

Nailing Down the Benefits of PIN Debit: the Truth About Costs, Advantages and Challenges in Debit Acceptance

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The onslaught of debit acceptance results from both consumer awareness and merchant costs. Today's consumer is more educated than ever before, and debit, or "check" cards have reached a saturation level. Increasingly, consumers are turning away from traditional credit payments and opting to pay with a debit card, in which funds are directly removed from his or her account, in part to avoid increasing debt.

Recent surveys repeatedly bear out consumers' debit preference. In a Pulse EFT survey released earlier this year, 81 percent of respondents said they would be "very unhappy" if a marketer stopped accepting their debit card, and 29 percent said they would stop utilizing the marketer altogether if debit were eliminated as an option. (CardLine, May 2004). By 2007, debit transactions are expected to reach about 15 percent in the consumer payments mix. That is up from 9 percent now and only 2 percent of the consumer payments mix in 1996. (see Chart B)

PIN-based versus signature-based debit

Those studies reveal the popularity of debit payments in general. However, it's important to note here that there are two different types of debit payments. One is signature-based, in which the card is swiped and processed like a credit transaction. This is referred to as offline debit, and the rates charged to the merchant for this type of transaction are essentially the same as a credit card transaction. Online debit transactions require that the consumer enter his or her PIN. Historically, PIN debit transactions have cost merchants less to accept than traditional credit card transactions.

Fears of theft in general and identity theft in particular have made the security of a PIN a more attractive option to consumers. The dollar amount of the transaction is key in determining how consumers prefer to pay. According to MasterCard International Attitude and Usage Study, consumers used debit for 29 percent of transactions for purchases less than \$20. For purchases between \$20 and \$50, (the sweet spot for most petroleum marketers) consumers chose to pay with debit 55 percent of the time. The preference was about the same, at 52 percent, for

purchases between \$50 and \$100. With today's gasoline prices, a \$20 to \$50 purchase at a petroleum location is more common than ever before.

For marketers, technology plays a role as well. Across the retail spectrum, PIN adoption among merchants is expected to increase dramatically. "Within five years, PIN debit will begin to overtake signature debit as the cost of PIN pads falls." (Digital Transactions News). For a traditional brick-and-mortar merchant, PIN pad prices have dropped to between \$100 and \$150. That cost in the petroleum world is very different. More on this later.

For those marketers that do not currently accept PIN-based debit, careful consideration is paramount in deciding whether or not to add this option. Here are some things to keep in mind:

PIN-based debit costs marketers – but how much?

It is a common assumption that PIN debit transactions are always less expensive than credit, but over the last year, partly as a result of a large lawsuit filed by Wal-Mart against Visa and MasterCard, debit networks have increased their fees. This is an effort by financial institutions to recoup tens of millions lost when interchange rates for signature debit were reduced. Prior to the lawsuit's outcome, there was speculation that petroleum marketers would benefit from the court's ruling that merchants no longer had to follow something called the "Honor All Cards Rule," requiring retailers to accept both credit and signature debit cards of the same brand (MasterCard and Visa) instead of only debit or only credit acceptance.

The net result? Today, retailers get to decide on their own which cards they will accept. Potentially allowing them to save money if they go with a cheaper transaction type. At first, it seemed that allowing marketers to accept only debit transactions (then processed at a lower rate) meant a tremendous cost savings was in store. But no sooner did the court deliver its verdict than debit networks opted to – you guessed it – increase the rates charged for PIN-based debit transactions. Whereas before, debit transactions capped at 45 cents, they now can cost as much as 65 cents per transaction. "Interchange rates set by personal identification number-based point-of-sale debit networks continue to rise." (Credit Card Management, August 2004)

Sometimes PIN-based debit transactions are more economical for marketers – depending on the average ticket size. If the average ticket size is \$100 (often not the case for a petroleum marketer), PIN-debit is a cost-effective payment method. However, if the average ticket size is less than \$15, credit transactions are the less expensive payment acceptance option. Another consideration in PIN debit acceptance is the cost of implementation at the pump, which currently runs about \$1,000, per pump, to outfit each with the proper encryption device.

Implementation also a “key” consideration

A word of caution for marketers implementing PIN Debit: make sure that you, rather than your processor, own and control you own PIN “key,” or encrypted code. When installing the encryption device at the pump, most processors set the PIN algorithm for the merchant. The programming required is quite complex, and they are sealed to prevent any tampering. Most networks issue their own proprietary key, that cannot be reprogrammed.

Here’s the crucial element: Should you choose to move to a different payment processor, if you do not control your own PIN key, new PIN pads may need to be installed. Needless to say, this is a tricky way to trap a marketer into staying with their current processor – or punish them for leaving. For multi-location marketers, it is possible (and wise) to negotiate with your processor to maintain control of your PIN key. To do this, the processor develops a unique code specific to your business. Just as today, many consumers opt to take their cell numbers with them regardless of which carrier they choose. It is your right as a consumer. The PIN key, for a petroleum marketer, is no different.

Finally, installing a PIN debit terminal is not enough, since customers usually opt in before entering their PIN. By all means, work with your point of sale and network provider to install customer prompts that encourage PIN usage.

ACH Cards are risky, but worth it? You decide.

As explained in our previous column, ACH cards (such as the Debitman product) offer two things: a potential for significant cost savings and an increased fraud risk. First, the risk. ACH cards are not real-time transactions. Funds are pulled from the customer's account at the end of the day, at settlement. So if the customer has been on a spending spree that day, the money might be gone. If the customer is actually a thief, who has stolen the card, there is little recourse available to the marketer in recapturing those funds. Now the good news. Because they are run as an ACH debit transaction, ACH cards do not require additional equipment. And they are less expensive to accept because they are not processed through a card association, such as Visa or MasterCard, or through a debit network, such as Pulse. While that translates to a much less expensive transaction, it also means that the marketer must assume all the risk of that transaction.

Debit firmly in place

Clearly, consumers have spoken, and debit is here to stay. Deciding which methods to accept can be complicated. To simplify things, we have included a chart with this article that differentiates between each payment type. Whatever form of payment you choose to accept, explore your options with your processor, and request an ROI analysis before plunging into anything that requires a drastic change.

Chart A

Annual Percentage Change In Online & Offline Debit Transactions

Year	PIN-Based (Online)	Signature-Based
1998	23%	48%
1999	23%	40%
2000	25%	30%
2001	31%	25%
2002	39%	20%

Source: [ATM&Debit News](#), March 2003

Chart B

Projected Consumer Payments Mix In The US, 2007

Cash (%)	Check (%)	Credit (%)	Debit (%)	ACH (%)	Other (%)
41.4	16.0	19.5	14.4	5.5	3.1

Source: [First Annapolis Consulting](#) and [US Federal Reserve](#), February 2004

Chart C: Comparing Payments Options

Payment type	How it works	Benefits	Cost (in general)	Issues/considerations
“Online” or PIN debit	Transaction is sent to a debit network, like Pulse. Funds removed almost immediately from customer’s account.	<ul style="list-style-type: none"> ▪ Customer security. ▪ Fraud/chargeback risk greatly reduced. 	Costs are roughly the same as a credit transaction (due to recent rate increases by debit networks).	<ul style="list-style-type: none"> ▪ Equipment costs at pump are high. ▪ Debit key is not reprogrammable and expensive to replace. (see article).
Offline debit (aka signature debit in traditional retail)	Run similar to credit card transaction.	Customer swipes card as with credit transaction. No additional equipment needed. Customer not required to enter information.	Costs per transaction are roughly the same as credit.	As with credit, there is a risk of chargeback. Customer can dispute transaction.
ACH card	<ul style="list-style-type: none"> ▪ Transaction is not sent through card association or through debit network. ▪ Card is authorized at point of sale, but funding and settlement happen at EOD. ▪ Funds are removed directly from customer’s account at end of day. 	Lower cost.	Costs are much less than that of a PIN debit or offline debit transaction.	<ul style="list-style-type: none"> ▪ Marketer assumes risk and does not have protection from card associations against chargebacks or fraud. ▪ Fraud risk is higher if cards are stolen. ▪ Funds are not removed immediately from customer’s account; some risk that funds will not be there at EOD settlement. ▪ Customer must “opt in” to keep information in marketers database.