The DeCoupled Debit Card: How risky is it?

Federal Reserve Bank of Chicago
2008 Payments Conference
Payments Fraud: Perception versus Reality
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Agenda

- The Debit Market in the U.S.
- How Decoupled Debit works
- Case Studies
- Risks and Mitigation
About Two Sparrows Consulting

- Independent Boutique Consulting Firm
- Payments Specialists
- Credit Cards, Debit Cards, ACH, Internet Payments
- Chip Cards, Stored Value, Loyalty, Merchant Acquiring, Bill Payment, Electronic Banking
- Project Management
- Training
- Marketing and Business Development
- M&A Services
## The Debit Market in the U.S.

### 2007 U.S. Statistics (in millions)

<table>
<thead>
<tr>
<th>Pinned Debit Cards</th>
<th>Pinned Debit Trans</th>
<th>Signature Debit Cards</th>
<th>Signature Debit Trans</th>
<th>Credit Cards</th>
<th>Credit Cards Trans</th>
</tr>
</thead>
<tbody>
<tr>
<td>85.5</td>
<td>11,667</td>
<td>312.2</td>
<td>16,980</td>
<td>678.1</td>
<td>25,415</td>
</tr>
</tbody>
</table>

Source: ATM & Debit News
Debit Market in the U.S.

- VISA has over 75% market share in US Signature Debit.¹
- 80% of U.S. consumers carry a debit card.²
- Active Debit users do 11 transactions per month.²
- Top 5 Signature Debit FIs account for only 22% of total cards issued.³

Sources: ¹VISA, ²First Data Corporation, ³ATM & Debit News
Decoupled Debit: How it Works

- Cardholder
- Merchant Processor
- Decoupled Debit Issuer
- DDA FI
- Card Brand Rules
- ACH Rules

June 6, 2008
PayPal ATM/Debit Card

- MasterCard branded debit card
- Funded by ACH Debit to Checking account
- Used for both online and physical payments
- Can be used at POS or ATM
- 1% Cash Back on Signature Debit
- Daily limits for ATMs and POS
Capital One Decoupled Debit Card

- MasterCard branded debit card
- Issued by Capital One
- Cardholder need not have DDA at Capital One
- Can be used at POS or ATM (Limits)
- Co-Brand Partner Focus
- Richer Rewards
- Suspension of two current programs
Decoupled debit is part of a broader payments innovation, now called OptiPay

Single card with multiple, selectable payment options

- Decoupled debit, credit, accrued rewards

Card program sponsors configure the program to offer some or all OptiPay components
Challenges

- Decoupled Debit Issuer (DDI) must manage risk
  - DDA balance unknown
  - MasterCard authorization rules apply
  - DDA may be closed or blocked by consumer

- Customer Service
  - Consumer may be confused on what FI to call when a transaction is in doubt

- DDI must offer increased cardholder utility vis a vis DDA FI (richer rewards)
Threats to Traditional Model

- Eliminates need for consumer to use DDA FI’s debit card.
- Introduces a low cost way for DDI to get consumer wallet share; cross sell additional products
- Eliminates DDA FI interchange income
- Could provide an entry for American Express and Discover
- Co-Brand Non-Bank Threat
Key Risk Challenges

- Issuance risk
  - Verification that the applicant owns the checking account

- Transaction Risks
  - NSF risk due to lack of visibility into DDA account balance
  - Customer service processes

- Exception Handling Risks
  - Managing the ACH representment process
Mitigating Risk

- Issuance Risk
  - Tools for assessing Know Your Customer (KYC), anti money-laundering (AML), and NSF/fraud risk

- Transaction Risk
  - 3rd party databases
  - Experience-based data for decision support criteria
  - Transaction Dollar Limits

- Exception Handling
  - Configurable representation processes
The Chinese use two brush strokes to write the word 'crisis.' One brush stroke stands for danger; the other for opportunity. In a crisis, be aware of the danger - but recognize the opportunity.

*John F. Kennedy, Speech in Indianapolis, April 12, 1959*

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*Drive thy business or it will drive thee.*

*Benjamin Franklin*
Questions?

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