register* no later than March 31 for an applicable period beginning July 1. Would this timeline provide sufficient notice to covered issuers, payment card networks, and other industry stakeholders to prepare for changes to these amounts? Should the Board increase or decrease the period between publication of these values and the beginning of the next applicable period?
9. Proposed comments 235.3(b)-4 and 235.4(b)-1 would provide that, for purposes of determining in which two-year period a debit card transaction is considered to be performed, a debit card transaction is considered to be performed on the date on which it is settled on an interbank basis. Is this proposed convention sufficiently clear? For example, should the Board specify which time zone is controlling for purposes of determining the date on which a transaction is settled on an interbank basis? Should the Board adopt an alternative standard, such as considering a transaction to be performed on the date on which the cardholder presents the debit card to the merchant for payment?

10. Would any of the proposed technical revisions described in section V, which are generally intended to make Regulation II clearer, create unintended consequences?
11. Does the Board's economic analysis of the proposal, set forth in section VIII.A, appropriately describe the likely impact of the proposal on various participants in the debit card market? Are there additional impacts of the proposal that the Board has not considered?

VIII. Regulatory Analyses

A. EFTA Section 904(a) Analysis

1. Statutory Requirement

Section 904(a)(2) of the EFTA requires the Board, in prescribing regulations to carry out the purposes of EFTA section 920, to prepare an economic analysis that considers the costs and benefits to financial institutions, consumers, and other users of electronic fund transfers. The analysis must address the extent to which additional paperwork will be required, the effect upon competition in the provision of electronic fund transfer services among large and small financial institutions, and the availability of such services to different classes of consumers, particularly low-income consumers. EFTA section 904(a)(2) also requires, to the extent practicable, the Board to demonstrate that the consumer protections of the proposed regulations outweigh the compliance costs imposed upon consumers and financial institutions. The Board interprets these requirements as applying with respect to both proposed and final rules implementing EFTA section 920.

In analyzing the potential effects of the proposal, the Board considered predictions of economic theory, information regarding debit card industry structure and practices, and issues raised during the original Regulation II rulemaking. The analysis also incorporates the

experience of debit card industry participants since the current interchange fee cap was adopted in 2011.

2. Cost/Benefit Analysis

a) Effects on Merchants⁸⁵

The Board believes that the primary way in which the proposal would impact merchants is by lowering their costs of accepting debit card transactions. The proposal would generally decrease the interchange fee paid by an acquirer (*i.e.*, a merchant's depository institution) on an average transaction performed using a debit card issued by a covered issuer, which would in turn decrease a merchant's costs by decreasing the merchant discount that the merchant pays to its acquirer for a debit card transaction.⁸⁶ Although the precise extent to which acquirers would pass on savings from lower debit card interchange fees to merchants may vary, competition between acquirers in the industry should generally result in acquirers passing on savings from lower interchange fees to their merchant customers.⁸⁷

Merchants that experience a decrease in the costs of accepting debit card transactions may pass on some or all these savings to consumers in the form of lower prices, foregone future price increases, or improved products or services.⁸⁸ The extent to which merchants would pass on such savings to consumers may depend on many factors. For example, merchants in more

⁸⁵ The Board interprets "other users of electronic fund transfer services" in EFTA section 904(a)(2) to refer primarily to merchants.

⁸⁶ Data collected by the Board show that, since adoption of the current interchange fee cap, actual per-transaction interchange fees for transactions subject to the interchange fee standards have been close in value to the amount permitted under the interchange fee cap. Thus, the Board expects that the proposed revisions to the interchange fee cap will directly lower per-transaction interchange fees for most transactions subject to the interchange fee standards.

⁸⁷ The extent to which an acquirer passes on savings from lower interchange fees to a merchant may depend on many factors, including the merchant's type and size.

⁸⁸ In addition, merchants may use savings from lower costs of accepting debit card transactions to enhance their operations, for example, by adding staff, improving their facilities, or implementing new technology.

competitive markets would be likely to pass on more of their cost savings to consumers compared with merchants facing less competition.

Measuring the extent to which merchants pass on cost savings to consumers, including any decrease in the costs of accepting certain forms of payment, is generally difficult.⁸⁹ Efforts to measure the extent to which merchants passed on to consumers any savings associated with the decrease in the costs of accepting debit card transactions in the period following the adoption of the current interchange fee cap in 2011 have yielded a wide range of results. For example, in response to a survey conducted soon after the introduction of the interchange fee cap, merchants did not consistently report making adjustments to their prices in response to the interchange fee cap.⁹⁰ By contrast, later research efforts analyzing data from longer time periods found evidence that merchants passed on to consumers a portion of their debit card acceptance costs (*e.g.*, by adjusting their prices) and that the degree of pass-through depended on merchant size.⁹¹

Finally, the decrease in costs of accepting debit card transactions may incentivize some merchants that until now have not accepted debit cards as a form of payment to begin doing so. In particular, while debit card acceptance is already high for most in-person transactions, the

⁸⁹ Potential challenges include (i) a lack of detailed price and cost data at the merchant level, (ii) contemporaneous changes in other costs for merchants, (iii) the small magnitude of cost variation due to changes in interchange fees relative to total price, and (iv) asymmetric price stickiness in the short term, meaning that merchants are more likely to increase prices in response to cost increases than to lower prices in response to cost decreases. For an overview of research looking to measure merchant cost pass-through, *see* Howard Chang, David S. Evans & Daniel D. Garcia Swartz, *The Effect of Regulatory Intervention in Two-Sided Markets: An Assessment of Interchange-Fee Capping in Australia*, 4 *Review of Network Economics* 328 (2005), <https://doi.org/10.2202/1446-9022.1080>.

⁹⁰ *See* Wang, Zhu, Scarlett Schwartz, & Neil Mitchell, *The Impact of the Durbin Amendment on Merchants: A Survey Study*, 100 *Federal Reserve Bank of Richmond Economic Quarterly* 183 (2014), https://www.richmondfed.org/-/media/RichmondFedOrg/publications/research/economic_quarterly/2014/q3/pdf/wang.pdf.

⁹¹ *See, e.g.*, Vladimir Mukharlyamov & Natasha Sarin, *Price Regulation in Two-Sided Markets: Empirical Evidence from Debit Cards* (last rev. Nov. 28, 2022) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3328579; Efraim Berkovich & Zheli He, *Rewarding the Rich: Cross Subsidies from Interchange Fees* (Hispanic Leadership Fund, May 3, 2022), https://hispanicleadershipfund.org/wp-content/uploads/2022/05/HLF_Report_RewardingTheRich-InterchangeFees_03May22.pdf.

proposal may encourage greater adoption of debit cards in market segments where acceptance may be lower, such as card-not-present (*e.g.*, ecommerce) transactions. Another market segment for which merchants may increase debit card acceptance are small-dollar purchases because, for this market segment, the proposed decrease in the base component would substantially reduce debit card acceptance costs as a proportion of the transaction value. Faced with lower debit card acceptance costs, some merchants may also look to provide incentives to their customers, or otherwise steer them, to pay with debit cards over alternative payment methods.

*b) Effects on Debit Card Issuers*⁹²

The Board believes that the proposal would have a direct effect on covered issuers but would not directly affect debit card issuers exempt from the interchange fee cap (exempt issuers).

The primary way in which the proposal would affect covered issuers would be by lowering their revenue from debit card transactions. In particular, covered issuers' interchange fee revenue would decline as the proposal would decrease the average interchange fee they collect on debit card transactions subject to the interchange fee standards. This reduction in covered issuers' total debit card interchange fee revenue could be offset to some extent by the likely continued growth in total debit card volume, with the offset potentially varying between different issuers. Debit card popularity has grown substantially since the current interchange fee cap was adopted; over this period, debit cards have become the most commonly used noncash payment method in the United States.⁹³ As noted above, further reduction in interchange fee

⁹² The Board interprets "financial institutions" in EFTA section 904(a)(2) to refer primarily to issuers of debit cards.

⁹³ Board of Governors of the Federal Reserve System, *The Federal Reserve Payments Study: 2022 Triennial Initial Data Release*, <https://www.federalreserve.gov/paymentsystems/fr-payments-study.htm>.

levels may support continued growth in debit card volumes to the extent that more merchants accept debit cards as a form of payment or encourage their customers to use debit cards.

Faced with lower interchange revenue from debit card transactions, covered issuers may offset some or all lost interchange fee revenue through a combination of customer fee increases and issuer cost reductions (*e.g.*, improvements to transaction-processing efficiency).⁹⁴ Depending on a variety of factors, such adjustments may make covered issuers' checking account and debit card programs less attractive to consumers. In response to these adjustments, consumers may switch to checking account or debit card programs offered by exempt issuers, or to alternative payment methods such as credit cards and digital payment methods, potentially leading to a further reduction in covered issuers' revenues from debit cards.⁹⁵

The experience following the introduction of the current interchange fee cap in 2011 provides information about how covered issuers may adjust their debit card programs in response to the proposal. Research shows that the adoption of the current interchange fee cap resulted in covered issuers increasing customer fees on checking accounts more than they otherwise would have, although these increases offset the reduction in interchange fee revenue only partially.⁹⁶

⁹⁴ An issuer seeking to reduce costs may reduce transaction-processing costs and/or other types of costs. Under the proposed approach, the former could result in a reduction to the interchange fee cap once data collected by the Board show a reduction in the transaction-weighted average of per-transaction transaction-processing costs across covered issuers.

Although another way in which covered issuers could offset a loss in interchange fee revenue could be through reductions in debit card reward programs, data collected by the Board show that following the adoption of the current interchange fee cap, covered issuers significantly limited or eliminated such programs, suggesting that issuers may not be able to reduce such programs much further. *See generally* Board of Governors of the Federal Reserve System, *Regulation II (Debit Card Interchange Fees and Routing): Reports and Data Collections*, <https://www.federalreserve.gov/paymentsystems/regii-data-collections.htm>.

⁹⁵ In addition, the reduction in covered issuers' interchange fee revenue could theoretically lead some covered issuers, particularly those serving niche market segments, such as high net-worth individuals, to downsize or potentially discontinue their debit card programs.

⁹⁶ Benjamin S. Kay, Mark D. Manuszak & Cindy M. Vojtech, *Competition and Complementarities in Retail Banking: Evidence from Debit Card Interchange Regulation*, 34 *Journal of Financial Intermediation* 91 (2018); Mark D. Manuszak & Krzysztof Wozniak, *The Impact of Price Controls in Two-Sided Markets: Evidence from US*

Furthermore, the continued growth in debit card popularity since the adoption of Regulation II, and the lack of a pronounced shift by consumers from covered issuers' to exempt issuers' debit card programs, suggest that such fee increases and other adjustments to checking accounts and debit card programs offered by covered issuers did not make them substantially less attractive to consumers.⁹⁷ Finally, the Board is not aware of any evidence that the adoption of the current interchange fee cap led any covered issuers to discontinue their debit card programs.

By contrast, the proposal would not directly or, the Board believes, indirectly affect exempt issuers (*i.e.*, those with consolidated assets under \$10 billion).⁹⁸ The experience following the introduction of the current interchange fee cap in 2011 provides information about whether exempt issuers are likely to be affected by the proposal. First, the adoption of the current interchange fee cap and the statutory exemptions for certain issuers and debit card transactions led all debit card networks to adopt pricing structures with different interchange fees for covered and exempt issuers. Second, data collected by the Board demonstrate that average per-transaction interchange fees for exempt issuers across all payment card networks did not decline after the

Debit Card Interchange Fee Regulation, Finance and Economics Discussion Series 2017-074, <https://www.federalreserve.gov/econres/feds/files/2017074pap.pdf>; Vladimir Mukharlyamov & Natasha Sarin, *Price Regulation in Two-Sided Markets: Empirical Evidence from Debit Cards* (last rev. Nov. 28, 2022) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3328579.

⁹⁷ See generally Board of Governors of the Federal Reserve System, *Regulation II (Debit Card Interchange Fees and Routing): Reports and Data Collections*, <https://www.federalreserve.gov/paymentsystems/regii-data-collections.htm>.

⁹⁸ The Board collects and reports annual information from payment card networks about their interchange fees for transactions subject to and exempt from the interchange fee cap. See Board of Governors of the Federal Reserve System, *Regulation II (Debit Card Interchange Fees and Routing): Average Debit Card Interchange Fee by Payment Card Network*, <https://www.federalreserve.gov/paymentsystems/regii-average-interchange-fee.htm>. The Board also annually publishes lists of covered and exempt institutions that issuers, payment card networks, and other market participants can use to determine which issuers qualify for the small issuer exemption. See Board of Governors of the Federal Reserve System, *Interchange Fee Standards: Small Issuer Exemption*, <https://www.federalreserve.gov/paymentsystems/regii-interchange-fee-standards.htm>.

current interchange fee cap was introduced in 2011 and have not declined since then.⁹⁹ Average per-transaction interchange fees for exempt issuers have remained at a level substantially higher than average per-transaction interchange fees for covered issuers, with the latest data collected by the Board documenting that average per-transaction interchange fees for exempt issuers increased in 2020 and 2021.¹⁰⁰

c) Effects on Consumers and Availability of Services to Different Classes of Consumers

As discussed above in the context of effects on merchants and debit card issuers, the proposal could affect consumers in two main ways. On the one hand, consumers could benefit if merchants pass on savings associated with the decrease in costs of accepting debit card transactions in the form of lower prices, forgone future price increases, or improvements in product or service quality. On the other hand, consumers could be negatively affected if covered issuers increase fees on debit cards or checking accounts, or make other adjustments that make these products less attractive to consumers.

The net effect on consumers, both individually and in the aggregate, will depend on which of these two effects predominates, which would in turn depend on many factors and is thus difficult to predict. As noted above, merchants in more competitive markets would likely pass on a larger portion of their cost savings to consumers. In a similar way, in response to declines in interchange fee revenue, covered issuers in more competitive markets would be less likely to increase fees or make other changes that negatively affect consumers. Covered issuers

⁹⁹ See Board of Governors of the Federal Reserve System, *Regulation II (Debit Card Interchange Fees and Routing): Average Debit Card Interchange Fee by Payment Card Network*, <https://www.federalreserve.gov/paymentsystems/regii-average-interchange-fee.htm>.

¹⁰⁰ See *id.*

that face strong competition from exempt issuers may be less likely to raise fees, as doing so could increase the probability that customers switch to these competing institutions.

In addition, the effect of the proposal could differ between particular classes of consumers in several ways. First, if the proposal results in merchants further increasing debit card acceptance (*e.g.*, for card-not-present transactions), consumers' ability to make such payments could increase, generating benefits to consumers without access to alternative non-cash payment methods, such as credit cards. Second, if the proposal results in covered issuers increasing fees, banking services could become less accessible to lower-income consumers who may be more sensitive to such fees.¹⁰¹

d) Additional Paperwork

The proposal would not substantively alter the reporting and recordkeeping requirements that § 235.8 of Regulation II imposes on covered issuers and networks, and would not alter the recordkeeping requirement for exempt issuers.¹⁰² Regulation II does not impose any reporting or recordkeeping requirements on consumers or merchants.

e) Effects Upon Competition in the Provision of Electronic Banking Services¹⁰³

The proposal could affect competition between covered and exempt issuers by reducing the average per-transaction debit card interchange fee received by covered issuers without

¹⁰¹ However, the Board notes that the unbanked rate in the United States has been steadily declining over time, including after the introduction of the current interchange fee cap in 2011. According to the data collected by the Federal Deposit Insurance Corporation, the rate of unbanked in the population fell from 8.2 percent in 2011 to an all-time low of 4.5 percent in 2021. *See* Federal Deposit Insurance Corporation, *2021 FDIC National Survey of Unbanked and Underbanked Households*, <https://www.fdic.gov/analysis/household-survey/2021report.pdf>.

¹⁰² However, the Board requests comment on whether § 235.8 of Regulation II should be amended to specify that a covered issuer is required to retain records supporting the data that the covered issuer reports on the Debit Card Issuer Survey. *See* section VII, *supra* (Question 6(b)).

¹⁰³ Although EFTA section 904(a)(2) requires the Board to consider the effects upon competition in the provision of electronic banking services among large and small financial institutions, the Board is considering the impact of the final rule on competition generally, including competition between large and small financial institutions.

affecting the amount received by exempt issuers. As noted above, the competitive effect of any adjustments made by covered issuers to their fee structures in response to the reduction in interchange fee revenue would depend on the degree of substitution between exempt and covered issuers. Research suggests that competition between smaller and larger depository institutions is weaker than competition between large depository institutions or competition between small depository institutions, likely because these institutions serve different customer bases.¹⁰⁴ In addition, data collected by the Board indicates that the proportion of debit card transactions attributable to covered and exempt issuers did not significantly change before and after the adoption of the current interchange fee cap.¹⁰⁵ In light of this evidence, the Board does not expect the proposal to have a significant impact on competitive dynamics between the two groups of issuers. The Board further does not believe that the proposal would affect competition between debit card networks.

f) Consumer Protection and Compliance Costs¹⁰⁶

Based on the analysis above, the Board cannot, at this time, determine whether the potential benefits of the proposal to consumers exceed the possible costs imposed on consumers and financial institutions. As described above, the proposal may yield benefits for consumers, but the magnitude of these benefits will depend on the behavior of various participants in the debit

¹⁰⁴ See, e.g., Robert M. Adams, Kenneth P. Brevoort & Elizabeth K. Kiser, *Who Competes with Whom? The Case of Depository Institutions*, 55 *Journal of Industrial Economics* 141 (2007); Andrew M. Cohen & Michael J. Mazzeo, *Market Structure and Competition Among Retail Depository Institutions*, 89 *Review of Economics and Statistics* 60 (2007); Timothy H. Hannan & Robin A. Prager, *The Profitability of Small Single-Market Banks in an Era of Multi-Market Banking*, 33 *Journal of Banking and Finance* 263 (2009).

¹⁰⁵ See generally Board of Governors of the Federal Reserve System, *Regulation II (Debit Card Interchange Fees and Routing): Reports and Data Collections*, <https://www.federalreserve.gov/paymentsystems/regii-data-collections.htm>.

¹⁰⁶ To the extent that the interchange fee standards and fraud-prevention adjustment constitute consumer protections, the Board believes that the aim of those protections is broadly to benefit consumers, rather than to address specific consumer rights. As such, the Board has, to the extent practicable, considered broadly whether the overall benefits of the proposed revisions to consumers outweigh other costs imposed on consumers or financial institutions.

card industry. The proposal may also impose costs on consumers and financial institutions, but the net effect on any individual or entity will depend on its particular circumstances. Because the overall effects of the proposal on consumers and on financial institutions are dependent on a variety of factors, the Board cannot determine at this time whether the potential benefits of the proposal to consumers exceed the possible costs imposed on consumers and financial institution.

B. Statutory Considerations for Proposed Revisions to the Interchange Fee Standards

In prescribing regulations to establish interchange fee standards, EFTA section 920(a)(4) requires the Board to consider the functional similarity between debit card transactions and checking transactions that are required within the Federal Reserve bank system to clear at par.¹⁰⁷

The Board considered the functional similarity between debit card transactions and checking transactions when the Board adopted Regulation II, and this analysis informed certain decisions the Board made when the Board established the interchange fee standards.¹⁰⁸ The similarities noted by the Board included the fact that both types of transactions result in a debit to an asset account; both involve electronic processing and deposit; both involve processing fees paid by merchants to banks and other intermediaries; and both have similar settlement timeframes. The differences noted by the Board included the closed nature of debit card systems compared to the open check clearing and collection system (and limitations on routing a debit card transaction based on the set of networks the issuer has enabled or that the merchant accepts); the payment authorization that is an integral part of debit card transactions (but not

¹⁰⁷ The same provision of the statute additionally requires the Board to (i) distinguish between certain types of costs incurred by debit card issuers and (ii) consult with certain other agencies. The allowable costs that the Board considered in establishing the interchange fee standards are discussed in section III.A, *supra*. The interagency consultation requirement is discussed in section VIII.D, *infra*.

¹⁰⁸ See 76 FR 43393, 43399 (July 20, 2011). For example, similarities and differences between debit card transactions and check transactions were factors in the Board's decision to include or exclude from allowable costs a number of types of costs incurred by debit card issuers. See 76 FR at 43428 (July 20, 2011).

check transactions), which generally guarantees that the transaction will not be returned for insufficient funds or certain other reasons (*e.g.*, a closed account); processing and collection costs incurred by the issuer (analogous to the payor's bank) for debit card transactions but not for check transactions; par clearance in the check system; payee deposit and availability; the amount of time in which a payor may reverse a transaction (which is much longer in the case of a debit card transaction compared to a check); and the increasing popularity of debit card payments (and declining use of check).

The Board has reviewed its analysis from 2011 regarding the functional similarity between debit card transactions and checking transactions and believes that the factual predicates underlying that analysis remain unchanged. For that reason, the Board continues to believe that its prior analysis remains sound.

*C. Statutory Considerations for Proposed Revisions to the Fraud Prevention Adjustment*¹⁰⁹

1. Statutory Requirement

EFTA section 920(a)(5)(B)(ii) requires the Board, in prescribing regulations for any fraud-prevention adjustment, to consider (i) the nature, type, and occurrence of fraud in debit card transactions; (ii) the extent to which the occurrence of fraud depends on whether authorization in a debit card transaction is based on signature, personal identification number (PIN), or other means; (iii) the available and economical means by which fraud on debit card transactions may be reduced; (iv) the fraud-prevention and data-security costs expended by each party involved in debit card transactions (including consumers, persons who accept debit cards as

¹⁰⁹ All data used in this section have been sourced from the Board's Debit Card Issuer Surveys and Payment Card Network Surveys. Reports and data tables published by the Board, as well as notes regarding the figures cited in this section, may be found on the Board's website. See Board of Governors of the Federal Reserve System, *Regulation II (Debit Card Interchange Fees and Routing): Reports and Data Collections*, <https://www.federalreserve.gov/paymentsystems/regii-data-collections.htm>.

a form of payment, financial institutions, retailers, and payment card networks); (v) the costs of fraudulent transactions absorbed by each party involved in such transactions (including consumers, persons who accept debit cards as a form of payment, financial institutions, retailers, and payment card networks); (vi) the extent to which interchange fees have in the past reduced or increased incentives for parties involved in debit card transactions to reduce fraud on such transactions; and (vii) such other factors as the Board considers appropriate.¹¹⁰ The Board has considered the factors set forth in EFTA section 920(a)(5)(B)(ii) in light of the latest data from covered issuers from 2021 and the cumulative data collected from covered issuers since the original Regulation II rulemaking.

When the Board adopted the current fraud-prevention adjustment of 1.0 cent, the Board focused on one factor in particular: the fraud-prevention costs expended by various parties involved in debit card transactions.¹¹¹ As discussed below, the Board believes that all parties continue to incur fraud-prevention costs and that the Board's proposed methodology for determining the fraud-prevention adjustment appropriately considers those costs.

Notably, as described below, data reported by covered issuers since the adoption of Regulation II show that the incidence, types, and relative rates of absorption of fraud losses have changed. As noted in section III.B, *supra*, in connection with the Board's proposed revisions to the *ad valorem* component, the Board has observed an overall increase in fraud losses to all parties related to covered issuer transactions, but the share of such fraud losses absorbed by covered issuers has declined. Changes in the median ratio of issuer fraud losses to transaction

¹¹⁰ EFTA section 920(a)(5)(B)(ii) does not specify precisely how the Board should evaluate each of these factors.

¹¹¹ See 77 FR 46258, 46265 (Aug. 3, 2012). The Board also considered the costs of losses absorbed by different parties to fraudulent transactions when it developed the fraud-prevention standards, which the Board does not propose to revise. See 77 FR at 46270. The Board additionally considered certain other factors in connection with the overall structure of the fraud-prevention adjustment, such as the incentives created by the adjustment. See 76 FR 43477, 43483 (July 20, 2011).

value among covered issuers would be reflected in the Board's proposed revisions to the *ad valorem* component.

2. Factors

a) Nature, Type, and Occurrence of Fraud

With respect to covered issuer transactions, fraud losses to all parties as a share of transaction value increased from 9.0 basis points in 2009 to 17.5 basis points in 2021, and have displayed an upward trend since 2011 (the first year for which the Debit Card Issuer Survey was mandatory). In 2021, the most commonly reported and highest-value fraud types for covered issuer transactions were card-not-present fraud, lost and stolen card fraud, and counterfeit fraud. Card-not-present fraud, at 8.6 basis points of transaction value, accounted for almost half of overall fraud in 2021. Lost and stolen card fraud accounted for 4.6 basis points of transaction value, and counterfeit card fraud accounted for 3.4 basis points of transaction value. In 2009, counterfeit card fraud, card-not-present fraud, and lost and stolen card fraud accounted for 4.3 basis points, 1.8 basis points, and 1.5 basis points, respectively, as a share of transaction value.

b) Extent to Which the Occurrence of Fraud Depends on Authentication Mechanism

Overall fraud incidence for covered issuer transactions approximately doubled from 2009 to 2021, and dual-message (traditionally mainly signature-authenticated) debit card transactions exhibited a considerably higher fraud incidence than single-message (traditionally mainly PIN-authenticated) debit card transactions, as has been the case since 2009. In 2021, 0.11 percent of covered issuer transactions were reported as fraudulent. Covered issuers reported as fraudulent 0.13 percent of dual-message transactions and 0.02 percent of single-message transactions. Across all covered issuer transactions, the average loss for dual-message transactions was 8.6 cents per transaction and represented 17.5 basis points of transaction value. For single-message

transactions, the average loss was 1.9 cents per transaction and represented 4.2 basis points of transaction value. In 2009, 0.04 percent of covered issuer transactions were reported as fraudulent. The average loss for dual-message transactions was 4.7 cents per transaction and represented 12.7 basis points of transaction value. The average loss for single-message transactions was 1.3 cent per transaction and represented approximately 3.2 basis points of transaction value.

The differential in fraud losses between single- and dual-message transactions can be explained in part by differences in the use of single- and dual-message networks for card-not-present transactions. As noted above, card-not-present fraud accounted for almost half of overall fraud on covered issuer transactions in 2021, and single message networks continue to be used relatively rarely for card-not-present transactions. In 2021, the percentage of card-not-present transactions out of the total number and value of all debit card transactions processed over single-message networks, at 6.1 and 6.7 percent, respectively, continued to be significantly lower than the analogous percentages for dual-message networks, at 44.2 and 60.7 percent, respectively.

c) Available and Economical Means by Which Fraud May Be Reduced

In response to the Board's voluntary survey of covered issuers concerning transactions performed in 2009, covered issuers identified several categories of activities used to detect, prevent, and mitigate fraudulent debit card transactions, including transaction monitoring; merchant blocking; card activation and authentication systems; PIN customization; system and application security measures, such as firewalls and virus protection software; and ongoing research and development focused on making fraud-prevention activities more effective.¹¹² Since

¹¹² See 77 FR 46258, 46261 (Aug. 3, 2012).

that time, the Board identified tokenization as an important emerging fraud-prevention technique, and added it to the list of fraud-prevention activities starting from the 2019 Debit Card Issuer Survey.¹¹³

d) Fraud-Prevention Costs Expended by Parties Involved in Debit Card Transactions

When the Board adopted current § 235.4 in 2012, the Board reviewed fraud-prevention costs expended by parties involved in debit card transactions.¹¹⁴ The Board continues to believe that all parties involved in debit card transactions incur fraud-prevention costs. For example, some consumers routinely monitor their accounts for unauthorized debit card purchases, but the opportunity cost of consumers' time to monitor their account is difficult to put into monetary terms. Merchants and acquirers incur costs for fraud-prevention tools, such as terminals that enable merchants to use various card- and cardholder-authentication mechanisms, address verification, geolocation services, and data-encryption technologies. Merchants may purchase services from third parties and may also develop their own fraud-prevention tools. In addition, merchants may also take steps and incur costs to secure data and comply with Payment Card Industry Data Security Standards (PCI-DSS) and other fraud-prevention standards.

As discussed in section IV of this notice, *supra*, the Board has collected data from covered issuers concerning the costs incurred by covered issuers in connection with debit card transactions performed in calendar years 2011, 2013, 2015, 2017, 2019, and 2021. These data show that fraud-prevention costs incurred by covered issuers have risen since 2009, such that the median per-transaction fraud-prevention costs among covered issuers was 1.3 cents in 2021.

¹¹³ See 84 FR 65815 (Nov. 29, 2019).

¹¹⁴ See 77 FR at 46261–62.

e) Costs of Fraudulent Transactions Absorbed by Different Parties Involved in Fraudulent Transactions

Most fraud losses associated with covered issuer transactions in 2021 were borne by covered issuers and merchants. In 2009, covered issuers, merchants, and cardholders bore 61.2 percent, 38.3 percent, and 0.5 percent of these fraud losses, respectively. In 2021, covered issuers, merchants, and cardholders bore 33.5 percent, 47.0 percent, and 19.5 percent of fraud losses, respectively. This shift reflects a number of factors. First, card-not-present transactions grew from 9.8 percent of covered issuer transactions in 2009 to 32.1 percent of covered issuer transactions in 2021. Second, card-not-present fraud accounted for almost half of overall fraud in 2021, and merchants bear a greater share of fraud losses for this type of transactions (almost two-thirds of card-not-present fraud in 2021). Third, merchants absorbed an increasing share of fraud losses across almost all transaction categories and fraud types in 2021, relative to 2009. For example, merchants' share of fraud losses has also increased over time for single-message transactions, from around 4 percent in 2009 to 31.9 percent in 2021.

f) Extent to Which Interchange Transaction Fees Have in the Past Affected Fraud-Prevention Incentives

In 2012, the Board noted that issuers have a strong incentive to protect cardholders and reduce fraud independently of interchange fees, and that competition among issuers for cardholders suggested that protecting cardholders from fraud is good business practice for issuers. At the time, merchants commented that, historically, higher interchange fee revenue for signature debit relative to PIN debit may have encouraged issuers to promote the use of signature debit over PIN debit, even though signature debit had substantially higher rates of fraud.¹¹⁵

¹¹⁵ 77 FR at 46262.

The Board continues to believe that covered issuers have an incentive to protect cardholders and reduce fraud, despite a reduction in the proportion of fraud losses borne by covered issuers and an increase in the proportion born by cardholders. Covered issuers continue to bear more than a quarter of all fraud losses, which means that their efforts to reduce fraud rates translate directly into lower fraud losses. Moreover, competition with other debit card issuers continues to provide downward pressure on the proportion of fraud losses that an issuer passes on to its cardholders, as passing on more fraud losses to cardholders increases the likelihood that they switch to competing issuers. Notwithstanding the adoption of the interchange fee standards and the fraud-prevention adjustment, the median per-transaction fraud-prevention costs among covered issuers has risen since 2009, to 1.3 cents per transaction in 2021.

Furthermore, data collected by the Board show that interchange fees on most transactions subject to the interchange fee cap are at or close to the cap, including for different authentication methods, which suggests that covered issuers have no incentives to promote the use of networks or authentication mechanisms that have higher rates of fraud.

D. Interagency Consultation

In addition to the economic analysis provided above, EFTA section 904(a)(2) requires the Board to consult with the other agencies that have enforcement authority under the EFTA on any rulemakings related to EFTA section 920.¹¹⁶ Separately, EFTA section 920(a)(4)(C) requires the Board to consult with certain other agencies in prescribing regulations under EFTA section

¹¹⁶ These agencies include the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Department of Transportation, the Securities and Exchange Commission, the Consumer Financial Protection Bureau (CFPB), and the Federal Trade Commission. *See* EFTA section 918.

920(a)(3)(A).¹¹⁷ The Board consulted with each of the relevant agencies prior to issuing this proposal.

E. *Regulatory Flexibility Act*

The Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.* (RFA), requires an agency to consider the impact of its rules on small entities. In connection with a proposed rule, the RFA generally requires an agency to prepare an Initial Regulatory Flexibility Analysis (IRFA) describing the impact of the rule on small entities, unless the head of the agency certifies that the proposal will not have a significant economic impact on a substantial number of small entities and publishes such certification along with a statement providing the factual basis for such certification in the *Federal Register*. An IRFA must contain (i) a description of the reasons why action by the agency is being considered; (ii) a succinct statement of the objectives of, and legal basis for, the proposal; (iii) a description of, and, where feasible, an estimate of the number of small entities to which the proposal will apply; (iv) a description of the projected reporting, recordkeeping, and other compliance requirements of the proposal, including an estimate of the classes of small entities that will be subject to the requirement and the type of professional skills necessary for preparation of the report or record; (v) an identification, to the extent practicable, of all relevant Federal rules that may duplicate, overlap with, or conflict with the proposal; and (vi) a description of any significant alternatives to the proposal that accomplish its stated objectives.

The Board is providing an IRFA with respect to the proposal. The Board invites comment on all aspects of this IRFA.

¹¹⁷ These agencies include the OCC, FDIC, Office of Thrift Supervision, NCUA, Small Business Administration (SBA), and CFPB.

1. Reasons Action is Being Considered

The Board proposes revisions to the interchange fee standards in § 235.3 and the fraud-prevention adjustment in § 235.4 of Regulation II.¹¹⁸ Under the proposal, the Board would determine, for every two-year period, the base component, *ad valorem* component, and fraud-prevention adjustment based on the latest data reported to the Board by covered issuers on the Debit Card Survey using the methodology described in proposed Appendix B. Initially, the base component and the *ad valorem* component would decrease to 14.4 cents and 4.0 basis points (multiplied by the value of the transaction), respectively, while the fraud-prevention adjustment would increase to 1.3 cents, for debit card transactions performed from the effective date of the final rule to June 30, 2025.

As described in section III.B, *supra*, one key rationale for the proposal is the significant decline in the average cost of a debit card transaction, as measured by the transaction-weighted average of per-transaction base component costs across covered issuers, since the Board first adopted § 235.3. In addition, in lieu of an ad hoc approach to updating the interchange fee cap components, the Board believes that, as much as practicable, these components should be updated regularly and predictably to reflect changes in the allowable costs and fraud-prevention costs incurred by covered issuers as those changes occur.

2. Objectives of and Legal Basis for the Proposal

Consistent with EFTA section 920(a)(3), the proposed revisions to § 235.3 are intended to ensure that the interchange fee standards will be effective going forward for assessing whether, for a debit card transaction subject to the interchange fee standards, the amount of any

¹¹⁸ As described in section V, *supra*, the Board additionally proposes a set of technical revisions to Regulation II. Because these proposed revisions are not intended to be substantive changes, the Board's IRFA does not address these aspects of the proposal.

interchange fee received or charged by a debit card issuer is reasonable and proportional to the cost incurred by the issuer with respect to the transaction. Consistent with EFTA section 920(a)(5), the proposed revisions to § 235.4 are intended to ensure that eligible covered issuers receive an adjustment to any interchange fee permitted under § 235.3 in an amount that is reasonably necessary to make allowance for the costs incurred by the covered issuer in preventing fraud in relation to debit card transactions involving that issuer.

3. Description and Estimate of the Number of Small Entities

The proposed revisions to § 235.3 and § 235.4 apply to debit card issuers subject to the interchange fee standards (*i.e.*, covered issuers). Pursuant to EFTA section 920(a)(6) and § 235.5(a), a debit card issuer that, together with its affiliates, has assets of less than \$10 billion as of the end of the calendar year preceding the date of the debit card transaction is exempt from the interchange fee standards, provided that such issuer holds the account that is debited.

The Board generally uses the industry-specific size standards adopted by the SBA for purposes of estimating the number of small entities to which a proposal would apply.¹¹⁹ The SBA has adopted size standards that provide that card-issuing institutions with average assets of less than \$850 million over the preceding year (based on the institution's four quarterly financial statements) are considered small entities.¹²⁰ Because all such issuers would qualify for the exemption from the interchange fee standards in § 235.5(a) provided that they hold the account that is debited, the proposed revisions would not apply to any small entities.

4. Description of Compliance Requirements

¹¹⁹ See 13 CFR 121.210. Consistent with the SBA's General Principles of Affiliation, the Board generally includes the assets of all domestic and foreign affiliates toward the applicable size threshold when determining whether to classify a particular entity as a small entity. See 13 CFR 121.103.

¹²⁰ See 13 CFR 121.201 (sector 522210). Although this size standard applies to credit card-issuing institutions, the Board believes that the same size standard should apply to debit card-issuing institutions.

The proposal would not substantively alter the reporting or recordkeeping requirements that apply to debit card issuers and payment card networks in § 235.8 of Regulation II.¹²¹ Rather, the proposed revisions would adjust the amount of any interchange fee that a covered issuer may receive or charge with respect to a debit card transaction subject to the interchange fee standards. Because interchange fees are collected by networks from acquirers and paid to issuers, a covered issuer should not need to make any changes to its systems to ensure that the amount of any interchange fee does not exceed the amount permitted under Regulation II.

5. Duplicative, Overlapping, and Conflicting Rules

The Board is not aware of any federal rules that may duplicate, overlap with, or conflict with the proposal.

6. Significant Alternatives Considered

As described in section III.B, *supra*, the Board considered several alternative methodologies for determining the base component. In addition, the Board considered a variety of different cost-recovery targets from which the fixed multiplier for determining the base component under the proposed formula is derived. However, due to the statutory exemption from the interchange fee standards for debit card issuers with consolidated assets under \$10 billion that hold the account that is debited, the Board does not believe that any of the alternatives considered by the Board would have affected the economic impact of the proposal on small entities.

¹²¹ However, the Board requests comment on whether § 235.8 of Regulation II should be amended to specify that a covered issuer is required to retain records supporting the data that the covered issuer reports on the Debit Card Issuer Survey. *See* section VII, *supra* (Question 6(b)).

F. *Paperwork Reduction Act*

Regulation II contains “collections of information” within the meaning of the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3501–3521). In accordance with the requirements of the PRA, the Board may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The Board reviewed the proposal under the authority delegated to the Board by OMB.

Sections 235.8(a) and (b) of Regulation II (12 CFR 235.8(a) and (b)) currently require the reporting of information to the Board, and this reporting requirement is conducted in the form of two surveys collected by the Board: the Debit Card Issuer Survey (FR 3064a; OMB No. 7100-0344) and Payment Card Network Survey (FR 3064b; OMB No. 7100-0344). The proposal would amend section 235.8(a) of Regulation II to reflect the reporting frequency of the FR 3064a and FR 3064b surveys. No revisions to these surveys are being proposed at this time, but the Board is proposing to extend the FR 3064a and FR 3064b for three years.

However, the Board requests comment on whether § 235.8 of Regulation II should be amended to specify that a covered issuer is required to retain records supporting the data that the covered issuer reports on the Debit Card Issuer Survey. *See* section VII.6, *supra* (Question 6(b)). The Board may revise § 235.8 of Regulation II based on comments received in response to this question.

Comments are invited on the following:

(a) Whether the collections of information are necessary for the proper performance of the Board’s functions, including whether the information has practical utility;

(b) The accuracy of the Board’s estimates of the burden of the information collections, including the validity of the methodology and assumptions used;

(c) Ways to enhance the quality, utility, and clarity of the information to be collected;

(d) Ways to minimize the burden of the information collections on respondents, including through the use of automated collection techniques or other forms of information technology; and

(e) Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

Comments on aspects of this document that may affect reporting, recordkeeping, or disclosure requirements and burden estimates should be sent to the addresses listed in the ADDRESSES section. A copy of the comments may also be submitted to the OMB desk officer for the Agencies: By mail to U.S. Office of Management and Budget, 725 17th Street NW, #10235, Washington, DC 20503 or by facsimile to (202) 395-5806, Attention, Federal Banking Agency Desk Officer.

Proposed Extension, Without Revision, of the Following Information Collection

(1) *Collection title:* Interchange Transaction Fees Survey.

Collection identifier: FR 3064.

OMB control number: 7100-0344.

General description of report: This information collection comprises the following reports:

Debit Card Issuer Survey (FR 3064a) collects data from issuers of debit cards (including general-use prepaid cards) that, together with their affiliates, have assets of \$10 billion or more, including information regarding the volume and value of debit card transactions; chargebacks and returns; costs of authorization, clearance, and settlement of debit card transactions; other costs incurred in connection with particular debit card transactions; fraud prevention costs and fraud losses; and interchange fee revenue.

Payment Card Network Survey (FR 3064b) collects data from payment card networks, including the volume and value of debit card transactions; interchange fees; network fees; and payments and incentives paid by networks to acquirers, merchants, and issuers.

The data from the FR 3064a and FR 3064b are used to fulfill a statutory requirement that the Board disclose certain information regarding debit card transactions on a biennial basis. In addition, the Board uses data from the Payment Card Network Survey (FR 3064b) to publicly report on an annual basis the extent to which networks have established separate interchange fees for exempt and covered issuers.

Frequency: Annual and biennial.

Affected Public: Businesses or other for-profit.

Respondents: Debit card issuers and payment card networks.

Estimated number of respondents:

FR 3064a – 534.

FR 3064b – 15.

Estimated average hours per response:

FR 3064a – 160.

FR 3064b – 75.

Estimated annual burden hours:

FR 3064a – 85,440.

FR 3064b – 1,125.

G. Solicitation of Comments on the Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act (Pub. L. No. 106-102, 113 Stat. 1338, 1471, 12 U.S.C. 4809) requires the federal banking agencies to use plain language in all proposed and

final rules published after January 1, 2000. The Board has sought to present the proposal in a simple and straightforward manner and invites comment on the use of plain language and whether any part of the proposal could be more clearly stated.

H. Providing Accountability Through Transparency Act of 2023

The Providing Accountability Through Transparency Act of 2023 (5 U.S.C. 553(b)(4)) requires that a notice of proposed rulemaking include the Internet address of a summary of not more than 100 words in length of the proposed rule, in plain language, that shall be posted on the Internet website under section 206(d) of the E-Government Act of 2002 (44 U.S.C. 3501 note).

In summary, the Board requests comment on a proposal to update the debit card interchange fee cap, which the Board established in 2011, based on the latest data reported to the Board concerning the costs incurred by large debit card issuers. The Board also requests comment on a proposal to establish an approach for updating the interchange fee cap every other year going forward.

The proposal and such a summary can be found at <https://www.regulations.gov> and <https://www.federalreserve.gov/supervisionreg/reglisting.htm>.

List of Subjects in 12 CFR Part 235

Banks, banking, Debit card routing, Electronic debit transactions, Interchange transaction fees

Authority and Issuance

For the reasons set forth in the preamble, the Board is proposing to revise Regulation II, 12 CFR part 235, as follows. Certain portions of this part are unchanged but are being republished for the convenience of the reader:

PART 235 – DEBIT CARD INTERCHANGE FEES AND ROUTING (REGULATION II)

1. Revise Part 235 to read as follows:

PART 235 – DEBIT CARD INTERCHANGE FEES AND ROUTING (REGULATION II)

Sec.

235.1 Authority and purpose.

235.2 Definitions.

235.3 Reasonable and proportional interchange transaction fees.

235.4 Fraud-prevention adjustment.

235.5 Exemptions.

235.6 Prohibition on circumvention, evasion, and net compensation.

235.7 Limitations on payment card restrictions.

235.8 Reporting requirements and record retention.

235.9 Administrative enforcement.

APPENDIX A to PART 235 – OFFICIAL BOARD COMMENTARY ON REGULATION II

APPENDIX B to PART 235 – DETERMINATION OF BASE COMPONENT, *AD VALOREM*
COMPONENT, AND FRAUD-PREVENTION ADJUSTMENT

Authority: 15 U.S.C. 1693o-2.

§ 235.1 – Authority and purpose.

(a) *Authority.* This part is issued by the Board of Governors of the Federal Reserve System (Board) under section 920 of the Electronic Fund Transfer Act (EFTA) (15 U.S.C. 1693o-2, as added by section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010)).

(b) *Purpose.* This part implements the provisions of section 920 of the EFTA, including standards for reasonable and proportional interchange transaction fees for electronic debit transactions, standards for receiving a fraud-prevention adjustment to interchange transaction fees, exemptions from the interchange transaction fee limitations, prohibitions on evasion and circumvention, prohibitions on payment card network exclusivity arrangements and routing restrictions for debit card transactions, and reporting requirements for debit card issuers and payment card networks.

§ 235.2 – Definitions.

For purposes of this part:

(a) *Account*

(1) Means a transaction, savings, or other asset account (other than an occasional or incidental credit balance in a credit plan) established for any purpose and that is located in the United States; and

(2) Does not include an account held under a bona fide trust agreement that is excluded by section 903(2) of the Electronic Fund Transfer Act and rules prescribed thereunder.

(b) *Acquirer* means a person that contracts directly or indirectly with a merchant to provide settlement for the merchant's electronic debit transactions over a payment card network. An acquirer does not include a person that acts only as a processor for the services it provides to the merchant.

(c) *Affiliate* means any company that controls, is controlled by, or is under common control with another company.

(d) *Cardholder* means the person to whom a debit card is issued.

(e) *Control* of a company means –

(1) Ownership, control, or power to vote 25 percent or more of the outstanding shares of any class of voting security of the company, directly or indirectly, or acting through one or more other persons;

(2) Control in any manner over the election of a majority of the directors, trustees, or general partners (or individuals exercising similar functions) of the company; or

(3) The power to exercise, directly or indirectly, a controlling influence over the management or policies of the company, as the Board determines.

(f) *Covered issuer* means, for a particular calendar year, an issuer that, together with its affiliates, has assets of \$10 billion or more as of the end of the preceding calendar year.

(g) *Debit card*

(1) Means any card, or other payment code or device, issued or approved for use through a payment card network to debit an account, regardless of whether authorization is based on signature, personal identification number (PIN), or other means, and regardless of whether the issuer holds the account, and

(2) Includes any general-use prepaid card; and

(3) Does not include –

(i) Any card, or other payment code or device, that is redeemable upon presentation at only a single merchant or an affiliated group of merchants for goods or services; or

(ii) A check, draft, or similar paper instrument, or an electronic representation thereof.

- (h) *Designated automated teller machine (ATM) network* means either –
- (1) All ATMs identified in the name of the issuer; or
 - (2) Any network of ATMs identified by the issuer that provides reasonable and convenient access to the issuer's customers.
- (i) *Electronic debit transaction*
- (1) Means the use of a debit card by a person as a form of payment in the United States to initiate a debit to an account, and
 - (2) Does not include transactions initiated at an ATM, including cash withdrawals and balance transfers initiated at an ATM.
- (j) *General-use prepaid card* means a card, or other payment code or device, that is –
- (1) Issued on a prepaid basis in a specified amount, whether or not that amount may be increased or reloaded, in exchange for payment; and
 - (2) Redeemable upon presentation at multiple, unaffiliated merchants for goods or services.
- (k) *Interchange transaction fee* means any fee established, charged, or received by a payment card network and paid by a merchant or an acquirer for the purpose of compensating an issuer for its involvement in an electronic debit transaction.
- (l) *Issuer* means any person that authorizes the use of a debit card to perform an electronic debit transaction.
- (m) *Merchant* means any person that accepts debit cards as payment.
- (n) *Payment card network* means an entity that –
- (1) Directly or indirectly provides the proprietary services, infrastructure, and software that route information and data to an issuer from an acquirer to conduct the authorization, clearance, and settlement of electronic debit transactions; and
 - (2) A merchant uses in order to accept as a form of payment a brand of debit card or other device that may be used to carry out electronic debit transactions.
- (o) *Person* means a natural person or an organization, including a corporation, government agency, estate, trust, partnership, proprietorship, cooperative, or association.
- (p) *Processor* means a person that processes or routes electronic debit transactions for issuers, acquirers, or merchants.
- (q) *Route* means to direct and send information and data to an unaffiliated entity or to an affiliated entity acting on behalf of an unaffiliated entity.

(f) *United States* means the States, territories, and possessions of the United States, the District of Columbia, the Commonwealth of Puerto Rico, or any political subdivision of any of the foregoing.

§ 235.3 – Reasonable and proportional interchange transaction fees.

(a) *In general.* The amount of any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction shall be reasonable and proportional to the cost incurred by the issuer with respect to the electronic debit transaction.

(b) *Reasonable and proportional fees.* An issuer complies with the requirements of paragraph (a) of this section only if each interchange transaction fee received or charged by the issuer for an electronic debit transaction is no more than the sum of –

(1) For an electronic debit transaction performed from October 1, 2011, to [one calendar day prior to effective date of final rule], a base component of 21.0 cents, and an *ad valorem* component of 5.0 basis points multiplied by the value of the transaction; and

(2) For an electronic debit transaction performed from [effective date of final rule], to June 30, 2025, a base component of 14.4 cents, and an *ad valorem* component of 4.0 basis points multiplied by the value of the transaction.

(c) *Determination of base component and ad valorem component.* For every two-year period, beginning with the period from July 1, 2025, to June 30, 2027, the Board will determine the base component and the *ad valorem* component using the approach described in Appendix B to this part.

§ 235.4 – Fraud-prevention adjustment.

(a) *In general.* In addition to any interchange transaction fee an issuer receives or charges in accordance with § 235.3, and subject to paragraph (c) of this section, an issuer may receive or charge an amount of no more than –

(1) For an electronic debit transaction performed from October 1, 2011, to [one calendar day prior to effective date of final rule], a fraud-prevention adjustment of 1.0 cent; and

(2) For an electronic debit transaction performed from [effective date of final rule], to June 30, 2025, a fraud-prevention adjustment of 1.3 cents.

(b) *Determination of fraud-prevention adjustment.* For every two-year period, beginning with the period from July 1, 2025, to June 30, 2027, the Board will determine the fraud-prevention adjustment using the approach described in Appendix B to this part.

(c) *Issuer standards.*

(1) To be eligible to receive or charge the fraud-prevention adjustment in paragraph (a) of this section, an issuer must develop and implement policies and procedures reasonably designed to take effective steps to reduce the occurrence of, and costs to all parties from,

fraudulent electronic debit transactions, including through the development and implementation of cost-effective fraud-prevention technology.

(2) An issuer's policies and procedures must address –

- (i) Methods to identify and prevent fraudulent electronic debit transactions;
- (ii) Monitoring of the volume and value of its fraudulent electronic debit transactions;
- (iii) Appropriate responses to suspicious electronic debit transactions in a manner designed to limit the costs to all parties from and prevent the occurrence of future fraudulent electronic debit transactions;
- (iv) Methods to secure debit card and cardholder data; and
- (v) Such other factors as the issuer considers appropriate.

(3) An issuer must review, at least annually, its fraud-prevention policies and procedures, and their implementation and update them as necessary in light of –

- (i) Their effectiveness in reducing the occurrence of, and cost to all parties from, fraudulent electronic debit transactions involving the issuer;
- (ii) Their cost-effectiveness; and
- (iii) Changes in the types of fraud, methods used to commit fraud, and available methods for detecting and preventing fraudulent electronic debit transactions that the issuer identifies from –
 - (A) Its own experience or information;
 - (B) Information provided to the issuer by its payment card networks, law enforcement agencies, and fraud-monitoring groups in which the issuer participates; and
 - (C) Applicable supervisory guidance.

(d) *Notification.* To be eligible to receive or charge a fraud-prevention adjustment, an issuer must annually notify its payment card networks that it complies with the standards in paragraph (c) of this section.

(e) *Change in status.* An issuer is not eligible to receive or charge a fraud-prevention adjustment if the issuer is substantially non-compliant with the standards set forth in paragraph (c) of this section, as determined by the issuer or the appropriate agency under § 235.9. Such an issuer must notify its payment card networks that it is no longer eligible to receive or charge a fraud-prevention adjustment no later than 10 days after determining or receiving notification from the appropriate agency under § 235.9 that the issuer is substantially non-compliant with the standards set forth in paragraph (c) of this section. The issuer must stop receiving and charging the fraud-prevention adjustment no later than 30 days after notifying its payment card networks.

§ 235.5 – Exemptions.

(a) *Exemption for small issuers* –

(1) *In general.* Sections 235.3, 235.4, and 235.6 do not apply to an interchange transaction fee received or charged by an issuer that –

- (i) Holds the account that is debited; and
- (ii) Is not a covered issuer when the electronic debit transaction is performed.

(2) *Determination of issuer asset size.* A person may rely on lists published by the Board to determine whether an issuer is a covered issuer for a particular calendar year.

(3) *Change in status.* If an issuer qualifies for the exemption in paragraph (a)(1) in a particular calendar year, but, as of the end of that calendar year the issuer, together with its affiliates, has assets of \$10 billion or more, the issuer must begin complying with §§ 235.3, 235.4, and 235.6 no later than July 1 of the succeeding calendar year.

(b) *Exemption for government-administered programs.* Except as provided in paragraph (d) of this section, §§ 235.3, 235.4, and 235.6 do not apply to an interchange transaction fee received or charged by an issuer with respect to an electronic debit transaction if –

- (1) The electronic debit transaction is made using a debit card that has been provided to a person pursuant to a Federal, State, or local government-administered payment program; and
- (2) The cardholder may use the debit card only to transfer or debit funds, monetary value, or other assets that have been provided pursuant to such program.

(c) *Exemption for certain reloadable prepaid cards* –

(1) *In general.* Except as provided in paragraph (d) of this section, §§ 235.3, 235.4, and 235.6 do not apply to an interchange transaction fee received or charged by an issuer with respect to an electronic debit transaction using a general-use prepaid card that is –

- (i) Not issued or approved for use to access or debit any account held by or for the benefit of the cardholder (other than a subaccount or other method of recording or tracking funds purchased or loaded on the card on a prepaid basis);
- (ii) Reloadable and not marketed or labeled as a gift card or gift certificate; and
- (iii) The only means of access to the underlying funds, except when all remaining funds are provided to the cardholder in a single transaction.

(2) *Temporary cards.* For purposes of this paragraph (c), the term “reloadable” includes a temporary non-reloadable card issued solely in connection with a reloadable general-use prepaid card.

(d) *Exception.* The exemptions in paragraphs (b) and (c) of this section do not apply to any interchange transaction fee received or charged by an issuer on or after July 21, 2012, with respect to an electronic debit transaction if any of the following fees may be charged to a cardholder with respect to the card:

(1) A fee or charge for an overdraft, including a shortage of funds or a transaction processed for an amount exceeding the account balance, unless the fee or charge is imposed for transferring funds from another asset account to cover a shortfall in the account accessed by the card; or

(2) A fee imposed by the issuer for the first withdrawal per calendar month from an ATM that is part of the issuer's designated ATM network.

§ 235.6 – Prohibition on circumvention, evasion, and net compensation.

(a) *Prohibition of circumvention or evasion.* No person shall circumvent or evade the interchange transaction fee restrictions in §§ 235.3 and 235.4.

(b) *Prohibition of net compensation.* An 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 or incentives received by an issuer from a payment card network with respect to electronic debit transactions or debit card-related activities, other than interchange transaction fees passed through to the issuer by the network, during a calendar year exceeds the total amount of all fees paid by the issuer to the network with respect to electronic debit transactions or debit card-related activities during that calendar year. Payments and incentives paid by a network to an issuer, and fees paid by an issuer to a network, with respect to electronic debit transactions or debit card related activities are not limited to volume-based or transaction-specific payments, incentives, or fees, but also include other payments, incentives or fees related to an issuer's provision of debit card services.

§ 235.7 – Limitations on payment card restrictions.

(a) *Prohibition on network exclusivity –*

(1) *In general.* An issuer or payment card network shall not directly or through any agent, processor, or licensed member of a payment card network, by contract, requirement, condition, penalty, or otherwise, restrict the number of payment card networks on which an electronic debit transaction may be processed to less than two unaffiliated networks.

(2) *Permitted arrangements.* An issuer satisfies the requirements of paragraph (a)(1) of this section only if the issuer enables at least two unaffiliated payment card networks to process an electronic debit transaction –

(i) Where such networks in combination do not, by their respective rules or policies or by contract with or other restriction imposed by the issuer, result in the operation of only one network or only multiple affiliated networks for a

geographic area, specific merchant, particular type of merchant, or particular type of transaction, and

(ii) Where each of these networks has taken steps reasonably designed to be able to process the electronic debit transactions that it would reasonably expect will be routed to it, based on expected transaction volume.

(3) *Prohibited exclusivity arrangements by networks.* For purposes of paragraph (a)(1) of this section, a payment card network may not restrict or otherwise limit an issuer's ability to contract with any other payment card network that may process an electronic debit transaction involving the issuer's debit cards.

(4) *Subsequent affiliation.* If unaffiliated payment card networks become affiliated as a result of a merger or acquisition such that an issuer is no longer in compliance with paragraph (a) of this section, the issuer must add an unaffiliated payment card network through which electronic debit transactions on the relevant debit card may be processed no later than six months after the date on which the previously unaffiliated payment card networks consummate the affiliation.

(b) *Prohibition on routing restrictions.* An issuer or payment card network shall not, directly or through any agent, processor, or licensed member of the network, by contract, requirement, condition, penalty, or otherwise, inhibit the ability of any person that accepts or honors debit cards for payments to direct the routing of electronic debit transactions for processing over any payment card network that may process such transactions.

§ 235.8 – Reporting requirements and record retention.

(a) *Entities required to report.* Each covered issuer shall file a report with the Board on a biennial basis in accordance with this section. Each payment card network shall file a report with the Board on an annual basis in accordance with this section.

(b) *Report.* Each entity required to file a report with the Board shall submit data in a form prescribed by the Board for that entity. Data required to be reported may include, but may not be limited to, data regarding costs incurred with respect to an electronic debit transaction, interchange transaction fees, network fees, fraud-prevention costs, fraud losses, and transaction value, volume, and type.

(c) *Record retention.*

(1) An issuer subject to this part shall retain evidence of compliance with the requirements imposed by this part for a period of not less than five years after the end of the calendar year in which the electronic debit transaction occurred.

(2) Any person subject to this part having actual notice that it is the subject of an investigation or an enforcement proceeding by its enforcement agency shall retain the records that pertain to the investigation, action, or proceeding until final disposition of the matter unless an earlier time is allowed by court or agency order.

§ 235.9 – Administrative enforcement.

(a) Appropriate agency.

(1) Compliance with the requirements of this part shall be enforced under –

(i) Section 8 of the Federal Deposit Insurance Act, by the appropriate Federal banking agency, as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)), with respect to –

(A) National banks, federal savings associations, and federal branches and federal agencies of foreign banks;

(B) Member banks of the Federal Reserve System (other than national banks), branches and agencies of foreign banks (other than federal branches, federal Agencies, and insured state branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act;

(C) Banks and state savings associations insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System), and insured state branches of foreign banks;

(ii) The Federal Credit Union Act (12 U.S.C. 1751 et seq.), by the Administrator of the National Credit Union Administration (National Credit Union Administration Board) with respect to any federal credit union;

(iii) The Federal Aviation Act of 1958 (49 U.S.C. 40101 et seq.), by the Secretary of Transportation, with respect to any air carrier or foreign air carrier subject to that Act; and

(iv) The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), by the Securities and Exchange Commission, with respect to any broker or dealer subject to that Act.

(2) The terms used in paragraph (a)(1) of this section that are not defined in this part or otherwise defined in section 3(s) of the Federal Deposit Insurance Act (12 U.S.C. 1813(s)) shall have the meaning given to them in section 1(b) of the International Banking Act of 1978 (12 U.S.C. 3101).

(b) Additional powers.

(1) For the purpose of the exercise by any agency referred to in paragraphs (a)(1)(i) through (a)(1)(iv) of this section of its power under any statute referred to in those paragraphs, a violation of this part is deemed to be a violation of a requirement imposed under that statute.

(2) In addition to its powers under any provision of law specifically referred to in paragraphs (a)(1)(i) through (a)(1)(iv) of this section, each of the agencies referred to in those paragraphs may exercise, for the purpose of enforcing compliance under this part, any other authority conferred on it by law.

(c) *Enforcement authority of Federal Trade Commission.* Except to the extent that enforcement of the requirements imposed under this title is specifically granted to another government agency under paragraphs (a)(1)(i) through (a)(1)(iv) of this section, and subject to subtitle B of the Consumer Financial Protection Act of 2010, the Federal Trade Commission has the authority to enforce such requirements. For the purpose of the exercise by the Federal Trade Commission of its functions and powers under the Federal Trade Commission Act, a violation of this part shall be deemed a violation of a requirement imposed under the Federal Trade Commission Act. All of the functions and powers of the Federal Trade Commission under the Federal Trade Commission Act are available to the Federal Trade Commission to enforce compliance by any person subject to the jurisdiction of the Federal Trade Commission with the requirements of this part, regardless of whether that person is engaged in commerce or meets any other jurisdictional tests under the Federal Trade Commission Act.

APPENDIX A to PART 235 – OFFICIAL BOARD COMMENTARY ON REGULATION II

Introduction

The following commentary to Regulation II (12 CFR part 235) provides background material to explain the Board's intent in adopting a particular part of the regulation. The commentary also provides examples to aid in understanding how a particular requirement is to work.

Section 235.2 – Definitions

2(a) – Account

1. *Types of accounts.* The term “account” includes accounts held by any person, including consumer accounts (i.e., those established primarily for personal, family or household purposes) and business accounts. Therefore, the limitations on interchange transaction fees and the prohibitions on network exclusivity arrangements and routing restrictions apply to all electronic debit transactions, regardless of whether the transaction involves a debit card issued primarily for personal, family, or household purposes or for business purposes. For example, an issuer of a business-purpose debit card is subject to the restrictions on interchange transaction fees and is also prohibited from restricting the number of payment card networks on which an electronic debit transaction may be processed under § 235.7.

2. *Bona fide trusts.* This part does not define the term bona fide trust agreement; therefore, institutions must look to state or other applicable law for interpretation. An account held under a custodial agreement that qualifies as a trust under the Internal Revenue Code, such as an individual retirement account, is considered to be held under a trust agreement for purposes of this part.

3. *Account located in the United States.* This part applies only to electronic debit transactions that are initiated to debit (or credit, for example, in the case of returned goods or cancelled services) an account located in the United States. If a cardholder uses a debit card to debit an account held outside the United States, then the electronic debit transaction is not subject to this part.

2(b) – Acquirer

1. *In general.* The term “acquirer” includes only the institution that contracts, directly or indirectly, with a merchant to provide settlement for the merchant's electronic debit transactions over a payment card network (referred to as acquiring the merchant's electronic debit transactions). In some acquiring relationships, an institution provides processing services to the merchant and is a licensed member of the payment card network, but does not settle the transactions with the merchant (by crediting the merchant's account) or with the issuer. These institutions are not “acquirers” because they do not provide credit to the merchant for the transactions or settle the merchant's transactions with the issuer. These institutions are considered processors and in some circumstances may be considered payment card networks for purposes of this part (See §§ 235.2(n), 235.2(p), and commentary thereto).

2(c) – Affiliate

1. *Types of entities.* The term “affiliate” includes any bank and nonbank affiliates located in the United States or a foreign country.

2. *Other affiliates.* For commentary on whether merchants are affiliated, see comment 2(g)-7.

2(d) – Cardholder

1. *Scope.* In the case of debit cards that access funds in transaction, savings, or other similar asset accounts, “the person to whom a card is issued” generally will be the named person or persons holding the account. If the account is a business account, multiple employees (or other persons associated with the business) may have debit cards that can access the account. Each employee that has a debit card that can access the account is a cardholder. In the case of a prepaid card, the cardholder generally is either the purchaser of the card or a person to whom the purchaser gave the card, such as a gift recipient.

2(e) – Control [Reserved]

2(f) – Covered Issuer

1. *Asset size determination.* An issuer would qualify as a covered issuer in a particular calendar year if its total worldwide banking and nonbanking assets, including assets of affiliates, other than trust assets under management, are at least \$10 billion, as of December 31 of the preceding calendar year.

2(g) – Debit Card

1. *Card, or other payment code or device.* The term “debit card” as defined in § 235.2(g) applies to any card, or other payment code or device, even if it is not issued in a physical form. Debit

cards include, for example, an account number or code that can be used to access funds in an account to make Internet purchases. Similarly, the term “debit card” includes a device with a chip or other embedded mechanism, such as a mobile phone or sticker containing a contactless chip that links the device to funds stored in an account, and enables an account to be debited. The term “debit card,” however, does not include a one-time password or other code if such password or code is used for the purposes of authenticating the cardholder and is used in addition to another card, or other payment code or device, rather than as the payment code or device.

2. *Deferred debit cards.* The term “debit card” includes a card, or other payment code or device, that is used in connection with deferred debit card arrangements in which transactions are not immediately posted to and funds are not debited from the underlying transaction, savings, or other asset account upon settlement of the transaction. Instead, the funds in the account typically are held and made unavailable for other transactions for a period of time specified in the issuer-cardholder agreement. After the expiration of the time period, the cardholder's account is debited for the value of all transactions made using the card that have been submitted to the issuer for settlement during that time period. For example, under some deferred debit card arrangements, the issuer may debit the consumer's account for all debit card transactions that occurred during a particular month at the end of the month. Regardless of the time period between the transaction and account posting, a card, or other payment code or device, that is used in connection with a deferred debit arrangement is considered a debit card for purposes of the requirements of this part.

3. *Decoupled debit cards.* Decoupled debit cards are issued by an entity other than the financial institution holding the cardholder's account. In a decoupled debit arrangement, transactions that are authorized by the card issuer settle against the cardholder's account held by an entity other than the issuer, generally via a subsequent ACH debit to that account. The term “debit card” includes any card, or other payment code or device, issued or approved for use through a payment card network to debit an account, regardless of whether the issuer holds the account. Therefore, decoupled debit cards are debit cards for purposes of this part.

4. *Hybrid cards.*

i. Some cards, or other payment codes or devices, may have both credit- and debit-like features (“hybrid cards”). For example, these cards may enable a cardholder to access a line of credit, but select certain transactions for immediate repayment (i.e., prior to the end of a billing cycle) via a debit to the cardholder's account, as the term is defined in § 235.2(a), held either with the issuer or at another institution. If a card permits a cardholder to initiate transactions that debit an account or funds underlying a prepaid card, the card is considered a debit card for purposes of this part. Not all transactions initiated by such a hybrid card, however, are electronic debit transactions. Rather, only those transactions that debit an account as defined in this part or funds underlying a prepaid card are electronic debit transactions. If the transaction posts to a line of credit, then the transaction is a credit transaction.

ii. If an issuer conditions the availability of a credit or charge card that permits pre-authorized repayment of some or all transactions on the cardholder maintaining an account at the issuer, such a card is considered a debit card for purposes of this part.

5. *Virtual wallets.* A virtual wallet is a device (e.g., a mobile phone) that stores several different payment codes or devices (“virtual cards”) that access different accounts, funds underlying the card, or lines of credit. At the point of sale, the cardholder may select from the virtual wallet the virtual card he or she wishes to use for payment. The virtual card that the cardholder uses for payment is considered a debit card under this part if the virtual card that initiates a transaction meets the definition of debit card, notwithstanding the fact that other cards in the wallet may not be debit cards.

6. *General-use prepaid card.* The term “debit card” includes general-use prepaid cards. See § 235.2(j) and related commentary for information on general-use prepaid cards.

7. *Store cards.* The term “debit card” does not include prepaid cards that may be used at a single merchant or affiliated merchants. Two or more merchants are affiliated if they are related by either common ownership or by common corporate control. For purposes of the “debit card” definition, franchisees are considered to be under common corporate control if they are subject to a common set of corporate policies or practices under the terms of their franchise licenses.

8. *Checks, drafts, and similar instruments.* The term “debit card” does not include a check, draft, or similar paper instrument or a transaction in which the check is used as a source of information to initiate an electronic payment. For example, if an account holder provides a check to buy goods or services and the merchant takes the account number and routing number information from the MICR line at the bottom of a check to initiate an ACH debit transfer from the cardholder's account, the check is not a debit card, and such a transaction is not considered an electronic debit transaction. Likewise, the term “debit card” does not include an electronic representation of a check, draft, or similar paper instrument.

9. *ACH transactions.* The term “debit card” does not include an account number when it is used by a person to initiate an ACH transaction that debits that person's account. For example, if an account holder buys goods or services over the Internet using an account number and routing number to initiate an ACH debit, the account number is not a debit card, and such a transaction is not considered an electronic debit transaction. However, the use of a card to purchase goods or services that debits the cardholder's account that is settled by means of a subsequent ACH debit initiated by the card issuer to the cardholder's account, as in the case of a decoupled debit card arrangement, involves the use of a debit card for purposes of this part.

2(h) – Designated Automated Teller Machine (ATM) Network

1. *Reasonable and convenient access clarified.* Under § 235.2(h)(2), a designated ATM network includes any network of ATMs identified by the issuer that provides reasonable and convenient access to the issuer's cardholders. Whether a network provides reasonable and convenient access depends on the facts and circumstances, including the distance between ATMs in the designated

network and each cardholder's last known home or work address, or if a home or work address is not known, where the card was first issued.

2(i) – Electronic Debit Transaction

1. *Debit an account.* The term “electronic debit transaction” includes the use of a card to debit an account. The account debited could be, for example, the cardholder's asset account or the account that holds the funds used to settle prepaid card transactions.
2. *Form of payment.* The term “electronic debit transaction” includes the use of a card as a form of payment that may be made in exchange for goods or services, as a charitable contribution, to satisfy an obligation (e.g., tax liability), or for other purposes.
3. *Subsequent transactions.* The term “electronic debit transaction” includes both the cardholder's use of a debit card for the initial payment and any subsequent use by the cardholder of the debit card in connection with the initial payment. For example, the term “electronic debit transaction” includes using the debit card to return merchandise or cancel a service that then results in a debit to the merchant's account and a credit to the cardholder's account.
4. *Cash withdrawal at the point of sale.* The term “electronic debit transaction” includes a transaction in which a cardholder uses the debit card both to make a purchase and to withdraw cash (known as a “cash-back transaction”).
5. *Geographic limitation.* This regulation applies only to electronic debit transactions that are initiated at a merchant located in the United States. If a cardholder uses a debit card at a merchant located outside the United States to debit an account held in the United States, the electronic debit transaction is not subject to this part.

2(j) – General-Use Prepaid Card

1. *Redeemable upon presentation at multiple, unaffiliated merchants.* A prepaid card is redeemable upon presentation at multiple, unaffiliated merchants if such merchants agree to honor the card.
2. *Selective authorization cards.* Selective authorization cards, (e.g., mall cards) are generally intended to be used or redeemed for goods or services at participating retailers within a shopping mall or other limited geographic area. Selective authorization cards are considered general-use prepaid cards, regardless of whether they carry the mark, logo, or brand of a payment card network, if they are redeemable at multiple, unaffiliated merchants.

2(k) – Interchange Transaction Fee

1. *In general.* Generally, the payment card network is the entity that establishes and charges the interchange transaction fee to the acquirers or merchants. The acquirers then pay to the issuers any interchange transaction fee established and charged by the network. Acquirers typically pass the interchange transaction fee through to merchant-customers.
2. *Compensating an issuer.* The term “interchange transaction fee” is limited to those fees that a payment card network establishes, charges, or receives to compensate the issuer for its role in the

electronic debit transaction. By contrast, payment card networks generally charge issuers and acquirers fees for services the network performs. Such fees are not interchange transaction fees because the payment card network is charging and receiving the fee as compensation for services it provides.

3. *Established, charged, or received.* Interchange transaction fees are not limited to those fees for which a payment card network sets the value. A fee that compensates an issuer is an interchange transaction fee if the fee is set by the issuer but charged to acquirers by virtue of the network determining each participant's net settlement position.

2(l) – Issuer

1. *In general.* A person issues a debit card by authorizing the use of debit card by a cardholder to perform electronic debit transactions. That person may provide the card directly to the cardholder or indirectly by using a third party (such as a processor, or a telephone network or manufacturer) to provide the card, or other payment code or device, to the cardholder. The following examples illustrate the entity that is the issuer under various card program arrangements.

2. *Traditional debit card arrangements.* In a traditional debit card arrangement, the bank or other entity holds the cardholder's funds and authorizes the cardholder to use the debit card to access those funds through electronic debit transactions, and the cardholder receives the card directly or indirectly (e.g., through an agent) from the bank or other entity that holds the funds (except for decoupled debit cards, discussed below). In this system, the bank or entity holding the cardholder's funds is the issuer.

3. *BIN-sponsor arrangements.* Payment card networks assign Bank Identification Numbers (BINs) to member-institutions for purposes of issuing cards, authorizing, clearing, settling, and other processes. In exchange for a fee or other financial consideration, some members of payment card networks permit other entities to issue debit cards using the member's BIN. The entity permitting the use of its BIN is referred to as the “BIN sponsor” and the entity that uses the BIN to issue cards is often referred to as the “affiliate member.” BIN sponsor arrangements can follow at least two different models:

i. *Sponsored debit card model.* In some cases, a community bank or credit union may provide debit cards to its account holders through a BIN sponsor arrangement with a member institution. In general, the bank or credit union will authorize its account holders to use debit cards to perform electronic debit transactions that access funds in accounts at the bank or credit union. The bank or credit union's name typically will appear on the debit card. The bank or credit union may directly or indirectly provide the cards to cardholders. Under these circumstances, the bank or credit union is the issuer for purposes of this part. Although the bank or credit union may distribute cards through the BIN sponsors, the BIN sponsor does not enter into the agreement with the cardholder that authorizes the cardholder to use the card to perform electronic debit transactions that access funds in the account at the bank or credit union, and therefore the BIN sponsor is not the issuer.

ii. *Prepaid card model.* A member institution may also serve as the BIN sponsor for a prepaid card program. Under these arrangements, a program manager distributes prepaid cards to the cardholders and the BIN-sponsoring institution generally holds the funds for the prepaid card program in an omnibus or pooled account. Either the BIN sponsor or the prepaid card program manager may keep track of the underlying funds for each individual prepaid card through subaccounts. While the cardholder may receive the card directly from the program manager or at a retailer, the BIN sponsor authorizes the cardholder to use the card to perform electronic debit transactions that access the funds in the pooled account and the cardholder's relationship generally is with the BIN sponsor. Accordingly, under these circumstances, the BIN sponsor, or the bank holding the pooled account, is the issuer.

4. *Decoupled debit cards.* In the case of decoupled debit cards, an entity other than the bank holding the cardholder's account enters into a relationship with the cardholder authorizing the use of the card to perform electronic debit transactions. The entity authorizing the use of the card to perform electronic debit transaction typically arranges for the card to be provided directly or indirectly to the cardholder and has a direct relationship with the cardholder with respect to the card. The bank holding the cardholder's account has agreed generally to permit ACH debits to the account, but has not authorized the use of the debit card to access the funds through electronic debit transactions. Under these circumstances, the entity authorizing the use of the debit card, and not the account-holding institution, is considered the issuer.

2(m) – *Merchant [Reserved]*

2(n) – *Payment Card Network*

1. *In general.* An entity is considered a payment card network with respect to an electronic debit transaction for purposes of this rule if it routes information and data to the issuer from the acquirer to conduct authorization, clearance, and settlement of the electronic debit transaction. By contrast, if an entity receives transaction information and data from a merchant and authorizes and settles the transaction without routing the information and data to another entity (i.e., the issuer or the issuer's processor) for authorization, clearance, or settlement, that entity is not considered a payment card network with respect to the electronic debit transaction.

2. *Three-party systems.* In the case of a three-party system, electronic debit transactions are processed by an entity that acts as system operator and issuer, and may also act as the acquirer. The entity acting as system operator and issuer that receives the transaction information from the merchant or acquirer also holds the cardholder's funds. Therefore, rather than directing the transaction information to a separate issuer, the entity authorizes and settles the transaction based on the information received from the merchant. As these entities do not connect (or “network”) multiple issuers and do not route information to conduct the transaction, they are not “payment card networks” with respect to these transactions.

3. *Processors as payment card networks.* A processor is considered a payment card network if, in addition to acting as processor for an acquirer and issuer, the processor routes transaction information and data received from a merchant or the merchant's acquirer to an issuer. For

example, if a merchant uses a processor in order to accept any, some, or all brands of debit cards and the processor routes transaction information and data to the issuer or issuer's processor, the merchant's processor is considered a payment card network with respect to the electronic debit transaction. If the processor establishes, charges, or receives a fee for the purpose of compensating an issuer, that fee is considered an interchange transaction fee for purposes of this part.

4. *Automated clearing house (ACH) operators.* An ACH operator is not considered a payment card network for purposes of this part. While an ACH operator processes transactions that debit an account and provides for interbank clearing and settlement of such transactions, a person does not use the ACH system to accept as a form of payment a brand of debit card.

5. *ATM networks.* An ATM network is not considered a payment card network for purposes of this part. While ATM networks process transactions that debit an account and provide for interbank clearing and settlement of such transactions, a cash withdrawal from an ATM is not a payment because there is no exchange of money for goods or services, or payment made as a charitable contribution, to satisfy an obligation (e.g., tax liability), or for other purposes.

2(o) – *Person [Reserved]*

2(p) – *Processor*

1. *Distinction from acquirers.* A processor may perform all transaction-processing functions for a merchant or acquirer, but if it does not acquire (that is, settle with the merchant for the transactions), it is not an acquirer. The entity that acquires electronic debit transactions is the entity that is responsible to other parties to the electronic debit transaction for the amount of the transaction.

2. *Issuers.* A processor may perform services related to authorization, clearance, and settlement of transactions for an issuer without being considered to be an issuer for purposes of this part.

2(q) – *Route*

1. An entity routes information if it both directs and sends the information to an unaffiliated entity (or affiliated entity acting on behalf of the unaffiliated entity). This other entity may be a payment card network or processor (if the entity directing and sending the information is a merchant or an acquirer) or an issuer or processor (if the entity directing and sending the information is a payment card network).

2(r) – *United States [Reserved]*

Section 235.3 – Reasonable and Proportional Interchange Transaction Fees

3(a) – *[Reserved]*

3(b) – *Reasonable and Proportional Fees*

1. *Two components.* The standard for the maximum permissible interchange transaction fee that an issuer may receive consists of two components: a base component that does not vary with a

transaction's value and an *ad valorem* component. The amount of any interchange transaction fee received or charged by an issuer may not exceed the sum of these components. In addition, an issuer may be permitted to receive or charge a fraud-prevention adjustment under § 235.4 of this part.

2. *Variation in interchange fees.* An issuer is permitted to charge or receive, and a network is permitted to establish, interchange transaction fees that vary based on, for example, the transaction value or the type of transaction or merchant, provided the amount of any interchange transaction fee for any transaction does not exceed the sum of the base component and the *ad valorem* component.

3. *Examples.* For a \$50 electronic debit transaction performed on June 30, 2023, the maximum permissible interchange transaction fee is 23.5 cents (21.0 cents plus 5.0 basis points multiplied by \$50). For a \$50 electronic debit transaction performed on July 1, 2023, the maximum permissible interchange transaction fee is 16.4 cents (14.4 cents plus 4.0 basis points multiplied by \$50). In addition, an issuer may be permitted to receive a fraud-prevention adjustment under § 235.4 of this part.

4. *Performance of an electronic debit transaction.* For purposes of § 235.3(b), an electronic debit transaction is considered to be performed on the date on which such transaction is settled on an interbank basis. For example, an electronic debit transaction that is authorized and cleared on June 30, 2023, but is settled on an interbank basis on July 1, 2023, is considered to be performed on July 1, 2023.

3(c) – [Reserved]

Section 235.4 – Fraud-Prevention Adjustment

4(a) – *Fraud-Prevention Adjustment Amount*

1. *Performance of an electronic debit transaction.* For purposes of § 235.4(a), an electronic debit transaction is considered to be performed on the date on which such transaction is settled on an interbank basis. For example, an electronic debit transaction that is authorized and cleared on June 30, 2023, but is settled on an interbank basis on July 1, 2023, is considered to be performed on July 1, 2023.

4(b) – [Reserved]

4(c)(1) – *Issuer Standards*

1. An issuer's policies and procedures should address fraud related to debit card use by unauthorized persons. Examples of use by unauthorized persons include, but are not limited to, the following:

- i. A thief steals a cardholder's wallet and uses the debit card to purchase goods, without the authority of the cardholder.

- ii. A cardholder makes a purchase at a merchant. Subsequently, the merchant's employee uses information from the debit card to initiate a subsequent transaction, without the authority of the cardholder.
 - iii. A hacker steals cardholder account information from the issuer or a merchant processor and uses the stolen information to make unauthorized card-not-present purchases or to create a counterfeit card to make unauthorized card-present purchases.
2. An issuer's policies and procedures must be designed to reduce fraud, where cost effective, across all types of electronic debit transactions in which its cardholders engage. Therefore, an issuer should consider whether its policies and procedures are effective for each method used to authenticate the card (e.g., a chip or a code embedded in the magnetic stripe) and the cardholder (e.g., a signature or a PIN), and for different sales channels (e.g., card-present and card-not-present).
3. An issuer's policies and procedures must be designed to take effective steps to reduce both the occurrence of and costs to all parties from fraudulent electronic debit transactions. An issuer should take steps reasonably designed to reduce the number and value of its fraudulent electronic debit transactions relative to its non-fraudulent electronic debit transactions. These steps should reduce the costs from fraudulent transactions to all parties, not merely the issuer. For example, an issuer should take steps to reduce the number and value of its fraudulent electronic debit transactions relative to its non-fraudulent transactions whether or not it bears the fraud losses as a result of regulations or network rules.
4. For any given issuer, the number and value of fraudulent electronic debit transactions relative to non-fraudulent transactions may vary materially from year to year. Therefore, in certain circumstances, an issuer's policies and procedures may be effective notwithstanding a relative increase in the transactions that are fraudulent in a particular year. However, continuing increases in the share of fraudulent transactions would warrant further scrutiny.
5. In determining which fraud-prevention technologies to implement or retain, an issuer must consider the cost-effectiveness of the technology, that is, the expected cost of the technology relative to its expected effectiveness in controlling fraud. In evaluating the cost of a particular technology, an issuer should consider whether and to what extent other parties will incur costs to implement the technology, even though an issuer may not have complete information about the costs that may be incurred by other parties, such as the cost of new merchant terminals. In evaluating the costs, an issuer should consider both initial implementation costs and ongoing costs of using the fraud-prevention method.
6. An issuer need not develop fraud-prevention technologies itself to satisfy the standards in § 235.4(c). An issuer may implement fraud-prevention technologies that have been developed by a third party that the issuer has determined are appropriate under its own policies and procedures.

4(c)(2) – Elements of Fraud-Prevention Policies and Procedures

1. *In general.* An issuer may tailor its policies and procedures to address its particular debit card program, including the size of the program, the types of transactions in which its cardholders commonly engage, fraud types and methods experienced by the issuer, and the cost of implementing new fraud-prevention methods in light of the expected fraud reduction.

4(c)(2)(i) – Methods to Identify and Prevent Fraudulent Debit Card Transactions

1. *In general.* Examples of policies and procedures reasonably designed to identify and prevent fraudulent electronic debit transactions include the following:

- i. Practices to help determine whether a card is authentic and whether the user is authorized to use the card at the time of a transaction. For example, an issuer may specify the use of particular authentication technologies or methods, such as dynamic data, to better authenticate a card and cardholder at the time of the transaction, to the extent doing so does not inhibit the ability of a merchant to direct the routing of electronic debit transactions for processing over any payment card network that may process such transactions. (See § 235.7 and commentary thereto.)
- ii. An automated mechanism to assess the risk that a particular electronic debit transaction is fraudulent during the authorization process (i.e., before the issuer approves or declines an authorization request). For example, an issuer may use neural networks to identify transactions that present increased risk of fraud. As a result of this analysis, the issuer may decide to decline to authorize these transactions. An issuer may not be able to determine whether a given transaction in isolation is fraudulent at the time of authorization, and therefore may have implemented policies and procedures that monitor sets of transactions initiated with a cardholder's debit card. For example, an issuer could compare a set of transactions initiated with the card to a customer's typical transactions in order to determine whether a transaction is likely to be fraudulent. Similarly, an issuer could compare a set of transactions initiated with a debit card and common fraud patterns in order to determine whether a transaction or future transaction is likely to be fraudulent.
- iii. Practices to support reporting of lost and stolen cards or suspected incidences of fraud by cardholders or other parties to a transaction. As an example, an issuer may promote customer awareness by providing text alerts of transactions in order to detect fraudulent transactions in a timely manner. An issuer may also report debit cards suspected of being fraudulent to their networks for inclusion in a database of potentially compromised cards.

4(c)(2)(ii) – Monitoring of the Issuer's Volume and Value of Fraudulent Electronic Debit Transactions

1. Tracking its fraudulent electronic debit transactions over time enables an issuer to assess whether its policies and procedures are effective. Accordingly, an issuer must include policies and procedures designed to monitor trends in the number and value of its fraudulent electronic debit transactions. An effective monitoring program would include tracking issuer losses from fraudulent electronic debit transactions, fraud-related chargebacks to acquirers, losses passed on to cardholders, and any other reimbursements from other parties. Other reimbursements could

include payments made to issuers as a result of fines assessed to merchants for noncompliance with Payment Card Industry (PCI) Data Security Standards or other industry standards. An issuer should also establish procedures to track fraud-related information necessary to perform its reviews under § 235.4(c)(3) and to retain and report information as required under § 235.8.

4(c)(2)(iii) – Appropriate Responses to Suspicious Electronic Debit Transactions

1. An issuer may identify transactions that it suspects to be fraudulent after it has authorized or settled the transaction. For example, a cardholder may inform the issuer that the cardholder did not initiate a transaction or transactions, or the issuer may learn of a fraudulent transaction or possibly compromised debit cards from the network, the acquirer, or other parties. An issuer must implement policies and procedures designed to provide an appropriate response once an issuer has identified suspicious transactions to reduce the occurrence of future fraudulent electronic debit transactions and the costs associated with such transactions. The appropriate response may differ depending on the facts and circumstances, including the issuer's assessment of the risk of future fraudulent electronic debit transactions. For example, in some circumstances, it may be sufficient for an issuer to monitor more closely the account with the suspicious transactions. In other circumstances, it may be necessary to contact the cardholder to verify a transaction, reissue a card, or close an account. An appropriate response may also require coordination with industry organizations, law enforcement agencies, and other parties, such as payment card networks, merchants, and issuer or merchant processors.

4(c)(2)(iv) – Methods to Secure Debit Card and Cardholder Data

1. An issuer must implement policies and procedures designed to secure debit card and cardholder data. These policies and procedures should apply to data that are transmitted by the issuer (or its service provider) during transaction processing, that are stored by the issuer (or its service provider), and that are carried on media (e.g., laptops, transportable data storage devices) by employees or agents of the issuer. This standard may be incorporated into an issuer's information security program, as required by Section 501(b) of the Gramm-Leach-Bliley Act.

4(c)(3) – Review of and Updates to Policies and Procedures

1.

- i. An issuer's assessment of the effectiveness of its policies and procedures should consider whether they are reasonably designed to reduce the number and value of fraudulent electronic debit transactions relative to non-fraudulent electronic debit transactions and are cost effective. (See comment 4(c)(1)-3 and comment 4(c)(1)-5).
- ii. An issuer must also assess its policies and procedures in light of changes in fraud types (e.g., the use of counterfeit cards, lost or stolen cards) and methods (e.g., common purchase patterns indicating possible fraudulent behavior), as well as changes in the available methods of detecting and preventing fraudulent electronic debit transactions (e.g., transaction monitoring, authentication methods) as part of its periodic review of its policies and procedures. An issuer's review of its policies and procedures must consider information from the issuer's own experience and that the issuer otherwise identified

itself; information from payment card networks, law enforcement agencies, and fraud-monitoring groups in which the issuer participates; and supervisory guidance. For example, an issuer should consider warnings and alerts it receives from payment card networks regarding compromised cards and data breaches.

2. An issuer should review its policies and procedures and their implementation more frequently than annually if the issuer determines that more frequent review is appropriate based on information obtained from monitoring its fraudulent electronic debit transactions, changes in the types or methods of fraud, or available methods of detecting and preventing fraudulent electronic debit transactions. (See § 235.4(c)(1)(ii) and commentary thereto.)

3. In light of an issuer's review of its policies and procedures, and their implementation, the issuer may determine that updates to its policies and procedures, and their implementation, are necessary. Merely determining that updates are necessary does not render an issuer ineligible to receive or charge the fraud-prevention adjustment. To remain eligible to receive or charge a fraud-prevention adjustment, however, an issuer should develop and implement such updates as soon as reasonably practicable, in light of the facts and circumstances.

4(d) – Notification

1. Payment card networks that plan to allow issuers to receive or charge a fraud-prevention adjustment can develop processes for identifying issuers eligible for this adjustment. Each issuer that wants to be eligible to receive or charge a fraud-prevention adjustment must notify annually the payment card networks in which it participates of its compliance through the networks' processes.

Section 235.5 – Exemptions for Certain Electronic Debit Transactions

1. *Eligibility for multiple exemptions.* An electronic debit transaction may qualify for one or more exemptions. For example, a debit card that has been provided to a person pursuant to a Federal, State, or local government-administered payment program may be issued by an issuer that is not a covered issuer. In this case, an electronic debit transaction made using that card may qualify for the exemption under § 235.5(a) for small issuers or for the exemption under § 235.5(b) for government-administered payment programs. A payment card network establishing interchange fees for transactions that qualify for more than one exemption need only satisfy itself that the issuer's transactions qualify for at least one of the exemptions in order to exempt the electronic debit transaction from the interchange fee restrictions.

2. *Certification process.* Payment card networks that plan to allow issuers to receive higher interchange fees than permitted under §§ 235.3 and 235.4 pursuant to one of the exemptions in § 235.5 could develop their own processes for identifying issuers and products eligible for such exemptions. Section 235.5(a)(2) permits payment card networks to rely on lists published by the Board to help determine eligibility for the small issuer exemption set forth in § 235.5(a)(1).

5(a) – Exemption for Small Issuers

1. *Account that is debited.* An issuer that is not a covered issuer is exempt under § 235.5(a) only if the issuer holds the account that is debited. For example, in the case of the sponsored debit card model described in comment 235.2(1)-3(i), if the bank or credit union is not a covered issuer, then that bank or credit union is exempt from the interchange fee restrictions because the issuer holds the account that is debited. However, in the case of the decoupled debit card described in comment 235.2(1)-4, the issuer of a decoupled debit card is not exempt under § 235.5(a), regardless of asset size, because it does not hold the account that is debited.

2. *Change in status.* If an exempt issuer becomes a covered issuer based on its and its affiliates assets at the end of a calendar year, that issuer must begin complying with the interchange fee standards (§ 235.3), the fraud-prevention adjustment standards (to the extent the issuer wishes to receive a fraud-prevention adjustment) (§ 235.4), and the provisions prohibiting circumvention, evasion, and net compensation (§ 235.6) no later than July 1.

5(b) – Exemption for Government-Administered Payment Programs

1. *Government-administered payment program.* A program is considered government-administered regardless of whether a Federal, State, or local government agency operates the program or outsources some or all functions to third parties so long as the program is operated on behalf of the government agency. In addition, a program may be government-administered even if a Federal, State, or local government agency is not the source of funds for the program it administers. For example, child support programs are government-administered programs even though a Federal, State, or local government agency is not the source of funds. A tribal government is considered a local government for purposes of this exemption.

5(c) – Exemption for Certain Reloadable Prepaid Cards

1. *Subaccount clarified.* A subaccount is an account within an account, opened in the name of an agent, nominee, or custodian for the benefit of two or more cardholders, where the transactions and balances of individual cardholders are tracked in such subaccounts. An account that is opened solely in the name of a single cardholder is not a subaccount.

2. *Reloadable.* A general-use prepaid card is “reloadable” if the terms and conditions of the agreement permit funds to be added to the general-use prepaid card at any time after the initial purchase or issuance. A general-use prepaid card is not “reloadable” merely because the issuer or processor is technically able to add functionality that would otherwise enable the general-use prepaid card to be reloaded.

3. *Marketed or labeled as a gift card or gift certificate.*

i. Electronic debit transactions made using a reloadable general-use prepaid card are not exempt from the interchange fee restrictions if the card is marketed or labeled as a gift card or gift certificate. The term “marketed or labeled as a gift card or gift certificate” means directly or indirectly offering, advertising or otherwise suggesting the potential use of a general-use prepaid card as a gift for another person. Whether the exclusion applies generally does not depend on the type of entity that makes the promotional message. For example, a card may be marketed or labeled as a gift card or gift certificate if anyone

(other than the purchaser of the card), including the issuer, the retailer, the program manager that may distribute the card, or the payment network on which a card is used, promotes the use of the card as a gift card or gift certificate. A general-use prepaid card is marketed or labeled as a gift card or gift certificate even if it is only occasionally marketed as a gift card or gift certificate. For example, a network-branded general purpose reloadable card would be marketed or labeled as a gift card or gift certificate if the issuer principally advertises the card as a less costly alternative to a bank account but promotes the card in a television, radio, newspaper, or Internet advertisement, or on signage as “the perfect gift” during the holiday season.

ii. The mere mention of the availability of gift cards or gift certificates in an advertisement or on a sign that also indicates the availability of exempted general-use prepaid cards does not by itself cause the general-use prepaid card to be marketed as a gift card or a gift certificate. For example, the posting of a sign in a store that refers to the availability of gift cards does not by itself constitute the marketing of otherwise exempted general-use prepaid cards that may also be sold in the store along with gift cards or gift certificates, provided that a person acting reasonably under the circumstances would not be led to believe that the sign applies to all cards sold in the store. (See, however, comment 5(c)-4.ii.)

4. *Examples of marketed or labeled as a gift card or gift certificate.*

i. The following are examples of marketed or labeled as a gift card or gift certificate:

A. Using the word “gift” or “present” on a card or accompanying material, including documentation, packaging and promotional displays;

B. Representing or suggesting that a card can be given to another person, for example, as a “token of appreciation” or a “stocking stuffer,” or displaying a congratulatory message on the card or accompanying material;

C. Incorporating gift-giving or celebratory imagery or motifs, such as a bow, ribbon, wrapped present, candle, or a holiday or congratulatory message, on a card, accompanying documentation, or promotional material;

ii. The term does not include the following:

A. Representing that a card can be used as a substitute for a checking, savings, or deposit account;

B. Representing that a card can be used to pay for a consumer's health-related expenses – for example, a card tied to a health savings account;

C. Representing that a card can be used as a substitute for travelers checks or cash;

D. Representing that a card can be used as a budgetary tool, for example, by teenagers, or to cover emergency expenses.

5. *Reasonable policies and procedures to avoid marketing as a gift card.* The exemption for a general-use prepaid card that is reloadable and not marketed or labeled as a gift card or gift certificate in § 235.5(c) applies if a reloadable general-use prepaid card is not marketed or labeled as a gift card or gift certificate and if persons involved in the distribution or sale of the card, including issuers, program managers, and retailers, maintain policies and procedures reasonably designed to avoid such marketing. Such policies and procedures may include contractual provisions prohibiting a reloadable general-use prepaid card from being marketed or labeled as a gift card or gift certificate, merchandising guidelines or plans regarding how the product must be displayed in a retail outlet, and controls to regularly monitor or otherwise verify that the general-use prepaid card is not being marketed as a gift card. Whether a general-use prepaid card has been marketed as a gift card or gift certificate will depend on the facts and circumstances, including whether a reasonable person would be led to believe that the general-use prepaid card is a gift card or gift certificate. The following examples illustrate the application of § 235.5(c):

- i. An issuer or program manager of prepaid cards agrees to sell general-purpose reloadable cards through a retailer. The contract between the issuer or program manager and the retailer establishes the terms and conditions under which the cards may be sold and marketed at the retailer. The terms and conditions prohibit the general-purpose reloadable cards from being marketed as a gift card or gift certificate, and require policies and procedures to regularly monitor or otherwise verify that the cards are not being marketed as such. The issuer or program manager sets up one promotional display at the retailer for gift cards and another physically separated display for exempted products under § 235.5(c), including general-purpose reloadable cards, such that a reasonable person would not believe that the exempted cards are gift cards. The exemption in § 235.5(c) applies because policies and procedures reasonably designed to avoid the marketing of the general-purpose reloadable cards as gift cards or gift certificates are maintained, even if a retail clerk inadvertently stocks or a consumer inadvertently places a general-purpose reloadable card on the gift card display.
- ii. Same facts as in comment 5(c)-5.i, except that the issuer or program manager sets up a single promotional display at the retailer on which a variety of prepaid cards are sold, including store gift cards and general-purpose reloadable cards. A sign stating “Gift Cards” appears prominently at the top of the display. The exemption in § 235.5(c) does not apply with respect to the general-purpose reloadable cards because policies and procedures reasonably designed to avoid the marketing of exempted cards as gift cards or gift certificates are not maintained.
- iii. Same facts as in comment 5(c)-5.i, except that the issuer or program manager sets up a single promotional multi-sided display at the retailer on which a variety of prepaid card products, including store gift cards and general-purpose reloadable cards are sold. Gift cards are segregated from exempted cards, with gift cards on one side of the display and exempted cards on a different side of a display. Signs of equal prominence at the top of each side of the display clearly differentiate between gift cards and the other types of

prepaid cards that are available for sale. The retailer does not use any more conspicuous signage suggesting the general availability of gift cards, such as a large sign stating “Gift Cards” at the top of the display or located near the display. The exemption in § 235.5(c) applies because policies and procedures reasonably designed to avoid the marketing of the general-purpose reloadable cards as gift cards or gift certificates are maintained, even if a retail clerk inadvertently stocks or a consumer inadvertently places a general-purpose reloadable card on the gift card display.

iv. Same facts as in comment 5(c)-5.i, except that the retailer sells a variety of prepaid card products, including store gift cards and general-purpose reloadable cards, arranged side-by-side in the same checkout lane. The retailer does not affirmatively indicate or represent that gift cards are available, such as by displaying any signage or other indicia at the checkout lane suggesting the general availability of gift cards. The exemption in § 235.5(c) applies because policies and procedures reasonably designed to avoid marketing the general-purpose reloadable cards as gift cards or gift certificates are maintained.

6. *On-line sales of prepaid cards.* Some web sites may prominently advertise or promote the availability of gift cards or gift certificates in a manner that suggests to a consumer that the web site exclusively sells gift cards or gift certificates. For example, a web site may display a banner advertisement or a graphic on the home page that prominently states “Gift Cards,” “Gift Giving,” or similar language without mention of other available products, or use a web address that includes only a reference to gift cards or gift certificates in the address. In such a case, a consumer acting reasonably under the circumstances could be led to believe that all prepaid products sold on the web site are gift cards or gift certificates. Under these facts, the web site has marketed all such products as gift cards or gift certificates, and the exemption in § 235.5(c) does not apply to any products sold on the web site.

7. *Temporary non-reloadable cards issued in connection with a general-use reloadable card.* Certain general-purpose prepaid cards that are typically marketed as an account substitute initially may be sold or issued in the form of a temporary non-reloadable card. After the card is purchased, the cardholder is typically required to call the issuer to register the card and to provide identifying information in order to obtain a reloadable replacement card. In most cases, the temporary non-reloadable card can be used for purchases until the replacement reloadable card arrives and is activated by the cardholder. Because the temporary non-reloadable card may only be obtained in connection with the reloadable card, the exemption in § 235.5(c) applies so long as the card is not marketed as a gift card or gift certificate.

5(d) – Exception

1. *Additional ATM access.* Some debit cards may be used to withdraw cash from ATMs that are not part of the issuer's designated ATM network. An electronic debit card transaction may still qualify for the exemption under §§ 235.5(b) or (c) with a respect to a card for which a fee may be imposed for a withdrawal from an ATM that is outside of the issuer's designated ATM network as long as the card complies with the condition set forth in § 235.5(d)(2) for

withdrawals within the issuer's designated ATM network. The condition with respect to ATM fees does not apply to cards that do not provide ATM access.

Section 235.6 – Prohibition on Circumvention, Evasion, and Net Compensation

6(a) – Prohibition of Circumvention or Evasion

1. *Finding of circumvention or evasion.* A finding of evasion or circumvention will depend on all relevant facts and circumstances. Although net compensation may be one form of circumvention or evasion prohibited under § 235.6(a), it is not the only form.

2. *Examples of circumstances that may constitute circumvention or evasion.* The following examples do not constitute per se circumvention or evasion, but may warrant additional supervisory scrutiny to determine whether the totality of the facts and circumstances constitute circumvention or evasion:

- i. A payment card network decreases network processing fees paid by issuers for electronic debit transactions by 50 percent and increases the network processing fees charged to merchants or acquirers with respect to electronic debit transactions by a similar amount. Because the requirements of this subpart do not restrict or otherwise establish the amount of fees that a network may charge for its services, the increase in network fees charged to merchants or acquirers and decrease in fees charged to issuers is not a per se circumvention or evasion of the interchange transaction fee standards, but may warrant additional supervisory scrutiny to determine whether the facts and circumstances constitute circumvention or evasion.
- ii. An issuer replaces its debit cards with prepaid cards that are exempt from the interchange limits of §§ 235.3 and 235.4. The exempt prepaid cards are linked to its customers' transaction accounts and funds are swept from the transaction accounts to the prepaid accounts as needed to cover transactions made. Again, this arrangement is not per se circumvention or evasion, but may warrant additional supervisory scrutiny to determine whether the facts and circumstances constitute circumvention or evasion.

6(b) – Prohibition of Net Compensation

1. *Net compensation.* Net compensation to an issuer through the use of network fees is prohibited.

2. *Consideration of payments or incentives provided by the network in net compensation determination.*

- i. For purposes of the net compensation determination, payments or incentives paid by a payment card network to an issuer with respect to electronic debit transactions or debit card related activities could include, but are not limited to, marketing incentives; payments or rebates for meeting or exceeding a specific transaction volume, percentage share, or dollar amount of transactions processed; or other payments for debit card related activities. For example, signing bonuses paid by a network to an issuer for the issuer's debit card portfolio would also be included in the total amount of payments or incentives

received by an issuer from a payment card network with respect to electronic debit transactions. A signing bonus for an entire card portfolio, including credit cards, may be allocated to the issuer's debit card business based on the proportion of the cards or transactions that are debit cards or electronic debit transactions, as appropriate to the situation, for purposes of the net compensation determination.

ii. Incentives paid by the network with respect to multiple-year contracts may be allocated over the life of the contract.

iii. For purposes of the net compensation determination, payments or incentives paid by a payment card network with respect to electronic debit transactions or debit card-related activities do not include interchange transaction fees that are passed through to the issuer by the network, or discounts or rebates provided by the network or an affiliate of the network for issuer-processor services. In addition, funds received by an issuer from a payment card network as a result of chargebacks, fines paid by merchants or acquirers for violations of network rules, or settlements or recoveries from merchants or acquirers to offset the costs of fraudulent transactions or a data security breach do not constitute incentives or payments made by a payment card network.

3. Consideration of fees paid by an issuer in net compensation determination.

i. For purposes of the net compensation determination, fees paid by an issuer to a payment card network with respect to electronic debit transactions or debit card related activities include, but are not limited to, membership or licensing fees, network administration fees, and fees for optional network services, such as risk management services.

ii. For purposes of the net compensation determination, fees paid by an issuer to a payment card network with respect to electronic debit transactions or debit card-related activities do not include network processing fees (such as switch fees and network connectivity fees) or fees paid to an issuer processor affiliated with the network for authorizing, clearing, or settling an electronic debit transaction.

4. Example of circumstances not involving net compensation to the issuer. The following example illustrates circumstances that would not indicate net compensation by the payment card network to the issuer:

i. Because of an increase in debit card transactions that are processed through a payment card network during a calendar year, an issuer receives an additional volume-based incentive payment from the network for that period. Over the same period, however, the total network fees (other than processing fees) the issuer pays the payment card network with respect to debit card transactions also increase so that the total amount of fees paid by the issuer to the network continue to exceed incentive payments by the network to the issuer. Under these circumstances, the issuer does not receive net compensation from the network for electronic debit transactions or debit card related activities.

Section 235.7 – Limitations on Payment Card Restrictions

7(a) – Prohibition on Network Exclusivity

1. *Scope of restriction.* Section 235.7(a) requires an issuer to configure each of its debit cards so that each electronic debit transaction performed with such card can be processed on at least two unaffiliated payment card networks. In particular, section § 235.7(a) requires this condition to be satisfied for each geographic area, specific merchant, particular type of merchant, and particular type of transaction for which the issuer's debit card can be used to perform an electronic debit transaction. As long as the condition is satisfied for each such case, section § 235.7(a) does not require the condition to be satisfied for each method of cardholder authentication (e.g., signature, PIN, biometrics, any other method of cardholder authentication that may be developed in the future, or the lack of a method of cardholder authentication). For example, it is sufficient for an issuer to issue a debit card that can perform signature-authenticated transactions only over one payment card network and PIN-authenticated transactions only over another payment card network, as long as the two payment card networks are not affiliated and each network can be used to process electronic debit transactions for every geographic area, specific merchant, particular type of merchant, and particular type of transaction for which the issuer's debit card can be used to perform an electronic debit transaction.

2. *Issuer's role.* Section 235.7(a) does not require an issuer to ensure that two or more unaffiliated payment card networks will actually be available to the merchant to process every electronic debit transaction. To comply with the requirement in § 235.7(a), it is sufficient for an issuer to configure each of its debit cards so that each electronic debit transaction performed with such card can be processed on at least two unaffiliated payment card networks, even if the networks that are actually available to the merchant for a particular transaction are limited by, for example, the card acceptance technologies that a merchant adopts, or the networks that the merchant accepts.

3. Permitted networks.

i. *Network volume capabilities.* A payment card network could be used to satisfy the requirement that an issuer enable two unaffiliated payment card networks for each electronic debit transaction if the network was either (a) capable of processing the volume of electronic debit transactions that it would reasonably expect to be routed to it or (b) willing to expand its capabilities to meet such expected transaction volume. If, however, the network's policy or practice is to limit such expansion, it would not qualify as one of the two unaffiliated payment card networks.

ii. *Reasonable volume expectations.* One of the steps a payment card network can take to form a reasonable expectation of its transaction volume is to consider factors such as the number of cards expected to be issued that are enabled by an issuer on the network and expected card usage patterns.

iii. *Examples of permitted arrangements.* For each geographic area (e.g., New York State), specific merchant (e.g., a specific fast food restaurant chain), particular type of merchant (e.g., fast food restaurants), and particular type of transaction (e.g., card-not-present transaction) for which the issuer's debit card can be used to perform an electronic

debit transaction, an issuer must enable at least two unaffiliated payment card networks, but those payment card networks do not necessarily have to be the same two payment card networks for every transaction.

A. *Geographic area*: An issuer complies with the rule only if, for each geographic area in which the issuer's debit card can be used to perform an electronic debit transaction, the issuer enables at least two unaffiliated payment card networks. For example, an issuer could comply with the rule by enabling two unaffiliated payment card networks that can each process transactions in all 50 U.S. states. Alternatively, the issuer could comply with the rule by enabling three unaffiliated payment card networks, A, B, and C, where network A can process transactions in all 50 U.S. states, network B can process transactions in the 48 contiguous United States, and network C can process transactions in Alaska and Hawaii.

B. *Particular type of transaction*: An issuer complies with the rule only if, for each particular type of transaction for which the issuer's debit card can be used to perform an electronic debit transaction, the issuer enables at least two unaffiliated payment card networks. For example, an issuer could comply with the rule by enabling two unaffiliated payment card networks that can each process both card-present and card-not-present transactions. Alternatively, the issuer could comply with the rule by enabling three unaffiliated payment card networks, A, B, and C, where network A can process both card-present and card-not-present transactions, network B can process card-present transactions, and network C can process card-not-present transactions.

4. *Examples of prohibited network restrictions on an issuer's ability to contract with other payment card networks*. The following are examples of prohibited network restrictions on an issuer's ability to contract with other payment card networks:

- i. Network rules or contract provisions limiting or otherwise restricting the other payment card networks that an issuer may enable on a particular debit card, or network rules or contract provisions that specify the other networks that an issuer may enable on a particular debit card.
- ii. Network rules or guidelines that allow only that payment card network's (or its affiliated networks') brand, mark, or logo to be displayed on a particular debit card, or that otherwise limit the ability of brands, marks, or logos of other payment card networks to appear on the debit card.

5. *Network logos or symbols on card not required*. Section 235.7(a) does not require that a debit card display the brand, mark, or logo of each payment card network over which an electronic debit transaction may be processed. For example, the rule does not require a debit card that an issuer enables on two or more unaffiliated payment card networks to bear the brand, mark, or logo of each such payment card network.

6. *Voluntary exclusivity arrangements prohibited.* Section 235.7(a) requires that an issuer enable at least two unaffiliated payment card networks to process an electronic debit transaction, even if the issuer is not subject to any rule of, or contract or other agreement with, a payment card network requiring that all or a specified minimum percentage of electronic debit transactions be processed on the network or its affiliated networks.

7. *Affiliated payment card networks.* Section 235.7(a) does not prohibit an issuer from enabling two affiliated payment card networks among the networks on a particular debit card, as long as at least two of the networks that can be used to process each electronic debit transaction are unaffiliated.

8. *Application of rule regardless of form.* The network exclusivity provisions in § 235.7(a) apply to electronic debit transactions performed with any debit card as defined in § 235.2, regardless of the form of such debit card. For example, the requirement applies to electronic debit transactions performed using a plastic card, a supplemental device such as a fob, information stored inside an e-wallet on a mobile phone or other device, or any other form of debit card, as defined in § 235.2, that may be developed in the future.

7(b) – Prohibition on Routing Restrictions

1. *Relationship to the network exclusivity restrictions.* An issuer or payment card network is prohibited from inhibiting a merchant's ability to direct the routing of an electronic debit transaction over any of the payment card networks that the issuer has enabled to process electronic debit transactions performed with a particular debit card. The rule does not require that an issuer allow a merchant to route a transaction over a payment card network that the issuer did not enable to process transactions performed with that debit card.

2. *Examples of prohibited merchant restrictions.* The following are examples of issuer or network practices that would inhibit a merchant's ability to direct the routing of an electronic debit transaction and that are therefore prohibited under § 235.7(b):

i. Prohibiting a merchant from encouraging or discouraging a cardholder's use of a particular method of cardholder authentication, for example prohibiting merchants from favoring a cardholder's use of one cardholder authentication method over another, or from discouraging the cardholder's use of any given cardholder authentication method, as further described in comment 7(a)-1.

ii. Establishing network rules or designating issuer priorities directing the processing of an electronic debit transaction on a specified payment card network or its affiliated networks, or directing the processing of the transaction away from a specified payment card network or its affiliates, except as (A) a default rule in the event the merchant, or its acquirer or processor, does not designate a routing preference, or (B) if required by state law.

iii. Requiring a specific payment card network to be used based on the form of debit card presented by the cardholder to the merchant (e.g., plastic card, payment code, or any other form of debit card as defined in § 235.2).

3. *Merchant payments not prohibited.* A payment card network does not restrict a merchant's ability to route transactions over available payment card networks in violation of § 235.7(b) by offering payments or other incentives to encourage the merchant to route electronic debit card transactions to the network for processing.

4. *Real-time routing decision not required.* A merchant need not make network routing decisions on a transaction-by-transaction basis. A merchant and its acquirer or processor may agree to a pre-determined set of routing choices that apply to all electronic debit transactions that are processed by the acquirer or processor on behalf of the merchant.

5. *No effect on network rules governing the routing of subsequent transactions.* Section 235.7 does not supersede a payment card network rule that requires a chargeback or return of an electronic debit transaction to be processed on the same network that processed the original transaction.

Section 235.8 – Reporting Requirements and Record Retention

8(a) – Entities Required to Report

1. *Two surveys.* The Board conducts a survey of covered issuers on a biennial basis using FR 3064a (OMB No. 7100-0344) and a survey of payment card networks on an annual basis using FR 3064b (OMB No. 7100-0344). Each survey collects information concerning electronic debit transactions performed during the previous calendar year.

2. *Change in status.* An issuer that is a covered issuer during the year in which the Board conducts a survey of covered issuers but was not a covered issuer during the previous calendar year is exempt from the reporting requirement in § 235.8.

8(b) – [Reserved]

8(c) – [Reserved]

Section 235.9 – Administrative Enforcement

[Reserved]

APPENDIX B to PART 235 – DETERMINATION OF BASE COMPONENT, *AD VALOREM* COMPONENT, AND FRAUD-PREVENTION ADJUSTMENT

(a) *In general.* For every two-year period beginning with the period from July 1, 2025, to June 30, 2027 (each an “applicable period”), the Board will determine the base component and the *ad valorem* component as set forth in § 235.3 and the fraud-prevention adjustment as set forth in § 235.4 using the approach described in this Appendix B.

(b) *Basis for determination.* The Board will determine the amounts described in paragraph (a) for an applicable period using the data reported to the Board by covered issuers pursuant to § 235.8 concerning transactions performed during the calendar year that is two years prior to the year in which the applicable period begins.

(c) *Base component.*

(1) *Formula.* The base component for an applicable period is the product of (A) the transaction-weighted average of per-transaction allowable costs (excluding fraud losses) across covered issuers, based on the data described in paragraph (b); and (B) 3.7, rounded to the nearest tenth of one cent.

(2) *Allowable costs (excluding fraud losses).* For purposes of paragraph (c)(1), allowable costs (excluding fraud losses) are the sum of (A) costs of authorization, clearance, and settlement as reported on line 3a of section II of FR 3064a (OMB No. 7100-0344); and (B) transactions monitoring costs tied to authorization as reported on line 5a.1 of section II of FR 3064a (OMB No. 7100-0344).

(3) *Transaction-weighted average of per-transaction allowable costs (excluding fraud losses) across covered issuers.* For purposes of paragraph (c)(1), the Board determines the transaction-weighted average of per-transaction allowable costs (excluding fraud losses) across covered issuers by (i) summing allowable costs (excluding fraud losses) across covered issuers that reported allowable costs (excluding fraud losses); (ii) dividing this sum by the sum of the total number of electronic debit transactions, as reported on line 1a of section II of FR 3064a (OMB No. 7100-0344), across covered issuers that reported allowable costs (excluding fraud losses); and (iii) rounding this result to the nearest tenth of one cent.

(d) *Ad valorem component.*

(1) *Metric.* The *ad valorem* component for an applicable period is, for a particular electronic debit transaction, the median ratio of issuer fraud losses to transaction value among covered issuers, based on the data described in paragraph (b), rounded to the nearest quarter of one basis point, multiplied by the value of the electronic debit transaction.

(2) *Ratio of issuer fraud losses to transaction value.* For purposes of paragraph (d)(1), issuer fraud losses are the value of fraud losses incurred by the covered issuer, as reported on line 8b of section II of FR 3064a (OMB No. 7100-0344). The ratio of issuer fraud losses to transaction value is issuer fraud losses divided by the total value of electronic debit transactions reported on line 1a of section II of FR 3064a (OMB No. 7100-0344).

(3) *Median ratio of issuer fraud losses to transaction value among covered issuers.* For purposes of paragraph (d)(1), the Board determines the median ratio of issuer fraud losses to transaction value among covered issuers by (i) for each covered issuer that reported issuer fraud losses, determining the ratio of issuer fraud losses to transaction value; (ii) sorting these ratios in ascending order; and (iii) selecting the ratio in the middle (if the number of ratios is odd) or calculating the simple average of the two ratios in the middle (if the number of ratios is even).

(e) *Fraud-prevention adjustment.*

(1) *Metric.* The fraud-prevention adjustment for an applicable period is the median per-transaction fraud-prevention costs among covered issuers, based on the data described in paragraph (b), rounded to the nearest tenth of one cent.

(2) *Per-transaction fraud-prevention costs.* For purposes of paragraph (e)(1), fraud-prevention costs are (A) total fraud-prevention and data-security costs, as reported on line 5a of section II of FR 3064a (OMB No. 7100-0344), minus (B) transactions monitoring costs tied to authorization, as reported on line 5a.1 of section II of FR 3064a (OMB No. 7100-0344). Per-transaction fraud-prevention costs are fraud-prevention costs divided by the total number of electronic debit transactions reported on line 1a of section II of FR 3064a (OMB No. 7100-0344).

(3) *Median per-transaction fraud-prevention costs among covered issuers.* For purposes of paragraph (e)(1), the Board determines the median per-transaction fraud-prevention costs among covered issuers by (i) for each covered issuer that reported fraud-prevention costs, determining per-transaction fraud-prevention costs; (ii) sorting these values in ascending order; and (iii) selecting the value in the middle (if the number of values is odd) or calculating the simple average of the two values in the middle (if the number of values is even).

(f) *Publication of applicable amounts.* The Board will publish in the *Federal Register* the amounts described in paragraph (a) for an applicable period no later than March 31 of the calendar year in which the applicable period begins.

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By order of the Board of Governors of the Federal Reserve System.

Ann E. Misback,
Secretary of the Board.