

# decoupling not so odd

By Julie Ritzer Ross

## Consumer interest fuels acceptance of decoupled and co-branded debit cards, yet obstacles prevent fast growth

**I**n recent years, consumers' ever-increasing interest in debit cards—and card issuers' push to capitalize on that interest—has sparked the introduction of new debit options to the market. Decoupled debit, one of those options, holds significant promise.

Unlike traditional debit cards, issued by the owner's bank, decoupled debit cards are not linked to a demand-deposit account. Transactions are settled over the branded payment networks, with funds deducted from consumers' checking accounts and paid to an intermediate service provider using the offline ACH network. Most decoupled debit cards offer enhanced rewards to users, such as points redeemable for merchandise and services.

Some decoupled debit cards are co-branded, issued in conjunction with a merchant, which have the advantages of

eliminating interchange fees, bolstering customer loyalty, and potentially expanding the customer base beyond a single bank.

### Who's in the Game

McLean, Virginia-based Capital One Financial Corp. generated big waves in the market in 2007 when it launched a co-branded decoupled debit card program in partnership with Sheetz Inc., the Altoona, Pennsylvania-based convenience store chain, and Ukrops, the Richmond, Virginia-based supermarket chain. Consumers using the MasterCard received bonus points redeemable for gift cards good at their particular stores. At the same time, an undisclosed number of existing Capital One credit cardholders were offered a decoupled MasterCard-branded debit card. Both products were marketed as providing users with three to five times



## KEY NOTES

- ▶▶ When Capital One ended its decoupled debit card pilots last May, industry players speculated that it had acceded to pressure from competing banks that perceived a threat to their demand-deposit bases.
- ▶▶ HSBC Retail Services and PayPal are both offering decoupled debit card programs.
- ▶▶ The enhanced rewards aspect of decoupled debit will be an irresistible lure for consumers and, in turn, a catalyst for the growth of decoupled debit products.
- ▶▶ Obstacles remain, however, and account settlement ranks at the top of potential glitches.



the actual value of traditional reward debit cards.

Capital One abruptly ended the tests in May 2008, touching off speculation that Capital One had acceded to pressure from competing banks perceiving a threat to their demand-deposit bases. Other observers blamed a new interpretation of a rule set by NACHA-The Electronic Payments Association, which states that transactions that require settlement to payees within 14 days (primarily, those tied to debit cards) cannot be processed in bundles because aggregating these payments means the loss of merchant and other information needed for risk assessment.

However, at the time, a Capital One spokesperson said the tests had ended as originally planned, with neither pressure from competitors nor any interpretation of NACHA rules figuring into the equation. “These were small pilot origination programs designed to inform our broader decoupled learning agenda that are complete,” she said, declining to disclose the number of cards issued or any other details.

Meanwhile, other forms of decoupled debit continue to enter the marketplace. Notably, HSBC Retail Services is testing co-branded decoupled debit cards in partnership with CVS Caremark Corp.

**Research points to a “sizeable potential market” for decoupled debit cards in the United States. One third of consumers are “interested” or “very interested” in decoupled debit card concepts, according to a 2008 Aite study.**

—Gwenn Bezard, research director,  
Aite Group LLC

of Woonsocket, Rhode Island, and Pathmark Stores, a regional supermarket chain based in Cateret, New Jersey. San Mateo, California-based Tempo Payments Inc. (formerly Debitman) handles the processing of HSBC cardholders’ decoupled debit transactions. Tempo has also begun marketing its decoupled debit platform to other institutions, according to CEO Mike Grossman.

In another twist, the PayPal unit of eBay

now offers participants a decoupled debit card that doubles as a MasterCard Premier BusinessCard; funds are deducted directly from cardholders’ PayPal accounts. Users receive one percent cash back on all purchases made with the card if they select the “credit” rather than the debit option during the checkout process.

Meanwhile, Capital One continues to apply a “test-and-learn” strategy with regard to decoupled debit, and is exploring decoupled and co-branded decoupled possibilities.

### Reason to Cheer

Some analysts and experts envision a rosy future for decoupled debit, co-branded, and otherwise. “There are reasons to be excited about this product,” says Gwenn Bezard, research director at Boston-based consulting and research firm Aite Group LLC. Aite’s research points to a “sizeable potential market” for decoupled debit cards in the United States. One third of consumers are “interested” or “very interested” in decoupled debit card concepts, according to a 2008 Aite study. Further, 36 percent of respondents would accept a debit card from a bank other than the bank where they hold a checking account if they could receive four to five times the rewards afforded by a traditional debit card.

The appeal of decoupled debit cards will be such that “incumbent financial institutions will [find themselves needing] to react to the risk of disintermediation of their business model,” suggests Bezard, adding that decoupled debit cards will “also expose Visa, MasterCard, and incumbent EFT networks to new competition in the debit arena.”

The enhanced rewards aspect of decoupled debit will be an irresistible lure for consumers and, in turn, a catalyst for the growth of decoupled debit products, agrees Paul Tomasofofsky, president of Montvale, New Jersey-based Two Sparrows Consulting.

“Without question, the consumer payments world is in transition,” writes Ariana-Michelle Wittlake, a senior analyst with the banking group of Boston-based research firm Celent LLC, in a report entitled, “Disruption in the Payments World.” Unquestionably, she notes, economic

pressures and consumers' push toward debit transactions as an alternative to incurring additional credit card debt will spur additional efforts by "credit-only or credit-centric issuers ... to diversify their payments mix and focus on building their debit payment options by way of decoupled debit programs."

Other reports bear out this contention. Branded decoupled debit products provide a more consumer-centric approach to the concept of debit, "with broader merchant acceptance," according to the Mercator Advisory Group report "Decoupled Debit: Let's Take a Closer Look."

### Warning Flags

Nonetheless, several issues surrounding co-branded decoupled debit, and decoupled debit cards in general, must be resolved before a market niche emerges. While a few of these issues may be of little concern to ISOs, others warrant consideration.

Some observers say co-branding may not be the right catalyst for fostering the growth of decoupled debit card programs. "Because co-brand(ed) cards usually restrict the scope of the rewards as opposed to non-branded cards ... the co-branded approach might not be the best path to marketing decoupled debit cards," suggests Bezard.

As for decoupled debit as a whole, account settlement ranks at the top of the list of possible glitches. In late 2007, NACHA initiated an analysis of transaction aggregation at the request of a member bank. While the financial institution had not experienced difficulty with aggregated transactions, its principals were concerned that the inability to identify such transactions would invite consumer disputes, according to a NACHA spokesperson. Bank officials also contended that performing risk assessments on aggregated transactions would prove problematic.

NACHA was also worried about the effect of aggregated transactions, eventually sparking its decision to enact the rule. "We didn't think we could analyze the data because merchant identification would not appear on the transaction," the spokesperson explains, adding that had Capital One continued with its decou-

pled debit program, it would likely have been compelled to refine its processes to adhere to the rule. Tempo, for its part, does not aggregate transactions.

Moreover, in the traditional debit scenario, card issuers can determine whether a given account contains sufficient funds prior to authorizing the transaction. Issuers of decoupled debit cards have no access to such information until a transaction is settled, generally two days after it is executed. HSBC reportedly sidesteps this roadblock by analyzing transactions at the point-of-sale using proprietary risk algorithms and authorization data, while observers say Capital One approved or declined transactions in accordance with a daily spend limit of \$500, rather than with the balance in customers' checking accounts.

The potential for fraud comes into play as well, according to Daniel Schutzer, executive director of the Financial Ser-

**Economic pressures and consumers' push toward debit transactions... will spur "credit-only or credit-centric issuers... to diversify their payments mix and focus on building their debit payment options by way of decoupled debit programs."**

—Ariana-Michelle Wittlake, senior analyst, Celent LLC

vices Technology Consortium in New York City. "When you have a relationship with a bank, it is so much easier to validate who you are, as the bank knows the customer's address and details and can validate who is the legitimate holder of the bank account," he notes. Although it is too early to say whether the decoupled sector has seen the significant incidence of fraud, most cases will probably not be reported unless their magnitude renders

them newsworthy, says Schutzer.

Some experts cite other factors that, if not mitigated or addressed, may also limit merchant and consumer acceptance of decoupled debit. For example, although merchants find favor with any product that reduces card-acceptance costs, they may need to invest time and money in training employees to manage decoupled debit transactions at the point-of-sale. This is especially true in cases where transactions are run on a proprietary network, according to the Celent report.

Many merchants are a bit fearful about the rewards side of decoupled debit, feeling they've been burned by rising interchange rates to support credit card rewards programs. Postings on the site [www.merchantaccountblog.com](http://www.merchantaccountblog.com) indicate a sense among merchants that debit card interchange fees will increase to pay for equally generous debit card reward programs. "Until consumers stop buying into reward cards" as a whole, "interchange can't go anywhere but up," comments one merchant on the blog.

The growth of co-branded decoupled debit will be limited to cards associated with very large merchants, contends Bob Giltner, a consulting partner for Austin, Texas-based debit rewards program provider My Rewards. It is unlikely consumers will "carry too many credit cards around in their wallets," unless some manner of significant incentive spurs them to do so. Additionally, Giltner says many consumers are wary of acquiring a debit card issued by an entity other than the financial institution with which they have a checking account.

Still, Tempo's Grossman remains convinced that the outlook for decoupled debit remains rosy. "The evolution will follow the pattern we have seen with debit cards," he asserts. "There will be certain winners and certain losers, but at the end of the day" decoupled debit will have a true presence. "It's coming and it's out there. Once the genie has emerged from the bottle, it's hard to get it back in." **TT**

---

*Julie Ritzer Ross is a contributing writer to Transaction Trends. Reach her at [julieros@aol.com](mailto:julieros@aol.com).*