

MONEY GUY

TIRED OF HEARING ABOUT THE DURBIN AMENDMENT?

THIS WILL WAKE YOU UP!



by Harold Montgomery



Harold Montgomery is the CEO of Calpian, Inc., a Dallas, Texas-based provider of financing opportunities to merchant acquirers. You can contact Harold at 800.589.1173 or portfolio@calpian.com. Follow Harold on Twitter at @twmoneyguy.

Think the Durbin Amendment that goes into effect this month doesn't matter? Think again – it matters to many ISOs and merchants and it matters a lot. The net of all the discussion about Durbin is that the wholesale price for debit transactions is about to fall by a large amount. I have been wondering what the order of magnitude of the decrease in cost will be so I started looking at an average portfolio my company, Calpian, Inc. (OTCBB:CLPI.OB), owns. The results surprised me.

I looked at a typical portfolio of seasoned brick and mortar merchants processing for the period January 2011 through June 2011 (six months.) The total volume of credit and debit processing for the six month period was \$18.2

million (about \$3.034 million per month.) Of that, \$6.6 million was debit (about \$1.1 million per month). There were 278,109 transactions over 6 months (46,352 each month.) *(Note: All portfolios are different and others may have more or fewer debit transactions and different merchant characteristics, such as average ticket size, etc.)*

I compared the revenues, costs and profits from this portfolio for the first six months of 2011 to the same numbers as if the Durbin pricing had been in effect since January 1, 2011. The difference in cost was almost 44% lower under the new pricing. The table on the following page summarizes the comparison results.

January - June 2011	Old Pricing	New "Durbin" Pricing
Transaction Count (#)	278,109	278,109
Total V+MC Debit Volume	\$6,579,739.67	\$6,579,739.67
Gross Revenue Paid By Merchant	\$130,807.84	\$130,807.84
All Interchange and Processor Cost	\$103,548.90	\$58,402.89
Margin	\$27,258.94	\$72,404.95
Margin Increase From Old Pricing to New Pricing		\$45,146.01
Percentage Increase in Margin		165.62%

I did not change the price to the merchant in this example to show how dramatic the decrease really is. Over the entire population of merchants accepting debit cards in the U.S., this change amounts to a huge amount of money.

But, who get the margin increase? Congress clearly intended for retailers to benefit from the cost reduction somehow, and left the Federal Reserve Bank to take care of the details. But, the Fed's rules don't specify who should get the reduction in cost or how the reduction should be passed along the chain of delivery from processor all the way to merchant. There are many mouths in the food chain that can (and probably will) grab a slice of this money flowing through the system wherever and whenever they can.

ISOs and merchants who have so-called "interchange plus" pricing will see a cost reduction on debit transactions when processors unilaterally lower the interchange rate. These ISOs won't see a change in their residual stream as a result of Durbin implementation.

However, ISOs with so-called "bundled pricing" will see the cost reduction accrue to the benefit of the ISO, whose residual will increase as a result. These ISOs control the merchant's pricing and they have a decision to make: whether or not to pass the savings along to the merchant? If so, do they pass 100% of it to the merchant? In addition, it's not clear the ISOs have the means to pass the

savings along if they elect to. They'll have to let the processor know to change the price table for the merchant to make the change stick.

In discussions I have had with merchants, I have found them surprisingly aware of the Durbin amendment and their expectations are that processing rates will fall sometime this year. Whether they will actually notice any reduction is unclear since merchants have a difficult time reading their statements, and any actual reduction in the amount spent on processing will depend on volume, card type used and many other factors.

The market will force a reduction in debit processing rates across the board in about a year or maybe two at the most. Those who can pass the savings on to merchants and choose not to do so risk the wrath of those merchants when they finally do figure it all out.

The Durbin Amendment is a terrible piece of legislation. It was conceived to serve the interests of a single group (retailers) at the expense of another (banks) which happened to be out of political favor at the time. To be generous, it was poorly thought through and the consequences were not well understood (that's very generous.) To me, the Amendment represents political revenge against banks. If that's not enough, Senator Chris Dodd, Chairman of the Finance Committee and co-author of the Dodd-Frank financial reforms, told

the ETA in May that he knew Durbin was a bad piece of legislation. But, Dodd was candid in saying that he needed Senator Durbin's vote to get the overall financial reform package passed through the Senate. (Upon hearing this, members of the ETA attending the speech were appropriately appalled, speechless and surprised. Thanks to the ETA for bringing Senator Dodd to the members to explain this piece of bare-knuckled political reality.)

This poor piece of public policy will harm the banking system irreparably and forever. Once something like this goes into place, it won't be removed. Durbin represents the worst kind of politically motivated overreaching by the government that we have seen in the payments business to my knowledge. There's no justification for it. But, we're stuck with it, regardless. The acquiring side is lucky the focus wasn't on it this time.

The real lesson of Durbin is that the payments business is on the government's radar screen, like it or not. There may be more regulation coming, and you can bet the next round will be more tightly written. If and when the government returns to see what the effects and lessons of the Durbin Amendment are, our industry will want to be seen as constructive, responsible actors. That places a responsibility on all payments business participants to handle the price reduction Durbin mandates with thoughtful care. If the industry handles this well, the government may not see a need to regulate further. If this issue isn't handled well, and some industry players keep the windfall from the Durbin changes, we won't have much of a case when the government comes back and asks what happened. Our industry would be well-served to make sure that Congress's intent is fulfilled and merchants receive the full benefit of the Durbin cost reduction. Anything else will be very hard to explain. ■