



News Release

For Immediate Release

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New Comprehensive PULSE Debit Industry Study Reveals Continued Growth in Debit Card Market

Debit Transaction Growth of 18 percent in 2006

Card Issuers Expect Similar Rise in 2007

HOUSTON — U.S. debit card-issuing financial institutions experienced debit card transaction growth of 18 percent in 2006 and expect continued strong growth in 2007, according to a new study commissioned by PULSE EFT Association.

The *PULSE 2007 Debit Issuer Study*, conducted by Dove Consulting, a division of Hitachi Consulting, is an update of a study PULSE released in December 2005. It offers more recent data on debit card program performance and fraud losses, and provides informative new insights on topics such as debit interchange and debit rewards.

Debit card usage continued to grow at a healthy pace in 2006. Issuers reported average transaction growth of 20.3 percent for signature debit and 15.7 percent for PIN debit last year, with large banks experiencing the highest growth rates.

Debit card activation rates averaged 56 percent in 2006 for issuers that define “active” cards as those that have made one signature-based transaction in the last 30 days. On average, active cardholders performed 16.1 transactions per month – 10.6 signature-based and 5.5 PIN-based.

Study participants achieved an average debit card penetration rate of 72 percent for consumer checking accounts, and 86 percent of the debit cards they issued were signature-capable.

“The financial institutions that participated in our study reported a solid year for debit in 2006 and are optimistic about the future of this payment method,” said PULSE Executive Vice President Cindy Ballard. “The *2007 Debit Issuer Study* is a comprehensive analysis of the U.S. debit card industry, providing insights into such varied areas as transaction activity, fees and fraud losses.”

A total of 55 debit card-issuing financial institutions participated in the study. These large banks, community banks and credit unions collectively issue more than 62 million debit cards.

Other findings regarding debit program performance included:

- Business debit cards are offered by 64 percent of the issuers surveyed and account for 5 percent of their total card base. (All of the large banks in the study offer business debit cards.)
- More participating institutions offered debit card rewards in 2006 (37 percent, compared to 36 percent* in 2005). Of those participants that offer debit rewards, 37 percent reward cardholders for both PIN and signature transactions, compared to 29 percent in 2005.
- Four percent of the issuers surveyed issued contactless cards in 2006. An additional 22 percent plan to do so in 2007, and 29 percent are considering it.

“Contactless cards are a hot topic in the industry, but most issuers are taking a ‘wait and see’ approach,” said Tony Hayes, vice president with Dove Consulting and project lead on the study. “Reasons for their hesitation include lack of widespread merchant acceptance, high levels of uncertainty about the future of the product and fraud-related concerns.”

Fees and Interchange

In the area of debit-related fees, the study offered the following findings:

- Twenty-eight percent of the issuers surveyed charge a PIN debit transaction fee to at least some account holders, compared to 32 percent in the previous study. These fees average \$0.48 and affect 5 percent of cardholders.
- Foreign ATM fees levied by survey participants averaged \$1.44 per transaction in 2006.
- Fifty-six percent of participants allow overdrafts on debit transactions.

The *2007 Debit Issuer Study* also delved into the subject of interchange rates on debit transactions, revealing some interesting results.

“Interchange is an important source of revenue for issuers, but deciphering interchange rates can be complex,” said Hayes. “What matters for issuers is the ‘effective’ interchange rate – the blended average rate across all merchants and transaction types, after network switch fees.”

Interchange pricing can vary depending on merchant segment, merchant transaction volume and authorization mechanism. Issuers say they have a much better understanding of the interchange they receive on signature debit transactions compared to PIN debit. Effective net interchange income averaged 111 basis points (bps) for signature debit and 46 bps for PIN debit. These averages are based only on the study participants that reported interchange income.

Fraud

In order to capture a full year’s worth of fraud data, issuers in the study were asked to report fraud-related information from 2005 (the previous study captured 2004 data).

“Fraud is shifting from the cardholder level to the system level, from a local issue to a global issue, and from predominantly signature debit to both signature and PIN debit,” said Hayes.

Based on the fraud losses reported by the study participants, issuers nationwide lost a total of \$662 million to debit card fraud in 2005, a 21 percent increase over 2004. Of these losses, 60 percent resulted from ATM transactions, 37 percent from signature debit transactions and 3 percent from PIN point-of-sale (POS) transactions. Signature-based losses grew 28 percent in 2005, while PIN-based losses (including ATM and PIN POS losses) rose 17 percent.

Issuers are utilizing more advanced fraud detection tools to combat evolving fraud tactics.

“Financial institutions ranked CVV/CVC checking, neural networks and international transaction blocks as the most effective fraud prevention tools,” said Hayes. “In fact, I expect their widespread use of CVV/CVC checking last year to reduce phishing-related PIN-based losses in 2006.”

Outlook

Debit card issuers continue to predict strong growth in the debit arena. Survey participants expect to grow their debit card programs by an average 17 percent during 2007, representing 18 percent growth in PIN debit volume and 16 percent in signature debit.

“This study reveals a debit card industry that is maturing yet still exhibiting strong growth and resilience,” said Ballard. “Debit card issuers and networks face the ongoing challenge of fighting fraud, but we have stepped up our focus in this area and are implementing new technologies and processes at a rapid rate to combat fraudulent activity. Overall, debit remains a great product that delivers significant value to financial institutions, merchants and consumers.”

About PULSE EFT Association LP

PULSE is one of the nation’s leading ATM/debit networks, currently serving more than 4,400 banks, credit unions and savings institutions across the country. PULSE is owned by Discover Financial Services LLC, a business unit of Morgan Stanley (NYSE:MS). The network links cardholders with nearly 260,000 ATMs, as well as POS terminals at retail locations nationwide. The company is also a valued resource for consumer research related to electronic payments and is committed to providing its participants with education on evolving products, services and trends in the payments industry. For more information, visit www.pulse-eft.com.

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*Corrects a previous reference to 33 percent, which appeared in an earlier version of the release.

Media may request an executive summary of PULSE’s 2007 Debit Issuer Study by contacting one of the people listed below.

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