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Is It Time to Reevaluate Debit Cards?

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Is It Time to Reevaluate Debit Cards?

Another major card compromise this month contributed to the endless list of merchants and processors that have exposed personal card and identification information. When do we get to the tipping point where issuing and supporting cards is no longer profitable?

Given the consumer affinity for card-based transactions, disdain for carrying cash and the very real concern of account safety and security, is there an alternative? Maybe, but it may take us back a few decades and it is not check-related.

Consumers understand the impacts of the exposure of their personal information, as they are greeted routinely with letters and replacement cards in their mailboxes. The churn of card replacement seems to be accelerating. To illustrate how commonplace replacements are now, the following actual example is not uncommon. A single customer has had a personal debit card, Health Savings Account debit card and an "Improved Security Features" chip and signature credit card compromised and replaced within the span of four months. Add to that, one issuance to this same customer by a significant U.S. Bank of a chip-enabled credit card that was quickly replaced due to a required change in chip technology. You can understand the consumers' concern. Even though consumers can be exercising caution about using their cards on-line, the cards continue to be used at retail organizations that have fallen prey to hackers. Consumers are victims of inconvenience in these account take-over 'events'. It is most often the bank and credit card issuers on the other hand who have been the victim of actual fraud and fraud prevention loss costs.

As organizations wrestle with card re-issuance to include EMV (cards with a computer chip), the costs of EMV card replacement in the face of continuing card compromises and replacements must factor

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into the decision. If you add the cost of RFI (radio frequency) to the EMV card, the factor of increase from the existing magnetic stripe card to an EMV enabled RFI card almost looks exponential. And the costs of card replacements will also look exponential. There should be no expectation that card compromises and card replacement will stop or even slow down in the near future. Merchants are not projected to fully adopt EMV for several years and they will still continue to swipe the magstripe. And this includes swiping the magstripe on the newly issued, high cost EMV card, as the cards are dual purpose, and will remain so for at least several years. Card fraud is not about to stop as result of EMV card issuance. There is also dire prediction that card-not-present fraud will increase, which likely will continue to fuel card replacement.

While explosive and unpredictable costs weigh heavy on the debit card, another important potential financial impact may be the reinterpretation of card-attributable overdraft fees becoming Reg Z governed, as is being predicted by several banking strategists. The Consumer Financial Protection Bureau has put forth Reg Z governance for overdrafts on prepaid (reloadable and payroll) cards for comment, and many believe this is the direction they will take with overdrafts attributable to card-based transactions on deposit accounts somewhere in the future. Because signature debit-card transactions are processed in two steps, authorization and settlement, these transactions often factor more predominantly into account overdrafts.

The following factors are stacked against debit cards:

- Historic reductions of debit card interchange
- Merchant direction of consumers to lower cost transactions (pinned POS usage)
- Explosion in losses due to fraud
- Cost of fraud prevention
- Costs of card replacement (now and projected with EMV or EMV/RFI)
- Likely continued erosion to overdraft fee income

There was a time when debit cards were only issued to select customers because of the transaction risk. The alternative to the debit card was the ATM card. The strategy has long since been eclipsed when the income opportunity from debit card transactions at their infancy of adoption fueled putting a debit card in every customer's hands, with incentive to sign for every transaction. But might it be time to consider going backwards in time, away from a card association branded debit card to an ATM/POS only card? It might surprise you to know that some organizations still offer them and some customers are requesting them. The rationale behind an inquiry with such a savvy customer (who is an industry participant) is that he rarely, if ever has been prevented from performing a debit transaction at the point of sale (POS), and he recognizes the added security of always requiring a PIN and avoiding signature-based two-step authorizations and settlements.

So maybe ATM only cards could make a comeback as part of a risk and profit-based strategy for the future. Think of this another way, if you are the executive approving a new product line, could a satisfactory cost/benefit be built to support the debit card given what has evolved as standard operating procedure, the risk, costs and the clouds on the horizon? The case for offering the alternative ATM card is actually rather strong. The next time you are in a store, look at the networks being supported on the terminal. It is far more than just MasterCard and VISA and we would even bet that your financial institution is a member of one or more of the non-card association networks.

If this were an approach to be considered, the reversion in strategy would certainly need to be packaged and sold to the consumer. With an ATM card used for a purchase at a supported Point of Sale (POS) terminal, it is an on-line direct debit to the account at the time of transaction, authorized by a PIN number just the same as having a withdrawal occur at an ATM or typically a withdrawal at the teller line. Organizations would need to validate ubiquitous access to network POS in their market areas and would need to join or participate in a network sharing strategy. While you would need to continue to offer card-association debit cards, since some clients will want to use their card to transact on-line, the alternative of a 'safer' ATM/POS card would appeal to many other consumers that have security concerns. This could also open the door for further stratification of specialized and limited distribution of EMV enabled cards, based upon the underlying product or the customer's relationship value, such as wealth clients.

The benefit for the financial institution could be reductions in signature authorizations, which are exposed to a higher level of risk. Your organization would not need to address the placement of holds for authorizations from a signature-based debit transaction, awaiting the settlement. The cost of future card compromises would be lower, if just for the savings of not moving to chip-enabled cards. Re-inventing the ATM card might be the card strategy that you need to consider as you look at your budgets for late 2015 and beyond. It is certainly worth a discussion.

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