Decoupled debit products pose a new challenge to the US cards and payment industry, and it appears European financial institutions want to become involved too. With a host of merits and potential flaws, financial institutions should consider carefully how decoupled debit products could give them a competitive advantage.

Decoupled debit products differ from traditional bank debit products as the card is offered by an issuer that does not administer the underlying bank account, according to Daniel Eckert, head of venture, acquisition and development for HSBC's card and retail services business. This means a decoupled debit product can be offered to anyone with an existing primary current account - regardless of where they bank.

A prospective decoupled debit cardholder must apply for his or her card, as opposed to receiving one as a 'feature' of their primary demand deposit account (DDA)."For customers, it allows them to participate in a debit card programme of their choice, without having to face the painful decision of moving their banking relationship from one institution to another. For card sponsors, such as retailers and other affinity groups, it allows nationwide access [in the US] to the fast-growing debit card population without having to tie itself to a particular banking relationship;' Eckert adds.

Settlement risk
In a decoupled debit transaction, when a payment is authorized the debit card issuer does not know if good funds reside in the associated account and this may entail taking settlement risk that differs from a traditional bank debit card, explains Eckert.

Over the last 12 months, the decoupled debit sector has mainly involved Capital One, HSBC, Tempo Payments, Pay Pal and MasterCard. Capital One began marketing a decoupled debit product to some of its existing cardholders in March 2007. The company's decoupled debit product is a MasterCard -branded card that can be linked to the customer's current account from a rival bank. Capital One subtracts funds from a customer's account via an automated clearing house (ACH).

A spokeswoman for Capital One says: "We have been testing two categories of this product: a 'stand-alone' Capital One debit card and a co-branded option with merchant partners. Partnering with merchants enhances our distribution channel access [in terms of POS terminals], and [provides] more diverse rewards currencies.

"From a business perspective, decoupled debit allows us to deepen our relationships with customers and market debit cards on a national basis outside our existing retail branch footprint. From a consumer perspective, it offers a way to maximize rewards points on everyday debit spending , getting points where consumers didn't get points before, without the hassle of changing banks or bank accounts," she adds.

Commenting on MasterCard's link with Capital One in launching a decoupled debit product, Richard Lyons, executive vice president for global debit and prepaid at
MasterCard Worldwide, says: "MasterCard and Capital One have enjoyed a long and successful relationship on the credit side, as well as with their retail bank affiliates Hibernia and North Fork. We supported Capital One's strategy to introduce its innovative debit offering to compete in an open-environment. MasterCard understands that consumers value choice on how to pay for their purchases and how to access their funds. The Capital One debit product serves as a companion to rather than a replacement of the core banking relationship, at the consumer's discretion."

As for other networks, a spokesperson for American Express says it is not involved in the debit business and will not speculate on future plans.

Leslie Beyer, senior PR manager of discover financial Services, says: "Decoupled debit is an emerging new payment option and Discover network is supporting its partners in evaluating this new product offering.

Strategic alliances
In April 2007, HSBC's North America's retail services business said it would begin offering retailers loyalty rewards and a PIN-based dual payment card solution through a strategic alliance with Concept Shopping. This was followed by a similar pilot programme between HSBC Finance Corporation and CVS/ pharmacy in June 2007.

In July 2007, payments technology provider Tempo Payments announced the availability of its debit product that enables financial institutions and other issuers to deploy ACH-based programmes.

In October 2007, HSBC Finance Corporation's card and retail services business agreed to offer a multi-purpose rewards and payment card for supermarket customers at Pathmark Stores, a regional supermarket in the US. HSBC's decoupled debit initiatives use a loyalty rewards PIN payment programme, termed OptiPay, which employs the Tempo Payment Network.

According to a report published by the Federal Reserve Bank of Kansas City in December 2007, being network branded provides wider acceptance. Terri Bradford, the payments system research specialist who wrote the report, said that the alliance between Tempo Payments and HSBC Retail Services came after the company had been working with merchants to offer merchant-branded, ACH-based debit card products. However, Bradford said that while Tempo Payments had some success in getting retailers to accept ACH-based debit cards, success in building up card issuers was "modest."

Intermediate service providers use a 'man in the middle' approach to switch consumers from their bank issued debit card to a debit card issued by the intermediate service provider. This effectively 'decouples' the consumer's DDA from the financial institution's debit card.

The consumer's card transaction is performed online over the branded payment networks between the merchant and the intermediate service provider, but is settled with the consumer's financial institution using the offline ACH network.

Therefore, Mike Grossman, CEO of Tempo Payments, believes decoupled debit offers merchants and consumers numerous advantages. He explains that for merchants
there is the opportunity to reduce the interchange fees they pay as the issuer will subsidize the transactions that take place at the co-brand partner's location.

Customers can also be incentivised with the attraction or higher rewards than traditional debit cards. Grossman says that the decoupling of the debit card from the DDA also means that the card functionality could be expanded to include additional tender formats, such as stored value, rewards redemption, or even credit accounts.

He adds that Tempo Payments plans to expand its presence and is in dialogue with other issuers, but declines to name which - although Grossman predicts that a large percentage of issuers will plan to pilot decoupled debit products in the near future. "Debit cards have been growing at a very rapid rate but there has been little innovation. Decoupled debit is a chance to shake up the debit card market. [Whenever] there is a paradigm shift, it can have a serious impact on the market. However, I don't think it is a zero-sum game as debit is still growing."

"The key event of the last eight months was Capital One's announcement of its decoupled debit product. Since then, there has been an enormous amount of interest. I think the issuers that regard it as an opportunity will win and the issuers that stick their head in the sand will lose," Grossman said.

It is widely accepted that the transaction process involved with decoupled debit cards usually means a time lag of approximately two days. As a decoupled debit card acquirer does not know at the point of authorization if the cardholder has enough funds to pay for the transaction, Eckert says this highlights the need to employ risk assessments. He adds that during the application process it is important to manage risk parameters such as identity verification, associated bank account verification and payment history assessments in order to mitigate exposures with a new card applicant.

In Grossman's view, financial institutions can also employ risk mitigation tools such as examining a cardholder's credit history. He adds that while decoupled debit, to his knowledge, is US-centric, Tempo Payments believes it can be applied by international financial institutions. "Different countries have different ACH-like organizations, so the challenge is that you need to leverage the equivalent of the ACH. We are seeing interest from financial institutions in Europe and several large financial institutions in the UK. [I expect that] in the next two or three years, it will come to Europe:"

EBA Clearing, which operates the pan-European ACH (PE-ACH), declined to comment on potential developments involving decoupled debit cards in Europe.

Daniel Schutzer - executive director for financial services at the Financial Services Technology Consortium - says that, as decoupled debit products essentially enable a company to issue an individual with a card for use with any bank account, the potential for fraud needs to be tackled because of the difficulties in verifying a customer's identity. "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 says.

In Schutzer's view, the potential for fraud also becomes an issue as decoupled debit cards do not allow a customer's account to be checked in real time. He observes that banks have been developing means of countering the threat of fraud, which mainly
involve sharing information and mitigating fraud as much as possible before it occurs.

While it is too early to say if fraud has occurred in the decoupled debit sector, Schutzer argues that most cases are likely to go unreported anyway -unless they are so large that they become newsworthy.

The question of liability also remains a challenge for decoupled debit products and still remains opaque, comments Schutzer. Using the scenario of a customer disputing a card transaction as an example, he questions whether the responsibility for repaying the customer lies with the provider of the decoupled debit product or the customer's bank.

Schutzer believes that decoupled debit products currently constitute a relatively small portion of the overall debit card market. However, he qualifies this statement by acknowledging that decoupled debit products could grow exponentially over time.

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