HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/HB 677 Interchange Fees on Taxes
SPONSOR(S): Insurance & Banking Subcommittee, Caruso
TIED BILLS: **IDEN./SIM. BILLS:** SB 564

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Insurance & Banking Subcommittee	12 Y, 4 N, As CS	Sellas	Lloyd
2) Commerce Committee			

SUMMARY ANALYSIS

Electronic payments through either a debit card or credit card involve many parties to authorize, settle, and fund the transaction between customer and merchant. A merchant will pay part of the transaction proceeds to the facilitating parties of this electronic transaction. This amount is known as a merchant discount fee, and typically amounts to 1-3% of the total transaction amount. The largest portion of the merchant discount fee is the interchange fee which is a fee charged by an issuing bank to the merchant bank. The interchange fee allows for card benefits to the cardholder but also reflects the risk of nonpayment from a cardholder as issuing banks will send out payments to merchant banks before the cardholder pays the issuing bank.

The bill prohibits the charge of interchange fees on the tax portion of an electronic payment transaction that is derived from certain state and local taxes. This prohibition applies to debit cards, credit cards, and any other payment devices approved through a payment card network. A payment card network can comply with this prohibition by deducting the tax portion of a transaction before calculating the interchange fee or the payment card network can rebate the merchant for the portion of the interchange fee attributable to the tax portion of the transaction.

The bill provides for a $1,000 civil penalty per each violation in addition to refunding the surcharge to the merchant.

The bill has an indeterminate negative impact on state expenditures and no impact on state revenues and local government. It also has indeterminate negative impacts on the private sector.

The bill has an effective date of October 1, 2023

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Background

The Florida Office of Financial Regulation (OFR) is responsible for all activities of the Financial Services Commission relating to the regulation of banks, credit unions, other financial institutions, finance companies, and the securities industry.[1] The OFR has three divisions: the Division of Consumer Finance, the Division of Financial Institutions, and the Division of Securities. The OFR also has a Bureau of Financial Investigations, which functions as a criminal justice agency and has a separate budget.[2]

Florida law defines the term "financial institution" as "a state or federal savings or thrift association, bank, savings bank, trust company, international bank agency, international banking corporation, international branch, international representative office, international administrative office, international trust entity, international trust company representative office, qualified limited service affiliate, credit union, or an agreement corporation operating pursuant to s. 25 of the Federal Reserve Act, 12 U.S.C. s. 601 et seq. or Edge Act corporation organized pursuant to s. 25(a) of the Federal Reserve Act, 12 U.S.C. ss. 611 et seq."[3]

Financial institutions may be either state or federally chartered. OFR's Division of Financial Institutions provides general supervision over all state financial institutions, their subsidiaries, and service corporations,[4] and is charged with the administration of the financial institutions codes, which apply to all state-authorized or state-chartered financial institutions and to the enforcement of all laws relating to state-authorized or state-chartered financial institutions.[5] The specific chapters under the financial institutions codes, which govern state-chartered financial institutions, are:

- Chapter 655, F.S. – Financial Institutions Generally
- Chapter 657, F.S. – Credit Unions
- Chapter 658, F.S. – Banks and Trust Companies
- Chapter 660, F.S. – Trust Business
- Chapter 662, F.S. – Family Trust Companies
- Chapter 663, F.S. – International Banking
- Chapter 665, F.S. – Capital Stock Associations
- Chapter 667, F.S. – Savings Banks

As of June 30, 2020, the Division of Financial Institutions regulates 197 financial institutions:[6]

- 69 banks
- 66 credit unions
- 21 international bank offices
- 15 trust companies
- 16 family trust companies
- 10 qualified limited service affiliates

Chapter 655, F.S., governs financial institutions generally. Pursuant to section 655.001(1), F.S., one of the stated purposes of the financial institutions codes is to provide general regulatory powers to be exercised by the Financial Services Commission and the OFR in relation to the regulation of financial institutions. Other purposes include providing for and promoting the safe and sound conduct of the

[1] S. 20.121(3)(a)2., F.S.
[2] *Id*.
[3] S. 655.005(1)(i), F.S.
[4] S. 655.012(1), F.S.
[5] Ss. 655.001(1) and 655.012(1), F.S.
[6] Office of Financial Regulation, *Fast Facts* (2021 ed.), https://flofr.gov/sitePages/documents/FastFacts.pdf.

business of state financial institutions, the prudent conservation of their assets, the maintenance of public confidence therein, and the protection of the interests of their depositors and creditors.[7]

Electronic Payment Transactions and Interchange Fees

Even the smallest credit or debit card transactions involve a host of parties that facilitate the exchange between the merchant and customer.

These parties include the cardholder, merchant, merchant bank, payment processors, issuing banks, and card associations.[8] In a typical transaction, a cardholder will purchase a good or service from a merchant through the use of a credit or debit card. At this time the merchant will send a payment authorization request to the merchant's payment processor who in turn submits the transaction to the correct card association.[9] The card association will then send this authorization request to the issuing bank where the transaction will either be approved or denied.[10] The issuing bank's response will then be sent back to the card association which sends the information to the merchant bank who send the information to the merchant.[11]

The parties:
- The cardholder is the buyer in the transaction and has a line of credit or a checking account with an issuing bank.
- The merchant is the seller in the transaction and in choosing to accept debit card and credit card purchases will partner with a payment processor.
- A payment processor sends payment information to the customer's card association.
- A card association acts as an intermediary between the issuing bank (customer's bank) and the merchant bank as they relay both payment information to the issuing bank and the issuing bank's response to the merchant bank.
- The issuing bank receives purchase information from the card association and either approves or denies the transaction. It will inform the card association of its determination. Upon determination from the issuing bank for a transaction the card association will inform the merchant bank.
- The merchant bank is the bank of the merchant and will inform the merchant of the issuing bank's determination.[12]

A credit card transaction is made up of three processes, the authorization process, the settlement process, and the funding process.[13] The authorization process happens near instantaneously and results in either approval or denial.[14] The authorization process reflects the issuing bank's approval or denial of a transaction which is then relayed through the card association's payment network to the merchant, as described above.

The settlement and funding process reflect the movement of funds from the issuing bank to the merchant.[15] Here, the merchant will send authorized transactions to their payment processor who sends this information to the card association, who in turn sends this information to the issuing bank.[16] The issuing bank then charges the cardholder for the amount of the transaction.[17] At this time the

[7] *See* s. 655.001(2)(a)-(e), F.S.
[8] FIS Global, *How Credit Card Processing Works*, https://www.fisglobal.com/en/insights/merchant-solutions-worldpay/article/how-credit-card-processing-works (last visited Mar. 7, 2023).
[9] *Id.*
[10] *Id.*
[11] *Id.*
[12] *Id.*
[13] *Id.*
[14] This process plays out in full when a debit or credit card is either accepted or rejected at a payment terminal.
[15] FIS Global, *How Credit Card Processing Works*, https://www.fisglobal.com/en/insights/merchant-solutions-worldpay/article/how-credit-card-processing-works (last visited Mar. 7, 2023).
[16] *Id.*
[17] *Id.*

issuing bank transfers the transaction amount to the merchant bank, minus the interchange fee.[18] Finally, the merchant bank deposits the transaction amount (minus interchange fees and other service fees) into the merchant's account.[19]

In a debit or credit card transaction, a merchant will pay a portion of their sales to the various parties that facilitate the use of the card. This payment is known as a merchant discount fee and is made of three parts; the interchange fee, the acquirer fee, and the network processing fee.[20] The:

- Interchange fee is paid to the issuing bank of the card in the transaction,
- Acquirer fee is paid to the merchant's bank, and
- Network processing fee is paid to the card association.[21]

The interchange fee is charged against the merchant bank by the issuing bank, but the merchant bank will typically pass this cost onto the merchant.[22] The default interchange fee amount is set by the card association,[23] but issuing and merchant banks can negotiate rates that differ from the default amount.[24] The interchange fee is typically a percentage of the underlying transaction amount, a flat fee, or a combination of both.[25] Typically, interchange fees will vary from 1-3% of the total transaction amount.[26] Interchange fees cover the cost and risks that issuing banks face in facilitating the transaction as well as funding the issuing bank's reward programs accessible to cardholders.[27]

In 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act. An amendment to this act, the Durbin Amendment, was adopted which mandated the Federal Reserve Board of Governors ("The Board") to reduce debit card interchange fees.[28] Following this mandate the Board issued Regulation II (Debit Card Interchange Fees and Routing) which established a cap on the debit card interchange fees a financial institution with more than $10 billion in assets can charge a merchant bank.[29] Regulation II limited the debit card interchange fee for these financial institutions to a base fee of $0.21, per transaction, to cover the issuer's processing cost, 0.05% of the transaction cost to cover fraud losses, as well as a $0.01, per transaction, to cover fraud loss.[30] On average, this regulation cut the debit card interchange fee rate in half.[31]

While the Durbin Amendment reduced the interchange fee rate it is unclear what the magnitude of this effect had on reducing interchange cost for merchants.[32] An unintended effect of this bill was that small value transactions, that had been charged a reduce rate in order to incentivize debit card adoption amongst merchants, now had their rates raised to the maximum allowed amount as the revenue generated on large value transactions, that made up for the loss on the small value reduced

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[18] *Id.*
[19] *Id.*
[20] Electronic Payments Coalition, *Overview of Interchange and its Value*, https://electronicpaymentscoalition.org/resources/overview-of-interchange-and-its-value/ (last visited Mar. 7, 2023).
[21] *Id.*
[22] Testimony from Sarah Bloom Raskin, Governor, Board of Governors of the Federal Reserve System, Testimony regarding Interchange fees from Feb. 17, 2011, https://www.federalreserve.gov/newsevents/testimony/raskin20110217a.htm (last visited Mar. 7, 2023).
[23] *Id.*
[24] Electronic Payments Coalition, *Overview of Interchange and its Value*, https://electronicpaymentscoalition.org/resources/overview-of-interchange-and-its-value/ (last visited Mar. 7, 2023).
[25] Julia Kagan, *Interchange Rate: Definition, calculation Factors, Examples*, https://www.investopedia.com/terms/i/interchange-rate.asp#:~:text=Interchange%20rates%20are%20set%20by%20credit%20card%20companies%20such%20as,might%20set%20their%20rates%20annually. (last visited Mar. 7, 2023).
[26] *Id.*
[27] Payment Depot, *A Practical Guide to Understanding Interchange Fees*, https://paymentdepot.com/blog/interchange-fees/ (last visited Mar. 7, 2023).
[28] Renee Haltom and Zhu Wang, *Did the Durbin Amendment Reduce Merchant Costs? Evidence from Survey Results*, Federal Reserve Bank of Richmond, Dec. 2015, at 1.
[29] *Id.*
[30] *Id.* at 2.
[31] *Id.*
[32] *Id.*

interchange rate, were now impossible to reach due to this lower maximum limit.[33] This led to interchange fee cost increasing for merchants with small value transactions such as the fast food and delivery service industry.[34] Speaking for merchants generally, it is unclear whether the Durbin Amendment reduced debit card interchange fee costs on merchants in more than just a limited manner.[35]

Effect of the Bill

The bill provides a definition of electronic payment transactions which includes payments made by credit card, debit card, or other payment code or device.

The bill prohibits payment card networks from charging interchange fees on taxes and fees levied under s. 125.0104 and Chapter 212, F.S.[36]

The payment card network must deduct the applicable tax from the calculation of the interchange fee or rebate the amount attributable to the applicable tax. The deduction or rebate must occur at the time of the settlement when the merchant submits the relevant tax information at the time of sale. If the merchant is unable to transmit the relevant tax information at the time of sale, the bill provides a merchant 180 days after the time of sale to submit proof of tax amounts to the payment card network for the rebate. The payment card network must rebate the amount of interchange fee attributable to the applicable tax to the merchant or credit the merchant's settlement account within 30 days of the merchant submitting the proof of tax amount.

The bill creates a civil penalty of up to $1,000, per violation, for violations of the bill's requirements. In addition, the payment card network must refund the surcharge to the merchant.

The bill provides an effective date of October 1, 2023.

B. SECTION DIRECTORY:

Section 1: Creates s. 655.969, F.S., relating to interchange fees on taxes prohibited.

Section 2: Provides an effective date of October 1, 2023.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   None.

2. Expenditures:

   The bill has an indeterminate, negative fiscal impact on OFR for implementation of the bill's requirements. OFR does not currently regulate some participants in the transactions affected by the bill and may need resources to accomplish enforcement.[37]

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   None.

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[33] *Id.*
[34] *Id.* at 3.
[35] *Id.* at 2.
[36] Chapter 212, F.S., establishes the tax on sales, use, and other transactions, while s. 125.0104, F.S., establishes the tourist development tax.
[37] Florida Office of Insurance Regulation, Agency Analysis of HB 677, p, 4 (Feb. 21, 2023).

2. Expenditures:

   None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill may require the implementation of new point of sale hardware and software and transaction processing software by the various participants in the transaction process to implement the bills requirements.

D. FISCAL COMMENTS:

State and local government, when making purchases using credit or debit cards will be impacted in the same fashion as the general public.

While the OFR is tasked with enforcing the bill's requirements, it is unclear whether the agency currently possesses the resources to carry out this enforcement and whether the OFR currently has sufficient administrative contact with the parties this bill seeks to regulate. Specifically, OFR does not currently regulate card networks directly. OFR may need additional resources to implement the bill.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

   Not Applicable. This bill does not appear to affect county of municipal governments.

2. Other:

   None.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

Payment card networks do not meet the definition of "financial institution" in section 655.005(1)(i), Fla. Stat, and are not currently regulated by the OFR as such. An appropriation may be necessary to fund this expansion of OFR regulation and oversight.

Subsection (6) of the bill references a surcharge, but it is not clear what the surcharge represents. An amendment could clarify what constitutes the surcharge that would be refunded to the merchant upon a violation of this bill's requirements

IV. AMENDMENTS/COMMITTEE SUBSTITUTE CHANGES

On March 14, 2023, the Insurance & Banking Subcommittee considered the bill, adopted an amendment, and reported the bill favorably as a committee substitute. The amendment:

- Replaced the term "debit card or credit card transaction" with "electronic payment transaction".
- Clarified which tax types are subject to the bill's provisions. Accordingly, an interchange fee could not be charged on state sales tax and local tourist development tax, rather than state sales tax and any county tax under ch. 125, F.S.
- Established that if the merchant is unable to transmit tax amounts at the time of sale, the merchant has 180 days to submit proof of tax amounts to the payment card network to access a rebate for the interchange fees on taxes.

- Clarified that the rebate or credit must be settled within 30 days of the payment card network receiving proof of the tax amount when it is not captured at the point of sale.
- Changed the effective date from July 1, 2023, to October 1, 2023.

This analysis is drafted to the bill passed by the Insurance & Banking Subcommittee.