REVENUE CREATION AND COST RECOVERY POST DURBIN: THE PATH FORWARD FOR RETAIL BANKING

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Where Investment and Innovation will be in the 'Post' Durbin Environment

In the past, U.S. market retail banking investment has been primarily focused on the revenue-generating side of the equation (e.g., rewards platforms and programs). However, due to the impact of the Durbin Amendment, future retail banking investments will be significantly more difficult to fund and primarily driven by three objectives:

1. Improve operational efficiency
2. Shift to an enterprise-wide view of consumer relationships and away from individual product silo analysis
3. Realize incremental fee revenue and build deposits through segmented offerings of products and services currently in the marketplace

These assumptions are based on a combination of MasterCard Advisors' U.S. market insight, experience in low-interchange markets across the globe, and analysis of ongoing issuer responses to regulatory shifts.

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INTRODUCTION

The implementation of the Durbin Amendment will generate substantial change in the way retail banks regard their demand deposit account (DDA) and debit card businesses.

The amendment imposes a cap on debit card interchange, "composed of a base component of 21 cents and an *ad valorem* component of five basis points to reflect a portion of fraud losses."[1] There is little disagreement that the Durbin Amendment will have a significant negative impact on the financial performance of retail banks. At the end of the process it is estimated that banks will realize a deficit of $22 billion in fee revenues over the next two years.[2] It is also estimated that, as a result of the cap on interchange, approximately 5% of current bank customers will be "pushed out" into the use of check-cashing stores and other nonbank financial services.[3] The loss is compounded by the impacts to revenue that many banks face with the implementation of the Reg E changes relating to overdrafts.[4]

ABSTRACT

For issuers in the U.S. to remain competitive despite this series of regulatory challenges, they must continue to invest and foster evolution in their products and service strategies. As observed in other low-interchange markets, despite the lack of a compelling standalone business case, issuers have still found a role for debit in the overall payments mix of the transaction account, disregarding the isolated financial impact of debit products.

The way banks manage their P&L may be changed forever as the Durbin Amendment drives banks to shift focus from primarily being on the revenue side to a more balanced approach encompassing both revenue and cost. MasterCard's view is that this change in focus represents an opportunity not only to ensure bottom-line results, but also to deliver better customer experience and value, leading to greater customer loyalty. In other words, Durbin will force debit issuers to redefine and refocus their efforts as they work to maximize efficiency and gain an enterprise-level understanding of customers and relationships in order to survive.

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- REACTIONS TO THE DURBIN AMENDMENT ARE WELL UNDER WAY
- INVESTMENT IN THE RETAIL BANKING SPACE WILL SHIFT DRAMATICALLY IN FOCUS
- PROCESS EFFICIENCY WILL BE MANDATED BY THE NEW REGULATION
- PRODUCT EVOLUTION WILL MOVE FORWARD AT THE ENTERPRISE LEVEL
- PRODUCT EVOLUTION WILL BE DRIVEN BY A CONVERGENCE OF CUSTOMER DEMAND FOR BETTER MONETARY VALUE AND REGULATORY PRESSURE

IMMEDIATE PATH FORWARD

In the short term, because of the lag time it will take for banks to implement their near-term revenue replacement decisions, investment in debit may indeed come to a standstill. However, in the background, what we believe is also happening is the real work on the future, as banks begin to redefine and refocus efforts to optimize P&L management in the harsh "new normal." This shift is occurring in two distinct categories: process efficiency and product evolution.

The Durbin Amendment does not make a debit card less important but less profitable. As it still remains every customer's access tool to the checking account, understanding the combined debit card and account usage patterns will still be important in identifying the type of relationship—primary, secondary, or even dormant; it will still represent the main gateway to understanding product cross-hold; and it will still constitute the starting point in developing cross-selling strategies aimed at increasing depth, length, and profitability of any customer's relationship. Success in the coming regulatory environment will require shifting to an enterprise-level view of customers and operating based on the insights provided by a view across individual product silos.

Competition among retail banks will be fierce as the Durbin Amendment creates pressure on profitability. Evolving to perform effectively in this new environment will be critical for retail banks as they redefine and refocus investments to continue to compete despite the regulatory challenges they face.

ENDNOTES

1 Fed Text: Staff Propose Capping Debit Card Fees at 21 Cents, http://imarketnews.com/node/32976

2 The Fed's Final Debit Rules: http://www.pymnts.com/The-Fed-s-Final-Debit-Rules-Did-Anyone-Win/

3 Fed Text: Staff Propose Capping Debit Card Fees at 21 Cents, http://imarketnews.com/node/32976

4 MasterCard Global Insights: "Innovative Strategies for Dealing with No Longer Profitable Customers," http://insights.mastercard.com/white-papers/innovative-strategies-for-dealing-with-no-longer-profitable-consumers-us/

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