

# The Less Obvious Impacts of Durbin on Billers' Payments

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As we enter the Durbin Era of debit card processing, much has been debated regarding the positive and negative impacts on the merchant community, in general. One merchant classification that has not been front and center during these debates has been the biller community. Card acceptance for bill payment has made great strides over the last several years, but what impact will the Durbin legislation have on continued growth? What bill payment trends are likely to form out of these changes? What less obvious impacts will there be on billers, and how should these changes be approached?

## The Cost of Acceptance: Getting Past the Rhetoric

While interchange has been the primary focus of the broader Durbin discussion, billers should understand other factors that comprise the full cost of card acceptance. To begin, when the Federal Reserve Board issued their preliminary guidance on debit interchange caps last December at 12 cents, and then raised it this June to 21 cents, most of the rhetoric was around those two numbers. In fact, for a biller the real cost of interchange on some debit cards will be 21 cents plus a penny (a temporary amount, related to fraud prevention) plus 5 basis points times the value of the payment. On a \$200 average bill, the interchange will be 32 cents.


The biller's acquirer will also pass through or assess additional fees for processing of the payment: card associations' assessments or switch fees, network access fees, fraud and chargeback fees to name a few. These non-interchange fees can add another 20 cents to the cost of the payment. In addition, new network fees have already been announced, though with no detail so they cannot be estimated.

Another consideration in understanding full card acceptance costs is that not all debit transactions will be included under the Fed interchange cap. The Durbin legislation has exempted the cards of all bank card issuers with less than \$10 billion in assets (small banks) plus certain prepaid cards from banks of all sizes. The exempt cards will continue to be processed under the existing interchange rate structure. When Online Resources considers the credit and debit card

cost impact really interesting, at least one of the major card networks has announced a rate increase to some of the pre-Durbin interchange rates.

Further, some special interchange rates have been created to promote card acceptance within certain industry verticals, like Visa or MasterCard's utility program or emerging market rates available to cable television providers and insurance carriers. No change in these programs has been announced as of this writing; if that remains the case, then a biller in one of those programs gets less benefit from the Durbin caps and their estimate of an improvement in cost needs to take that into account.

All of these cost estimates are discussed with an "all else equal" mindset. Of course, nothing will be further from reality. Issuers, acquirers, networks, billers, and consumers will all



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payments in our biller client base, we estimate that 44% of all biller card payments will be processed under non-Durbin rates. To make the estimated

be incited and have already begun to change their behavior in a way that makes the future cost-mix different than the past.



## Payment Routing: New Rights & Complexities

The most common discussion on Durbin has centered on the new debit interchange caps but there are other pieces of the legislation that will impact a biller's card acceptance. First, the new law prohibits network exclusivity on any debit card. Over the last several years, exclusive network relationships formed by a card issuer had negatively impacted a biller's ability to route card transactions over the most cost effective networks. Under Durbin each card must be able to be processed over at least two non-affiliated networks, and the biller's choice of over which network a payment will settle must be accommodated.

A second element of payment routing will be the biller's desire and ability to incent the consumer to use a low-cost payment method. Durbin grants the biller certain new rights in this regard. The simplest example might be a reduction in the billed amount for the consumer choosing to fund their payment in a low-cost way. We don't know yet the size of the consumer incentive required to generate sufficient adoption of the low-cost method to justify the billers' change in the accounts receivable system – and that incentive will likely be fighting against counter-incentives being offered by those invested in high-cost methods.

These two routing topics on network choice and consumer incentives are not unrelated to the previous topics on cost. In fact, each Durbin consideration is related to every other. A good example is routing payments over the PINless debit networks.

One common reaction we have heard from billers so far is that there is less incentive to accept PINless debit cards for bill payments. The flawed, "all else equal" logic says, "Since all debit cards cost 21 cents and the difference in loss rates versus signature debit have never been material, it may not be worth maintaining an 'extra' connection and reconciliation." To caution, there is nothing to say that the PINless networks will keep their

rates the same as signature debit rates – they just can't be higher. The risk advantages to the biller also don't have to remain the same as today. And debit cards from small banks will still benefit from being processed as PINless debits. For now, billers can maintain their connection and reconciliation for PINless in a manner that isn't "extra" until the networks settle on whether they'll be making changes in the coming months.

## Payments Chess

Generally, billers will want to keep all their options open. As in the last example, it would be unfortunate for a biller to have disabled their ability to accept PINless debits only to have the cost or risk reduced by half just a month later. Right now, the secondary and tertiary effects of Durbin are beginning to emerge and will likely unfold for 18-to-24 months in a giant game of payments chess among billers, consumers, payment networks, issuers, acquirers and regulators. Following are the two effects that our biller clients see as most impactful.

**Debit vs. Credit:** Issuers have already reduced or eliminated debit rewards, having lost the interchange income required to fund them. Issuers will be incented to promote credit card use. Will they put limits on debit card use? Will consumers be incented to use credit cards more for bill payment? Will billers be incented to stop accepting credit cards? The current debit-to-credit card ratio is about 3-to-1 for bill payment. Given the billers' right to route and incent, we think the impact will be muted.

**Electronic Adoption:** There are several ways we see Durbin impacting the rate of electronic billing and payment adoption for billers:

- Banks' change in fee structures across products will increase the organic rate of electronic payment adoption. As an example, Bank of America already has a preferred-fee DDA for electronic bankers. Such a dynamic increases the importance of a biller having a strong solution for consolidating home-banking payments.

- Banks will have an increased interest in issuing prepaid cards that are exempt from the Durbin interchange caps. Traditionally, these cards have been held most often by the un-/under-banked and obtained in non-bank locations (e.g., retail locations). The ideal solution the biller can offer this group of ePayers is the ability to pay via mobile phone using their prepaid card.
- As these forces drive e-payment adoption beyond 50% and into the majority, the importance of electronic bill presentment will rise. The consumer mass market will require it. Billers must make bills available at websites, bank sites, in email and via mobile devices. For their effort, billers will gain the cost advantage of suppressing the paper bill and related documents. Utilities, for example, have doubled their rate of paper suppression in the last two years and expect to do so again in the next two. Billers who achieve electronic bills and payments have achieved a fully electronic billing relationship with the consumer. That relationship can then serve as a corridor to future service customization and consumption.

Biller interests in Durbin run quite a bit deeper than the "21 cents" that is the focus of the broader discussion on this legislation. The cost structure is much higher and more complex than that, even if all players' behavior stayed constant. The legislation contains certain routing and consumer-incentive biller rights that will ensure changes in behavior. There will be secondary and tertiary effects from the law that will be at least as impactful as the statute itself. No part of Durbin should be considered independent of the others or at a static point in time. Patience and good counsel will benefit all billers as they seek to gain maximum benefit from Durbin and shape their card acceptance policies to best meet the needs of their consumers.



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