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## THE DURBIN AMENDMENT AND THE FUTURE OF DEBIT INTERCHANGE

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CSCU

Policy website: [www.policywebsite.com](http://www.policywebsite.com)

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MICHIGAN CREDIT UNION LEAGUE AND AFFILIATES

## AGENDA

- Industry Overview
- Credit Overview
- Debit Overview
- The Durbin Amendment and Debit Interchange
  - Interchange
  - Network Routing
- What To Do Now
- Summary
- Q & A

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## INDUSTRY OVERVIEW



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## THOUGH SHOWING SIGNS OF IMPROVEMENT, THE ECONOMY REMAINS FRONT PAGE NEWS!

### Good

- Stock Market
- Corporate Earnings
- Productivity
- Interest Rates –  
Homebuyers
- Home Values - Buyer

### Not So Much

- Employment
- Budget Deficits
- Delinquencies, Charge-offs and Foreclosures
- Interest Rates - Lenders
- Home Values - Sellers

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### DOW JONES INCREASES 64%



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### CREDIT UNION INDUSTRY TRENDS

	Dec. 2009	Variance #	Variance %
Total # of CUs	7,710	(276)	(3.5%)
Total Assets	\$896.8B	\$71B	8.5%
Total Members	91.2M	1.3M	1.4%
Total Loans	\$580.5B		1.0%
Real Estate	\$314.4B		1.5%
Autos	\$175.4B		-1.6%
Other	\$90.6B		4.3%
Credit Card	\$35.3B		6.3%
ROA	0.18%		0.2%



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Source: Callahan & Associates 4<sup>th</sup> Quarter Trendwatch

### CU's vs. BANKS: 2009 vs. 2008

	Banks	CU's
Total Loans	-7%	1%
Credit Card Lines	-20%	4%

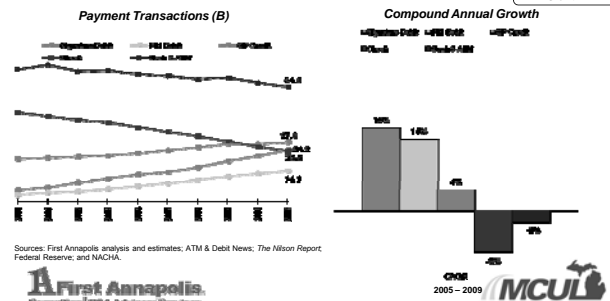
Banks Reduced Lines By \$800B While CU's Set A New High of \$108B.



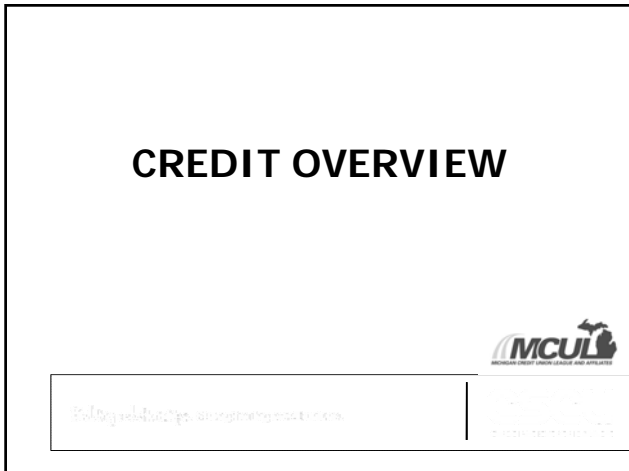
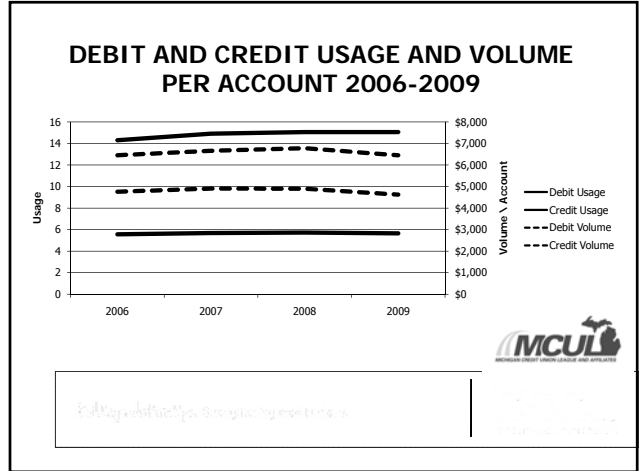
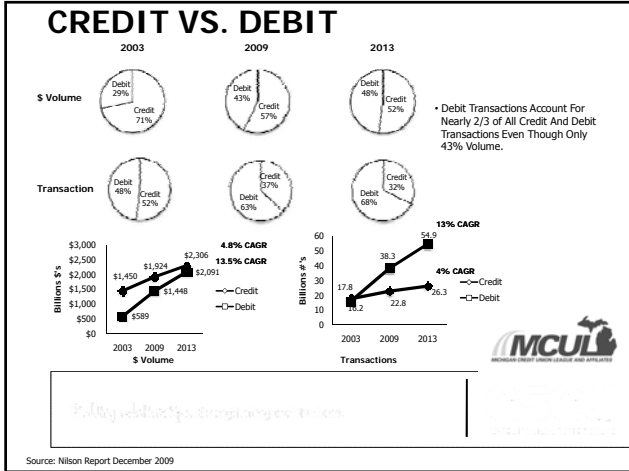
Callahan & Associates, Inc. | 410.426.1111

Source: Callahan & Associates

### Debit Remains The Fastest Growing Payment Form, Primarily At The Expense of Checks And Cash.



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### 2009 VISA/MASTERCARD ISSUER P & L/ROA

	2009	\$ +/- 2008	% +/- 2008
<b>Revenues</b>			
Finance Charge	\$81.66	(\$5.84)	-7%
Interchange	21.72	(2.27)	-9%
Penalty Fees	10.35	2.11	26%
Cash Advance Fees	3.28	(2.50)	-43%
Annual/Other Fees	4.49	(0.01)	-0%
<b>Total Revenue</b>	<b>\$121.50</b>	<b>(\$8.51)</b>	<b>-7%</b>
<b>Expenses</b>			
Cost of Funds	\$13.04	(\$10.00)	-43%
Charge-Offs	72.74	29.53	68%
Ops/Mkt	36.02	0.01	0%
Fraud	0.95	(0.16)	-14%
<b>Total Expense</b>	<b>\$122.75</b>	<b>\$19.38</b>	<b>19%</b>
Pretax Profit	(\$1.25)	(\$27.88)	-105%
Pretax ROA	(0.18%)		

Source: Card & Payments, May 2010

### CREDIT CARD TY/LY COMPARISON

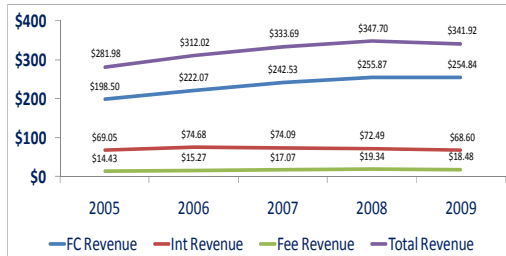
	2009	2008	Variance #	Variance %
Total Volume/Account	\$4,818	\$5,129	(\$311)	(6%)
Usage	5.79	5.89	(0.10)	(2%)
Average Balance	\$3,043	\$2,977	\$66	2%
Average Credit Line	\$6,505	\$6,544	(\$39)	(.6%)
% of Credit Line Used	45.6%	44.5%		1.1%
Finance Charge Revenue	\$262	\$263	(\$1)	(.4%)
Interchange Revenue	\$68	\$72	(\$4)	(6%)
Fee Revenue	\$18	\$19	(\$1)	(5%)
Total Revenue	\$348	\$354	(\$6)	(2%)

Stagnant Economy Reflected in 2009 Performance!



Building relationships for a stronger market.

### CREDIT CARD REVENUE / ACCOUNT



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### PLATINUM CARDS VS. CLASSIC CARDS

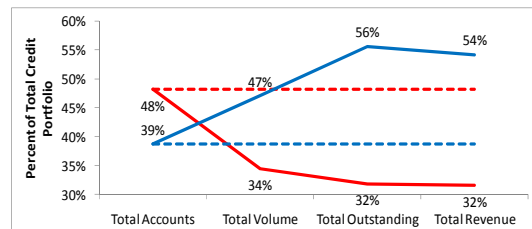
- Platinum Cards Significantly Outperform Classic Cards
  - 70% More Revenue
  - Upgrade As The Normal Reissue Process

	Classic	Platinum	Var.
% Accts w/Finance Charge	64.1%	66.6%	3.9%
% Accts Active	59.5%	63.8%	7.2%
Usage	4.70	6.00	27.7%
Avg. Credit Line	\$ 3,753	\$ 8,045	114.4%
Avg. Outstanding	\$ 1,816	\$ 3,679	102.6%
Total Volume/Acct.	\$ 3,371	\$ 5,345	58.6%
Total Revenue/Acct.	\$ 247	\$ 419	69.8%

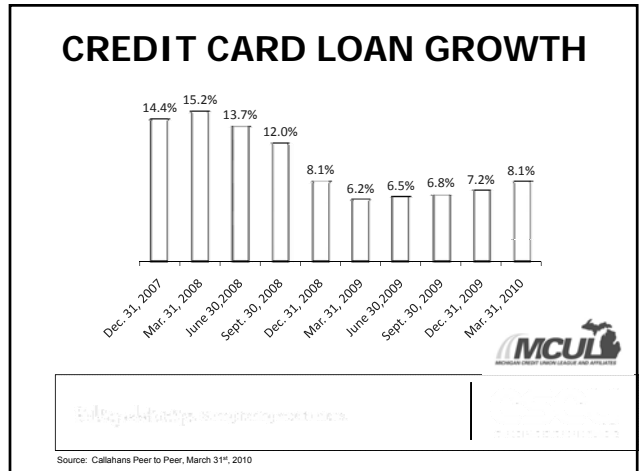
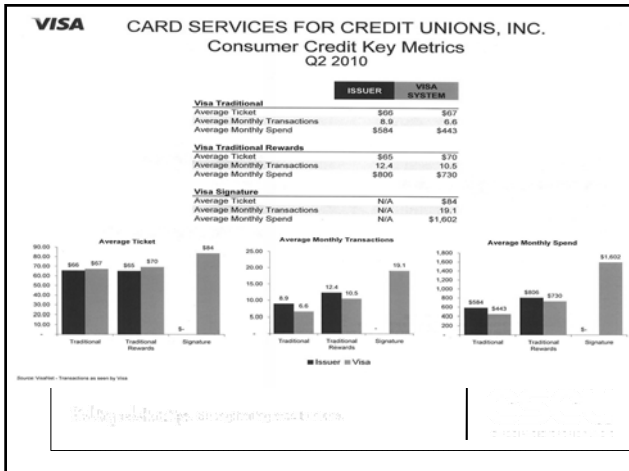
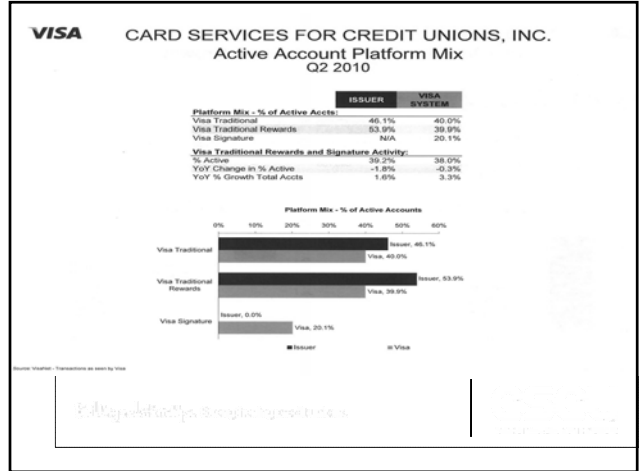
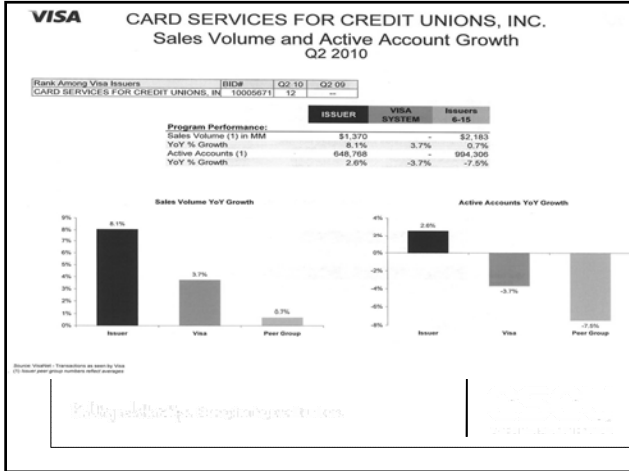


Building relationships for a stronger market.

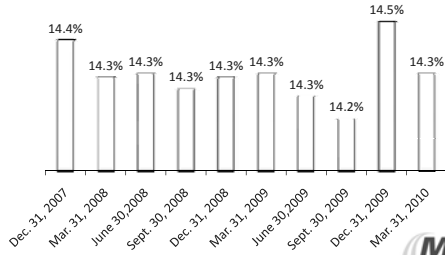
### PLATINUM CARDS VS. CLASSIC CARDS CONTRIBUTION TO TOTAL PORTFOLIO



Building relationships for a stronger market.

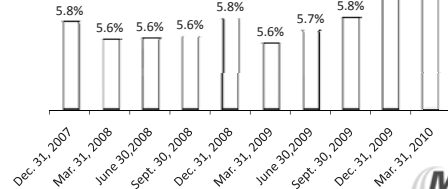


### CREDIT CARD PENETRATION



Source: Callahans Peer to Peer, March 31<sup>st</sup>, 2010

### CREDIT CARDS/TOTAL LOANS



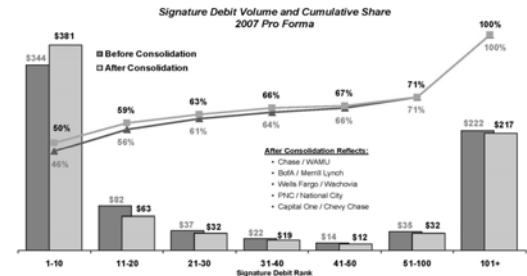
Source: Callahans Peer to Peer, March 31<sup>st</sup>, 2010

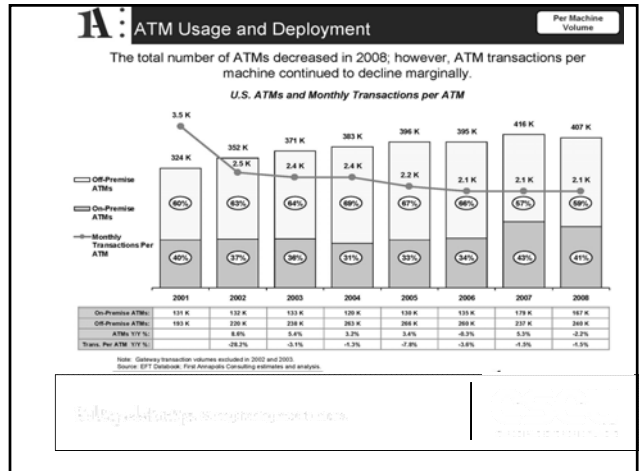
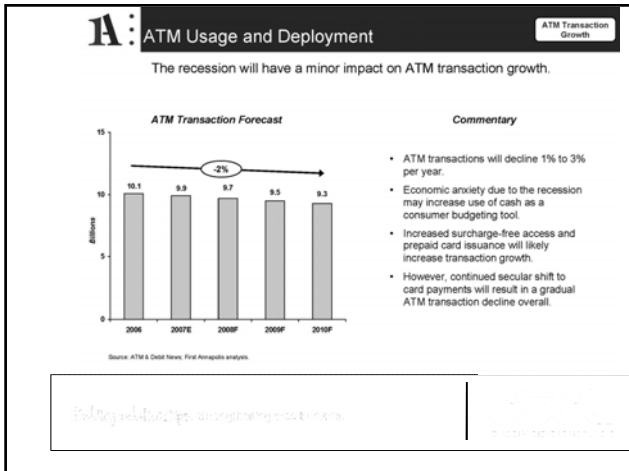
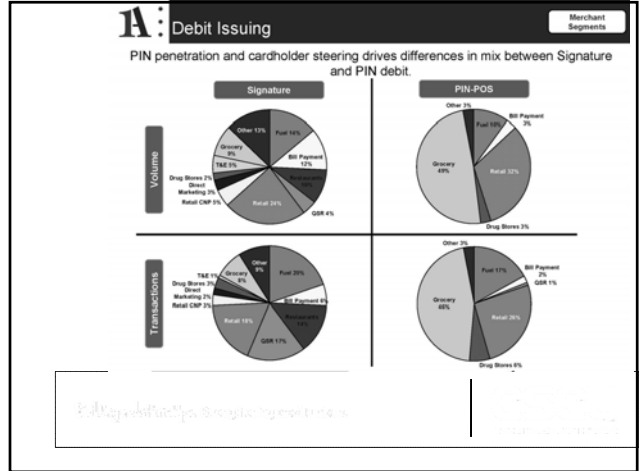
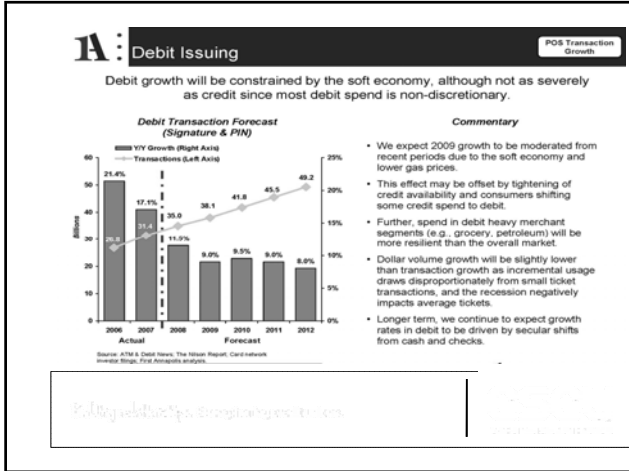
### DEBIT OVERVIEW



### Debit Issuing

The top 10 debit issuers now represent half the industry volume, but the segment remains unconcentrated.






VISA		1Q10 CSCU CONSUMER DEBIT SCORE CARD						
Consumer Debit Products Scorecard		Visa System & Peer Comparison						
		% change represents the percentage from the same quarter of the previous year						
Metric	CSCU	Visa System	Issuers 1-20 >\$700m Quarterly	Issuers 21-50 >\$165m Quarterly	Issuers 51-100 >\$90m Quarterly	Issuers 101-250 >\$38m Quarterly	Issuers >\$38m Quarterly	
Power Scores:								
Transaction (P x A x U)	8.34	6.73	8.56	8.00	7.96	7.94		
Sales Volume (P x A x U x Avg. Ticket)	\$112.16	\$244.24	\$311.92	\$285.97	\$286.87	\$282.42		
PAU:								
Penetration	65.8%	74.7%	77.5%	75.4%	75.7%	73.1%		
Activation	22.9%	65.8%	70.8%	75.8%	75.7%	73.9%		
Usage	13.1	13.7	15.6	14.0	14.4	14.7		
Portfolio Growth:								
Sales Volume	12.4%	17.7%	15.0%	11.6%	14.9%	16.5%		
Transaction Volume	13.3%	15.9%	13.0%	9.7%	14.2%	15.2%		
Average Ticket	\$36.66	\$36.27	\$36.44	\$35.74	\$36.05	\$35.57		
Accounts & Cards:								
VCC Accounts**	87,188	165,525.65	5,461,208	292,698	141,545	72,299		
VCC Account Growth	4.2%	7.2%	5.3%	6.0%	6.1%	6.4%		
VCC Card Growth	3.4%	2.1%	2.9%	3.9%	7.7%	5.4%		
Sales Volume by MCC***:								
Retail	27.60%	27.50%	27.20%	27.80%	28.40%	28.00%		
Restaurants	10.90%	10.40%	10.60%	10.40%	10.00%	10.50%		
Supermarkets	8.60%	8.40%	8.10%	9.20%	10.20%	9.00%		
Fuel	12.60%	10.60%	9.50%	11.60%	12.30%	11.70%		
Bill Payment	13.80%	15.40%	16.50%	13.70%	13.20%	13.50%		
Quick Service Restaurants	6.20%	5.70%	5.60%	6.10%	5.60%	6.10%		
Mail/Telephone Order	8.80%	10.80%	11.20%	9.80%	9.70%	9.80%		
Hotels	15.60%	16.30%	16.70%	15.00%	14.60%	15.30%		
Operations Metrics***:								
Authorization Approval Rate	95.2%	96.0%	96.3%	96.0%	95.6%	95.6%		
Decline Rate	3.5%	3.1%	2.9%	3.1%	3.4%	3.4%		
Overall Chargeback Rate	0.03%	0.03%	0.04%	0.03%	0.02%	0.02%		
Reported Fraud Loss Rate (bp)	8.32	10.92	11.37	9.48	9.81	8.75		

Source: Visa 1Q2010 Consumer Debit Products Scorecard  
 \*Simple averages based on Operating Certificate data. All metrics exclude Prepaid volumes. \*\*Account number shown in peer groups is the average number of accounts in that group. \*\*\*Sales Volume by MCC reflect data in key merchant categories and channels.


## THE DURBIN AMENDMENT AND THE IMPACT ON DEBIT INTERCHANGE




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 Financial  
 Research & Analytics


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## INTERCHANGE BASICS

- Interchange Fees Are Ultimately Paid By Merchants To Card Issuers To Compensate The Issuer For:
  - Float On Signature Transactions
  - Fraud Risk
  - Cardholder Servicing
  - Processing
  - Value to Merchant: Guaranteed Payment, Faster Customer Thru-Put at POS
- 99% of Debit Card Revenue Is Interchange To Issuer



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# INTERCHANGE RATES

• Transaction Type Results In Significant Difference In Issuer Revenue/Merchant Expense

Transaction Type	Approximate Interchange Rate	Average Transaction	Approximate I/C Rec'd	\$100 Transaction
Credit	180 bps	\$80	\$1.44	\$1.80
Signature Debit	138 bps	\$40	\$0.55	\$1.38
PIN Debit	65 bps	\$40	\$0.26	\$0.65



Policy related to this document is located in the following link: [http://www.mcul.org/interchange-rates](#)

# MERCHANT VS. ISSUER AT THE POINT OF SALE

- Swipe Debit Card
- Merchant Tries To Reduce Transaction Cost By "Steering Transaction" With "Enter PIN"
- Issuer Incent Cardholder To Select "Credit via Rewards"
  - Cardholder Enters PIN # \$40 @ 65bps = \$0.26
  - Cardholder Selects Credit \$40 @ 138 bps = \$0.55
  - Difference \$0.29/Transaction

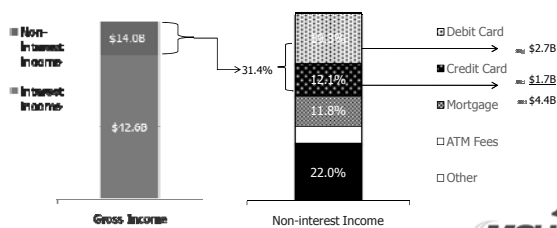
	Number Of Transactions				
	1K	100K	1M	100M	1B
Signature	\$550	\$55K	\$550K	\$55M	\$550M
PIN	\$260	\$26K	\$260K	\$26M	\$260M
Difference	\$290	\$29K	\$290K	\$29M	\$290M

• How Much Interchange Are We Talking About For CU's?



Policy related to this document is located in the following link: [http://www.mcul.org/interchange-rates](#)

# INTERCHANGE TO CU'S



Policy related to this document is located in the following link: [http://www.mcul.org/interchange-rates](#)

Source: Callahan's, Visa

# THE PLAYERS

Player	Objective
Issuer (FI's)	<ul style="list-style-type: none"> <li>• Grow Deposit Relationships/Share/Primary FI/Offer Rewards To Attract Members</li> <li>• Grow Transactions – Penetration, Activation, Usage</li> <li>• Grow Interchange Revenue</li> </ul>
Network - Visa, MasterCard, CU 24, NYCE, Pulse, Star	<ul style="list-style-type: none"> <li>• Want/Need Merchant To Accept Network</li> <li>• Grow Transactions/Market Share On Network</li> <li>• Compete For Issuers And Their Cardholders Via Growth/Higher Interchange Rates</li> </ul>
Cardholder – Consumers, Business	<ul style="list-style-type: none"> <li>• Access Deposit Accounts – Anytime, Anywhere</li> <li>• Pay For Goods &amp; Services</li> <li>• Rewards – What's In It For Me?</li> </ul>
Merchants	<ul style="list-style-type: none"> <li>• Grow Sales</li> <li>• Accept Networks With Large Card Bases</li> <li>• Reduce Cost Of Transaction</li> </ul>



Policy related to this document is located in the following link: [http://www.mcul.org/interchange-rates](#)

## HOW DID WE GET HERE?

- Networks Would Negotiate With Issuers With The Goal Of:
  - Networks Growing Transactions/Share → Drive I/C Rates
  - Issuers Growing I/C Revenue
- Issuer Could Control Transaction Routing Via Network Membership
- Savvy Networks And Issuers Would Pursue Exclusive Deals
- As Network Grew In Terms Of Issuers, Cards And Transactions, Network Had Ability To Drive Interchange Rates; Raising Issuer Revenue And Merchant Costs
- Networks Competed For Issuer Business Based On Higher Interchange Rates
- Merchants Banded Together – Merchant Payment Coalition – And Found A Sympathetic Ear In Senator Durbin
- Simply A Pricing Issue

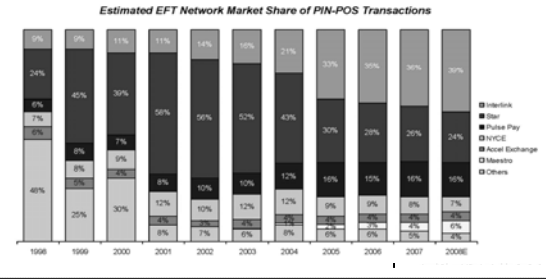


Policy solutions, supporting merchants

Member Credit Unions, Banks and Affiliates

## A: Debit Issuing

Visa's Interlink has emerged as the leading PIN POS network, while MasterCard has rapidly grown share from a small base.



## SIGNATURE AND PIN DEBIT NETWORKS

Signature	PIN
Visa	Interlink
MasterCard	Maestro
N/A	Star
N/A	Pulse
N/A	NYCE
N/A	CU24

- Pre Durbin - Issuers Select Networks That Maximize Issuer Revenue
- Post Durbin – Merchants Select Networks That Reduce Transaction Costs



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## KEY PROVISIONS OF THE DURBIN AMENDMENT

- Interchange Regulation
- Network Routing
  - Issuer/Networks Cannot Restrict The Number Of Payment Card Networks
    - o Must Have 2 Or More Non-Affiliated Networks
  - Issuer/Network Cannot Inhibit Ability (Of Merchant) To Direct Routing
- Government And General Purpose Reloadable Prepaid Cards Exempted
- Sets Minimum For Credit Card Transactions @ \$10
- No Discrimination Between Debit Or Credit Within A Payment Card Network On Basis Of Issuer
- Discounts For Alternate Forms Of Payment



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Member Credit Unions, Banks and Affiliates

## INTERCHANGE PROVISION

- Federal Reserve Board (FRB) Given Authority To Regulate Interchange Fees
- FRB Establish Rules 9 Months After Enactment  $\approx$  4/21/10
- Law Says Interchange Fee Shall Be "Reasonable and Proportional To The Cost Incurred By The Issuer With Respect To The Transaction".
- FRB Shall "Consider The Functional Similarity Between Electronic Debit Transactions and Checking Transactions Required To Clear At Par"
- FRB May Adjust For Fraud Prevention Cost
- Interchange Regulation Does Not Apply To Issuers < \$10B In Assets



Policy related to regulatory provisions

## NETWORK ROUTING PROVISIONS

- Fed To Regulate Limitation On Payment Card Network Restriction
- Issuer Or Payment Card Networks Shall Not Restrict The Number Of Payment Card Networks On Which A Debit Transaction May Be Processed To:
  - 1 Such Network
    - o Appears To Eliminate Signature Debit Transaction Only Debit Cards
    - Or
    - o Requires At Least 2 Competing Networks
  - 2 Or More Affiliated Networks Or Networks Affiliated With An Issuer
    - o Appears To Eliminate Debit Cards That Are Visa/MasterCard For Signature and Interlink/Maestro For PIN
- Issuer Or Payment Card Network Shall Not Inhibit The Ability Of Any Person Who Accepts Debit Cards To Direct The Routing For Processing Over Any Payment Card Network
  - Merchant Can Select Least Cost Network
- Currently, No Carve Out For FI's < \$10B In Assets
- Fed To Prescribe Regulations Within 1 Year Of Enactment July 21, 2011



Policy related to regulatory provisions

## INTERCHANGE - WHAT WE DON'T KNOW/WHAT WE THINK

- Whether The Fed Will Set A Specific Rate Or A Cap?
- Whether There Will Be Different Rates For Signature And PIN Transactions?
  - Law Does Not Differentiate Between Signature And PIN Debit Transactions/Rates
    - o Seems Reasonable To Expect Some, Maybe Total Rate Convergence
- Carve Out Of Issuers Less Than \$10B Possible Via BIN Tables, But:
  - Merchants, Acquirers, Visa/MC And Issuer Processors Need To Be In Sync To Insure Proper Interchange Paid On Each Transaction
    - o Who Is Paying For It?
    - o Can It Be Ready In Time?



Policy related to regulatory provisions

## INTERCHANGE FEE REVENUE REDUCTION TABLE

Assumption: Annual Interchange Revenue Per Account = \$81.84

# of Accounts	Pre-Durbin Yearly Interchange Revenue	Post Durbin Yearly Interchange Revenue with a Reduction of:						
		10%	25%	33%	50%	66%	75%	90%
1,000	\$81,840	\$73,656	\$61,380	\$54,833	\$40,920	\$27,826	\$20,460	\$8,184
5,000	\$409,200	\$368,280	\$306,900	\$274,164	\$204,600	\$139,128	\$102,300	\$40,920
10,000	\$818,400	\$736,560	\$613,800	\$548,328	\$409,200	\$278,256	\$204,600	\$81,840
25,000	\$2,046,000	\$1,841,400	\$1,534,500	\$1,370,820	\$1,023,000	\$695,640	\$511,500	\$204,600
50,000	\$4,092,000	\$3,682,800	\$3,069,000	\$2,741,664	\$2,046,000	\$1,391,280	\$1,023,000	\$409,200
75,000	\$6,138,000	\$5,524,200	\$4,603,500	\$4,112,460	\$3,069,000	\$2,086,920	\$1,534,500	\$613,800
100,000	\$8,184,000	\$7,365,600	\$6,138,000	\$5,483,280	\$4,092,000	\$2,782,560	\$2,046,000	\$818,400
150,000	\$12,276,000	\$11,048,400	\$9,207,000	\$8,224,920	\$6,138,000	\$4,173,840	\$3,069,000	\$1,227,600
200,000	\$16,368,000	\$14,731,200	\$12,276,000	\$10,966,560	\$8,184,000	\$5,565,120	\$4,092,000	\$1,636,800
350,000	\$29,460,000	\$26,414,000	\$21,345,000	\$19,708,200	\$10,230,000	\$6,956,400	\$5,115,000	\$2,046,000
Amount to Re-Coop Per Transaction		\$0.04	\$0.10	\$0.13	\$0.20	\$0.24	\$0.30	\$0.36
Amount to Re-Coop Per Account/Yr		\$8.18	\$20.46	\$27.01	\$40.92	\$54.01	\$61.38	\$73.66



Policy related to regulatory provisions

### POTENTIAL WAYS TO RE-COOP INTERCHANGE REVENUE REDUCTIONS

- Segment Members Into CU Relationship/Income Pools
  - Consider Loan/Deposit Balances
  - Consider New/Increased Fees To Less Active
  - Incent Members Who Increase Relationships
- Encourage Electronic Payments/Delivery While "Going Green"
  - Consider Fees For Paper Statements, Checks
- Increase Debit Card Penetration, Activation And Usage
- Increase Credit Card Penetration, Activation And Usage
  - Rewards, Competitive Fees/APR
- Fraud Mitigation Best Practices For Card Programs
- Leverage Processing Costs – Credit, Debit, ATM Driving
- Charge A Debit/Checking Transaction/Account Fee



Building relationships for long-term success

### OPPORTUNITIES TO IMPROVE CREDIT CARD PERFORMANCE

- Improve Penetration from 14%
  - 25% Should Be A Minimum Goal
- Regular Credit Line Reviews
  - Improve Revenue, Reduce Exposure
- Implement Rewards To Drive CU Card Loyalty
  - Increase Usage, Volume, And Revenue (Chase, Cap One)
- Reissue Classic And Gold To Platinum
  - AND Adjust Credit Lines, Include Rewards
- Target Appropriate Members For Balance Transfers



Building relationships for long-term success

### Opportunities To Improve Debit Card Performance

- Increase Usage, Volume, Revenue
  - Promote Bill Pay
- Implement Debit Rewards
  - Pay On Signature Transactions Only
  - Household Points With Credit
  - 29% Of 2009 Visa Debit Volume Was On A Rewards Card, Up From 22%



Building relationships for long-term success

### SUMMARY

- Change Is Coming, Develop Scenarios, Plan For Them Pending Final Rules From FRB
- Interchange Scenario Planning:
  - If Interchange Decreases By 10%, 25%, 33%, 50%, 66%, 75%, 90%, The CU Will Do What?
  - Develop Alternative Revenue Sources; New/Increased Fees
- Network Scenario Planning
  - Evaluate Existing Signature And PIN Relationships
  - Do They Meet New Rules?
  - How Do They Compare Vs. Other Options On Issuer Interchange Revenue?
  - Select Revenue Optimizing Networks



Building relationships for long-term success

# QUESTIONS?



For more information, please contact us at:  
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# THANK YOU!



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