

## What a 'Decoupled' World Might Look Like

American Banker | Tuesday, February 26, 2008

*Decoupled debit cards, which settle transactions through the automated clearing house network, enable issuers to offer cards that access checking accounts at any bank. This arrangement offers the promise, or the threat, of fundamentally remaking the relationship between consumers and banks.*

Capital One Financial Corp. made waves last June when it said it was working on a decoupled debit card, and Tempo Payments Inc., of San Mateo, Calif., is currently testing a decoupled product with HSBC North America Holdings Inc.

As the idea gained ground last year, many banks, especially community banks, said they consider the cards a competitive threat to their debit fee income.

In a wide-ranging conversation with American Banker's technology editor Will Wade, Tempo's chief executive Mike Grossman discusses how decoupled debit will change the debit market, who stands to benefit, and what kinds of financial companies may be most at risk of losing out.

### **How will these cards change the current debit relationship with consumers?**

**MIKE GROSSMAN:** Historically, a debit card and the DDA relationship have been synonymous. Debit cards have been features of bank accounts, nothing more. Now, with decoupled debit, the market has opened up, and there isn't necessarily going to be any relationship between where somebody gets their debit card and where they bank.

That's exactly analogous to what has happened over the past 20 years in the credit card market. If you could go in a time machine back to the 1980s, most people got credit cards from the same bank where their DDA account was held. When credit cards were introduced, it was simply a logical step for banks to offer credit cards as a logical up-sell to their existing checking account customers.

But eventually came the monoline issuers, which opened up the market, so that 20 years later there's typically no relationship between where somebody gets their credit card and where they have their checking account. What's happening in the debit market now is entirely analogous, and the name for it is decoupled debit.

### **With this technology, are banks about to lose one of their stickiest of products?**

**GROSSMAN:** It'll just change the landscape. In some cases, banks will have checking accounts without debit cards — they'll lose the debit relationship.

In other cases, banks will gain a debit relationship without having the checking account, so they'll gain a customer. There will be every permutation, just like with credit cards. And in the process, the losers will be banks, and the winners will be banks.

**What kind of banks might be the most interested in offering this type of card?**

**GROSSMAN:** In general, it's banks that have a more proactive view about customer acquisition. One segment is financial institutions that don't have a huge retail footprint. For them, the opportunity to get new customers using debit is something they have never been able to do before because they needed to have the bank account relationship first — and it's very difficult to get folks to switch their bank account. So that's one segment that has responded particularly well.

Within banks that have a larger retail footprint, there's a spectrum of opinion. Some are more inclined to see this as a big opportunity, and there are some that are more leery about it.

**What kind of banks may lose out?**

**GROSSMAN:** Financial institutions that have always relied on the stickiness of the debit relationship have the potential to lose if they don't approach the issue proactively.

**What kind of banks are you talking to now? Community banks? Regional banks? Top 10 banks? Or all of the above?**

**GROSSMAN:** The most interest has been from relatively larger banks. But to some extent that's a self-fulfilling prophecy. We've spent more time talking to larger banks, so that's probably why we've made more progress with them. It's only been more recently that we've started talking more to smaller banks.

I think decoupled debit is going to have real relevance in the community banking segment. In many communities, there are several community banks, and typically one of them will be more entrepreneurial than the others.

**When will we start seeing a significant number of decoupled debit cards in use?**

**GROSSMAN:** You'll start seeing that in 2008. We will be issuing cobranded cards with a variety of leading retailers in the relatively near term.

But financial institutions move at a measured pace, and they often like to test things before they aggressively roll them out. These things don't happen overnight.

**Can using the ACH network reduce the issuers' costs?**

**GROSSMAN:** The overall cost might be impacted, but the interchange is no different. It's hard to predict what the economic impact of decoupled debit will be because there are different forces at work, which will affect costs.

To promote these cards, you have to be willing to invest in [a] rewards program. Traditionally, debit cards have not had much in the way of rewards. I think that this shift heralds a much more competitive debit market, which could have some effect on costs, but in the long run it's hard to predict what will happen.

**You have said that the main draw for decoupled debit is going to be appealing rewards programs. What exactly does that mean?**

**GROSSMAN:** The typical rewards for our decoupled debit cards are in the half-percent to 1% range in general, and they can be tied to point systems, or they can be provided in the form of cash. The key is finding a reward that people find attractive and that motivates them to sign up for a new debit card.

**This represents a significant shift for consumers, who think that debit cards are part of their bank accounts. How are you planning to educate them?**

**GROSSMAN:** It's true that consumers see debit cards as part of a checking account, but decoupled debit cards function in almost every way like a traditional debit card. You can use it in all the same places, and it takes money out of your bank account.

In our experience, customers have not been confused at all, even less than I expected. We did some market research with decoupled debit users, and the level of satisfaction with their cards was enormously high. Ninety-seven percent of people said they were either very satisfied or somewhat satisfied with their card.

So I don't know if a lot of education will be necessary. They will be marketed by issuers as debit cards with attractive rewards and in some cases tied to a cobrand relationship where the consumer has some sort of affinity for the cobrand partner. All they need to understand is that it works just like a debit card. If the reward is compelling, consumers will pay attention.

**How important are cobranded affinity relationships?**

**GROSSMAN:** I think these cobranded cards are going to be one of our key segments but not the only segment. In some cases financial institutions will market directly to consumers without a cobrand partner. In other cases, a cobrand partner will be involved.

Cobranded debit cards will be successful because a lot of merchants have cobrand credit card programs, but a large percentage of consumers can't qualify for them.

But with decoupled debit, the universe of people who will be accepted is much higher. To be able to offer a debit card option to consumers is a very good fit for a lot of their best shoppers.

In addition, debit card [use] has been growing at a significantly faster clip than credit card [use], and merchants recognize that. The reason is that there's a segment of the population that's motivated to use debit a lot, and historically, their motivation for that has not really been tied to rewards, but it's clear that rewards can influence their behavior.

**Many people have several credit cards, but only one debit card. How will that fact affect issuers' strategies once they start competing for debit customers?**

**GROSSMAN:** People might end up having multiple debit cards, in some cases, cards that are tied to specific merchants. I think that's possible.

In fact, in our experience with the decoupled debit cards that have been issued, customers typically still have a traditional debit card, which shows a willingness for people to have more than one.

But I don't know how much they're using the existing one. I think, in many cases, the decoupled debit card will move to the top of the wallet. The point is that they're motivated to get another debit card.

I can't predict the specific number of cards per person, but it's clearly going to go above  $n=1$ , which has been the definition since debit cards were introduced.

**Are there any increased risks involved?**

**GROSSMAN:** I doubt that fraud is going to be any different with decoupled debit. Just because the issuer is now a different organization than the DDA-holding bank, I don't think is going to increase the risk of fraud.

But there is a type of risk that's specific to decoupled debit: the risk of insufficient funds because the issuer doesn't know the account balance.

That's a new kind of risk that decoupled debit issuers need to be comfortable with.

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