

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

Fraud Prevention (Docket No. R-1404) (RIN 7100-AD63)

Summary

The Board of Governors of the Federal Reserve System (the Board), under delegated authority from the Office of Management and Budget (OMB), is implementing the recordkeeping and reporting requirements associated with Regulation II (Debit Card Interchange Fees and Routing) (Reg II; OMB No. 7100- to be obtained). The Paperwork Reduction Act (PRA) classifies reporting, recordkeeping, or disclosure requirements of a regulation as an “information collection.”¹

On July 20, 2011, the Board published a notice of interim final rulemaking (IFRM) in the *Federal Register* for public comment (76 FR 43478). The Board is adopting an IFRM and requesting comment on provisions in Regulation II adopted in accordance with Section 920(a)(5) of the Electronic Fund Transfer Act (EFTA), which governs adjustments to debit interchange transaction fees for fraud-prevention costs.

The information collections associated with the IFRM are located in section 235.4 of Regulation II (12 CFR part 235). The provisions allow an issuer to receive an adjustment of 1 cent to its interchange transaction fee if the issuer develops, implements, and updates policies and procedures reasonably designed to identify and prevent fraudulent electronic debit transactions; monitor the incidence of, reimbursements received for, and losses incurred from fraudulent electronic debit transactions; respond appropriately to suspicious electronic debit transactions so as to limit the fraud losses that may occur and prevent the occurrence of future fraudulent electronic debit transactions; and secure debit card and cardholder data. If an issuer meets these standards and wishes to receive the adjustment, it must certify its eligibility to receive the fraud-prevention adjustment to the payment card networks in which the issuer participates. The comment period expired on September 30, 2011. The IFRM is effective October 1, 2011. The total annual burden for this information collection is estimated to be 76,032 hours for the 380 issuers regulated by the federal financial regulatory agencies required to comply with the recordkeeping and reporting provisions under section 235.4 of Regulation II.²

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

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 Board, 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.

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

U.S.C. § 1693 et seq.) by adding a new section 920 regarding interchange transaction fees and rules for payment card transactions.

Section 920 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 transaction must be reasonable and proportional to the cost incurred by the issuer with respect to the transaction. This section requires the Board to establish reasonable and proportional standards for assessing interchange transaction fees. The Board has separately adopted a final rule implementing standards for assessing whether interchange transaction fees meet the requirements of section 920(a) and establishing rules regarding routing choice and network exclusivity required by section 920(b).

Under EFTA section 920(a)(5), 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 fraud-prevention standards established by the Federal Reserve Board. 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.⁴

In issuing the standards and prescribing regulations for the adjustment, the Board must consider (1) the nature, type, and occurrence of fraud in electronic debit transactions; (2) the extent to which the occurrence of fraud depends on whether the authentication in an electronic debit transaction is based on a signature, personal identification number (PIN), or other means; (3) the available and economical means by which fraud on electronic debit transactions may be reduced; (4) the fraud-prevention and data-security costs expended by each party involved in the electronic debit transactions (including consumers, persons who accept debit cards as a form of payment, financial institutions, retailers, and payment card networks); (5) 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); (6) the extent to which interchange transaction fees have in the past reduced or increased incentives for parties involved in electronic debit transactions to reduce fraud on such transactions; and (7) other such factors as the Federal Reserve Board considers appropriate.

Following the enactment of the Dodd-Frank Act, the Federal Reserve gathered information about fraud-prevention programs in the debit card industry in several ways. The Federal Reserve held numerous meetings with debit card issuers, payment card networks, merchant acquirers, merchants, industry trade associations, and consumer groups to discuss these programs. Topics discussed in those meetings included technological innovation in fraud

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.

prevention, fraud loss allocation among parties to electronic debit transactions, and fraud risk associated with different types of electronic debit transactions (e.g., signature and PIN debit transactions).

In September 2010, the Board surveyed 131 bank holding companies and other financial institutions that, together with affiliates, have assets of \$10 billion or more, and 16 payment card networks. As part of those surveys, the Board gathered information about the nature, type, and occurrence of fraud in electronic debit transactions; the losses due to fraudulent transactions absorbed by parties involved in those transactions; and the fraud-prevention and data-security activities and costs and related research and development costs (herein, collectively, referred to as fraud-prevention activities and costs) incurred by issuers in 2009.⁵ From these surveys, the Board was able to estimate industry-wide fraud losses to all parties of a debit card transaction and to perform a more detailed analysis of fraud losses by type of authentication method (e.g., PIN or signature). The survey data also provided an estimate of the loss allocation among parties to the transaction.⁶

Description of Information Collection

Develop and implement policies and procedures - section 235.4(b)(1)

The information collection in section 235.4(b)(1) requires that in order to be eligible to receive a fraud prevention adjustment, an issuer must develop and implement policies and procedures reasonably designed to (1) identify and prevent fraudulent electronic debit transactions; (2) monitor the incidence of, reimbursements received for, and losses incurred from fraudulent electronic debit transactions; (3) respond appropriately to suspicious electronic debit transactions so as to limit the fraud losses that may occur and prevent the occurrence of future fraudulent electronic debit transactions; and (4) secure debit card and cardholder data.

Procedures may include practices, activities, methods, or technologies that are used to implement and make effective an institution's fraud-prevention policies. Together, these policies and procedures shall be reasonably designed to detect, prevent, and mitigate fraudulent electronic debit transactions and as provided for in section 235.4(b)(1)(i-iv).

⁵ The surveys also requested information regarding the number of cards and accounts, the number and value of debit card transactions processed, interchange revenue received from networks, various costs associated with processing debit card transactions and operating a card program, and exclusivity arrangements and routing procedures.

⁶ The Board reported preliminary survey results in the proposed rule (*See* 75 FR 81740-41, Dec. 28, 2010). Since that time, the Board has further analyzed the data and addressed a number of minor problems, changing the number of usable responses. For example, some issuers provided fraud loss for certain types of fraud but did not report total fraud losses. In those instances, the sum of the reported fraud losses was used as that respondent's total fraud loss. In other instances, issuers misreported total fraud losses in a different field. Those totals were included in subsequent analysis of the data. In addition, prepaid fraud loss and fraud-prevention cost data have been included where appropriate. Therefore, in certain instances, some data reported in the initial proposal have changed. These data are reported separately (*see* "2009 Interchange Revenue, Covered Issuer Cost, and Covered Issuer and Merchant Fraud Loss Related to Debit Card Transactions" published on the Federal Reserve Board's public web-site at www.federalreserve.gov).

Review and update policies and procedures - section 235.4(b)(2)

The information collection in section 235.4(b)(2) requires that an issuer review and update its fraud-prevention policies and procedures as least annually. In certain circumstances, more frequent updates may be necessary if there are significant changes in fraud types, fraud patterns, or fraud-prevention techniques or technologies.

Certification - section 235.4(c)

The information collection in section 235.4(c) requires an issuer to certify to its payment card networks that its fraud-prevention standards comply with the Federal Reserve Board's standards as provided for in section 235.4(b). Issuers that are eligible for the adjustment should certify their compliance annually to each payment card network in which the issuer participates that allows issuers to receive or charge a fraud-prevention adjustment to their interchange transaction fee as permitted under sections 235.3 and 235.4.

Time Schedule for Information Collection and Publication

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

Sensitive Questions

This collection of information contains no questions of a sensitive nature, as defined by OMB guidelines.

Legal Status

The Board's Legal Division has determined that section 1075 of the Dodd Frank Act (Public Law 111-203, 124 Stat. 1376 (2010)) authorizes the Federal Reserve to require these recordkeeping and reporting requirements. The obligation of covered issuers to respond to this information collection is required to obtain or retain benefits. Since the Federal Reserve does not collect any information no issue of confidentiality should arise.

Consultation Outside the Agency

On July 20, 2011, the Board published an IFRM in the *Federal Register* for public comment (76 FR 43478). The comment period for this notice expired on September 30, 2011.

Estimate of Respondent Burden

The total annual burden for Reg II is estimated to be 76,032 hours.⁷ The Federal Reserve estimates that the 380 issuers would take, on average, 160 hours (one month) to develop and implement policies and train staff to comply with the recordkeeping provisions under section

⁷ The estimated total annual burden hours published in the ~~interim final rulemaking~~ IFRM was understated by 3,000 hours due a transposition error and will be corrected during the Federal Reserve's final submission to OMB.

235.4. This one-time PRA burden is estimated to be 60,800 hours. On a continuing basis, the Federal Reserve estimates issuers would take, on average, 40 hours (one business week) annually to review its fraud prevention policies and procedures, updating them as necessary, and estimates the annual PRA burden to be 15,200 hours. The Board estimates 380 issuers would take, on average, 5 minutes to comply with the annual certification reporting provision under section 235.4(c) and estimates the annual reporting burden to be 32 hours. The Reg II recordkeeping and reporting requirements represent less than 1 percent of the total Federal Reserve System paperwork burden.

Fraud Prevention	<i>Estimated number of respondents⁸</i>	<i>Estimated annual frequency</i>	<i>Estimated average time per response</i>	<i>Estimated annual burden hours</i>
Implement policies & procedures (section 235.4(b)(1)) (<i>one-time</i>)	380	1	160 hours	60,800
Review and update policies and procedures (section 235.4(b)(2))	380	1	40 hours	15,200
Certification (section 235.4(c))	380	1	5 mins	<u>32</u>
<i>Total</i>				76,032

The total cost to the public for this information collection is estimated to be \$3,299,789.⁹

Estimate of Cost to the Federal Reserve System

The cost to the Federal Reserve System is negligible.

⁸ Of these respondents, it is estimated that none would be small entities as defined by the Small Business Administration (i.e., entities with less than \$175 million in total assets) www.sba.gov/contractingopportunities/officials/size/table/index.html.

⁹ Total cost to the public was estimated using the following formula: percent of staff time, multiplied by annual burden hours, multiplied by hourly rate (30% Office & Administrative Support @ \$16, 45% Financial Managers @ \$50, 15% Legal Counsel @ \$54, and 10% Chief Executives @ \$80). Hourly rate for each occupational group are the median hourly wages (rounded up) from the Bureau of Labor and Statistics (BLS), Occupational Employment and Wages 2010, www.bls.gov/news.release/ocwage.nr0.htm. Occupations are defined using the BLS Occupational Classification System, www.bls.gov/soc/.