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PROCESSING SERVICES

Key Trends Shaping Card Payments

What Every Card Issuer Needs to Know

Plastic cards have experienced little innovation over the decades. While the back-end technology supporting card transactions has evolved, the plastic card has remained essentially unchanged. However, the race to differentiate is heating up. From more aggressive rewards to customizable card graphics, issuers are trying to reinvigorate the traditional card in an all-out sprint to capture the cardholder's coveted top-of-wallet status. While these new features are compelling, they lack meaningful innovation to change the paradigm.

Traditional cards are slowly yielding to some break-through innovation. In just a few short years, many plastic cards will also include a micro-chip for greater fraud protection. Alternative cards are also being tested that provide the cardholder options to use their rewards with the push of a button on the card itself. A few issuers are also exploring hybrid cards that include both PIN Debit and Credit on one plastic. And, mobile payments are ushering in the age where transactions become interactions. Vast storehouses of mobile transactions will be leveraged to offer real-time offers to highly targeted customers via their smartphones.

Mobility Turns Transactions into Interactions

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In fact, 90 million U.S. adults had adopted Smartphones in 2011; that figure rose by 15 million to 105 million users in 2012. Projections are that Smartphone ownership will grow by 10.4% CAGR reaching 172 million U.S. adults by 2017 (Javelin Strategy & Research, 2012). Today, more consumers own a mobile phone than landline phones – a trend likely to accelerate. This shift in behavior is forcing financial institutions to reconsider their traditional distribution channels.

Card processing is one category bearing witness to the change. Cardholders are beginning to access new form factors at checkout thanks to mobile developments ushered in by the Smartphone. Square card readers (and their counterparts) can be found in micro-business across the U.S. Consider that Square alone is processing $4 billion in transactions each year and growing. For the first time, micro-businesses can now accept card transactions where before they were limited to cash or checks. The bottom line for card issuers is higher transactions and interchange income.

Small business is not the only benefactor. Consumers now have more options at checkout thanks to the Smartphone. Innovations like 2D Barcodes at Starbucks, Google Wallet, QR Codes and many others provide a fun and interactive way for consumers to process payments. And the utility provided with these options help consumers manage and track their purchases (e-Receipts, loyalty tracking, etc). Merchants gain the ability to offer instant couponing and highly targeted offers to drive new business where they were once limited to inefficient print channels.

Mobility is changing the game, and the result for financial institutions is greater real-time interaction with product delivery and account servicing. Consider that by 2015, U.S. consumers will process upwards of $220 billion in mobile payments (Aite, 2011). But, there are serious challenges with mobility. Banks and credit unions must now compete with alternative payment providers that threaten to usurp the coveted consumer relationship. Consider the payment innovation by PayPal. The day now exists where a PayPal customer can walk into a merchant without any payment cards and conduct a transactions with the simple press of a cell phone number and PIN. More concerning is that the customer can fund his/her PayPal account with ACH thereby striking any interchange income the card issuer would receive.

Card issuers can protect their consumer relationships through a combination of card design, features and rewards offerings. While a consumer can fund a PayPal account via ACH, they lose the ability to capitalize on that transaction with meaningful rewards. Additionally, the zero liability that credit card payments provide gives consumers reassurance that if their account is compromised they have the ability to dispute the transaction before it hits their bank accounts. However, banks and credit unions will need to compete in mobile payments if they want to protect their cardholder relationships. For most, partnering will be key to leveraging the technology as most small to medium banks and credit unions lack the ability and scale to develop a solution within their shops.

Hybrid Cards Differentiate on the Traditional Model

While mobility provides a new checkout experience, hybrid cards or multi-function cards build off the traditional card design with new combination features. Some card issuers see these new cards as a way to combat attrition and diminishing wallet share since both the credit and debit are ported onto one plastic. Consumers often have multiple, often conflicting, factors to evaluate when selecting the card of choice in a purchase transaction (available balance, size of purchase, willingness to incur debit and so on). In the case of hybrid cards, one plastic can meet most needs.

Hybrid cards have been deployed in Australia, Brazil and France with limited adoption rates. However, these regions have very different markets with consumer preferences and card usage characteristics varying significantly.

The U.S. market is following with the introduction of Fifth Third's DUO card being the most widely publicized. Fifth Third's hybrid card provides credit and PIN debit transaction options. However, cardholders can only earn rewards points from credit transactions, and cannot transact using signature-based debit.

Citi, in partnership with Dynamics Inc., has been testing a different hybrid card. Dynamics produces and manufactures intelligent powered cards that use programmable mag stripes with simple consumer interfaces. Various models are available from dual-account cards (similar to Fifth Third's DUO card) to redemption-based cards that let cardholders use their rewards points at checkout. The key differentiator is a push-button smart card that allows the cardholder to select what account he/she prefers to use at checkout all designed on the plastic itself.

Mass adoption of hybrid cards is not likely to come soon. Much investment and innovation is being redirected to mobile-based payment technologies such as NFC payments, and various cloud-based payment alternatives. Another challenge for hybrid cards is their cost. Current estimates by Auriemma Consulting Group peg hybrid cards as being 10 times more expensive than issuing a standard plastic. Yet, despite these challenges, hybrid cards may become more common for niche groups (e,g., heavy credit users who need access to debit on a limited bases might prefer the DUO card).

Chip Cards Add a Layer of Security

For decades, the plastic card has remained unchanged with the magnetic stripe being the primary transaction method linking the card account on the plastic to the POS terminal. The smart chip imbedded in the plastic securely stores account information and the issuer's payment application, and it performs cryptographic processing for validating the card number and certain static and dynamic data used in the transaction. This provides a strong form of card authentication validating the legitimacy of the payment type being used. The result is stronger protection against common consumer-level attacks such as fraudulent use of lost or stolen cards, counterfeit cards and skimming.

Recently some of the card brands signaled their intentions to support EMV-enabled payments in the U.S. Their reasoning is clear: chip cards are fundamentally more resistant to fraud than magnetic strip cards. Aite Group reports that card fraud in the U.S. already costs the card payment industry (primarily issuers) $8.6 billion a year, and industry experts are concerned losses will rise as fraud migrates to the U.S. from smart card-enabled countries. Equally compelling is that Aite estimates that U.S. payment card issuers missed out on nearly $4 billion in 2008 charge volume and approximately $78.8 million in interchange fees because of problems cardholders had with their cards while traveling abroad. Now, more than ever, issuers have a compelling reason to take chip-cards more seriously.

The fraud savings associated with EMV cards should cause issuers to take note. Consider the U.K. Payment card fraud losses in the U.K. dropped from 18 basis points to 12 basis points between 2001 and 2008 after the U.K. rolled out EMV in 2001. More recently, total fraud losses on U.K. cards dropped 17 percent between 2009 and 2010.

Visa and MasterCard have taken steps to accelerate the migration to chip-based EMV cards. Visa intends to institute a U.S. liability shift for domestic and cross-border counterfeit card-present point-of-sale (POS) transactions, effective October 1, 2015. Currently, POS counterfeit fraud is largely absorbed by card issuers. With the liability shift, if a contact chip card is presented to a merchant that has not adopted, at minimum, contact chip terminals, liability for counterfeit fraud may shift to the merchant's acquirer. Visa provided a carrot to merchants. They will eliminate the requirement for merchants to annually validate their compliance with the PCI Data Security Standard for any year in which at least 75 percent of the merchant's Visa transactions originate from chip-enabled terminals

Card issuers should realize that chip cards like EMV come with a price. The typical cost of a magnetic stripe card is about $0.15, whereas, on average, EMV cards can cost between $2$4. Though this is a considerable difference, financial institutions should see the initial costs of the chip card offset over time by the reduction in fraud.

Issuers should begin building their EMV strategies. The risk of fraud and potential for lost transaction and interchange income for overseas travelers should compel issuers to action. Consider your cardholder segments to identify low-hanging fruit; are there frequent international travelers in your card portfolio? If so, consider an EMV prepaid card to meet their needs today. Then, work with your processors to identify a long-term plan to ensure risk mitigation.

Conclusion

Card issuers have much to consider as the market for card payments continues to evolve. From new technologies to new alternative payment providers, issuers must innovate and partner with the right long-term providers to remain relevant. Relying solely on the traditional magnetic stripe card is not a winning strategy in this new age of payment processing.

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