Credit vs. Debit: The Network Perspective
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Overview

• Origins of Payment Cards
• Four-Party Payment System Model
• Anatomy of a Transaction
• Benefits of Payment Cards
  • Cardholder Benefits
  • Merchant Benefits
• Financial Reform Legislation
  • The Durbin Debit Interchange Amendment
Origins of Payment Cards

• Payment cards and extending credit for purchases were merchant innovations conceived to enhance their own profitability.

• Rather than continuing to develop and operate their own payment systems, however, merchants have increasingly chosen to take advantage of other options such as those offered by MasterCard, Visa, American Express, Discover, PayPal and others.

**1920s**
A group of merchants issue payment cards directly to retail customers, creating a simple two-party payment model to increase sales by offering credit and convenience at the point of purchase.

**1949**
According to industry legend, the idea of payment cards that could be accepted by numerous merchants was inspired at a luncheon in New York when the host, Frank McNamara, found himself short on cash and unable to settle the bill.

**1950**
Under a three-party system—which refers to consumers, merchants, and the entity that takes on the role of card issuers and acquirers—Diners Club issued the first “universal” payment card. American Express followed suit eight years later.

**1960s**
Two groups of banks formed so-called “four-party” payment card systems, thereby further expanding consumer choice in payment options. One ultimately became MasterCard; the other, Visa.
Four-Party Payment System Model

Network

Issuer
(Cardholder’s FI)

Cardholder

Acquirer
(Merchant’s FI)

Merchant
Anatomy of a Transaction

1. Cardholder submits MasterCard card to merchant
2. Merchant's bank asks MasterCard to determine cardholder's bank
3. MasterCard's authorization system validates the card security features and forwards to cardholder's bank for purchase approval
4. Cardholder's bank approves purchase
5. MasterCard sends approval to merchant's bank
6. Merchant's bank sends approval to merchant
7. Seconds later, cardholder completes purchase and receives receipt
Debit Card Processing

1. Swipe
2. Sign or Enter PIN

**Signature**
- Also Called “Offline” Transaction
- Processed the same as Credit

**PIN**
- Also Called “Online” Transaction
- Authorized in Real Time
- Payment to Merchant 2–3 Business Days
Benefits of Payment Cards: Cardholders

- **Convenience:** Credit, debit, and prepaid payment products make it easier to access funds and pay for goods and services.

- **Safety:** More secure. A cardholder’s liability resulting from a lost or stolen card is limited (e.g., federal law and MasterCard’s “zero liability” policy).

- **Better Record Keeping:** Cardholders receive convenient, detailed statements of payment activity.

- **Rewards:** By using their cards to make purchases, many consumers receive additional value through rewards or incentives, such as “cash back,” college savings or frequent flier miles, offered by the card issuer.
### Maximum Liability for Unauthorized Card Use (US Only)

<table>
<thead>
<tr>
<th>Before Use</th>
<th>Credit</th>
<th>Debit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Within 2 Business Days*</td>
<td>$50</td>
<td>$50</td>
</tr>
<tr>
<td>After 2 but Before 60 Business Days</td>
<td>$50</td>
<td>$500</td>
</tr>
<tr>
<td>After 60 Business Days</td>
<td>Unlimited</td>
<td>Unlimited</td>
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</tbody>
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*MasterCard Offers Zero Liability on Signature Based Debit and Credit Transactions
Benefits of Payment Cards: Merchants

• **Increased Revenues:** Incremental sales gains; & bigger ticket purchases. The risk of credit and fraud losses falls on the issuer. Additionally ticket size is no longer limited to cash in wallet, or willingness to take a check.

• **Increased Efficiency and Customer Satisfaction:** Payment cards and related innovations (e.g., MasterCard’s PayPass) speed up checkout lines and are important for quick-service restaurants, convenience stores, and transit.

• **Reduced Cash and Check Costs:** Merchants see reduced cash and check costs, including loss from cash theft, deposit preparation time and charges, armored car or service fees, bounced checks, check verification and guarantee services, and check processing costs.

• **Enable Remote (Internet) Sales:** Payment cards enable merchants to participate in global commerce as never before. Merchants can do business with billions of cardholders worldwide via the Internet or telephone.
Debit vs. Check

- Guaranteed Payment (typically by next day)
- Faster Checkout Times
- Increased Sales
- Administrative Gains
- Reduced Fraud Risk

- Bank Holds and Slower Payment
- Difficult to Process at POS (increased “tender time”)
- Bounced Checks
- Higher Fraud Risk
Durbin Debit Interchange Amendment

1. The amount of any fee established by a debit card network to compensate an issuer for its involvement in a debit card transaction must be “reasonable and proportional” to the cost incurred by the issuer with respect to the transaction.

2. Expands the ability of merchants to provide a discount or in-kind incentive for payment by the use of cash, check, debit card, or credit card.

3. Under the amendment, a merchant may establish a minimum dollar value (up to $10) for acceptance of credit cards.

4. Neither an issuer nor a payment card network may establish exclusive network arrangements for debit cards or inhibit the ability of a merchant to choose among different networks for routing a debit transaction.
The Australia Experience

• The Durbin amendment will harm consumers because they will pay more for their debit cards and receive fewer benefits in return.

• The same is likely to hold true for other banking products as well.

• The Reserve Bank of Australia (RBA) adopted similar regulations reducing interchange fees.

• The net effect of the RBA’s arbitrary limits has been that consumers have seen their annual fees and finance charges increase, while their benefits have decreased.

• No evidence that merchants have passed their savings on card acceptance fees onto consumers by lowering prices.
Other Consumer Harms

- What impact will the Durbin provisions have on state and federal agencies that have recently migrated public benefit payments from paper checks to prepaid card programs?

- Will the expanded merchant flexibility regarding discounting and the minimum/maximum transaction amounts result in cardholder confusion?

- Are merchants the best entity in the payments chain to make network routing decisions?

- Will issuers have less of an incentive to promote debit-related products and services and look to cover their costs differently by fee-based approaches to debit accounts?

- Will the cost of financial services rise for consumers across a wide range of economic levels?
Thank You

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