

# EFT Connect

April 2008

## DEBIT CARD INTERCHANGE REVENUE OPPORTUNITIES

By Michael J. Kelly

**T**he VISA IPO on March 19th raised \$19.65 billion, making it the largest initial public offering in U.S. history. MasterCard® stock has risen five-fold since it went public in May of 2006. These performances are startling for a number of reasons, not the least of which is the current shape of our economy – we are a mess, basically. The continuing sub-prime mortgage fiasco, the federal government intervening to save Bear Stearns from collapse and talk of \$4.00 a gallon gas prices this summer are recent concerns that few have previously witnessed.

It is nearly impossible to turn on the TV or read the newspaper without finding new information about the havoc being wrought on our economy. If the sky really is falling, how then did VISA® manage to do so well on its IPO, why is MasterCard's growth continuing at such a pace and why should credit unions be paying close attention to these developments?

### IT'S IN THE TRANSACTIONS

The short answer is that both VISA and MasterCard's business models are based on facilitating electronic transactions and people are doing more electronic transactions than ever. In a study recently published by the Fed, credit and debit cards accounted for more than two thirds of the 93.3 billion non-cash transactions in the U.S. last year (Wall Street Journal, 11 Dec 2007, B16). Growth in this



sector is expected to continue as consumers find more ways to transact without using cash or checks.

Both VISA and MasterCard are no doubt doing all they can to drive this trend and are well suited to capitalize on each new development. They are also shielded from downturns in the economic cycle because whether gas is \$2.00 or \$4.00, people want to pay with plastic. If the transaction is debit or credit, chances are that one of these two companies will handle the transaction. VISA, for instance, collects switch fees from the issuer and the acquirer for each transaction. Multiply the switch fee times the amount of transactions and it isn't hard to understand why their IPO was the country's largest in history.

## CAN CREDIT UNIONS JOIN IN ON THE FUN?

VISA and MasterCard earn switch fees for handling transactions and the generated revenue is unquestionably incredible. A credit union executive would be justified to say “I know, I pay those switch fees!” There is good news for credit unions, however. Credit unions that issue debit cards earn interchange on debit transactions and on a per transaction basis, interchange far outweighs the switch fees earned by VISA or MasterCard. A typical switch fee earned by VISA might be anywhere from \$.09 to \$.15 for a signature debit transaction. A credit union’s interchange income on a signature debit transaction is on average more than \$.50 per transaction! What credit unions need to embrace is the fact that our economy is rapidly evolving to be electronic transaction-based; that fact can no longer be ignored. Credit unions need to be in the game for both financial and member service reasons.

The first step in debit issuance is to have the member take the debit card. If they want an ATM-only card or no card, the credit union must educate its staff with messages to overcome this obstacle. The high performance issuers have percentages in the 90% range of DDAs linked to debit cards. Credit unions can then take the new account opening process to a higher level by focusing on educating members about how to use their new debit card. This time, dedication to education can also help the credit union strengthen its relationship with the member. During this time, it is paramount that the member understands the capability of the card and be provided with examples of potential use as illustration. The message can be as simple as “pay the utility bill, go buy lunch and a latte, and put dinner and a tank of gas on the card.” Simple messages like these can bolster activation and usage.

Educating members to use a debit card is an enormous revenue opportunity for the credit union. As financial institutions begin to devote more staff and member education regarding card usage, there is always concern that the time could be spent on other cross-selling. That concern must be weighed against the benefit of having the member use the credit union branded piece of plastic each day. Do members visit a branch each day? Probably not, but they might do at least one transaction a day. Cards have become more than an account access device; they are now a relationship tool and an extension of the credit union. These cards are representative of the credit union, in both how the card looks and how the card works. The goal is to have the credit

union’s debit card to be top of mind and top of wallet. The day of payments through the mobile device is no longer so far away and if credit unions want to compete in that space, they better get organized soon. If a credit union is not able to have its membership transact with them today, why should we think they will compete in the mobile space in the next five years?

## THE REVENUE OPPORTUNITY

The revenue opportunity in debit is big. Debit should be a revenue center for credit unions, so whether a member uses their P.I.N. or a Pen to sign for authorization, the credit union can be paid interchange by the merchant. The interchange schedules are wide-ranging in terms of fee calculations, but a good approximation is to state that P.I.N. debit earns from \$.15 to \$.25 per transaction and signature debit (using a pen to sign as authorization for the transaction) can earn more than \$.50 per transaction. These numbers are enticing to say the least, but these numbers have also been available to the credit unions for a few years now which begs the question, why haven’t more credit unions capitalized on the opportunity to take part in the transaction ecosystem? There are too many credit unions with only a fraction of its membership using debit cards. A credit union must know how many members it has, how many of those members have a debit card, how many debit card-holders use the card and how often. Understanding these crucial metrics is the first step toward building a solid foundation for a payments portfolio.

## DECOUPLED DEBIT

In January’s EFT Connect newsletter, you read about decoupled debit. The scary thing about decoupled debit is that the day can be envisioned where debit cards are issued just like credit cards are today. It used to be that in order to get a credit card, the credit union had to issue one to the member. That isn’t the case today, in fact many credit unions sold their credit portfolios and do not have a direct offering for members today. The decoupled debit product might facilitate the same structure in that now a member needn’t worry about changing her DDA share-draft but can still take advantage of using a debit card to earn rewards. If the credit union is not also the rewards provider for the member, what is to stop her from using an alternate payment provider?

## CHOOSING GOOD BUSINESS PARTNERS

There are various reasons that credit unions, and banks for that matter, have struggled to make

sense of the revenue opportunity. The schedules are complicated. There are audit requirements that overshadow growth opportunities, burdens on staff time and some immediate barriers to good performance. Whatever the reasons, the fact is that the pace of the industry is quickening and as VISA and MasterCard report to "The Street" each quarter, the pressure will ramp up more than ever to provide new and compelling ways for consumers to transact through their respective systems. The burden on credit unions is only getting bigger, so a credit union will do well to pick good business partners that can help them gain traction in the current market and so that they can thrive in the future.

There are efficiencies to be gained in the number of relationships a credit union maintains. Streamlining the back office is a good idea and an option because credit unions no longer need to be affiliated with four or five different ATM/POS networks – the industry has changed and consolidated and now the top five networks can basically provide a full transaction set and coverage for member access at foreign ATMs and at merchants. The industry has also evolved in that many of the EFT processors are also ATM/POS networks. The consolidation has made it so that a credit union can "one stop shop" if it chose to do so and get EFT processing and network (ATM/POS & debit) from the same company.

### **CAN CREDIT UNIONS RESPOND?**

It will be interesting to observe the developments in the credit union industry over the coming months and years. Can credit unions increase transactions and grow revenue? Will they keep decouplers at bay and maybe even go on the offensive and offer decoupled debit products themselves? Will they be ready for mobile payments when they finally arrive?

The credit unions that are organized and driving growth toward their profit centers today have the best chance for tomorrow. If a credit union does not already know how many of its members have a card, how many of its members use a card and how often they use it, chances are high that this type of credit union will struggle mightily as the industry continues to evolve. Credit unions must pick good business partners, know the important metrics that indicate the health of the payments portfolio and be able to offer its members compelling reasons to take advantage of its products and services.



## **Upcoming EFT Council Meeting**

**May 7, 2008**

10:00 a.m. – 1:30 p.m. EST  
Commerce Club  
34 Broad Street NW  
Atlanta, Georgia 30305

### **Topics Include:**

**Economic Update** – Steve Rick, CUNA

**Easy Saver (Debit Card Round Up Program for Savings)**

– Tim Mislansky, Wright Patt Credit Union

**Payday Lending Alternative Services** – Tim Mislansky,  
Wright Patt Credit Union

## **Upcoming Plastic Card Fraud Working Group Meeting**

Please plan to arrive at 9:30 a.m. in order to take the shuttle bus from the parking lot to the building and to go through security.

**June 19, 2008**

10:00 a.m. – 12:00 noon EST  
The Coca-Cola Family Credit Union  
1 Coca-Cola Plaza  
Atlanta, Georgia 30313

*Don't forget to use the EFT Council ListServ to report any fraud trends that your credit union is seeing. The EFT Council ListServ address is [Eftcouncil@doig.cuna.org](mailto:Eftcouncil@doig.cuna.org)*

*Please include the Merchant ID (or Card Acceptor ID), state or country, and MCC.*

### **CONTACT INFORMATION**

Michael Kelly is the founder and current President of ePayments Consulting Group. He can be reached via email at [mkelly@epcgonline.com](mailto:mkelly@epcgonline.com)