March 2013

sold its

$5.7 billion

consumer credit card portfolio and entered into a long term strategic relationship with

March 13, 2013

The undersigned served as financial advisors to Target Corporation

The Resurgence of the ATM Channel: Leading Banks' ATM Strategies in 2012

People are talking about ATMs again. And not just as a cost center to be managed or a mature asset to be maintained, but as an investment priority, and increasingly, as a competitive imperative.

ATMs are not the profit centers they once were, nor are there expectations that they will be. But leading banks' behind-the-scenes investments in advancing their ATM technology platforms (as well as their broader technology infrastructure) over the past several years have laid the foundation for new features and functionality—most notably image-enabled deposits—that are now coming to market and changing consumers' ATM experience in meaningful... More

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Commercial Cards: Delivery Models Matter

As commercial cards, central travel accounts, and non-plastic virtual accounts continue to gain in popularity, financial institutions (FIs) with significant commercial banking activities are increasingly asking the question: do we have the right program delivery model for our commercial cards offerings?

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Employee Incentive Cards: The Open-Loop Advantage

Prepaid comprises the fastest growing segment of the U.S. debit market, driven largely by increasing penetration into existing markets. This trend is visible in the employee incentives space, where prepaid cards—in particular, open-loop cards—have gained traction and are now coming to the forefront of the... More

Payments Industry Stock Price Tracker

Figure 1 is the March Payments Industry Stock Price Tracker. The chart measures current stock prices and market caps (as of March 20, 2013) as well as movement over the last 30 days, and year-to-date. Breaking through the static start to 2013, the companies we track across the payments value... More

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By Melissa Fox

People are talking about ATMs again. And not just as a cost center to be managed or a mature asset to be maintained, but as an investment priority, and increasingly, as a competitive imperative.

ATMs are not the profit centers they once were, nor are there expectations that they will be. But leading banks' behind-the-scenes investments in advancing their ATM technology platforms (as well as their broader technology infrastructure) over the past several years have laid the foundation for new features and functionality—most notably image-enabled deposits—that are now coming to market and changing consumers' ATM experience in meaningful ways.

With significant benefits to be gained from the mass-market roll-out of deposit imaging and further challenges and opportunities looming on the horizon with the rise of mobile banking and payments, banks are re-thinking the role of the ATM within their distribution strategy.

ATMs have become exciting again, and with the renewed focus on the channel, we may be entering a fourth "phase" in the evolution of the ATM industry in the U.S.: channel resurgence.

To understand banks' evolving ATM strategies, First Annapolis spoke with a number of leading banks earlier this year regarding their channel focus, deployment and placement strategies, technology investments, and priorities for ATM functionality. This study is the latest in a series of informal studies that we have conducted over the past several years based on primary and secondary research, allowing us to monitor the ongoing changes in banks' strategies and areas of focus.

Channel Focus

For the past several years, leading banks have been slowly returning to the customer-service roots of the ATM channel, with their primary strategic focus now shifting from expanding access to enhancing the user experience. In recent years, banks have focused on increasing customers' fee-free ATM access through direct deployment and alternative arrangements (e.g., ISO ATM branding), and many of them have now achieved their optimal network size. As deposit imaging gains traction and initial roll-outs demonstrate early returns in terms of transaction migration and increased customer satisfaction, a renewed focus on the user experience is reflected in their channel strategies.

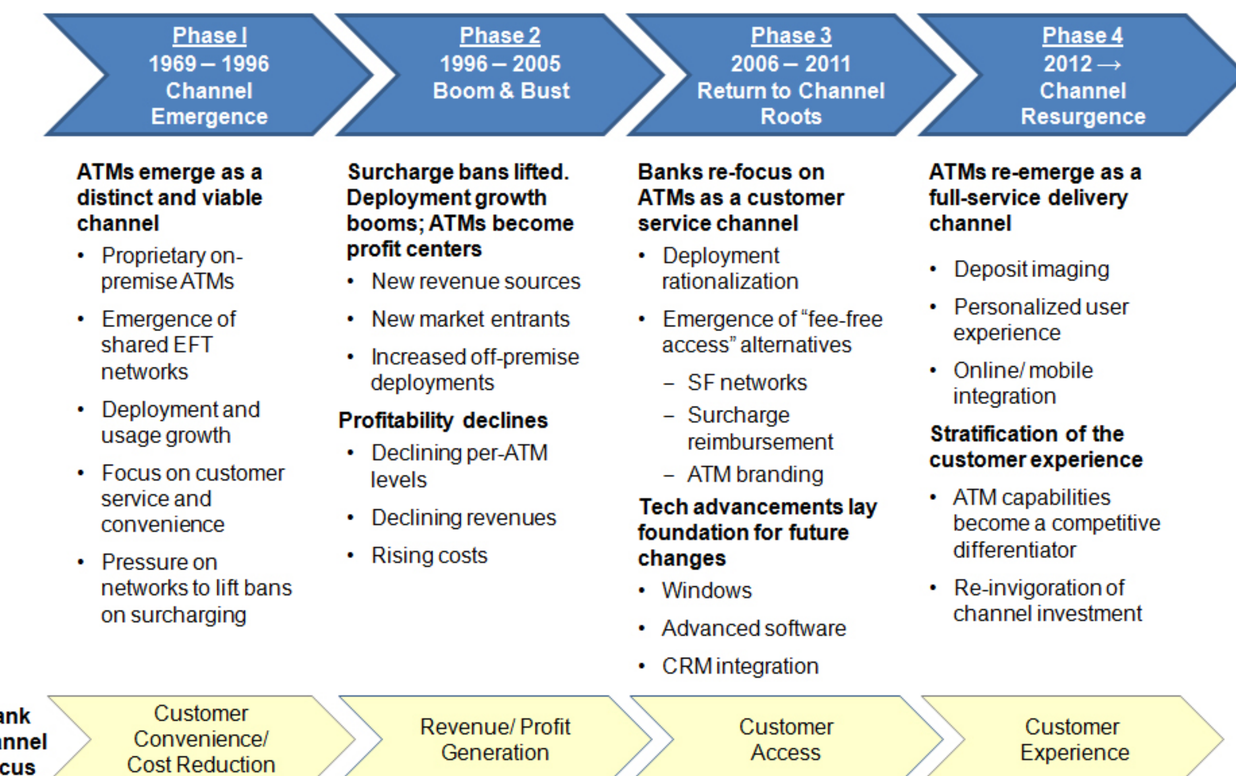
> "We were focused on aggressively expanding deployments, but in the past year or so, we feel we have finally achieved the right density. The goal now is to improve the experience at the machine. Our priorities are focused on imaging, marketing, and increasingly migrating teller functions to the ATM."
>
> --Large Regional Bank Channel Manager

Direct profitability, while still an important factor in managing the business, is no longer a strategic driver for most banks.

Consumer-Centric Deployment Strategies

Leading banks' deployment strategies tend to be retail-centric, in line with their customer service focus, and center on on-premise deployments and in-footprint off-premise deployments intended to serve their existing customer bases.

Figure 1: U.S. ATM Industry Evolution



Source: First Annapolis Consulting, Leading Banks ATM Strategies 2012.

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Leading banks currently have an average of 2.8 ATMs per branch (including both bank-owned ATMs and bank-branded ATMs owned by ISOs). The average bank fleet is 60% on-premise/ 40% off-premise, with many banks supplementing their own direct off-premise placements with branded ISO-owned locations.

Looking forward, most deployers believe they are at or close to the "right" number of ATMs for their customer base. As such, they are more focused on rationalizing current placements and filling distribution gaps than on wholesale expansion of their ATM networks. Future growth is expected to be in-line with banks' branch network expansion, with most of the growth being on-premise, with limited off-premise expansion in select markets to fill service gaps or support new branches.

Investing in the Customer Experience

With their network footprints more or less stabilized, banks appear to be shifting their focus more towards the customer experience they deliver—or want to deliver—via the ATM. In some cases this means more intuitive screen designs or an updated look-and-feel that better reflects their brand; in others, it means increased speed and convenience with personalized transaction preferences or better positioning the ATM as a full service delivery channel with image-enabled deposits and extended cut-off times.

The experience that banks are able to deliver via the ATM is very much tied to the technology foundation that underpins their network. Historical investment in ATM technology has varied significantly among leading banks. For some banks, maintaining and upgrading their ATM technology is part of their strategy; for others, competing demands for resources or a strategy of leveraging depreciation run-off have constrained investment in ATM technology.

The result is a stratification of ATM functionality and capabilities: those that have invested in upgrading their technology infrastructure are realizing functional and operational benefits (in the form of development cost savings, lower hardware costs, and improved consistency), and are positioned to introduce additional functionality. For others, significant investments in completing the migration to Windows and/or the bank's end-state software destination are core foundational items required before they can move forward.

With the four largest deployers (Bank of America, Chase, Wells, and Citi) having completed their conversions to image-enabled ATMs, the bar for ATM functionality has been raised. Most deployers are currently in some stage of roll-out of deposit-imaging capabilities, and with early positive returns, the business case for deposit imaging has driven/ is driving many deployers' fleet upgrades.

The case for deposit imaging is compelling both in terms of the significant cost savings opportunity associated with the elimination of daily deposit pick up and transportation expense, as well as the renewed opportunity migrate transactions to a self-service environment by improving the customer experience. One early mover saw their ATM deposit volume increase by 75% in the first 12 months after rolling out deposit imaging, and many other deployers have experienced similar lifts and shifts in volume. Earlier this year, Bank of America announced a milestone: half of their branch deposits now come through the ATM channel.

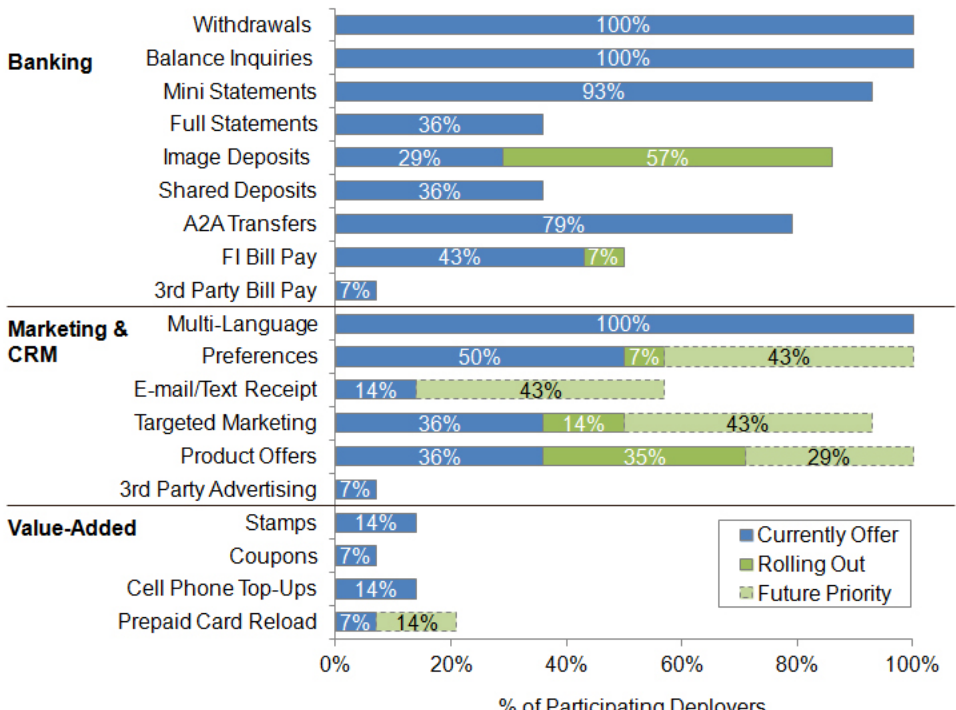
In addition to benefiting from the operational efficiencies that come from transaction migration and increased customer confidence/ satisfaction, increasing competitive pressure to meet customer expectations and extend deposit cut-off times is causing many banks to accelerate their roll-out schedules.

Backed by a compelling business case for a fleet upgrade, deployers indicate that they are now actively investing in their ATM technology and functionality—but existing platforms will drive their investment priorities, capabilities, and

Figure 2: Technology Investment Stratification

Market Leaders	Followers	Laggards
• Completed Windows migration • Running single (often proprietary) software platform • Completed deposit-imaging roll out	• Completed Windows migration • Running on (or shifting to) a single software platform • Rolling out deposit imaging	• Older fleets; OS-2 terminals account for more than 50% of ATMs • Software tied to hardware • Limited deposit imaging
Focused on targeted marketing, product offers, and channel/mobile integration	Focused on completing deposit imaging upgrades; preferences and targeted marketing are near-term priorities	Focused on upgrading fleet and laying technology foundation before enhancing functionality

Figure 3: Q1 2012 ATM Functionality



Source: First Annapolis Consulting, Leading Banks ATM Strategies 2012.

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timelines. Deployers' current priorities are focused on completing their roll-outs of image-enabled deposits, and their sights are set on leveraging their upgraded networks to enable product offers, preferences and targeted marketing capabilities down the road.

The ATM user experience, which until recently has been largely undifferentiated, is starting to become a competitive factor. Deposit imaging is poised to become standard, and the changes it enables in terms of extending deposit cut-off times and improving the overall user experience are resetting consumer expectations for banks' ATM capabilities and how they interact with their bank through this channel.

* * *

The business case for deposit imaging has driven and is driving many banks to upgrade their ATM technology, and has redefined the functionality baseline for "competitive parity." The divide between the "haves" and the "have nots" is becoming more pronounced, and a number of banks are now in the position of playing catch-up. This dynamic is driving a broad-based reinvigoration of investment in the ATM channel that extends beyond just the short-term conversion to image-enabled ATMs and is laying the foundation for banks to redefine the role of the ATM within their broader distribution strategies. Channel discussions are no longer focused exclusively on the more mundane and tactical aspects of managing a fleet of ATMs, but are centering on bigger strategic questions:

- How ATMs (and other networked devices) can be leveraged to deliver additional services and enhance customer relationships
- How ATMs and other self-service channels will work together to increasingly replace the traditional branch as consumers' primary point of interaction with their bank
- How ATMs can be used to complement or enhance innovations in mobile technology

As one bank executive observed, "ATMs are bringing sexy back!", and banks are rethinking their investment strategies and the overall importance of the channel accordingly.

This article previously appeared in the February 2013 issue of the ABA Banking Journal.

For more information, please contact Melissa Fox, Manager specializing in Deposit Access and Prepaid Strategy, melissa.fox@firstannapolis.com

TSYS/ NetSpend Transaction Offers Strong Signal of Prepaid's End Game

By Lee Manfred

The recently announced acquisition of NetSpend by card processing giant TSYS is arguably the highest profile and most important transaction in the history of the prepaid industry. Not only does the deal mark a dramatic change in the structure of the industry, but it is also a harbinger of an end game to the long anticipated consolidation of the prepaid industry.

TSYS paid a rich premium for NetSpend, $16 per share, roughly 30% over NetSpend's pre-announcement price. The $1.4 billion deal is being financed mostly with debt, and about $100 million of cash on hand and is expected to close in mid-2013. In return, TSYS is getting a leader in GPR and payroll card issuing, which generated $351 million in 2012 revenues from its direct-to-consumer, retail, bank, and partner distribution channels. NetSpend appears to have strong momentum, with new relationships with Intuit for tax refund cards for TurboTax customers, and with PayPal for GPR.

Strategically, the deal is an important one for TSYS. NetSpend enhances TSYS's share and capabilities in the fastest-growing segment in the payments industry. Prepaid not only accelerates TSYS's growth trajectory, but diversifies its revenue sources beyond credit card and merchant processing. Further, NetSpend boasts an industry-leading, prepaid-specific operating platform, which TSYS can leverage to deliver expanded services to its customer base in the U.S. and in international markets. Perhaps most importantly, NetSpend moves TSYS from a processing-only vendor, into program management, distribution, and servicing functions. These new value chain components

Figure 1: Prepaid Industry Consolidation

Date	Buyer	Target	Deal Terms	Rationale
Feb. 2013	TSYS	netSpend	$1.4B	Strategic acquisition that positions TSYS as leading program manager and processing provider
Nov. 2012	usbank	FSV Payment Systems	N/A	Strategic acquisition to acquire processing platform and increase payroll and incentive capabilities
Nov. 2012	account now	nFinanSe	N/A	Strategic acquisition to expand into retail channel
Apr. 2012	Google	TxVia	N/A	Strategic acquisition to enhance Wallet platform
Jan. 2012	green dot	ecommlink	$2.5M	Strategy to further vertically integrate platform

Source: First Annapolis Consulting research and analysis.

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represent revenue pools 3 to 4 times greater than legacy processing, an enormous opportunity for TSYS.

However, NetSpend brings TSYS into the direct-to-consumer business for the first time, and puts it in direct competition with many of its issuer clients, notably Green Dot. TSYS's ability to navigate these real and potential conflicts will be critical to the success of the acquisition over the long haul. In the prepaid sector, TSYS will also need to manage industry-wide price competition, the risk of increased scrutiny from regulators, and multiple distribution partners that drive program volume. To do so, TSYS plans to manage NetSpend as a stand-alone business unit while retaining NetSpend's management team to continue to execute its growth agenda.

With the deal, TSYS leaps immediately into a small group of scale providers in prepaid, along with American Express, JPM Chase, USBank, and Green Dot. The vertical integration these companies bring to the table is emerging as the prime basis of competition for large and small programs alike. This trend, combined with the rich valuation of NetSpend, suggests that industry consolidation will continue as strategic players try to enhance their capabilities across the value chain, and smaller providers take advantage of an attractive sellers market.

Finally, the deal will likely spur a number of competitive responses. First Annapolis expects most retail banks to enter the GPR and payroll card markets in some form, if they have not already done so. Much like the credit card business, the market will then be comprised of a handful of vertically-integrated strategic issuers/ program managers, and scores of franchise issuers that offer prepaid as an additional relationship product for consumer and business clients. Further, we expect prepaid processors that lack broader program management capabilities (e.g., FIS, Visa, and MasterCard) to explore alternatives to enhance their customer value propositions.

For more information, please contact Lee Manfred, Partner specializing in Deposit Access and Prepaid Strategy, depositaccesspractice@firstannapolis.com

Field Notes from the Isis Pilot

By Paul Grill and Stephen Kiene

Nearly three years since rumors began to swirl that the major mobile network operators (MNOs) sought to provide NFC payments, the Isis mobile wallet finally launched in late October 2012. While the initial rollout is focused on only two cities (Austin, TX and Salt Lake City, UT) and handset availability and merchant acceptance are still limited, Isis's market entry is a milestone in the evolution of mobile payments. First Annapolis has been tracking the Isis launch (primarily in Austin) and testing the wallet, and below we provide our observations to-date.

Availability & Advertising

The starting point for downloading and using the Isis wallet is a NFC-enabled handset. The three Isis carriers (AT&T, Verizon, and T-Mobile) currently offer 18 compatible handsets. The only overlaps among all three carriers are the popular Samsung Galaxy S III smartphone and Samsung Galaxy Note II, but each MNO enables at least four NFC-capable android devices, which they list on their websites and label in their retail stores. Apple's iPhone is one of the major handset models that does not have NFC integrated, although NFC cases and an iOS version of the wallet software are being developed.

An Isis-compatible payment account is the next requirement for the wallet. Chase, Capital One, and American Express are all promoted on the Isis website as eligible credit issuing partners, and each bank has designed a unique application to load and manage cards through the mobile wallet. American Express provides the widest range of card eligibility, with all personal and small business cards accessible through the wallet. Chase enables four bank-branded card products (Freedom, Sapphire, Slate, and JPM Palladium), but Capital One has not yet publicized its eligible cards. Barclaycard was originally announced as an additional issuing partner, but is not yet enabled in the wallet. For consumers who do not have one of the eligible credit products, an Isis Cash prepaid product (issued by Chase) is available in every wallet and preloaded with $10.

Isis should be available to use at any NFC accepting merchant, and on its website, Isis currently lists over 1,400 contactless payment acceptance locations in the two launch markets. However, Isis has also worked to promote new NFC enablement, enlist merchants to provide offers via the Isis wallet, and to promote the Isis brand at the POS. As a result of these efforts, Isis has formed more significant relationships with at least seven national retailers and 50 local merchants in the two launch markets. Several of the national merchant partners (including Macy's, Champs Sports, and Foot Locker) are also promotional partners of other mobile wallet initiatives, while some of the local partners (including the SLC public transit authority) enhanced their existing contactless payment systems to support Isis. Department stores and specialty retail/ apparel shops are the most common merchant categories, and an analysis of the Isis test markets in late 2012 indicated that over 40% of likely card accepting merchant locations in these categories within the two launch cities are capable of accepting contactless payments.

Isis conducted a wide-ranging marketing campaign in the Salt Lake City and Austin markets that included television, newspaper, and billboard advertisements. Merchant promotion typically remains limited to window stickers or POS terminal logos at promotional partner locations, but some retailers who have integrated Isis marketing offers have installed additional signage about the service. The three carriers promote Isis heavily in their retail stores, including posters, training terminals, and handset labels for wallet-enabled models, and each MNO has a webpage dedicated to Isis information and FAQs.

Wallet Enablement & Usage Experience

In order to use the wallet, customers must not only obtain an eligible NFC handset, but also upgrade the internal SIM to an Isis-ready version. Most of Isis's promotion directs consumers to these retail locations for information, and associates are trained to support customers with the wallet enablement process. Once the correct hardware has been obtained, the consumer must download the wallet application from Google Play. The wallet app confirms that the hardware requirements are met prior to installation.

A relatively straightforward sign-up process follows where users agree to the wallet's terms of service, establish a four digit PIN, and await text message confirmation that the wallet has set up the handset's secure element. To

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Figure 1: Isis Mobile Wallet User Interface

Cash Card | Loading New Card | Select Card Issuer | Verify Cardholder ID

Source: Isis and First Annapolis Consulting field research.

complete set-up at first login, the user may need to turn on the phone's NFC capability if it is not already enabled. In our testing, the wallet set-up process required about 5 minutes to complete.

Once a consumer is logged into the wallet for the first time, they can enable Isis Cash, add an eligible credit card, and set up offers. Isis Cash (issued by Chase) is a prepaid account that comes preloaded with $10. Adding funds to the account requires upgrading to a reloadable account by agreeing to additional disclosures and providing personal information. This process takes just a few minutes, although confirmation of the upgrade may take 24 hours. Users are provided an additional $15 for upgrading.

Consumers load credit accounts in the mobile wallet using a unique process for each issuer. American Express requires logging into an established online account to select the appropriate card, while Chase allows users to load accounts entirely in-app. Both issuers use a multi-step verification process for loading, including an authorization request sent directly to a previously established primary phone number or email address on file with the bank. While the verification steps may seem excessive, wait times to receive codes via text and email were typically only about 10-30 seconds.

Once the wallet and payment products are set-up, a consumer can begin to complete transactions by activating one of the "READY TO PAY" buttons that appears over the loaded payment accounts. Once activated, the button turns green and a NFC radio wave symbol appears on the phone's status bar. The wallet can be active even with another application in the foreground, but variable timeout settings ensure that payments can't be made after periods of inactivity. When the POS requests payment, the phone must be moved close to the surface of a NFC enabled terminal. Assuming the transaction is successful, the NFC terminal may beep and/or a series of green LEDs may illuminate. Simultaneously, the wallet will display confirmation that the payment is being made with the selected product.

In our testing, unlocking the wallet and waving/ tapping the phone elicited a transaction confirmation from both the terminal and the phone just about as quickly as fetching and swiping a card. On some occasions, it took an extra few seconds to receive an acknowledgement from the terminal, but it was unclear if this was a result of the NFC interface or a little too much waving and tapping on our part. While most transactions (including a split tender purchase with both the Cash Card and Amex) worked well, a handful (mostly outside the pilot cities) were not completed successfully. In these scenarios the phone indicated that a transaction had been sent, but neither the NFC receiver nor the POS system acknowledged receipt. We speculate that these failures were due to NFC not being fully enabled at the merchant locations in question, and no transactions were posted to the cards loaded in the wallet in these situations.

Closing Observations

Overall, Isis's initial wallet offering works as advertised, and its shortcomings (as reported in app store reviews) are generally related to availability, rather than to usability, reliability, or security. However, consumers, not payments industry professionals, will be the real judge of whether the Isis wallet can supplant cards over time. Recent reports that the wallet interface will be re-developed suggest that even Isis is not fully satisfied with its initial offering. Also, Isis and the industry at large understand that the ultimate success of the wallet will be driven by the adoption of NFC, which will be a multi-year process. However, while much of the industry commentary has highlighted that swiping a plastic card is a reliable, well-entrenched process and that mobile payments don't solve a specific problem, we should also ask the question, "If mobile provides a quick and reliable payments experience, why wouldn't consumers pay with their phone?"

For more information, please contact Paul Grill, Partner specializing in Mobile Commerce & Alternative Payments, paul.grill@firstannapolis.com; or Stephen Kiene, Consultant specializing in Mobile Commerce & Alternative Payments, stephen.kiene@firstannapolis.com

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By Frank Martien

As commercial cards, central travel accounts, and non-plastic virtual accounts continue to gain in popularity, financial institutions (FIs) with significant commercial banking activities are increasingly asking the question: do we have the right program delivery model for our commercial cards offerings?

To explore this question further, one may first consider the various commercial card program delivery models observed across markets and illustrated in Figure 1.

Referral Arrangements:

In the first model, Referral Arrangement, the FI is promoting a suite of FI-branded commercial card solutions offered by another provider (the referral partner). Typically, the FI's commercial bank relationship managers and treasury services sales would not actively promote these commercial cards, but would reactively direct commercial banking clients seeking a commercial card solution to the referral partner. Once referred, the partner would underwrite and issue commercial card solutions requested by the commercial banking client. Usually, but not always, this same referral partner would also be selected to run the FI's own internal employee travel and purchasing card programs. These solutions are branded with the FI's name on the front of the cards albeit with clear disclosures naming the referral partner as issuer of the cards.

Within such an arrangement, the FI will receive a referral fee from the partner, which is typically calculated as basis points on spend and/or a specified amount per card issued. The referral partner owns the P&L and all associated revenues and costs of delivery. Upfront and ongoing investment requirements for the brand partner are minimized; but given the relatively nominal level of referral fees received, brand partner, banker, and client engagement in this type of commercial card program delivery model are often quite low.

With regards to contractual rights and responsibilities, the FI, with limited control over program delivery, wants to protect their brand and may require certain minimum standards related to how its clients will be serviced by the referral partner. The FI may also seek to establish or document the underwriting and credit line assignment standards that will be deployed by the referral partner – an area for which we often see program issues encountered. Thirdly, and at termination of an arrangement, the FI may wish to have an exercisable purchase right at the program's then fair market value should the FI prefer to migrate the program in-house (i.e., self-issue) or to another referral partner.

Figure 1: Commercial Card Program Delivery Models

		Referral Arrangement	Full-Service Outsourcing	Systems Outsourcing
Program Setup	Upfront / ongoing platform investment	low	medium	high
	Choice of card network	✓	✓	✓
	Card and collateral branding	✓	✓	✓
Product	Product management & development			✓
	Product pricing (e.g., rebates, fees)		✓	✓
	Rewards program management			✓
	Card issuance / account ownership		✓	✓
Promotion	Commercial card lead generation	✓	✓	✓
	Rebate pricing / tenders / contract		✓	✓
Credit	Account underwriting		✓	✓
	Receivables funding		✓	✓
	Ongoing risk / fraud management			✓
Client Setup & Usage	End-user implementations			✓
	Card plastics production / mailing			
	Transaction authorization			
	Daily settlement		✓	✓
	Transaction accounting / accounts on file			
	Online access / controls / reporting			
Servicing	Client card administrator call line		✓	✓
	Cardholder call line			✓
Billing	Statement file generation			
	Statements rendered online / production			
	Electronic payment / wire / lock box		✓	✓

✓ denotes responsibility of FI
gray boxes denote outsourced functions

Source: First Annapolis Consulting research and analysis.

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Figure 2: Delivery Model Decision Tree

Source: First Annapolis Consulting research and analysis.

Typically such a purchase would be for the client commercial card account relationships only; and, consequently, a systems conversion would not take place. Rather, the legacy partner would close and collect residual amounts due on the old accounts while these same account relationships would be reissued new cards by the new issuer.

Full-Service Outsourcing:

In this second example, the FI is not only the brand partner, but may also hold the card network membership and be the bona fide issuer of the cards. As issuer of the cards, the FI would typically have the power to price each client program (e.g., signing bonus, rebates, card fees), underwrite the credit, and thereby own the P&L. The full-service outsourcing partner would then responsible for everything else, including delivery of the product and service to clients.

To effectively deliver the product and service to clients, the role of the outsourcing partner can be quite extensive. For example, when an FI's commercial banker has a qualified client lead, a card product specialist representative from the outsourcing partner may accompany this banker to help explain details regarding the product and help complete the sale. The outsourcing partner may also lead the implementation process and provide card administrator service support, cardholder service support, the online solution through which clients can access and manage their cards, transaction accounting, billing, and remittance processing.

This type of structure has several positive attributes. For example, the FI can access a strong product offering for its clients without incurring product development investment. The outsourcing partner can earn incremental fee revenue for program delivery to help cover some of its fixed costs.

Drawbacks from this approach can be the lack of product or service delivery control for the FI and concerns from the outsourcing partner about spawning a future competitor. Consequently, key contractual provisions for these types of arrangements can often revolve around control mechanisms for the above as well as rules of engagement for competitive situations – such as what happens when the FI and the partner both receive the same end-user organization card program RFP. Theoretically, this type of program delivery model is quite possible; however, finding commercial card issuers with an interest in being an outsourcing partner can be a challenge. As such, full-service outsourcing is far less common than referral arrangements or systems outsourcing.

Systems Outsourcing:

In a systems outsourcing model, the FI is squarely in the business both strategically and operationally with control over most client-facing components of servicing. Under this model, an FI will often contract with one or more third parties to provide card production/ mailing, transaction accounting, billing, and remittance support as well as an online solution through which clients can manage their cards. Many FIs just launching or re-launching a commercial card program will also contract with a third party to provide ancillary components of client servicing support such as overflow, off hours, lost/ stolen reporting, or fraud monitoring and management.

Under the systems outsourcing model, the FI owns the client relationship, underwriting, product, and much of the servicing. As such, contractual requirements are more narrowly focused on clearly defining the third parties' role, flexibility and exclusivities (if any) regarding this role, service level standards, and pricing.

Key Conclusions:

For any FI desiring a commercial card program, the optimal delivery model will certainly vary. Figure 2 provides a high-level decision approach for which delivery model may fit best.

As one can see from this diagram, a natural first question for an FI considering a commercial card program is whether or not they want to offer this product at all. Clearly, no delivery model is needed if the answer is "no" if, for example, the FI focuses on the consumer and/or small business market only. Under a "yes" scenario, a next question might be to gauge how important incremental revenue or earnings may be in the broader decision to have a commercial card program. If the program is merely an accommodation for clients desiring cards, then the most effective model may be had via a referral arrangement. Alternatively, an FI's last strategic question may be level of commitment to resources in deciding between the full service and systems outsourcing models.

In conclusion, FIs have several choices and considerations regarding how to offer a commercial card product to clients. Going forward, we expect to see most FIs go the systems outsourcing route given the treasury services relationship and revenue build opportunity from commercial cards.

For more information, please contact Frank Martien, Partner specializing in Commercial Payments, frank.martien@firstannapolis.com

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Outsourcing Servicing Functions to Credit Card Processors

By Scott Reaser

The prevailing operating model for the largest consumer credit card issuers in the U.S. is to deliver key portfolio servicing functions (e.g., customer service, collections, etc.) in-house or, in the case of the very largest issuers, use a combination of internal and specialized BPO providers for delivery. However, many large issuers still leverage third party credit card processors to deliver select servicing functions such as fraud detection, lost/ stolen or chargeback processing. This allows them to take advantage of specialized skills, scale, and other capabilities provided by their card processor.

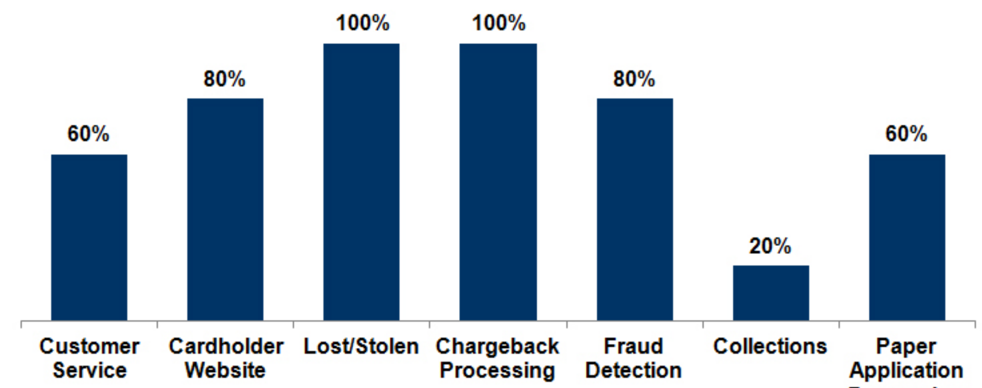
Recent entrants and re-entrants to the credit card market have taken a different approach to servicing, relying more heavily on their processors for program delivery. While their reasons vary, accessing capabilities, launch complexity, time to market or conversion timing (for those institutions re-acquiring their portfolio), and delivery management (i.e., integrated provider) have been the key drivers of outsourcing servicing functions. Likewise, credit card processors have made it easier for card issuers to outsource portfolio servicing functions, including customer service. Many have shown flexibility in deal structure and delivery model to facilitate those issuers that would like to transition particular functions in-house over time as it builds out internal capabilities.

The chart below depicts select portfolio servicing functions outsourced to card processors by new entrants/ re-entrants. The data reflects five recent program launches that First Annapolis advised in setting up and sourcing card processing and portfolio servicing partners. In most cases, the card issuer chose to outsource a majority of servicing functions to its card processor, including customer service, cardholder website, and other critical customer facing functions, while maintaining strategic decisioning (e.g., account acquisition strategy, risk management, etc.) in-house.

It is unclear whether the trend for large card issuers (and in this case, new issuers) will be to outsource customer service and other key servicing functions to card processors. While unique circumstances dictated several of the delivery strategies described above, we expect the card processors to be long-term players in the portfolio servicing space. Card processors are increasingly enhancing their capabilities in portfolio analytics, campaign management, and marketing execution areas. This allows them to offer a more robust set of solutions to their card issuing customers. We believe integrating the various components of analytics, execution, card processing, and servicing together will likely create a viable value proposition for new entrants and other card issuers.

For more information, please contact Scott Reaser, Principal managing the Strategic Sourcing practice, scott.reaser@firstannapolis.com

Figure 1: Percent of Observed New Entrant Issuers that Outsourced Servicing Functions to their Credit Card Processor



Source: First Annapolis Consulting research and analysis.

Employee Incentive Cards: The Open-Loop Advantage

By Steven Le

Prepaid comprises the fastest growing segment of the U.S. debit market, driven largely by increasing penetration into existing markets. This trend is visible in the employee incentives space, where prepaid cards—in particular, open-loop cards—have gained traction and are now coming to the forefront of the industry.

The business case for incentive cards hinges on greater personalization relative to cash and ease of implementation relative to travel/ merchandise awards. In a 2012 survey of incentive program planners conducted by Incentive Magazine, 37% of respondents believed that gift cards were more effective than cash and 76% believed they were at least as effective. The figures are even more persuasive when comparing cards to merchandise; 55% believed they were more effective than merchandise, while 90% said they were at least as effective[1].

Research among incentive recipients validates program planners' beliefs. In a 2012 study conducted jointly by the Incentive Research Foundation and Incentive Gift Card Council, given the choice between a prepaid card reward and cash, over 80% of employees preferred the prepaid card. However, the type of card is a significant driver; open-loop rewards are preferred to cash, but cash is preferred to closed-loop cards. In fact, open-loop cards are three times as popular as closed-loop cards and cash combined[2].

Although closed-loop has historically led open-loop in share of cards awarded (55% to 45% in 2011), open-loop has steadily closed the gap[3]. Incentive planners report that the use of open-loop cards has increased significantly over the past four years. If the recent trend continues, we expect the open-loop segment to overtake closed-loop as the largest component of incentive prepaid within the next two years.

The overwhelming preference for receiving an open-loop card can be explained by a number of factors. Psychological research suggests that cash rewards tend to be incorporated into a recipient's regular budget, whereas

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prepaid cards are more likely to be spent on discretionary – and potentially more memorable – purchases[4]. An open-loop card provides the opportunity to spend freely on "fun" purchases, without the limitations of a single-merchant card. Given these factors, it is no wonder that open-loop prepaid cards are capturing share at the expense of alternative incentive categories. They offer planners an opportunity to simplify their incentive programs while providing more effective rewards to their employees. This value proposition will continue to drive growth of open-loop prepaid in the employee incentive market in the coming years.

[1] *Incentive Mag 2012 Gift Card IQ Survey, http://www.incentivemag.com/Resources/Research/Articles/2012-Gift-Card-IQ--Gift-Cards-Outpace-Cash/.*

[2] *It's in the Cards: An In-Depth Look at Prepaid Cards in Incentive, Rewards & Recognition Programs (IRF/IGCC 2012), http://theirf.org/direct/user/site/0/files/Its%20in%20the%20Cards%20ver%20April%2020.pdf.*

[3] *2012 First Data Prepaid Employee Incentive Card Study, http://www.firstdata.com/downloads/thought-leadership/B2B_Incentive_Card_WP.pdf.*

[4] *White, R. (2008). The mental accounting of gift card versus cash gift funds.*

For more information, please contact Steven Le, Senior Analyst specializing in Deposit Access and Prepaid Strategy, steven.le@firstannapolis.com

Payments Industry Stock Price Tracker

By Collin Bauer

Figure 1 is the March Payments Industry Stock Price Tracker. The chart measures current stock prices and market caps (as of March 20, 2013) as well as movement over the last 30 days, and year-to-date. Breaking through the static start to 2013, the companies we track across the payments value chain generally experienced positive results over the last 30 days, but are still just shy of the broader market's 7% gain thus far in 2013.

In summary:

Stocks within the issuing sector posted gains of 5% as a whole over the last 30 days, with none of our tracked issuers posting stock price declines. FleetCor, Discover, Amex, and Citi have posted double-digit YTD gains. Discover's stock rose 15% this month after announcing a new stock repurchase program and an increase to second quarter dividends of over 40%. Bank of America also announced a new share repurchase program that helped its stock realize an 8% gain over the last 30 days. Capital One has begun to recover from its disappointing start to the year by posting a 3% gain over the last 30 days, but is still down 12% on the year.

The processor/ acquirer sector shared mixed results over the last 30 days, but still posted an overall gain of 4% for the month to help push its total realized gains to 6% YTD. Fiserv announced the merging of its mobile banking and p2p platforms in early March, which has helped its stock price post 6% gains over the last 30 days. TSYS' stock steadily climbed throughout the month to finish up 10% following news of its $1.4 billion agreement to purchase NetSpend.

MasterCard and Visa posted similar results over much of the last 30 days, but news in recent days about Visa exploring possibilities to purchase its European counterpart gave the stock a late surge. In aggregate, the sector is up 2% year to date.

For more information, please contact Collin Bauer, Senior Analyst specializing in Credit Card Issuing, collin.bauer@firstannapolis.com

Figure 1: Monthly Average Stock Price Tracker

Companies	Mar. 20, 2013	30 Day Δ	YTD Δ	Current Market Cap ($Billions)
Issuers				
American Express	$66.00	7%	12%	$72.91
Bank of America	$12.78	8%	6%	$138.28
Capital One	$53.91	3%	-12%	$31.13
JPMorgan Chase	$49.12	1%	10%	$186.83
Citi	$46.09	7%	12%	$140.06
Discover	$44.96	15%	14%	$22.37
FleetCor	$69.74	2%	26%	$5.66
U.S. Bank	$33.93	0%	3%	$63.22
WEX	$76.69	2%	0%	$2.97
Weighted Average	-	*5%*	*8%*	-
Acquirers / Processors				
FIS	$38.44	4%	7%	$11.32
Fiserv	$85.76	6%	6%	$11.45
Global Payments	$47.77	-5%	4%	$3.76
Heartland	$31.00	-5%	3%	$1.14
TSYS	$24.10	10%	8%	$4.50
Vantiv	$23.07	5%	12%	$3.28
Weighted Average	-	*4%*	*6%*	-
Networks				
MasterCard	$518.62	1%	2%	$63.67
Visa	$159.33	3%	3%	$105.39
Weighted Average	-	*2%*	*2%*	-
Market Index				
S&P 500	$1,558.71	3%	7%	-

Note: Weighted Averages are based on current market caps.
Source: Yahoo Finance, First Annapolis Consulting research and analysis.

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