Decoupled Debit's Promise

BY ERIC GROVER

>> *Eric Grover* is a principal at Intrepid Ventures, which provides corporate development and strategy consulting in the payments space. He can be reached at *Eric.Grover@IntrepidVentures.com* <<

The U.S. debit card market is markedly less competitive than the credit card market. But nascent debit card issuance decoupled from demand deposit accounts is potentially a game-changer, offering a path by which debit-market competition could emulate that of the credit card market. Hints we may be on the brink of such a transformation are emerging.

For a competitive decoupled debit card market to flourish, foremost it needs issuers with compelling consumer-value propositions for which interchange is vital. Without the DDA, issuers earn no float and have less opportunity to assess fees.

Though European debit card competition is also trifling, robust DDA-free debit card issuance is more likely to emerge in the United States because of higher interchange and more bank-independent payment networks.

A world in which any bank and a variety of nonbanks compete for debit relationships tied to any DDA would be a boon for consumers. And debit-issuer competition and, consequently, stronger consumer-value propositions would spur electronic payments growth.

Much as they have done in the credit-card realm, retailers can bring innovation to debit. Nordstrom's decoupled debit card offers rewards and resonates with some customers. HSBC offers hybrid retail card programs with decoupled debit and credit.

Mobile-phone operators bring a different perspective and value to the payments arena. Bundling prepaid cards to their payment products leverages MasterCard's and Visa's global retail and ATM acceptance. They also could issue debit products directly to their subscribers and use the automated clearinghouse networks to reach DDAs.

E-commerce payments pioneer PayPal's decoupled debit MasterCard offers 1% cash back, which is attractive for debit. Amazon and Google operate decoupled payment products, though both pay interchange because consumers use payment cards to move funds to their e-wallets.

Capital One Financial Corp. has piloted decoupled debit cards with several retailers and is still tinkering. With its eminently successful monoline credit card-issuer legacy and modest debit share, it should have the wherewithal and motivation to cultivate decoupled debit.

Issuers alone, however, are not sufficient. Decoupled debit needs networks to access DDAs and for retail acceptance. The MasterCard, Visa and ACH networks provide DDA access. Though it has minimal retail acceptance and less-than-robust risk-management and exception-processing systems, ACH provides an adequate and inexpensive, if imperfect, means to clear debit transactions.

Using existing card-payment networks to debit accounts for other issuers' transactions and their own would improve product and risk-management integrity. But a Bank of America Corp. or a Wells Fargo & Co., understandably, would be loath to permit competitors a level playing field courting their customers' debit card business.

Issuing debit cards without DDA control exposes issuers to insufficient-funds risks. At the Chicago Federal Reserve Bank's June payments conference, Two Sparrows Consulting LLC's Paul Tomasofsky cited early gross decoupled debit loss estimates of 21 cents per $100 in volume. Of that, issuers recovered 16 cents and collected 10 cents in penalty fees, netting 5 cents. While premature to draw definitive conclusions, this suggests the increased credit and fraud risk is manageable.

Debit untethered by the DDA strengthens retail card-payment networks' value propositions. Networks with smaller debit share, such as MasterCard and Discover, have more to gain than Visa from increasing and broadening the field of debit-issuer competition.

A decoupled-debit market's transformative effect is that it would systematically increase and enhance issuer competition and innovation. Would it displace most traditionally issued bank debit cards? No. But it would not have to transform the market. Banks controlling the DDA no longer could take debit card customers, attendant fees and interchange for granted but instead would have to compete and innovate to hold them. **CP**