

**Supporting Statement for the
Recordkeeping and Disclosure Requirements Associated with Regulation II
(Debit Card Interchange Fees and Routing)
(Reg II; OMB No. 7100-0349)**

Summary

The Board of Governors of the Federal Reserve System proposes to extend for three years, without revision, the Federal Reserve's Recordkeeping and Disclosure Requirements associated with Regulation II (Debit Card Interchange Fees and Routing) (Reg II; OMB No. 7100-0349). The Paperwork Reduction Act (PRA) classifies reporting, recordkeeping, or disclosure requirements of a regulation as an "information collection."¹

Regulation II implements, among other things, standards for assessing whether interchange transaction fees for electronic debit transactions are reasonable and proportional to the cost incurred by the issuer with respect to the transaction, as required by section 920 of the Electronic Fund Transfer Act. The regulation sets a cap of 21 cents plus 5 basis points of the transaction's value on interchange transaction fees of covered issuers.

Regulation II allows adjustments to debit card interchange transaction fees to make an allowance for fraud-prevention costs incurred by issuers. The regulation permits an issuer to receive or charge an amount of no more than 1 cent per transaction in addition to its interchange transaction fee if the issuer develops and implements policies and procedures that are reasonably designed to take effective steps to reduce the occurrence of, and costs to all parties from, fraudulent electronic debit transactions. An issuer must notify its payment card networks annually that it complies with the Federal Reserve's standards for the fraud-prevention adjustment.

Regulation II requires issuers to retain evidence of compliance with the requirements imposed for a period of not less than five years after the end of the calendar year in which the electronic debit transaction occurred.

The total annual burden for this information collection is estimated to be 7,771 hours for the 131 issuers regulated by the federal financial regulatory agencies required to comply with the recordkeeping and disclosure provisions under section 235.4 of Regulation II.²

¹ See 44 U.S.C. § 3501 *et seq.*

² For purposes of the PRA, the Federal Reserve is estimating the burden for entities currently regulated by the Federal Reserve, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and National Credit Union Administration (collectively, the 'federal financial regulatory agencies'). Such entities may include, among others, state member banks, national banks, insured nonmember banks, savings associations, and Federally-chartered credit unions.

Background and Justification

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act)³ was enacted on July 21, 2010. Section 1075 of the Dodd-Frank Act amends the EFTA (15 U.S.C. § 1693 et seq.) by adding a new section 920 regarding interchange transaction fees and rules for debit card transactions.

Section 920(a) of the EFTA provides that, effective July 21, 2011, the amount of any interchange transaction fee that an issuer receives or charges with respect to an electronic debit transaction⁴ must be reasonable and proportional to the cost incurred by the issuer with respect to the transaction. This section requires the Federal Reserve to establish reasonable and proportional standards for assessing interchange transaction fees. Under EFTA section 920(a)(3)(B), the Federal Reserve may require any issuer (or agent of an issuer) or payment card network to provide the Federal Reserve with such information as may be necessary to carry out the provisions of the subsection.⁵

Under EFTA section 920(a)(5), the Federal Reserve may allow for an adjustment to an interchange transaction fee amount received or charged by an issuer if (1) such adjustment is reasonably necessary to make allowance for costs incurred by the issuer in preventing fraud in relation to electronic debit card transactions involving that issuer and (2) the issuer complies with fraud-prevention standards established by the Federal Reserve. Those standards must be designed to ensure that any adjustment is limited to the reasonably necessary fraud-prevention allowance described in clause (1) above; takes into account any fraud-related reimbursements received from consumers, merchants, or payment card networks (including amounts from chargebacks) in relation to electronic debit transactions involving the issuer; and requires issuers to take effective steps to reduce the occurrence of, and costs from, fraud in relation to electronic debit transactions, including through the development and implementation of cost-effective fraud-prevention technology.

Section 920(b) of the EFTA requires the Federal Reserve to prescribe rules related to the routing of debit card transactions. Section 920(b)(1) requires the Federal Reserve to prescribe rules that prohibit issuers and payment card networks (“networks”) from restricting the number of networks on which an electronic debit transaction may be processed to one such network or two or more affiliated networks. This section also requires the Federal Reserve to prescribe rules prohibiting issuers and networks from inhibiting the ability of any person that accepts debit cards from directing the routing of electronic debit transactions over any network that may process such transactions.

³ Pub. L. No. 111-203, 124 Stat. 1376 (2010).

⁴ Regulation II defines electronic debit transaction (or “debit card transaction”) to mean the use of a debit card (which includes a general-use prepaid card), by a person as a form of payment in the United States to initiate a debit to an account. This term does not include transactions initiated at an automated teller machine (ATM), including cash withdrawals and balance transfers initiated at an ATM.

⁵ EFTA section 920(a)(3)(B) requires the Federal Reserve, on at least a bi-annual basis, to disclose aggregate or summary information concerning the costs incurred, and interchange transaction fees charged, or received, by issuers or payment card networks in connection with the authorization, clearance or settlement of electronic debit transactions as the Federal Reserve considers appropriate and in the public interest. The burden estimate associated with that information collection is calculated in a separate PRA memo.

The Federal Reserve implemented the requirements of section 920(a) and 920(b) in Regulation II (12 CFR pt. 235).

Description of Information Collection

Issuers Standards - Section 235.4(b)(1). The provisions in this section requires that in order to be eligible to receive or charge the fraud-prevention adjustment in paragraph (a), 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. The Federal Reserve previously estimated one-time burden for implementing the policies and procedures and, staff believe that, on a continuing basis, there would be no additional increase in burden.

Issuer's Policies and Procedures - Section 235.4(b)(2) (recordkeeping). The provisions in this section requires that an issuer's policies and procedures address the following:

- 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.

Review and Update Issuer Standards – Section 235.4(b)(3) (recordkeeping). The provisions in this section requires that an issuer must review its fraud-prevention policies and procedures, and their implementation, at least annually, 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 of 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.

Notification and Change in Status - Sections 235.4(c) and (d) (disclosure). Section 235.4(c) requires 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 standards under section 235.4(b). Section 235.4(d) requires that, within 30 days of receiving notification from the appropriate agency under section 235.9 that the issuer is substantially non-compliant with the standards set forth in section 235.4(b), the issuer must notify its payment card networks that it is no longer eligible to receive or charge a fraud-prevention adjustment. The issuer must stop

receiving and charging the fraud-prevention adjustment as soon as reasonably practical thereafter.

Record Retention – Section 235.8(c) (recordkeeping). Section 235.8(c) requires that issuers subject to Regulation II shall retain evidence of compliance with the requirements imposed for a period of not less than five years after the end of the calendar year in which the electronic debit transaction occurred. Because compliance is evidenced by the review and update of issuer standards, and further involvement by an employee of the institution is minimal, burden associated with this requirement is negligible for purposes of the PRA.

Time Schedule for Information Collection and Publication

The information collection pursuant to the disclosure requirement under section 235.4(c) and (d) must be provided to the payment card network annually as established by the law and regulation as discussed above. The information is not published.

Legal Status

The Board’s Legal Division has determined that under section 920(a)(5) of the EFTA, the Board may allow for an adjustment to an interchange transaction fee amount received or charged by an issuer if “(1) such adjustment is reasonably necessary to make allowance for costs incurred by the issuer in preventing fraud in relation to electronic debit card transactions involving that issuer and (2) the issuer complies with the fraud-related standards established by the Board” (15 U.S.C. § 1693o-2(a)(5)). Section 920(a)(5) further provides detailed requirements pertaining to the fraud-related standards to be established by the Board and authorizes the Board to promulgate such standards by rule. In order to be eligible to receive a fraud-prevention adjustment, an issuer must develop and implement policies and procedures, review and update same, certify to payment card networks that its fraud-prevention standards comply with Federal Reserve standards, and retain evidence of compliance with these requirements for five years. Therefore, the obligation of covered issuers to respond is required in order to obtain or retain a benefit. Under Regulation II, issuers are only required to develop and maintain certain policies, certify same to payment card networks, and retain evidence of compliance, in order to receive the fraud-related adjustment: the Board does not collect any information. Therefore, no confidentiality issues arise.

Consultation Outside the Agency

On September 15, 2015, the Federal Reserve published a notice in the *Federal Register* (80 FR 55360) requesting public comment for 60 days on the extension, without revision, of the Reg II information collection. The comment period for this notice expired on November 16, 2015. The Federal Reserve did not receive any comments. On December 8, 2015, the Federal Reserve published a final notice in the *Federal Register* (80 FR 76286).

Estimate of Respondent Burden

The total annual burden for Reg II is estimated to be 7,771 hours. Federal Reserve staff estimates that approximately 15 issuers per year would take, on average, 160 hours (one month) to develop and implement policies and train staff to comply with the recordkeeping provisions under section 235.4. This one-time PRA burden is estimated to be 2,400 hours. On a continuing basis, the Federal Reserve estimates that 131 issuers would take, on average, 40 hours (one business week) annually to review their fraud prevention policies and procedures, updating them as necessary, and estimates the annual PRA burden to be 5,240 hours. The Federal Reserve estimates 131 issuers would take, on average, 30 minutes to comply with the annual notification provision under section 235.4(c); and 30 minutes to comply with the change in status notification provision under section 235.4(d); and estimates the annual reporting burden to be 131 hours. The Reg II recordkeeping and disclosure requirements represent less than 1 percent of the total Federal Reserve System paperwork burden.

Reg II	<i>Number of respondents⁶</i>	<i>Annual frequency</i>	<i>Estimated average hours per response</i>	<i>Estimated annual burden hours</i>
Implement policies and procedures Section 235.4(b)(2) <i>one-time</i>	15	1	160	2,400
Review and update policies and procedures Section 235.4(b)(3)	131	1	40	5,240
Annual notification and change in status Sections 235.4(c) and (d)	131	1	1	<u>131</u>
	<i>Total</i>			7,771

The total cost to the public for this information collection is estimated to be \$402,149.⁷

⁶ Of these respondents, none are small entities as defined by the Small Business Administration (i.e., entities with less than \$550 million in total assets) www.sba.gov/contractingopportunities/officials/size/table/index.html.

⁷ Total cost to the public was estimated using the following formula: percent of staff time, multiplied by annual burden hours, multiplied by hourly rates (30% Office & Administrative Support at \$17, 45% Financial Managers at \$63, 15% Lawyers at \$64, and 10% Chief Executives at \$87). Hourly rates for each occupational group are the (rounded) mean hourly wages from the Bureau of Labor and Statistics (BLS), Occupational Employment and Wages 2014, published March 25, 2015, www.bls.gov/news.release/ocwage.nr0.htm. Occupations are defined using the BLS Occupational Classification System, www.bls.gov/soc/.

Sensitive Questions

These collections of information contain no questions of a sensitive nature, as defined by OMB guidelines (e.g., ethnicity, sexual relationships, etc.).

Estimate of Cost to the Federal Reserve System

The cost to the Federal Reserve System is negligible.