Debit Card Interchange

The impact of debit interchange regulation and what financial services institutions can do to support a positive outcome

People matter, results count.

Contents

1 Highlights

In 2010, the U.S. Congress passed the Dodd-Frank Wall Street and Consumer Protection Act, a sweeping change to financial regulation in the United States. The Durbin amendment, part of the Dodd-Frank Act, allows the Federal Reserve board to implement a comprehensive system of debit card interchange. The amendment establishes standards for an interchange fee[1], and prohibits issuers and networks from restricting the number of networks over which an electronic debit transaction may be processed.

Several countries have experienced similar reform, with Australia being the first country to implement regulatory changes related to the debit card interchange fee. The impact of these regulatory reforms in Australia has been positive, with the Reserve Bank of Australia concluding that merchants' lower costs are flowing through as lower prices for consumers. There has also been a stronger growth in new debit accounts since the reforms[2]. Canada, New Zealand, and the European Union have also taken similar actions relating to interchange fees over the last few years.

Similarly, the debit card interchange reforms in the U. S. are likely to have both a direct and indirect impact on the economy. Issuers are the most affected by the regulation, and estimates point to a loss of up to $12 billion in annual revenues as the debit interchange revenue is expected to experience an average drop of $0.44 to $0.24[3] per transaction. Consequences for consumers, though uncertain for now, may range from lower prices for debit card-based purchases (a positive) to higher fees for other banking products as a means to offset the losses (a negative). Networks might also see a drop in their revenues as they restructure their fees to compete with the new unrestricted network policy.

Banks should take a holistic approach to address the new debit card regulation with the following main priorities:

- Overhaul overall payment systems
- Increase flexibility to support changing regulations
- Enhance the predictive analytics capabilities needed to assess the impact of the regulations in diverse situations, such as a lower debit card fee in an era of increasing debit card usage coupled with decreasing credit card usage

Banks together with network players should look to improve their relationships with customers, networks, and regulators in order to craft a mutually agreeable path forward.

[1] Interchange fee is the fee paid by the retailer's bank (acquiring bank) to the cardholder's bank (issuing bank) for acceptance of the card transaction

[2] Federal Reserve System Docket No. R-1404v, "Review of the Impact of Australian Payments Reforms," TransAction Resources (February 2011)

[3] The average is $0.24, based on a basic transaction fee of $0.21 plus an extra fraud fee on an average transaction of $38 or more

2 Overview of the U.S. Debit Card Interchange Regulation

> The Durbin amendment establishes standards for determining whether an interchange fee, received or charged by an issuer with respect to a debit card transaction, is reasonable and proportional to the issuer's cost.
>
> **Federal Reserve**[4]

2.1. Durbin Amendment of the Dodd-Frank Act

In July 2010, the U.S. Congress passed the Durbin amendment as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act. According to the Federal Reserve, "The Durbin amendment establishes standards for determining whether an interchange fee, received or charged by an issuer with respect to a debit card transaction, is reasonable and proportional to the issuer's cost.[4]" As established in an update on June 29, 2011, debit interchange revenue for regulated card issuers will likely decline by 52%, from an average of $0.44 per transaction, to at most, $0.21[5] per transaction plus five basis points multiplied by the value of the transaction and an additional one cent fraud-prevention adjustment under the interim rule starting October 1, 2011.

Exhibit 1: Durbin Amendment Timeline[6]

July 21, 2010

- The Senate passes the Dodd-Frank Act, which includes the Durbin amendment

October 12, 2010

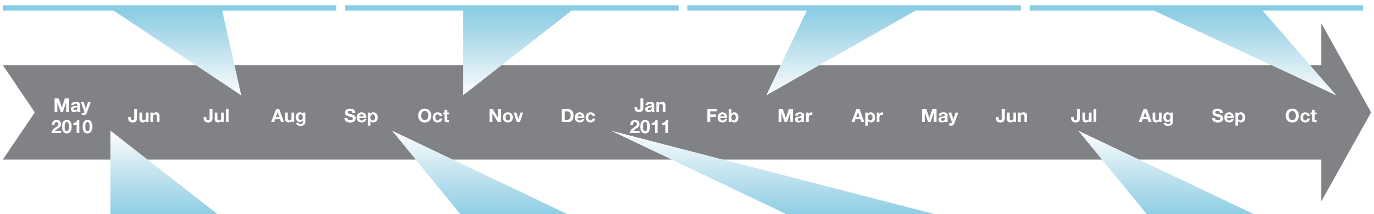
- TCF National Bank ("TCF"), a subsidy of TCF Financial Corporation, announced it is filing a lawsuit challenging the constitutionality of the Durbin Amendment

February 22, 2011

- A coalition of every major FSIs (U.S. bank and credit union trade association) urges the Federal Reserve in a letter to fundamentally revise its proposed rule on debit card interchange fees

October 1, 2011

- All interchange fee rules/ regulations prescribed by Durbin go into effect



May 13, 2010

- Durbin Amendment approved by the Senate

September 13, 2010

- The Fed issued surveys to networks, issuers, and merchant acquirers requesting debit-related information and data, to help draft the final rules

December 16, 2010

- Fed taskforce issues draft rules on the Durbin Amendment (proposes two alternatives) which are approved by Fed voting members and open for public commentary

June 29, 2011

- Final rules and interim rule (comments accepted till September 30, 11) released;
- All affected parties have three months to implement and comply with law and regulations

Source: Capgemini Analysis, 2011
Highlights from the Durbin Debate: A Timeline Perspective, PYMNTS.com, http://pymnts.com/Highlights-from-the-Durbin-Debate-A-Timeline-Retrospective/

[4] Federal Reserve System 12 CFR Part 235 Debit Card Interchange Fees and Routing, December, 2010

[5] Updated to $0.21 from $0.12, in a recent ruling from the US Fed - June 29th 2011

[6] The effective date for the network exclusivity prohibition is April 1, 2012 for issuers and October 1, 2011 for payment card networks. Issuers of certain health-related and other benefit cards and general-use prepaid cards have a delayed effective date of April 1, 2013 or later in certain circumstances

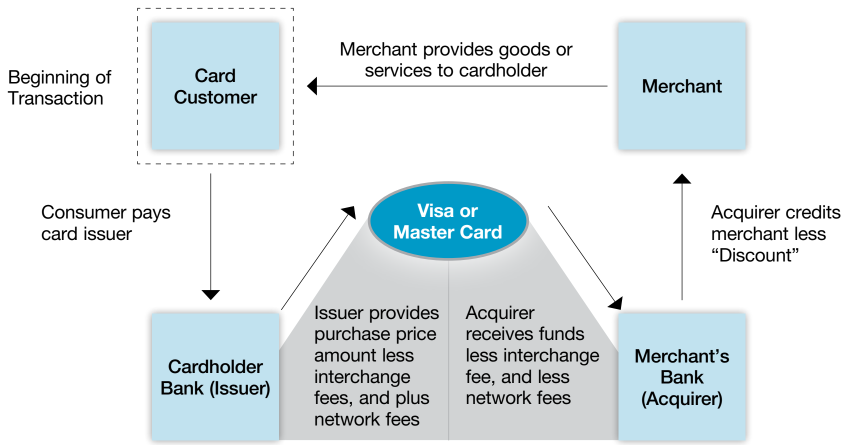
The Federal Reserve stated, "The Durbin amendment also prohibits issuers and networks from restricting the number of networks over which a debit card transaction may be routed, and from inhibiting the ability of a merchant to direct the routing of a debit card transaction.[4]" All debit cards must participate in at least two unaffiliated debit card networks—one network for signature debit and a different, unaffiliated network for PIN debit.

The original plan by the Federal Reserve was to implement the interchange fee rule of the Durbin amendment by July 1, 2011, but due to intensive debate and legal hurdles from other parties, the Federal Reserve made revisions to the initially planned drop in the interchange fee. On October 1, 2011, all interchange fee rules and regulations prescribed by the Durbin amendment went into effect.

2.2. Interchange Fee in a Debit Card Transaction

An interchange fee is the fee charged by the customer's bank to the merchant's bank for the acceptance of the card transaction. Interchange fees comprise the major component of acquirers' marginal costs for processing transactions and accounts for most of the fees paid by merchants to acquirers. As the banks collectively control the setting of interchange fees, there is an agreement among banks to establish both a minimum merchant fee and a commission paid to card-issuing banks, which affects both merchants and consumers.

Exhibit 2: Flow of Funds in a Debit Card Transaction[7]



[7] Capgemini Analysis, 2011
Alan S. Frankel & Allan L. Shampine, "The Economic Effects of Interchange Fees," 73 Antitrust Law Journal No. 3 (2006)

If cardholders and merchants—the major stakeholders in a card interchange transaction—obtained their card services from a single financial institution, there is no reason for any interchange fee. A three-party card scheme, such as those offered by American Express or Diners Club, has similar arrangements.

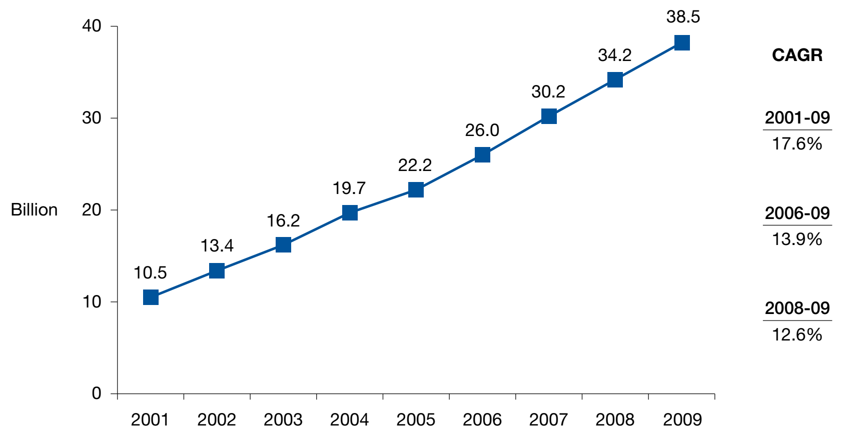
2.3. Debit Card Usage in the United States

Debit card usage recorded a double digit growth rate during the last decade. After the 2008 financial crisis, debit card usage continued to grow rapidly. With consumers moving away from credit cards to debit cards, especially in mature markets with elevated levels of household indebtedness, debit card usage is expected to grow even more in the coming decade.

In 2006, debit cards overtook checks to become to most used non-cash payment mode in the United States.

Source: The 2010 Federal Reserve Payments Study, Noncash Payment Trends in the United States: 2006 – 2009

Exhibit 3: United States Debit Card Usage (billion), 2001–2009



Source: Capgemini Analysis, 2011
Bank for International Settlements Redbook, 2010

For merchants, debit cards are an efficient method of receiving payment because they offer assured and immediate payment. Debit cards help reduce fraud costs associated with checks and enable merchants to provide e-commerce and telephone sales. They also reduce the risk of unsecured lending to the issuer as they are directly linked to a customer's account balance.

For customers, debit cards help control spending and provide a shorter payment cycle than other payment modes. These advantages for both consumers and merchants make debit card transactions superior to other non-cash payment transaction modes.

2.4. Drivers for U.S. Debit Interchange Regulation

High Interchange Fee for Merchants

Merchants have been regularly complaining to the government about the high interchange fees charged by issuers. In fact, stores such as 7-Eleven in the U.S. have lobbied aggressively on this issue.

Consumer Protection

The primary responsibility of most regulatory bodies is to ensure consumers are not being misled or manipulated, while supporting a fair and transparent marketplace. Regulators set the eligibility standards for market participants when identifying consumer protections. Since the current interchange fee calculation was not transparent and a lower interchange fee was expected to lead to lower prices for consumers, the U.S. government pressed for a lower interchange fee.

Oligopolistic Market

The payment card market in the U.S. is dominated by a few players—mainly Visa® and MasterCard®—who have established strong relationships with banks. The government has decided external intervention is required to establish a fair standard for debit interchange prices.

Debit Card Usage

Debit card usage grew at a CAGR of around 13% in the last decade and the current trend indicates the high growth will likely continue in the coming years. The U.S. government feels that a lower interchange fee will help promote debit card usage further compared to other payment products, thereby increasing the overall efficiency of the payment process across the country.

Multiple Interchange Pricing

PIN debit networks started with a fixed per transaction interchange fees, but in the early 2000s PIN debit networks added a variable component to the interchange fee with a limit on the total amount. Signature debit networks operated similar to credit card networks charging both a fixed component and a variable component, without any cap on the total amount charged.

Before 2003, the signature debit interchange fee was higher than the PIN debit interchange fee. With an increasing PIN debit fee in the early 2000s and declining signature debit at the same time, the difference between the two charges was reduced. Also, banks and card schemes used various strategies to drive more volume toward signature debit, such as disguising the fact that a consumer was using a debit rather than a credit card or only awarding cardholder points for signature transactions. These practices were overturned with the Wal-Mart settlement in April 2003[8].

[8] MasterCard Wins Ruling Against Visa on Debit Fee by Associated Press, June 9, 2007, New York Times, http://www.nytimes.com/2007/06/09/business/09card.html

2.5. Viewpoints and Estimated Impact for Key Stakeholders

Government and Regulators

The government wants to lower the interchange fee with the goal that merchants will pass on lower interchange fees to consumers in the form of lower prices. Under the final rule, the interchange fee is limited to:

- $0.21 per transaction, plus
- five basis points multiplied by the value of the transaction, plus
- $0.01 fraud-prevention adjustment.

Press

The financial media have mixed reactions on the benefits of a reduced interchange fee for consumers and merchants. Some agree that it will help lower consumer prices, while others recognize that the decreased profits will force banks to stop offering loyalty programs and other incentives to cardholders.

Merchants

Merchants have indicated that the interchange fee was too high and persuaded the Federal Reserve to ensure that debit card interchange fees are reasonable and proportional.

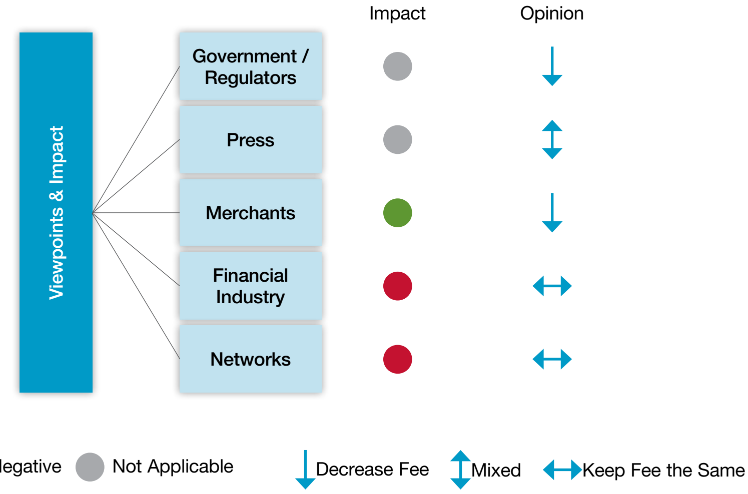
Financial Industry Stakeholders

Banks have indicated that the interchange fee was reasonable and government interference will hamper innovations in the payment industry.

Networks

Networks fear the new debit interchange fee rules creates unintended consequences for the industry and consumers.

Exhibit 4: Debit Card Interchange Fee Regulation Viewpoints and Opinion



Source: Capgemini Analysis, 2011

3 Debit and Credit Interchange Interventions around the World

The U.S. is not alone in attempting to address the problem of interchange fees. Other countries have taken the following actions:

- Regulating and improving relationships within the payment industry among merchants, issuers, and card networks
- Establishing a limit on interchange fees or average interchange fees
- Investigating the functioning of the payment card market

In 2003, Australia was the first country to intervene in the debit card interchange fee through its payment reforms plan. Subsequently Canada, the European Union, and New Zealand investigated the fee charged or limited the fee.

3.1. Australia

In Australia, debit card interchange fee reforms were implemented in November 2006. Before the reforms were implemented, average debit interchange fees were around 20 cents per transaction. New EFTPOS[9] interchange fees of 4.5 cents were introduced in November 2006, based on mutual negotiations.

These debit interchange reforms had a largely positive impact on consumers and the Australian payment industry. Debit card usage has grown faster than credit card usage since the reforms were introduced. According to the Reserve Bank of Australia, consumers were able to get lower prices for their purchases as merchants passed on the lower costs. The implementation of the new reforms led to strong growth in debit accounts. Also, despite issuers not receiving any interchange income from debit cards, they have not attempted to generate additional income from cardholder fees[10].

3.2. Canada

In September, 2008, the Canadian Federation of Independent Business launched a nationwide campaign to prevent Visa and MasterCard companies from adding debit cards to their product portfolio. In Canada, the debit-card system is managed by a not-for-profit national network called the Interac Association. Associated members pay a low, flat fee per transaction. The Canadian Federation of Independent Business claimed that the credit-card companies would alter the fee structure to a fee based on the value per transaction, similar to the way merchants are charged for credit-card transactions.

---

[9] EFTPOS is the Australian domestic PIN debit card system

[10] Federal Reserve System Docket No. R-1404v, "Review of the Impact of Australian Payments Reforms," TransAction Resources (February 2011)

In March 2009, the Competition Bureau of Canada investigated whether Visa and MasterCard abused their dominant position in the Canadian marketplace and whether they were involved in anti-competitive practices. In June, 2009, the Canadian Senate's Committee on Banking, Trade, and Commerce released a detailed report based on its research on the Canadian debit card market. The report recommended reforming the swipe fee process. It concluded that these reforms were necessary to improve transparency and enhance cooperation between merchants and Visa and MasterCard member banks. While the report suggested more supervision and responsibility by the Canadian government over the interchange system, to date no legislative action has been taken.

3.3. European Union

In December 2007, the European Commission ruled that MasterCard's cross-border interchange fee was anti-competitive for the entire system.

In April 2009, the commission, forced MasterCard to reduce the multilateral interchange fees for cross-border card payment rates, as well as increase transparency and efficiency in the card market.

3.4. New Zealand

In November, 2006, New Zealand's Commerce Commission ruled that the interchange fee rules breached the restrictive trade practices provisions of the Commerce Act.

In August, 2009, Visa and MasterCard each agreed to improve interchange process transparency and increase access to information for both consumers and retailers.

4 Implications for Stakeholders

Changes to the U.S. debit card interchange fee impact the entire payment landscape including consumers, merchants, issuers, networks, and potentially the whole economy. While it is not yet clear whether consumers will benefit from a reduced interchange fee, evidence from other markets such as Australia has shown it is possible. What is clear is any increase in the fee structure of other banking products and services will have a negative effect.

Similarly, while merchants seek to benefit from a lower interchange fee in the short term, any changes in consumer buying patterns that impact sales will likely result in a long term revenue decrease for merchants.

Card issuers are the most hit by the regulation and may lose up to $12 billion in annual revenues. If issuers force networks to share their losses, then networks will also feel the impact. Networks are likely to plan new fee structures to fend off competition since under the new rules issuers must enable two unaffiliated networks for debit transactions.

Exhibit 5: Summary of Potential Implications of Lower Interchange Fee and Impact on Stakeholders

Impact Area	Consumers	Merchants	Issuers	Networks	Economy
Lower Consumer Prices	● Very High (Positive)	◕ High (Positive)	○ Negligible (Uncertain)	○ Negligible (Uncertain)	◑ Medium (Positive)
Increase in Other Fees and Lower Benefits	● Very High (Negative)	◕ High (Negative)	○ Negligible (Uncertain)	○ Negligible (Uncertain)	◑ Medium (Negative)
Change in Consumer Preferences	○ Negligible (Uncertain)	● Very High (Negative)	○ Negligible (Uncertain)	○ Negligible (Uncertain)	○ Negligible (Uncertain)
Hampering Payment Innovation	◕ High (Negative)	◕ High (Negative)	● Very High (Negative)	● Very High (Negative)	● Very High (Negative)
Increasing Cash/Checks Usage	◔ Low (Negative)	◑ Medium (Negative)	◕ High (Negative)	● Very High (Negative)	◕ High (Negative)
Lower Fraud Innovation Budgets	◑ Medium (Negative)	◕ High (Negative)	● Very High (Negative)	● Very High (Negative)	● Very High (Negative)
Lower Interchange Revenues	○ Negligible (Uncertain)	○ Negligible (Uncertain)	● Very High (Negative)	○ Negligible (Uncertain)	○ Negligible (Uncertain)
Increasing Use of Debit Cards	◑ Medium (Positive)	◑ Medium (Positive)	● Very High (Positive)	● Very High (Positive)	◑ Medium (Positive)

Impact Severity

Direction of Impact: Positive, Negative, Uncertain

Level of Impact: ○ Negligible, ◔ Low, ◑ Medium, ◕ High, ● Very High

Source: Capgemini Analysis, 2011

Finally, any increase in the usage of inefficient payment modes or lower contributions from the issuers to federal programs will likely impact the overall economy.

4.1. Implications for Issuers

Revenue Loss

Issuers may lose up to $12 billion[11] due to reduced debit interchange fees. To compensate, banks may increase the cost of other financial services to consumers.

Unlikely Adherence to a Two-Tier Structure

The new interchange fee is applicable for financial services institutions with more than $10 billion in total assets, which creates a two-tiered market structure. It is unlikely that large banks—which are essential to achieving the economies of scale necessary to support a nationwide network—would support a system that gives an advantage to their competition. Instead, large banks will probably focus on services with higher profitability than debit cards. Smaller banks will find it harder to compete with larger, fee-regulated banks to provide other services effectively.

4.2. Implications for Merchants

Change in Consumer Preferences

With lower revenues from debit cards, banks might promote other payment modes. Less debit usage will likely have a negative impact on e-commerce and telephone sales using debit cards and reduce the average sales. Any changes in consumer preferences might lead to lower overall sales volumes, which would impact the bottom-line for merchants. Also, some banks are planning to put a cap on debit transactions—potentially a maximum of $100—to drive consumers away from debit cards towards credit and other means of generating higher levels of interchange[12].

Increased Use of Cash and Check Payments

If consumers lower their debit card usage, merchants will lose the efficiencies provided by electronic payments versus cash or check payments. Cash and check handling increases labor and maintenance costs for merchants. Also, merchants may be exposed to the higher fraud risks associated with checks.

4.3. Implications for Customers

Lower Prices

The new amendment allows merchants to offer lower prices to consumers who pay using cards issued by large banks with pre-defined rates. If merchants decide to pass on the benefit of a lower interchange fee to consumers, these same consumers might be able to enjoy lower prices for their purchases.

---

[11] Oliver Wyman, "*The US debit market and the Durbin Amendment: Worse than the worst-case scenario*," The Durbin Amendment: Impact Analysis, Mercator Advisory Group, December 2010

[12] Aparajita Saha-Bubna, Corrie Driebusch, and David Benoit, "Banks May Cap Debit Purchases to Combat New Rules", Wall Street Journal (http://online.wsj.com/article/SB10001424052748704399804576193320313890728.html)

Higher Other Fees and Lower Fringe Benefits

The decline in a bank's interchange fee income would likely lead to an increase in other fees, such as account or transaction fees charged to checking account holders. For consumers, these new fees could increase their financial burden and reduce their use of debit cards or even checking accounts. These fees could also lead to increases in consumer banking fees along with drop in payment rewards programs and other free offerings. Banks may also reduce or eliminate loyalty programs on debit cards to lower debit card usage.

4.4. Implications for Networks

Slowed Innovation

The modern payments industry is experiencing key development and innovation in product features and security. Networks forced to operate under a par pricing model where prices are determined by external stakeholders will face a difficult challenge in the ability to create innovative products.

Decreased Profits

If banks force the networks to share the losses from a reduced interchange fee, network providers will lose profits. Since issuers must enable two unaffiliated networks for debit transactions, networks may plan new fee structures to fend off competition.

Lower Budgets for Fraud Prevention

Lower profits from card operations could reduce research and development budgets and may lead to lower fraud-prevention budget allocation which is detrimental to the long term success of any payment medium.

4.5. Implications for the Economy

Higher Use of Cash and Checks

The benefits that debit cards offer merchants and consumers far outweigh the benefits of using checks and cash. Any increase in cash or check usage will decrease the overall efficiency of the U.S. economy.

Unintended Consequences

The whole electronic payments market works like a unified economy and operates on inter-related production, delivery, and utilization activities. Altering any element will affect all other elements, since it is unlikely that the impact is restricted to a few individual stakeholders.

5 Recommendations for Financial Services Institutions

Financial services institutions must take a holistic view of the interchange fee effect and work collaboratively with all payments stakeholders to address the changing regulations. We recommend financial firms look across four areas:

- **Political:** Maintain open dialogue with regulators
- **Economic:** Transform debit card business; re-examine the entire payment product portfolio; modernize payment operations; and renew network strategy
- **Social:** Continue merchant dialogue; manage interbank relationships; improve customer perceptions towards the bank through efficient service; and change approach towards payment value added services
- **Technological:** Effectively manage payment portfolio with predictive analysis; update payment systems; consolidate application and data centers; implement dynamic pricing and revenue management; and enhance risk management

5.1. Political

Maintain Open Dialogue with Regulators

With the growing wave of regulatory measures to protect consumers, it is time for banks to make the costs they incur to provide improved, safe, convenient, and effective payment services to consumers more transparent to the external world, including customers, regulators, and other stakeholders. In this way, regulators will have a better idea of the impact of proposed regulations and will likely consult banks before going ahead with the implementation. Bankers, through effective negotiations with regulators and other stakeholders, should suggest innovative solutions to develop an efficient, effective, and secure payments system and should seek unbiased ways to share the overall costs and benefits.

5.2. Economic

Transform Debit Card Business

With lower interchange fee, there will be reduced revenues from every debit card transaction to the banks. This makes it critical for banks to achieve higher operational efficiencies across the cards value chain (IT, resources, and partners) which lead to higher cost savings. Banks should also consider whether the current debit card promotional reward programs need to be removed to reduce usage of a product with lower contributing margins to its profits. Finally, with both signature and PIN debit cards coming under the fee cap structure, banks need to assess which product has a lower cost structure and try to promote those cards. They can go with the following options going forward to compensate the loss in revenues:

- **Monthly and annual fees.** Banks can charge a monthly or annual fee for usage of the debit card. Banks can minimize the impact on customers by employing various strategies. For example, banks may charge the fees then waive them based on the number and/or dollar amount of transactions during the fee period, thus encouraging the customer to use card more frequently.

- **Transaction fees.** Banks can charge a percentage of the transaction amount as a transaction fee. Banks also can set up monthly and annual ceiling limits for the transaction fees.
- **Rewards fees.** Due to reduction in interchange fee income, it will become more difficult for the banks to continue with free debit cards rewards programs. Banks may offer customers debit rewards programs by charging periodic rewards fees. These fees could be of two types—rewards enrolment fees and/or redemption fees.
- **Issuance of prepaid cards.** As Durbin amendment regulations exclude prepaid debit, banks may have to look at the strategy of issuing prepaid debit cards. Only prerequisite for this is to have a checking account that can be linked to prepaid debit card for loading the money. All other features remain unchanged.

Re-examine the Payment Product Portfolio

In the current market situation where usage of debit cards will lead to lower contributions to the banks, they might be forced to remove all the perks like free checking accounts and other associated lower fees. Banks might have to re-examine their entire payment product portfolio including debit and credit cards, checks, mobile and e-payments to identify, develop, and promote products that have higher contribution margins.

Modernize Payments Operations

The U.S. banking industry has so far lagged behind other industries in implementing lean, agile or integrated supply chain management in their processes and systems. While it is not an easy task to replicate such concepts in banking, banks should leverage past experiences and try piloting in smaller scale before going for a complete overhaul of operations. Implementing such systems and processes will likely help in automation of labor-intensive parts of payment processing and reduce manual rework and error. These streamlining initiatives help banks to lower costs while simultaneously enabling them to offer faster, safe, convenient, and efficient services to customers.

Renew Network Strategy

Since the Durbin Amendment mandates issuers to enable at least two unaffiliated payment card networks on every card, banks need to evaluate new potential network partners based on fee structure adjustments proposed by the networks. Banks need to sign new partners and work closely with networks and acquirers to develop better interchange pricing policies.

5.3. Social

Continue Merchant Dialogue

Though merchants have largely benefited from both the plastic and electronic money mediums developed by banks and networks, there might be many instances where merchants do not fully understand the benefits they derived from an improved payment medium. It is the responsibility of the banks and card companies to include merchants as true partners in the payment dialogue and make the economics of payment acceptance clear and understandable. Any new payment medium that a bank plans to introduce needs active support from merchants to be successful. Mutually beneficial solutions can be implemented that will create higher value and benefits for the merchant and the bank. This is more important due to the fact that the merchants have already started to reap huge benefits of reduced interchange fees[13]. Banks can pursue them to share part of these benefits with them as with the consumers.

Manage Interbank Relationships

Smaller banks that primarily depended on debit-card driven business models need to rethink their agent relationship with other larger banks to work on promoting products with higher margins.

Improving Customer Perception towards the Bank

Banks needs to work towards improving its customer service levels. This should start with proper employee training and communications, followed by monitoring through scorecards and KPIs, and finally rewards and recognition to motivate everyone to improve their performance levels. Employees should be able to project an unbiased view towards helping customers chose the right products, both from an individual and the bank's perspective. These practices instill customer loyalty and strengthen the bank's public image.

5.4. Technological

Effectively Manage Payment Portfolio with Predictive Analytics

With the convergence of increasing debit card usage, decreasing credit card usage, and lower interchange fees, banks need to be in a position to accurately predict the overall impact of lower revenue from their debit card portfolio and try to find ways to compensate through other payment modes. Additionally banks need a comprehensive view of their current payments product portfolio to identity, invest and develop new products that increase profitability. Payment analytics (business intelligence) solutions can help generate the insights necessary for the banks to monitor currents products and services across the business lines.

---

[13] *Merchants, not consumers, start to see the Durbin Amendment Savings*, Rita, Uplend, October 7, 2011, CreditNewsline.com (http://creditnewsline.com/news/merchants-not-consumers-start-to-see-durbin-amendment-savings/)

Update Payment Systems
With constant innovation, changing regulations, uncertain financial conditions, and increasing competition, banks need flexible payment architectures which can respond swiftly to the changing market conditions and quickly position the bank to take advantage of the challenges posed by the new market requirements. Most banks have payment architectures designed using payment silos which do not suit the modern needs. Banks can choose between various modern options like payment services hubs, enterprise payments infrastructure, or cloud architecture to update and deal with the current market conditions.

Consolidate Application and Data Centers
Many large banks are currently leveraging a very high number of applications across their payments products portfolio. Most of these applications share a common value chain of validation, authorization, routing, clearing and settlement. By application and data center consolidation, banks can simplify their payments environment, significantly reduce costs, respond quickly to changes, improve service levels and enhance application performance.

Implement Dynamic Pricing and Revenue Management
With effective business intelligence and analytics tools, banks can implement dynamic pricing and revenue management that enables banks to provide a relationship-based pricing to every customer. Banks can treat each customer uniquely, based on the overall relationship value (risk, revenue, and profitability), with innovative pricing and product strategies targeted to each customer, achieved through streamlining and automating the payments functions across the enterprise.

Enhance Risk Management
As the use of non-cash payment instruments grows, so does concern about the potential for fraud. Banks are pursuing various innovations to tackle fraud and better secure non-cash transactions—and thereby shore up consumer confidence in such payment means. Banks need to examine faster, enterprise-quality approaches to payment risk management through which they centralize their fraud prevention functions. This will help in reducing fraud and overall costs involved. Additionally, it may be the right time for the U.S. to decide on the deployment of Europay, MasterCard®, VISA® chip standard technology to fight counterfeiting and fraud from lost or stolen cards. Large merchants are clamoring for this as a way to reduce their exposure to charge-backs, reduce their investments in PCI compliance, and reduce the effects of lower interchange fees[14].

[14] Patrick Gauthier, "Is EMV Right for the U.S. Market?," Lydian Journal, May 2011, (http://pymnts.com/is-emv-right-for-the-u-s-market/)

6 Conclusion

The Durbin Amendment on interchange fees in the U.S. will have substantial and comprehensive consequences for all retail banks. Banks will lose a major source of traditional revenue and need to seriously analyze and consider how retail banking services are priced to consumers so that the drop in debit revenue does not affect their profitability. Debit card operations will need to be re-structured to comply with the new network participation requirements and also to increase efficiency and effectively support the new interchange pricing requirements.

All retail banks will be affected by this regulation. Banks need to act now to prepare for the realignment necessary in their services and operations.

References

1. Federal Reserve System 12 CFR Part 235 Debit Card Interchange Fees and Routing, December, 2010

2. *The Durbin Amendment: Impact Analysis*, Mercator Advisory Group, June, 2010

3. U.S. Federal Reserve. *The Evolution of Interchange Fees*, January 25, 2010, State Capitol, Room 444, Sacramento, California

4. *Swipe Fee Reform. International Lessons*, unfaircreditcardfees.com

5. *The Consequences of Debit Interchange Price Fixing*, The Financial Services Roundtable, February, 2011

6. Kansas City Federal Reserve

7. *Growing pains: Outlook for US Payment Industry*, Mckinsey & Company

8. *Assessing and addressing the implications of new financial regulations for the US banking industry*, Mckinsey & Company, March 2011

9. Arscott-Mills, T., Cope, R., Gonzalez, N., Stewart, D. (2011). U.S. *payments trends: Enduring a turbulent passage. McKinsey on Payments*

10. Kristin R. Moyer, Christophe Uzureau, Alistair Newton, *Transformation Needed Regardless of the Fate of U.S. Debit Card Interchange*, Gartner, January 2011

11. *Global Payments: Top 10 Technology Initiatives for 2011*, Tower Group

www.capgemini.com/payments

About the Authors

Chakravarthy Singampalli is a Senior Consultant in Capgemini's Strategic Analysis Group within the Global Financial Services Market Intelligence team. He has total experience of six years in the Banking and Capital Markets industry with expertise in retail banking and payments.

Girish Apte is a Technical Architect in Capgemini's Cards Practice Group within the Global Financial Services Market Intelligence team. He has more than 12 years of experience in the Cards domain.

Neeraja Edulakanti is an SME in Capgemini's Cards Practice Group within the Global Financial Services Market Intelligence team. She has more than 11 years of experience in the Cards domain.

The authors would like to thank **Kripashankar Rajappa**, **Prasanth Perumparambil**, **Deborah Baxley**, **William Sullivan**, **David Wilson**, and **Chirag Thakral** for their overall leadership of this publication.

For more information, visit **www.capgemini.com/payments** or e-mail **payments@capgemini.com.**

About Capgemini and the Collaborative Business Experience

Capgemini, one of the world's foremost providers of consulting, technology and outsourcing services, enables its clients to transform and perform through technologies.

Capgemini provides its clients with insights and capabilities that boost their freedom to achieve superior results through a unique way of working, the Collaborative Business Experience™.

The Group relies on its global delivery model called Rightshore®, which aims to get the right balance of the best talent from multiple locations, working as one team to create and deliver the optimum solution for clients.

Present in 40 countries, Capgemini reported 2010 global revenues of EUR 8.7 billion and employs around 112,000 people worldwide.

Capgemini's Global Financial Services Business Unit brings deep industry experience, innovative service offerings and next generation global delivery to serve the financial services industry.

With a network of 21,000 professionals serving over 900 clients worldwide, Capgemini collaborates with leading banks, insurers and capital market companies to deliver business and IT solutions and thought leadership which create tangible value.

For more information please visit **www.capgemini.com/financialservices**