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Jason Oxman brings two decades of technology and policy experience to the ETA, the global trade association representing more than 500 financial and technology companies in the electronic payments industry. Jason joined the ETA from the Consumer Electronics Association, owner of the International CES®, where he served as Senior Vice President of Industry Affairs. Previously, Oxman served as General Counsel of a technology industry trade association and as Vice President of a Silicon Valley-based technology company. Oxman also worked at the Federal Communications Commission to develop and implement technology and broadband policies. He began his legal career as... More

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A Conversation with Jason Oxman, Chief Executive Officer of the Electronic Transactions Association (ETA)

By Scott Calliham

We recently had the opportunity to speak with Jason Oxman, Chief Executive Officer of the Electronic Transactions Association (ETA), about the ETA's strategy. In this Q&A session, we cover topics such as the outlook for the ETA in the coming year, challenges facing the payments industry, and the ETA's thought leadership programs.

Jason Oxman brings two decades of technology and policy experience to the ETA, the global trade association representing more than 500 financial and technology companies in the electronic payments industry. Jason joined the ETA from the Consumer Electronics Association, owner of the International CES®, where he served as Senior Vice President of Industry Affairs. Previously, Oxman served as General Counsel of a technology industry trade association and as Vice President of a Silicon Valley-based technology company. Oxman also worked at the Federal Communications Commission to develop and implement technology and broadband policies. He began his legal career as a law clerk for the Maine Supreme Court, and he is also a former broadcast journalist. Oxman received his B.A., cum laude, from Amherst College, and his M.S. and J.D. from Boston University.

What are your goals for the ETA this year and beyond?

Our focus is to continue to position the ETA as the hub of activity in the payments and technology world. The ETA is a central hub of industry activity, education, policy activity, and overall business activity, as well as credentialing activities related to standards and best practices.

What do you view as the biggest change that the ETA faces today?

The biggest change in the ETA's 22-year history has been the expansion of the payments industry to include technology companies. I think the most important change that our industry is experiencing and, therefore the ETA is experiencing, is viewing innovation of the payments network as a positive for incumbents in the industry. That is to say, that the traditional ISO and acquiring channels have grown up over the last 30 years in a particular way. I think disruption in technology is presenting huge opportunities for traditional payment companies that embrace new products and services for merchants. I think the change, again, for both the ETA and for the industry, is that we all view that kind of disruption as a huge positive for us as long as we're willing to make the necessary changes to embrace and deploy new technologies.

What do you see as the biggest risks or challenges with either new technology or other issues that are coming up?

I think the biggest risk is disintermediation, and that is the bypassing of traditional channels to merchants. I think the value proposition that the ETA is communicating on behalf of its members to new technology companies is that there is no better channel than the traditional acquiring channel to reach the nation's eight million merchants that accept electronic payments. No matter how disruptive and how innovative the new payments technology is, it still needs an established channel to reach the merchant. The payments industry is enormously complicated and heavily regulated; it still needs companies that know what they're doing in payments. So preservation of that channel that the ETA traditionally represents is, first and foremost, our priority. Ensuring that new technology companies work together with existing payments companies to bring their products to market, really, is how we want to capitalize on this opportunity.

What are some of the new ways the ETA is spearheading educational change and capturing the voice of its members?

The ETA established two new committees in 2013 that have been enormously successful; the first is our Mobile Payments Committee, which is currently our largest committee. We have more than 60 companies participating and it has really become an essential focus for the mobile payments industry working together to educate consumers and merchants about the value of deploying mobile payments. We've been extremely pleased to welcome all of the nation's mobile network operators, AT&T, Verizon, Sprint, and T-Mobile, as members in the ETA. Additionally, there are technology companies like Google, Microsoft, Intel, Amazon, as well as mobile application companies and new payments technology companies participating in the ETA's Mobile Payments Committee. I am quite pleased with this enormously successful undertaking.

Our second new committee, which has also been enormously successful, is our Large Processor Council. Our Large Processor Council is a body that addresses the very specific and very important issues faced by our nation's largest processors. All of the largest processors in the country are members of the ETA and because of their position in the payments value chain, the processors interface with almost every player in the payments ecosystem from the card networks to acquirers, ISOs, equipment manufacturers, and other vendors. In fact, really, everybody in the payments ecosystem has a business arrangement with processors and therefore processors have a large number of issues that are unique to them and very important to the industry. So our Large Processor Council is designed to address those needs through various working groups within the Council to tackle industry-specific issues. As you know, First Annapolis has helped with this Council from the beginning, and has been engaged with facilitating the working groups, providing industry expertise and helping to draft the work product that the Council is interested in pursuing. We're pleased with the participation we have in the Large Processor Council and it's working very well.

What issues have these committees focused on recently?

I would say that the one important issue that the Large Processor Council has been engaged in is related to law enforcement investigations of merchants that happen to be on processors' networks. The concern that the ETA is addressing with the Federal Trade Commission, Department of Justice, and on Capitol Hill is that if processors happen to have a merchant that is in violation of a particular law on their network, we believe the processor should not be held liable for criminal behavior by the merchant simply because the merchant happens to be accepting payment cards and selling products that it shouldn't have been selling. The concern is that law enforcement has tried to bring processors in as liable for the behavior of bad merchants on their networks when processors have no involvement in, and no awareness of, what those merchants are doing that's against the law. As soon as the processors do become aware of it, they terminate those merchants from their networks.

The Large Processor Council has asked the ETA to become heavily engaged in this issue. We're dealing directly with those law enforcement agencies to make sure that processors aren't unfairly caught up in investigations, which can be costly and time consuming. We've also developed, and are in the

process of deploying, best practices guidelines for the use of all ETA members who want to know what the industry's best practices are regarding merchant onboarding and monitoring, ISO monitoring, and the like. It's a very significant undertaking for the ETA and it has been very helpful to our members.

The Electronic Transactions Association is an international trade association representing companies who offer electronic transaction processing products and services. The purpose of the ETA is to influence, monitor and help shape the merchant acquiring industry by providing leadership through education, advocacy and the exchange of information.

ETA's membership spans the breadth of the payments industry, from financial institutions to transaction processors to independent sales organizations (ISOs) to equipment suppliers. More than 500 companies worldwide are members of the ETA.

For questions about the ETA, including membership please contact Jason Oxman at joxman@electran.org, (202) 677-7402.

For more information, please contact Scott Calliham, Principal, specializing in Merchant Acquiring, scott.calliham@firstannapolis.com.

U.S. Circuit Court Overturns Leon Ruling: Industry Implications

By Lee Manfred and Frank Verhaegen

On March 21st, the U.S. Circuit Court of Appeals reversed District Court Judge Richard Leon's ruling that the Federal Reserve violated the Durbin Amendment of the Dodd-Frank Act in establishing the interchange fee cap for debit transactions, and in implementing the transaction routing provisions. The resolution of the legal battles (for now) will provide regulatory clarity for all, but the implications for key stakeholders will vary. These implications include:

Investment in Issuing: Prior to the Leon decision, debit issuing had returned to its historic position as a growth business. While revenue for regulated issuers remained well below pre-Durbin levels, banks enjoyed year-over-year growth driven by consumer usage, which increased steadily at 8% to 10% annually. Even at regulated rates, debit is clearly the most attractive DDA-based payment form. As such, with the uncertainty created by the Leon ruling eliminated, debit issuers will likely return to a growth agenda given the enduring consumer affinity for the product.

Acceleration of EMV: Debit EMV, already challenged by the requirement of multiple unaffiliated networks residing on a single chip, was virtually frozen by the possibility that two signature and two PIN networks would be required. Further, the potentially steep reductions in regulated debit interchange suggested by Leon caused most issuers to suspend even minor investments in debit, not to mention EMV. Overturning Judge Leon's ruling, along with recent agreements among MasterCard, Visa, and several PIN debit networks to cross-license applications, sets the stage for accelerated issuance of EMV-enabled debit cards.

Focus on Fraud: Fraud losses are the third largest expense for debit issuers, following network fees and processing costs. In the wake of highly publicized data breaches at major retailers, reducing transaction fraud has grown from an internal control issue to a public relations mandate. EMV only addresses certain fraud types, and tokenization efforts are still in their infancy, but failing to act to reduce fraud invites scrutiny from both consumer advocates and regulators.

Operational Relief: Irrespective of the progress of EMV deployment in the U.S., the "2-by-2" model favored by the merchants would have placed enormous operational burdens on issuers, networks, and processors. Existing debit network infrastructure did not contemplate a regulatory requirement to route multiple signature brands. Similarly, back office work flows are typically designed around the network employed for the original transaction; merging those functions would be a tremendous undertaking. Avoiding that investment is a benefit for virtually all stakeholders.

Revenue enhancement: While current interchange rates will remain intact, issuers will continue efforts to replace the revenue lost via Reg II. That revenue will generally come from three sources: new products, migration to existing higher-revenue products, and volume growth. GPR prepaid has emerged as a competitive requirement for all banks, either as a DDA alternative or as a companion product. Migrating spend to Durbin-exempt prepaid or to credit is not a panacea, but can be effective with key customer segments. Most important, however, will be sustained growth in DDAs and associated debit cards, still favored by large segments of customers for their security and control, and targeted by issuers with a variety of creative account and fee structures.

The debit business was facing months, if not years, of paralysis pending final determination of Judge Leon's ruling, and any required drafting and implementing of new regulations. The appellate court's overturning that ruling eliminates a significant portion of the uncertainty facing the industry, and clears the way for a renewed growth agenda among issuers.

For more information, please contact Lee Manfred, Partner lee.manfred@firstannapolis.com or Frank Verhaegen, Associate frank.verhaegen@firstannapolis.com. They are members of our Deposit Access Practice, specializing in Debit and Prepaid.

Small Business Credit Card Risk Abates

By Frank Martien

On a quarterly basis, First Annapolis tracks small business credit card net charge-off rates using four monoline issuers' C&I loan reporting and Bank of America's quarterly financial supplements as a proxy. As shown in Figure 1, annualized net charge-off rates for small business credit cards have continued to decline through 4Q 2013 and are currently tracking in the low single digits for many issuers. As a result, most small business credit card issuers are enjoying after-tax ROAs in the mid-single-digit range.

Many factors have resulted in improved credit risk performance, including:

- Cancellation of dormant and subprime accounts as well as reductions in credit lines dating back to the 2009 to 2010 timeframe.
- Measured improvements in the housing market, which has re-opened some liquidity for entrepreneurs from sources such as refinancings and home equity lines.

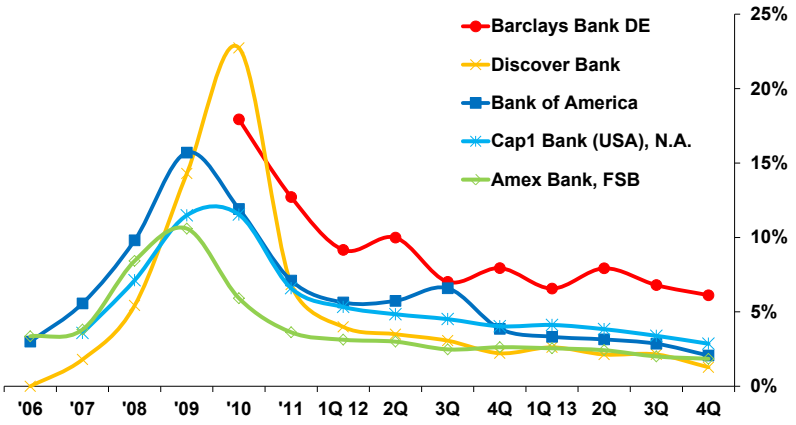
- Re-focus on rewards and marketing to relationship customers as a strategy. Even for monolines, "relationship customers" can be found in co-brand or agent bank partners' customer bases as well as cross-selling small business credit cards to existing consumer cardholders who demonstrate propensity for business spend on their cards.
- Avoidance of aggressive marketing techniques (e.g., balance transfer offers, convenience checks) to promote small business credit card balance growth.

Looking forward, we anticipate small business credit card risk will continue to be more volatile than consumer and thereby more vulnerable to future economic downturns. Fortunately, the difference in credit volatility between consumer and small business credit cards has been measurably reduced through more caution, including factors referenced above.

In summary, now is a generally favorable time for prudent investment in small business credit card programs.

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

Figure 1: Small Business Credit Card Annualized Net-Charge Off Rate



Note: Figures for total C&I loans except for BofA, which is for small business credit cards.

Source: Bank of America; FDIC call reports sourced via SNL.

Alternative Consumer Financing Models Emerge in U.S. Retail Segment

By John Grund and Andrew Broadhead

One of the lasting after-effects of the great recession is mixed credit availability. With the stock market at new highs and home prices recovering, consumer spending is being buoyed by affluent households with abundant access to credit. However, there are sizeable segments of the U.S. demographic that are still feeling the effects of the economic meltdown – they have impaired credit profiles, weak household balance sheets, and the road to recovery has been a case of fits and starts. Their access to traditional sources of credit is very limited given the pullback in non-prime lending by many mainstream financial institutions in response to the recession and new regulatory requirements.

Retailers are on the front-line of this particular dynamic and are quite active in exploring a range of alternative consumer financing solutions including layaway, different forms of rent-to own, and a variety of second look credit arrangements. While the table below is not meant to be comprehensive, it is clear that the dislocation of traditional credit providers has been a catalyst for the pursuit of alternatives. In many ways, it is a classic case of a supply and demand imbalance giving rise to new entrants and new solutions. While regulatory requirements are increasingly complex, advancements in technology and a repackaging of legacy services such as layaway and rent to own coupled with fresh investment capital is driving innovation in the

Figure 1: Select Listing of Alternative Retail Financing Models

Category	Representative Companies
Rent-to-Own (Lease Purchase)	Progressive; RAC Rent-A-Center; Why Not Lease It
Second Look Providers	Fortiva; Genesis Financial Solutions; NCL NewComLink
Specialized Solutions*	Progreso Financiero; Flexi Compras; GreenSky Home Improvement Finance; Pioneer Services Division MidCountry Bank; UpgradeUSA; presta; MCC MyComputerClub; Tronixcountry

Note: *Specialized solutions tend to focus on a specific customer/demographic segment or merchandise category. Models differ as some are direct-to-consumer and others are delivered in partnership with retailers.

Source: First Annapolis Consulting research and analysis.

space. Retailers such as Sears, Walmart, h.h. gregg, Zale Corporation, and others have different forms of alternative financing solutions in place based on unique market needs.

Similarly, there is renewed activity among specialists and a new breed of lending models seeking to fill a market void on either a direct-to-consumer basis and/or in partnership with retailers. Specialized lenders such as Springleaf Financial Services (formerly American General) and Santander Consumer Finance are focused on addressing the underserved market segment. Well-funded players such as Think Finance have successfully launched a host of innovative solutions such as Presta, a lease-purchase product. New business models such as Lending Club have emerged in the personal loan space with the potential to marry lenders and borrowers further down the credit spectrum. Additionally, there are a host of specialists focused on providing a more streamlined customer experience for retailers in need of a second look credit solution – companies such as Fortiva, Genesis Financial, and NewComLink are taking a fresh approach to the legacy secondary credit market. With so much activity, it is apparent that the imbalance of supply and demand in mainstream consumer credit is attracting investors and innovators alike. Time will tell if this new wave of solutions can strike the right balance between retailers, consumers, lenders, and, of course, regulators.

For more information, please contact John Grund, Partner, john.grund@firstannapolis.com; or Andrew Broadhead, Consultant, andrew.broadhead@firstannapolis.com. Both specialize in Credit Card Issuing.

Mobile Payments Update: An Overview on Host Card Emulation (HCE)

By Jeff Crawford

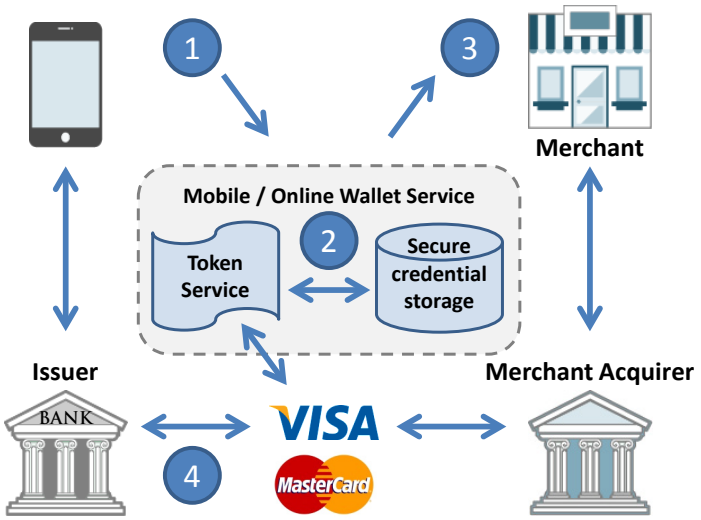
In late October 2013, Google announced an update to its mobile phone operating system. Android 4.4 (KitKat) changes the way in which the mobile device can interact with an installed near field communication (NFC) antennae. This feature, known as Host Card Emulation (HCE), has the potential to shape the future of mobile payments. HCE is an open architecture that allows mobile applications to emulate a contactless smartcard. Unlike traditional NFC transactions that rely an embedded or SIM card Secure Element (SE), HCE is a purely software-based solution. This new approach is significant for the industry because: 1) it takes control away from mobile network operators (MNOs) who control access to a mobile device's SE and, 2) it creates new possibilities for using a phone's NFC feature. While many questions remain, HCE has the potential to simplify the way in which for issuers and cardholders load payment credentials and complete transactions.

HCE works by storing payment credentials on a remote cloud rather than the SE (see Figure 1). Conceptually, a mobile application could be programed to send requests to allow access to these credentials via a secure token. This token would then be passed via the phone's NFC antennae to another contactless reader to complete a payment transaction. A key requirement is ensuring that the token is recognized by the reader as a valid payment credential. In late February, the two leading payment acceptance networks, Visa and MasterCard, addressed this issue by updating their contactless payment specifications, PayWave and MasterPass respectively, to read and accept these tokens.

This development may prove troubling to some mobile wallets, like the Mobile Network Operator-led Isis, which relies on the SE approach. Isis currently requires card issuers to integrate with a Trusted Service Manager (TSM) to facilitate access to a device's SE. HCE provides an alternative to TSM integration, which can be expensive and time consuming. To date, only a few European banks have explored HCE deployment, but there are service providers that are prepared to enable similar solutions in the U.S. market. Visa and MasterCard have also independently announced their intentions to provide software development kits (SDKs) that would allow issuers and other potential wallet providers to write HCE applications that conform to the existing contactless payment specifications.

Although it is too early to tell if HCE will be the long-awaited catalyst that leads to meaningful mobile payments adoption, HCE is a promising development with the potential to reduce some of the legacy barriers that have slowed progress to date. Furthermore, the HCE approach could be used to store and pass a variety of other credentials, such as offers, loyalty credentials, and transit and ticketing information, which support payment transactions. While HCE by no means addresses all hurdles related to meaningful mobile payments adoption, including the requirement for merchants to deploy the necessary contactless readers, it is a potential "game changer" that should be monitored closely in the months to come.

Figure 1: Example HCE Transaction



1.	Merchant terminal or consumer device requests payment
2.	Online / mobile wallet facilitates request, and token is created
3.	Token is passed by NFC-enabled terminal / phone via acquirer and payment network
4.	Token is read by payment network and verified by issuer; payment clears and settles per existing process.

Source: First Annapolis Consulting research and analysis.

For more information, please contact Jeff Crawford, Manager in the Deposit Access practice, specializing in Mobile Payments, jeff.crawford@firstannapolis.com.

Payments Industry Stock Price Tracker

By Collin Bauer

First Annapolis monitors monthly and annual movement in stock prices and market capitalization for companies across the payments value chain. Observations for March 2014 are reflected in Figure 1. Last month, the payments sectors that First Annapolis tracks experienced mixed results, with only the issuing sector exceeding the broader market's 1% increase year-to-date in 2014.

In summary:

In March, the issuing sector experienced gains of 3% in aggregate, which slightly outperformed overall market trends (the market experienced a 1% gain). While nearly half of the tracked issuers posted declines in March, significant gains by the nation's two largest issuers, JPMorgan Chase (7%) and Bank of America (4%), helped lift the issuing sector. The issuing sector, as a whole, has experienced gains of 2% thus far in 2014 on a YTD basis.

The processor / acquirer sector posted overall declines of 2% in March. Downward pressure was largely driven by stock price declines from the two largest companies tracked within the sector, FIS (-3%) and Fiserv (-2%). Heartland Payments rebounded in March after posting back-to-back declines over the past two months, but its stock price is still down 17% since the beginning of 2014. While individual performance has varied significantly, the processor / acquirer sector as a whole posted declines of 3% in 2014.

In aggregate, MasterCard and Visa posted declines of 4% in March, and have posted declines of 6% year-to-date in 2014.

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

Figure 1: Monthly Stock Price Tracker

Companies	March 31, 2014	Month Δ	YTD Δ	Market Cap ($Billions)
Issuers				
American Express	$60.33	7%	4%	$226.34
Bank of America	$17.20	4%	10%	$180.51
Capital One	$47.60	-2%	-9%	$144.23
JPMorgan Chase	$89.80	-1%	-1%	$96.30
Citi	$42.86	5%	6%	$78.22
Discover	$77.16	5%	1%	$44.07
FleetCor	$58.19	1%	4%	$27.29
U.S. Bank	$115.10	-11%	-2%	$9.47
WEX	$95.05	-2%	-4%	$3.59
Weighted Average	-	3%	2%	-
Acquirers / Processors				
FIS	$53.45	-3%	0%	$15.29
Fiserv	$56.69	-2%	-4%	$14.46
Global Payments	$30.41	0%	-9%	$5.68
Heartland	$71.11	1%	9%	$5.10
TSYS	$30.22	-5%	-7%	$4.21
Vantiv	$41.45	2%	-17%	$1.58
Weighted Average	-	-2%	-3%	-
Networks				
MasterCard	$215.86	-4%	-3%	$137.77
Visa	$74.70	-4%	-10%	$88.45
Weighted Average	-	-4%	-6%	-
Market Index				
S&P 500	$1,872.34	1%	1%	-

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

