EMV Rollout and the U.S. Payments Landscape

With the liability shift over a month in the rear view mirror, issuers in the United States are moving fast to equip their members with EMV chip debit cards. Reissuing all existing mag stripe cards into EMV chip cards is a large undertaking in terms of resources and capital investments, but Issuers have been planning for this ever since the industry began talking about an EMV migration. We have seen many forecasts about how many issuers and merchants will be ready to meet the liability shift, but most have not been reliable. There are a couple of possible reasons for the forecast variances, and in order to even begin discussing the migration efforts, we need to consider the complicated payments landscape in the U.S.

The payments value chain is complex and each entity has a business model wrapped around offering and accepting debit cards, and switching debit card transactions.

Value Proposition with Mag-Stripe Technology

Issuers

Issuers have over the years come to expect that interchange income from their debit card portfolio helps support other value added services they offer packaged with the card, as well as new technologies and security standards that help issuers manage fraud. Features like rewards and purchase protection as well as convenient mobile remote deposit capture and mobile banking are all things that an issuer will assess alongside interchange income when evaluating a business case for value added services. In order to maximize interchange income some issuers choose to steer to the higher interchange fee transaction, which is signature. This brings the issuer more interchange income per transaction, but it comes with the cardholder's ability to choose to sign for the transaction, rather than enter their PIN or not to be validated at point of sale at all. Issuers typically offer some type of reward in order to influence this behavior with their cardholders. Keeping the ability to still choose, or at least opt-out of entering the PIN, is key for some issuers to keep the current business model structured around their cards and transaction routing.

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Merchants

Merchants historically have partially accomplished their goal, which is to reduce the interchange and switch costs from accepting cards, as set by the card networks. Reg II and the Durbin amendment have certainly helped this mission, as interchange that the networks are assessing on card transactions have been regulated for issuers with $10B or more in total assets. Some estimates show that the regulated issuers account for about 60% of the total card spend in the United States. But there is still the other 40% of spend where merchants are paying list interchange price on those transactions, as published by each network for "unregulated" issuers. Many of these issuers are credit unions, and they depend on interchange income from their debit card portfolio to manage card fraud and offer value added services to their members. The Durbin amendment also shifted the ability to choose the network over which card transactions will route, essentially enabling merchants to optimize their cost from transaction routing by matching the available networks on the card with the lowest cost for each transaction. This happens today on mag-stripe cards, and it's accomplished in the background by the merchant/merchant acquirer system. With EMV, the POS terminal also plays a role as well. Debit EMV chip cards have two applications from which the terminal needs to choose and route the transaction based on that selection. One application (Global AID) is owned by the card brand (VISA or MasterCard; the other (Common AID) is licensed by the card brand to PIN networks (STAR, NYCE, PULSE, etc.). It becomes critical for the POS terminal to choose the

right application to ensure that when this transaction is routed over a network, the merchant still keeps the ability to choose the lowest cost network available on the card over which the transaction can be routed to the host for approval.

Card Networks

Card networks have been focused on issuers and bringing value to the issuers by retaining interchange pricing at levels that appeal to them. They have essentially competed for issuer participation by driving interchange pricing to an issuer favorable position, and to keep their share of the total transaction volume. The larger the share, the more leverage they had with merchants and issuers alike to expand and enhance their business model. Networks also collect fees per transaction, called "switch fees," from both parties involved in the transition – merchants and issuers. Reg II and the Durbin amendment have essentially flipped this business model around to be more merchant-centric, giving the merchants the ability to choose the lowest cost network available on the card. With that change, networks quickly figured out that lowest pricing wins volume, and so have adopted an approach to incent merchants to route transactions over their network by restructuring their pricing models, which in effect lowers the interchange and switch fees. In some cases, card networks have taken a new approach to assessing the switch fees by moving to a fixed cost model, rather than the traditionally variable cost pricing approach.

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Consumers

Consumers have come to embrace using the cards as a convenient and more secure way of paying for their purchases then cash or checks. From the consumer perspective, all they need is to make the purchase and for this experience to be seamless and possibly add value/incentivize them to spend with the particular merchant. Consumers are expecting their data to be safe, not to be affected by various breaches and other fraud schemes, and we are finding that security and breaches are quickly becoming an expectation and reason to look for another issuer or location to spend their money, in case of security issues.

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Value Proposition with EMV Technology

So, while each player in the payments value chain is looking to retain and enhance their ability to influence cardholder spend and the resulting revenue/cost from those transitions – technology, like EMV chip cards, tends to introduce additional complexity to attain that goal in today's payments landscape. One of the reasons why the EMV technology standard for debit card transactions took as long as it did to emerge is the complexity in the payments value chain. That complexity and the fact that migration to EMV technology was a government mandate in some countries – which helped speed up the move – is what makes the U.S. market unique from the rest of the world.

Issuers

With ever shrinking revenue from card transactions, issuers have to live with the fact that merchants will continue to optimize cost from card acceptance and transaction routing by going to the lowest cost network available on the card. Going through the EMV migration effort, credit unions naturally hope that merchant deployment and support for debit EMV will also preserve the ability for their members to choose if they want to sign for the purchase, or choose to enter their PIN. This choice is critical, as member experience with their cards is a very important factor for credit unions. Continuing to effectively fight card fraud and add valuable credit union services today is very much dependent on how merchants choose to implement debit EMV.

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Merchants

While Issuers are busy trying to figure out the best EMV deployment strategy while balancing revenue and fraud protection, merchants are hard at work figuring out how to best implement support for EMV technology, while maintaining the ability to route to the lowest cost network available on the card. In order to preserve the transaction routing choice, the merchants want to be able to effectively support the U.S. Common AID. The U.S. Common AID is one of the two AIDs developed and agreed upon by the merchants, associations, networks and issuers, and created for debit card transactions. Make no mistake, widespread EMV support will be there once merchant systems and their acquirers have come up with a seamless way to choose where they want to route the EMV transaction from a debit card. The bottom line is that merchants are in the business of selling goods and services, and they will not let technology impact the ability to do that. However, at the same time, the merchant community will not give up much of what they worked hard for, in terms of interchange cost optimization, just because they rush in to support for EMV technology.

Card Networks

Networks are realizing that the various approaches to EMV support from the merchant community may translate to

losses of their share of sales volume, and are quickly adopting ways to accept and support new transaction sets. PINless and signature transactions, over what have been traditionally PIN networks, are the best examples of this new dynamic where card networks are competing for every transaction. And while card networks are protecting and expanding their business model, this is translating into interchange revenue compression to the credit union community. Card networks compete for merchant volume on price, by driving current interchange yields down. All PIN card networks are using the same EMV standard, but old volume share problems persist and will continue impacting issuer revenues for some time to come.

Consumer Experience post EMV

So, what's ahead for us in terms of EMV migration in the United States? Well, first we need to standardize the approach to EMV acceptance/migration, from merchants to issuers.

Today's reality is that the EMV card acceptance provides different consumer experiences based on each merchant's approach, down to each merchant location implementing different approaches to EMV acceptance. There are a few reasons for this, but mainly merchants are still trying to figure out exactly how to approach this implementation, and what is the best way to implement the new technology while still maintaining all the choices they have today in terms of transaction routing. As a quick way of supporting debit EMV, merchants have quickly deployed support for Global AID, but support for the Common AID is not as widespread. This leads to many consumer impacts, like cash-back at the point of sale. Using Global AID, most merchant terminals are not set-up to support this option, and until Common AID is supported, cash-back may not be an option - although this should only be a short term impact. Consumers have come to expect convenience and effective merchant support for debit and EMV is certainly key in this experience.

That's why it's important to ensure that you are communicating to and educating your member, on how to use their new chip enabled cards. Your customer service center should be properly trained and able to answer questions that may arise from different experiences your members are bound to encounter. Also, your branch staff should be able to accommodate and answer any questions from members who may walk into the branch. Leverage the multiple touch points you have today to offer additional education on what EMV cards are, what they do for the member and how to use the cards.

In addition, consider ways to leverage this new card and reinvigorate your portfolio, to entice card usage and offer a piece of mind that your members' data is safer now with this new technology. Leverage this opportunity to offer functionality and products that will make this card more attractive to your members – introducing rewards, offering multi-channel PIN changes and leveraging phone/app/call center/ATMs to offer added convenience.