

Executive Summary
2010 Debit Issuer Study



Study Overview



- Discover commissioned Oliver Wyman to conduct the *2010 Debit Issuer Study*, the definitive assessment of the debit card market
 - Based on primary research with 64 financial institutions (FIs)
 - Conducted in February and March 2010
 - Sample includes 78.7 million debit cards, balanced across FI size, geography and network participation

Study Sample

Segment	Label	Completed Interviews
Large banks (Top 60)	LB	29
Credit unions	CU	21
Community banks	CB	14
	Total	64

Performance Metrics



Performance metrics were analyzed in nine categories

Debit Performance – Consumer <ul style="list-style-type: none">• Cards and transactions• PAU metrics	Debit Performance – Business <ul style="list-style-type: none">• Cards and transactions• PAU metrics	Debit P&L <ul style="list-style-type: none">• Interchange• Costs and revenues	Reg E <ul style="list-style-type: none">• Overdrafts• Impact of reg. changes	Rewards <ul style="list-style-type: none">• Programs• Results and satisfaction
Fraud <ul style="list-style-type: none">• Loss rates• Data breaches	ATMs <ul style="list-style-type: none">• Transactions• Fees and surcharges	Prepaid Cards <ul style="list-style-type: none">• Offerings• Gift card economics	Alternative Payments <ul style="list-style-type: none">• Mobile services• Contactless	

Section 1: Key Findings

Summary of Key Findings



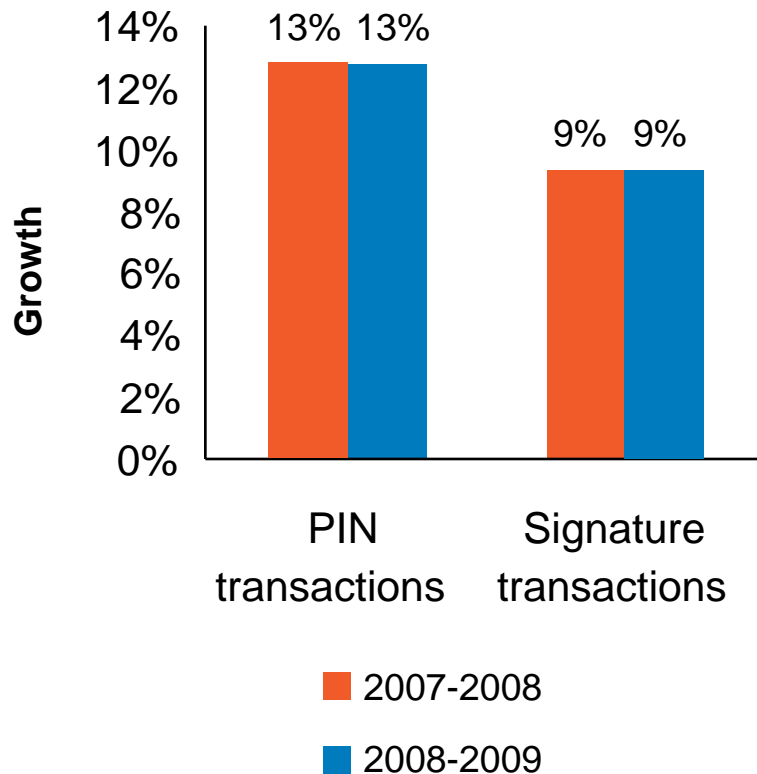
1. Debit transaction growth remained robust in 2009, despite the downturn; Growth in low-ticket purchases produced lower GDV growth
2. Debit is displacing cash usage, as ATM transactions decline
3. A growing number of FIs are using, or considering, instant debit card issuance to improve their performance metrics
4. Consumer debit economics support the underlying DDA business
5. Business debit economics are strong, but growth is slower than consumer
6. Reg E changes will negatively impact debit card profitability
7. Interest in traditional debit rewards programs is diminishing with low cardholder engagement
8. High-profile data breaches led to rising fraud rates
9. Many FIs are reevaluating their prepaid gift card programs, given lackluster results
10. Mobile banking and alerts are taking off, while mobile payments have yet to resonate; contactless cards are losing steam

Debit Transaction Growth



Transaction growth remained robust in 2009 despite the downturn

Consumer PIN and Signature Transaction Growth



“We have seen continued growth as members are using their own funds instead of using credit cards.”

– CU

“Our number of transactions is continuing to increase. Our customers are doing more transactions than they did the year before.”

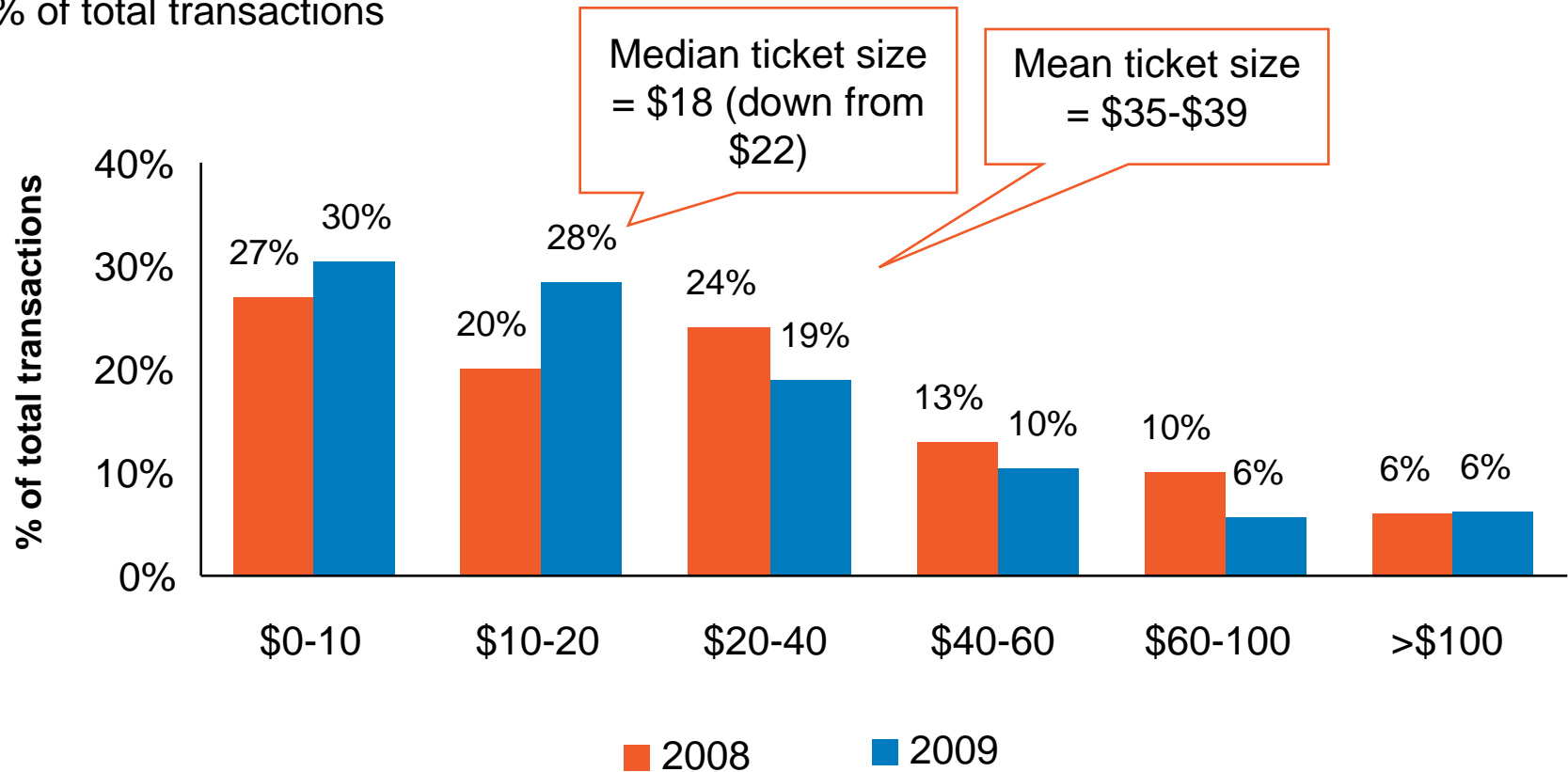
– CB

Ticket Size Distribution

Debit growth is in small value transactions

Distribution of Ticket Size for Debit Transactions

% of total transactions

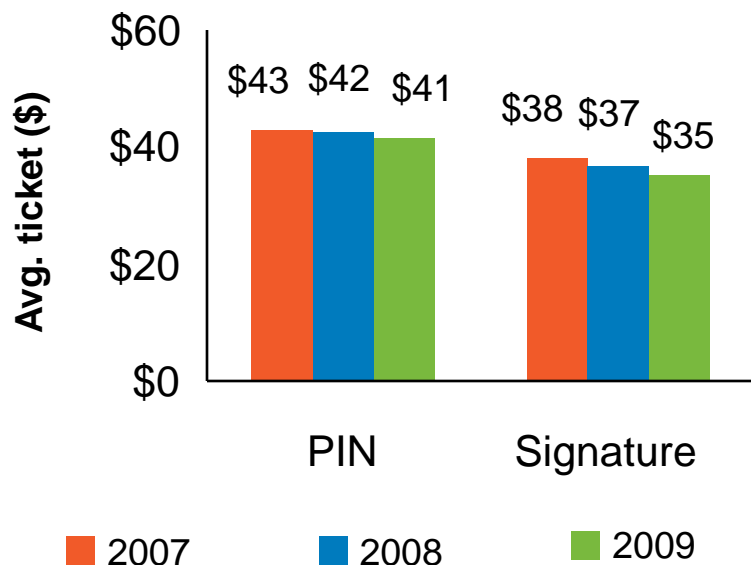


Debit Ticket Size

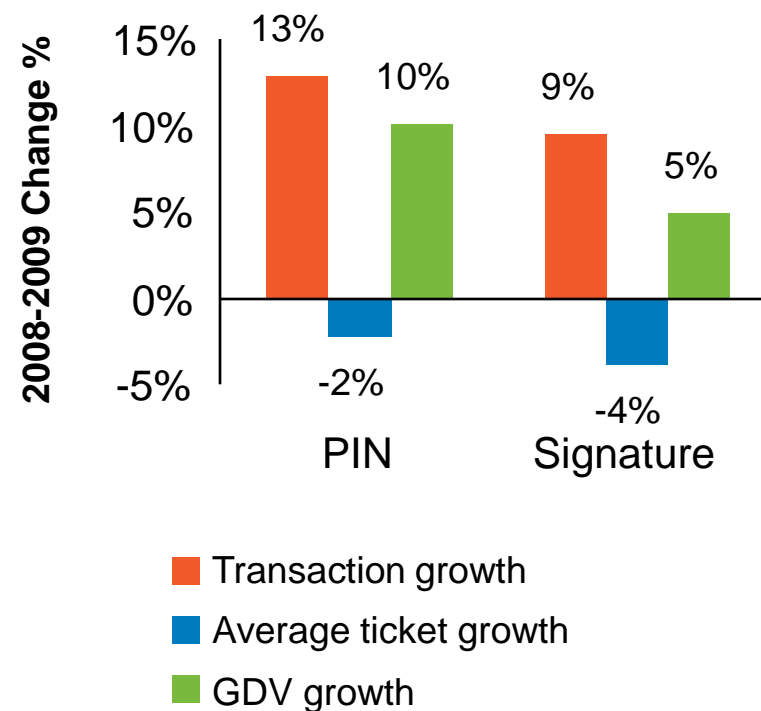


Declining ticket sizes pulled down GDV growth

Average Consumer Debit Ticket Size¹



Transaction, Average Ticket, and GDV Growth



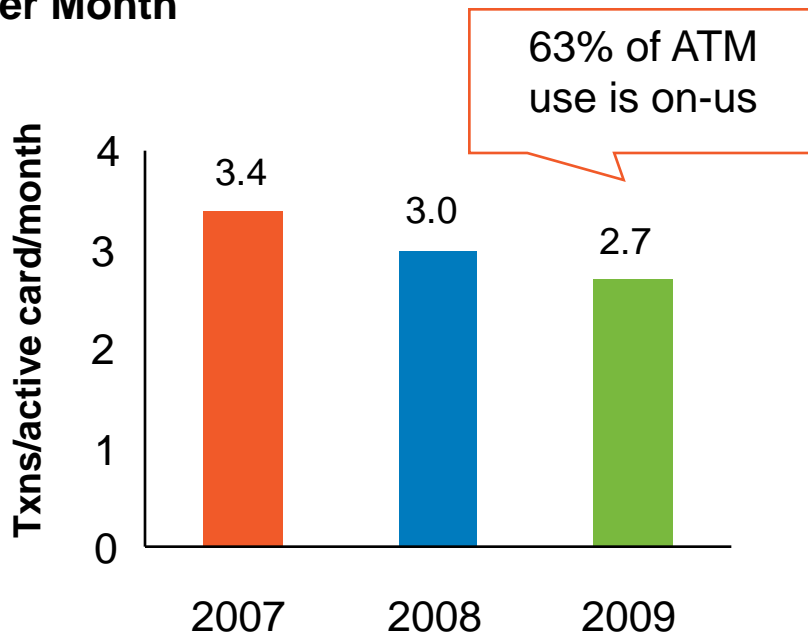
1. Average PIN debit ticket size may be overstated by the inclusion of cash-back, which some issuers combine with sales volume

ATM Transactions



At least some of debit's growth is from displacing cash

ATM Transactions Per Active Card Per Month



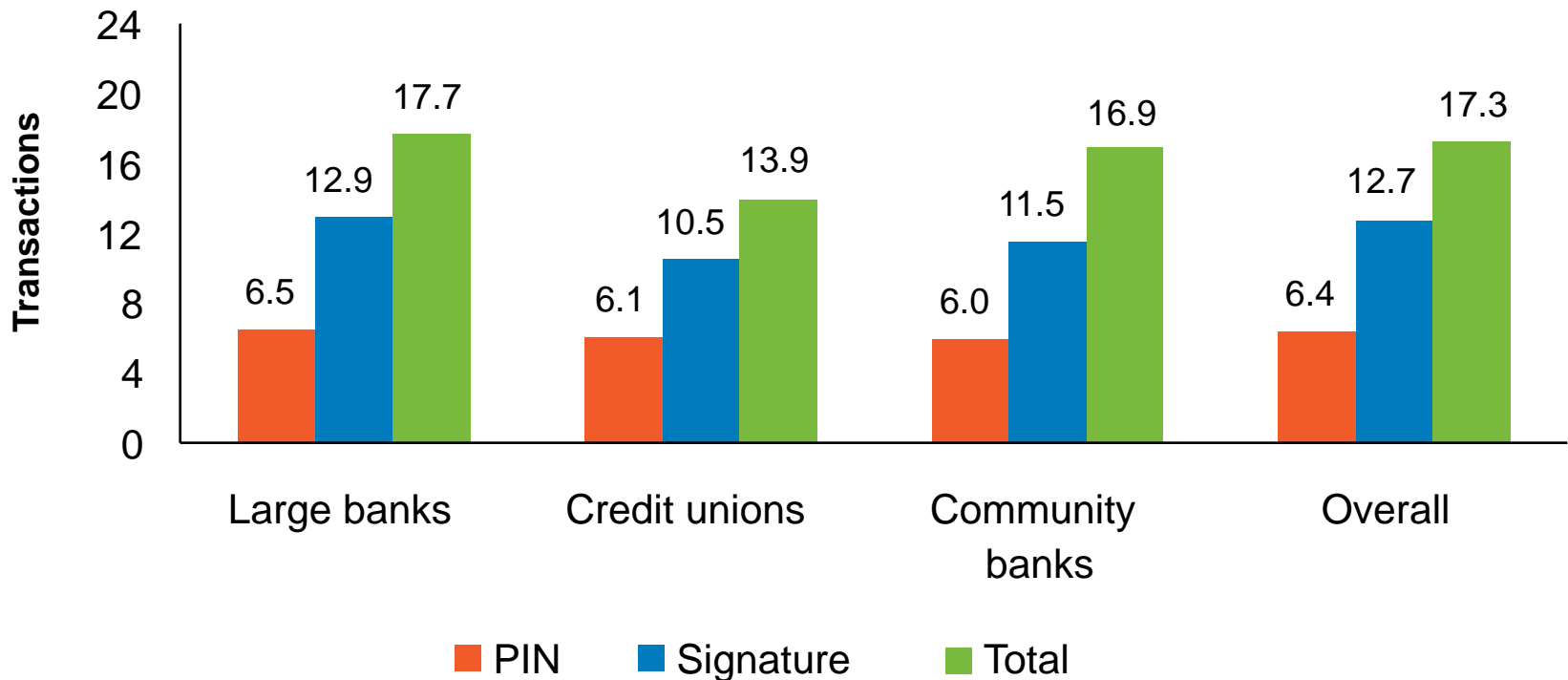
“The decline in our ATM transactions is due to customers not relying as much now on cash. I think debit is capturing a lot of the cash transactions.” **– LB**

Debit Card Usage



Active cardholders perform an average of 17.3 POS transactions per month

Monthly POS Transactions per Active Card¹



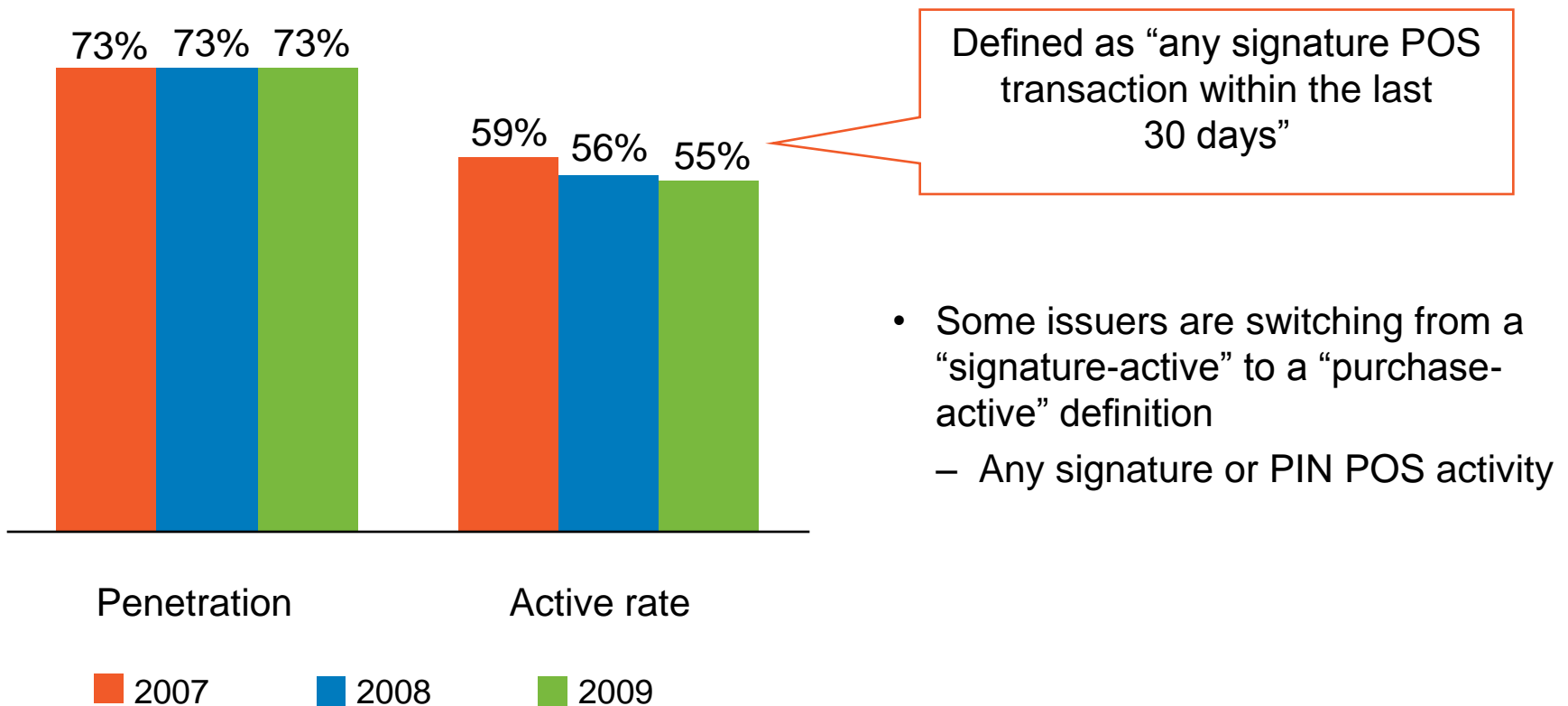
1. Active cards based on FIs active definition. PIN and signature transactions per card do not sum to total transactions per card due to the presence of dual-function cards

Debit Card Penetration and Activation



Card penetration remained flat, while active rates declined slightly

Average Penetration and Active Rates

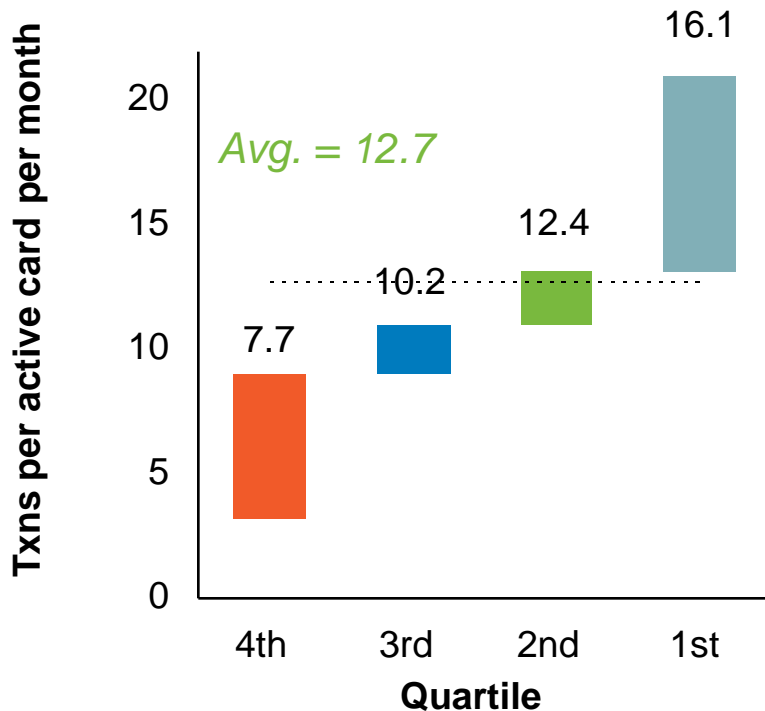


Usage of Best-in-Class Performers

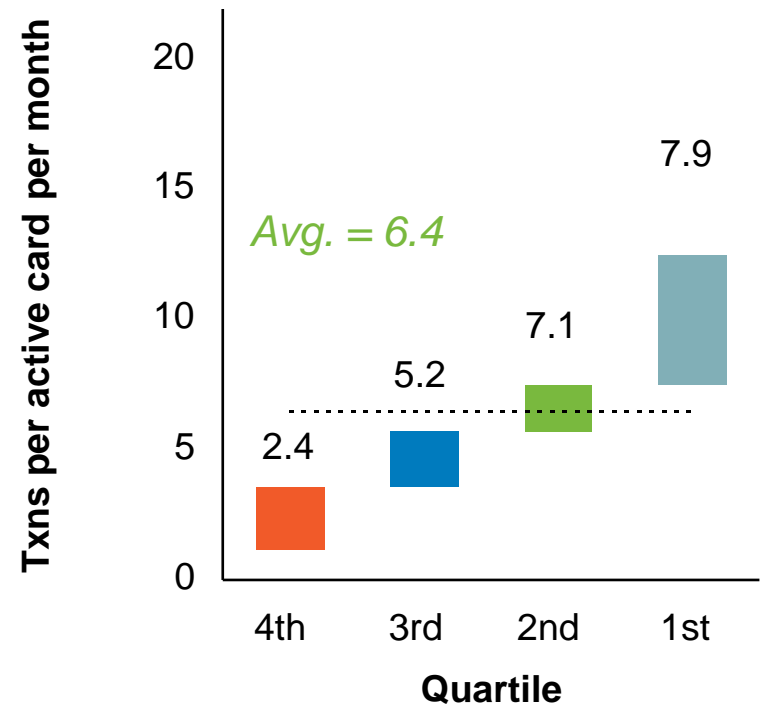


Leading issuers have managed to generate more transactions per active card

Monthly Signature Transactions¹



Monthly PIN Transactions¹



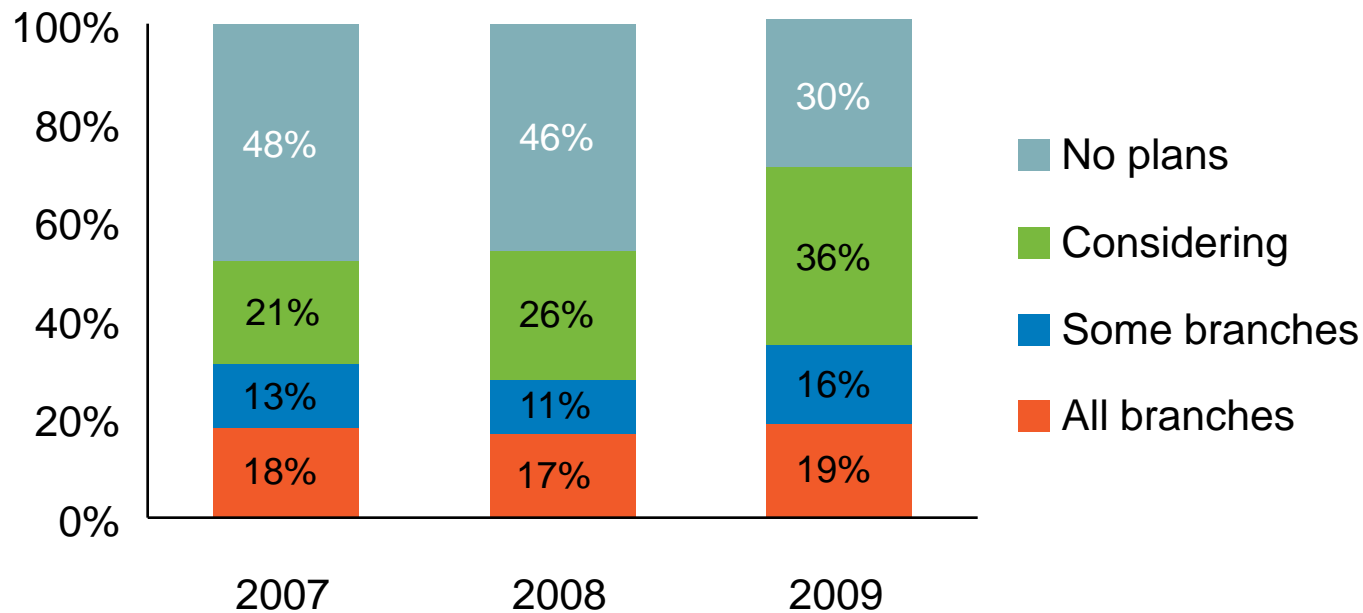
1. Quartile comparison, in which participating issuers are divided into four clusters based on performance. Issuers in the 1st quartile are the top 25% of issuers, while issuers in the 4th quartile are the bottom 25% of issuers (for that metric). Quartile values represent the weighted average for issuers within that quartile.

Instant Issuance



A growing number of FIs are looking to instant debit card issuance to improve their performance metrics

FIs Using Instant Issue

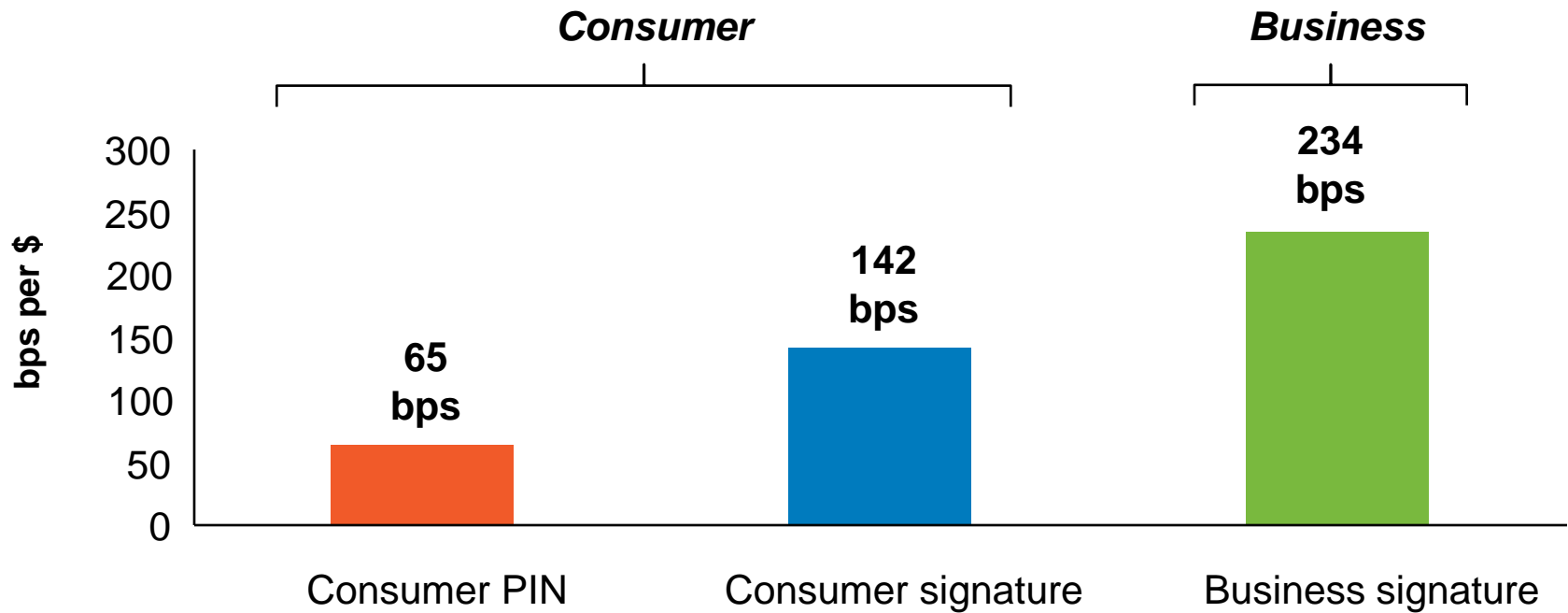


Average Gross Interchange Rate



Gross Interchange Rates

In bps per \$



Debit Revenue Per Card

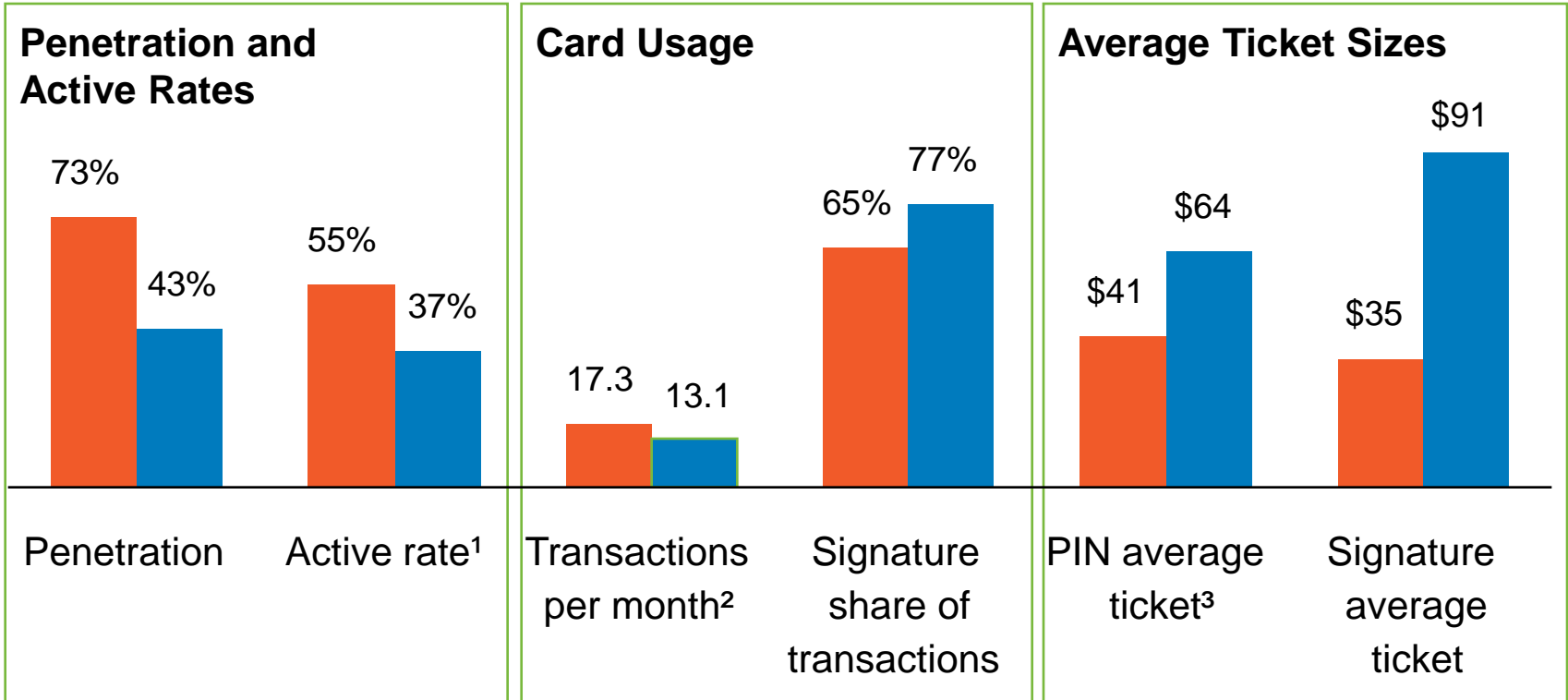


# of transactions per active card per month	Average ticket (blend of PIN and sig.)	Spend per active card per year	Blended interchange rate (bps)	Interchange rev. per active card per year
17.3	× \$37	= \$7,800	× 115	▶ \$87

Business Debit Performance



70% of FIs issue business debit cards; business debit represents 6% of total cards



■ Consumer ■ Business

1. For FIs with an active definition of “any signature transaction within the last 30 days”
2. Active cards based on FIs active definition. PIN and signature transactions per card do not sum to total transactions per card due to the presence of dual-function cards
3. Average PIN debit ticket size may be overstated by the inclusion of cash-back, which several issuers combine with sales volume

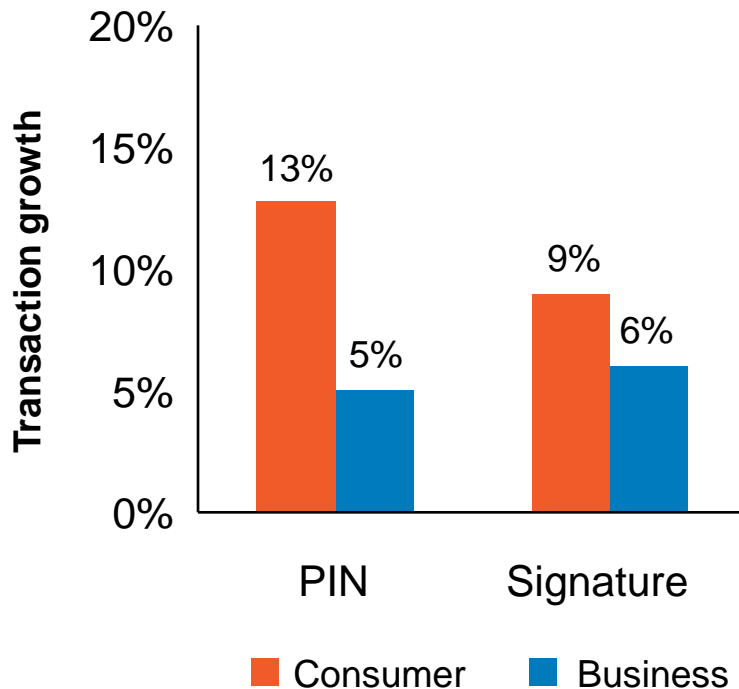
Business Transaction Growth



Despite a smaller base, business debit is growing slower than consumer portfolios

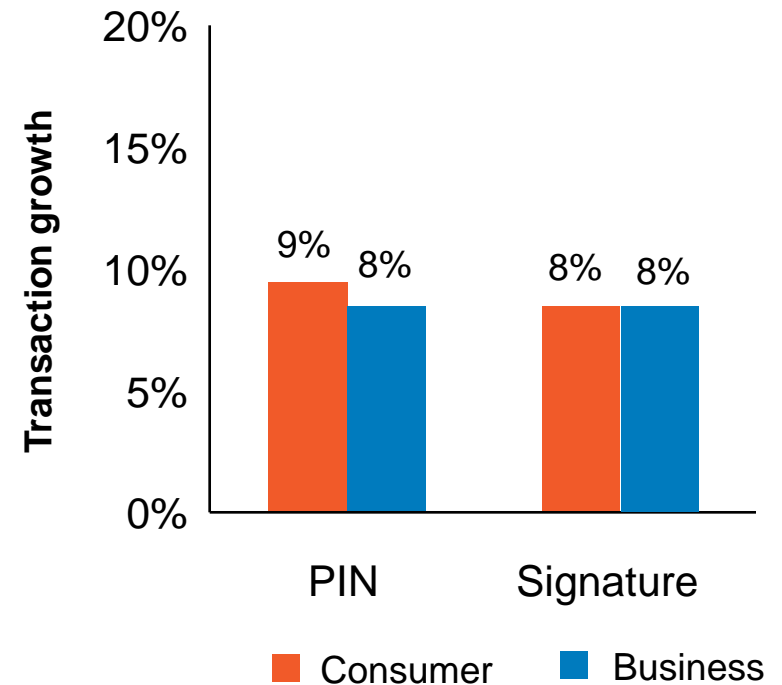
2009 Transaction Growth

2009 actual



Projected Transaction Growth 2010

expected

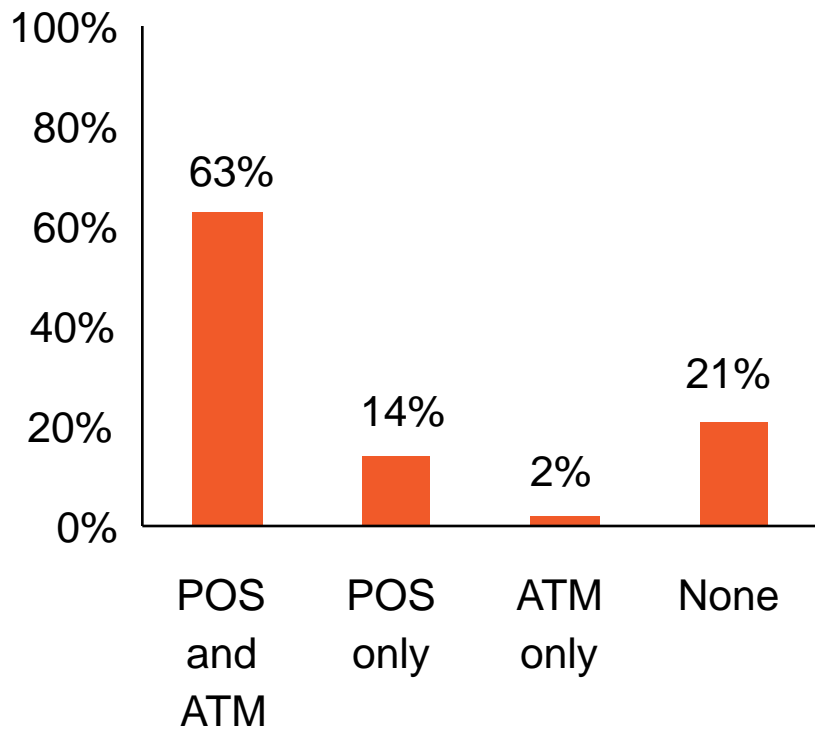


Overdraft Programs



79% of FIs allow cardholders to overdraw using their debit cards

% of FIs that Allow Cardholders to Overdraw Their Accounts



- Reg E changes that take effect in summer 2010 will require opt-in consent before consumers can incur overdraft charges

Overdraft Transactions



Revenue from overdraft charges drives up debit card profitability

For issuers that allow overdrafts, 1.4% of all POS transactions are currently authorized into a negative balance



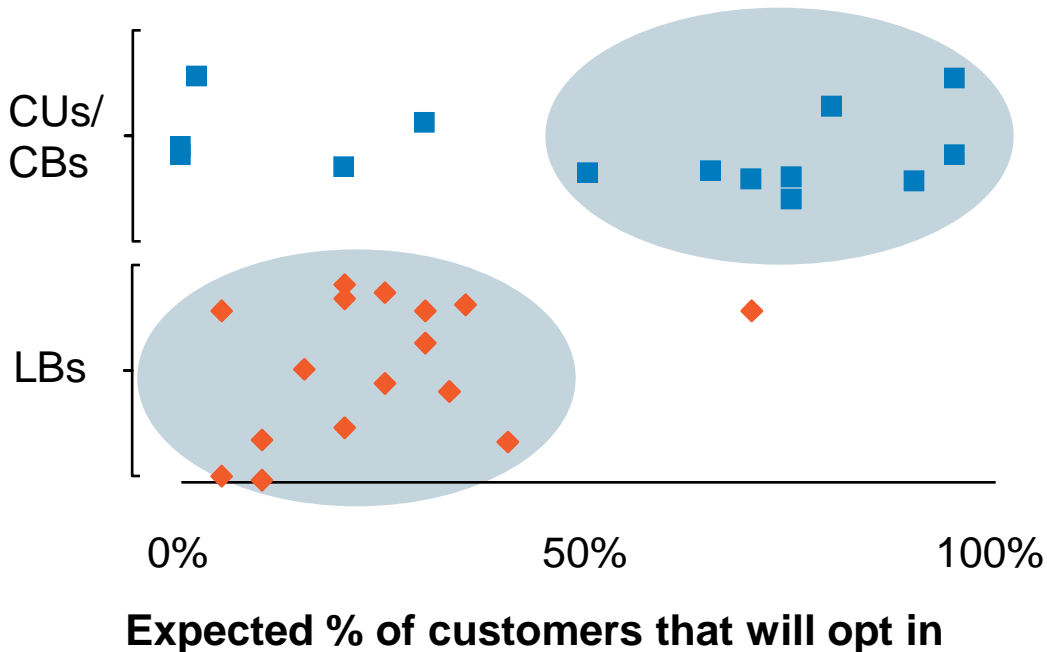
- Overdraft programs can increase annual revenue per active card by \$31, from \$87 to \$118
- Assumes
 - \$27 overdraft fee
 - 17.3 transactions per active card per month
 - 39% of transactions that are authorized at a time when they are negative actually settle into a negative balance¹

1. Based on Bank of America's March 2009 comment letter on pending Reg E regulation

Impact of Reg E

On average, issuers expect 30% of consumers to “opt in” – but two distinct schools of thought have emerged

Issuers' Expectations of % of Customers that will Opt into Overdraft Services

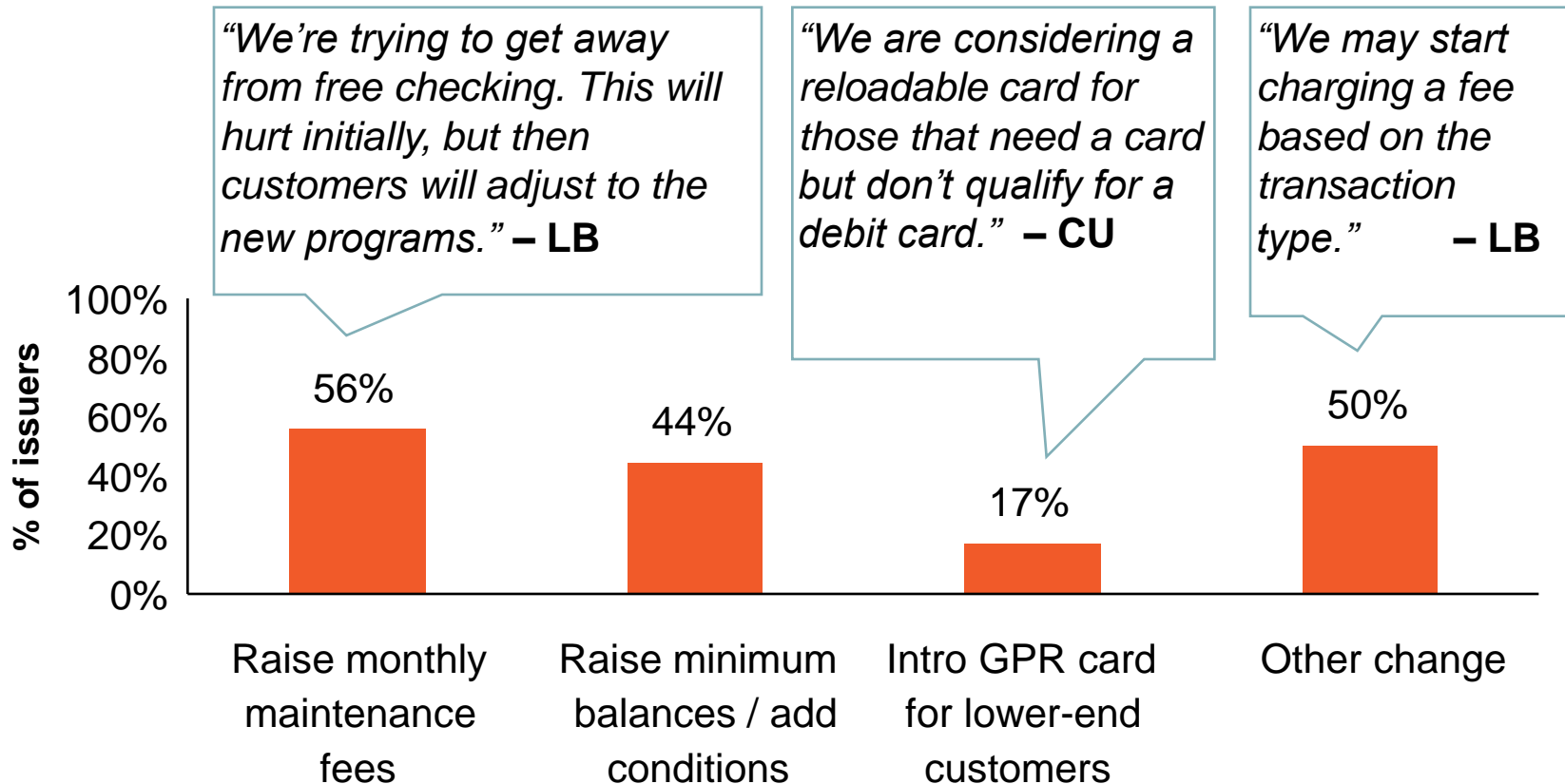


- FIs expect that Reg E will result in fewer approved transactions, lower interchange income and less profitable debit card programs
- 45% of issuers have already created a plan for counteracting decreased fee income

Plans for Counteracting Reg E Impact



Expected Responses of Issuers that have Formulated a Plan¹



1. May add up to more than 100% because FIs were allowed to select more than one choice

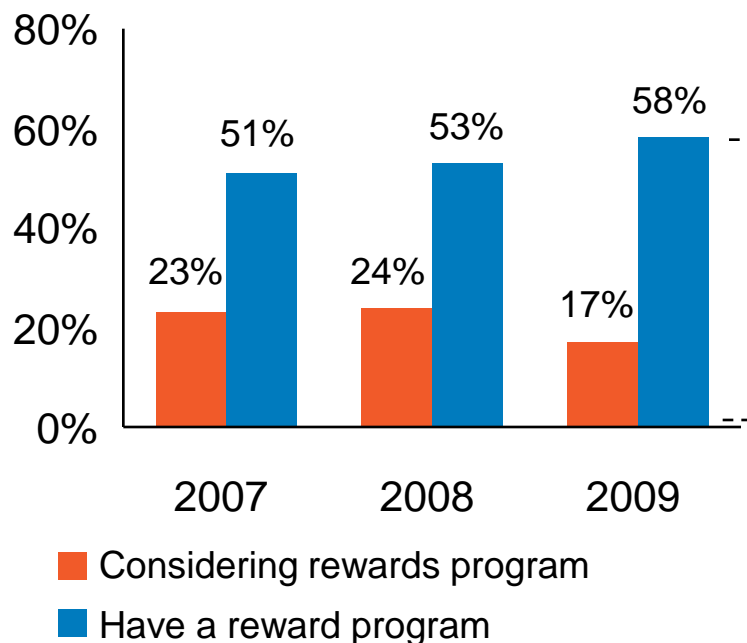
Rewards Programs



58% of FIs offer debit rewards but interest in launching new programs is waning

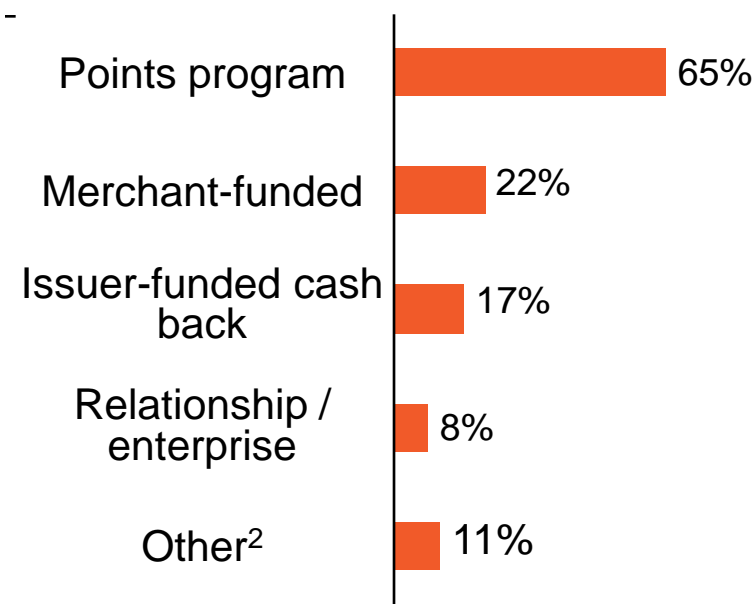
Rewards Program Incidence

% of all issuers



FI Reward Offerings – by Type¹

% of FIs that have rewards programs



1. Percentages sum to more than 100% because some issuers offer more than one type of rewards program

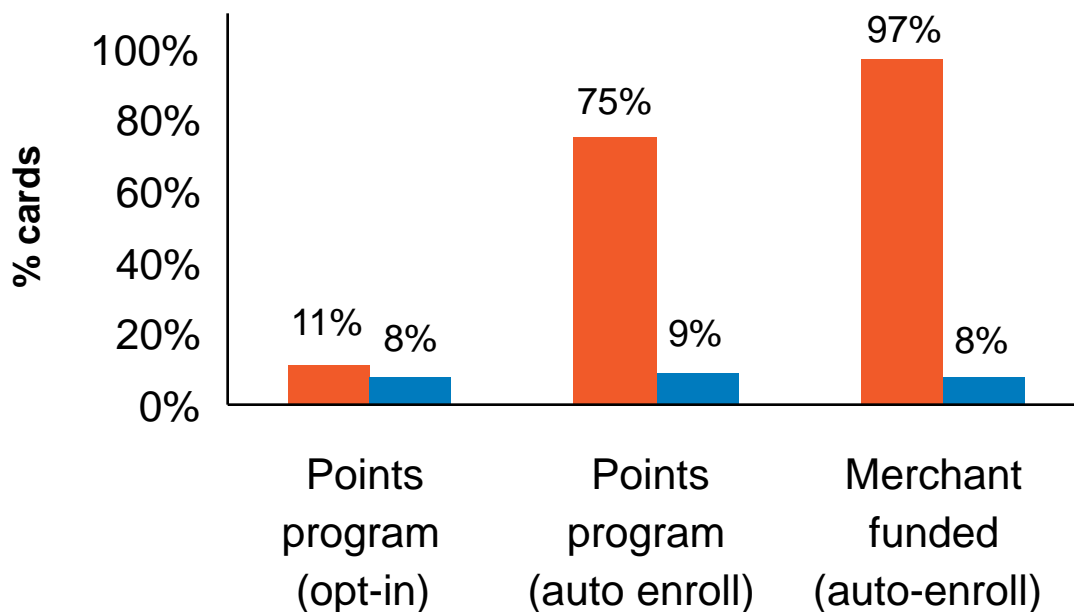
2. Other category includes co-branded, airline miles and charity/school donations rewards programs

Results of Rewards Programs



Faced with low cardholder engagement, FIs are looking to new types of programs

Cardholder Engagement with Rewards Programs



■ Enrolled as % of all cardholders

■ Registered as % of all cardholders

- FIs are evaluating the cost and self-sustainability of rewards programs
- Current interest is in enterprise/relationship rewards and checking-account-based programs

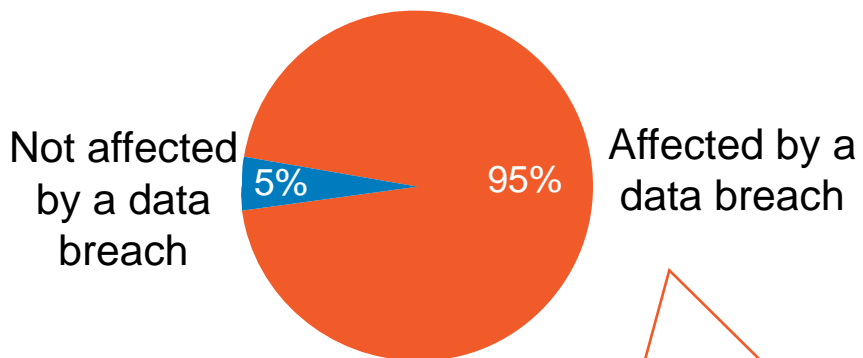
Note: Enrollment means that the card qualifies for rewards points; registration means that the cardholder has actively signed up for the program and is able to track usage

Data Breaches



Data breaches affected 95% of FIs but only 2% of cards have fraudulent activity

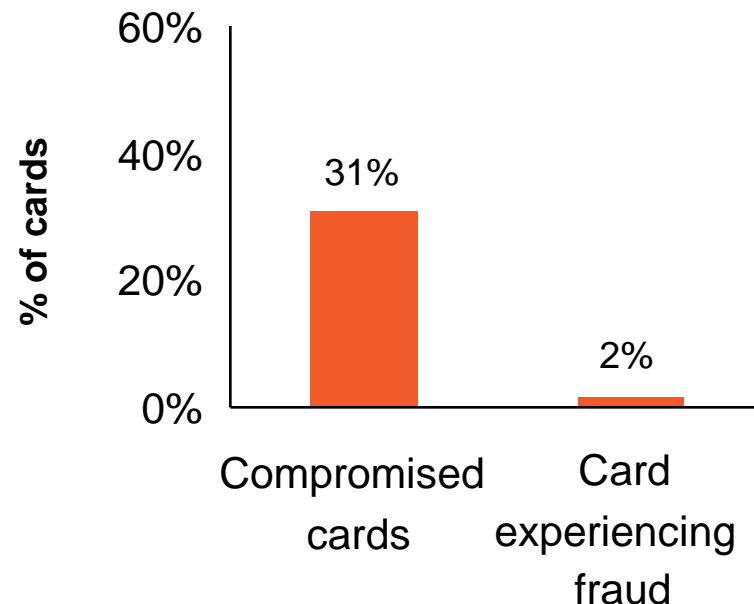
Percentage of FIs Affected by a Data Breach



24% of FIs reissued all of the affected cards; other FIs only reissued a portion of the affected card base

Percentage of Cards Affected by a Data Breach

Card base of affected FIs only



Fraud Losses

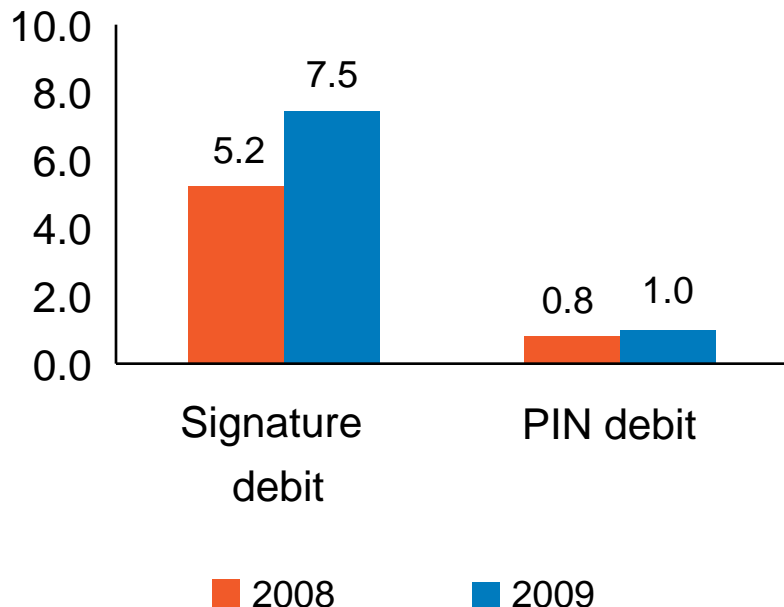


Fraud loss rates increased by 43% for signature and 24% for PIN POS debit

Signature Debit and PIN Debit

Loss Rates

In bps per \$



“The breaches were a nightmare. About 35% of our cards were compromised.”

– CB

“In 2009 there were two large breaches that increased our losses.”

– CU

“Losses from PIN debit make up an extremely minimal portion of our total losses.”

– LB

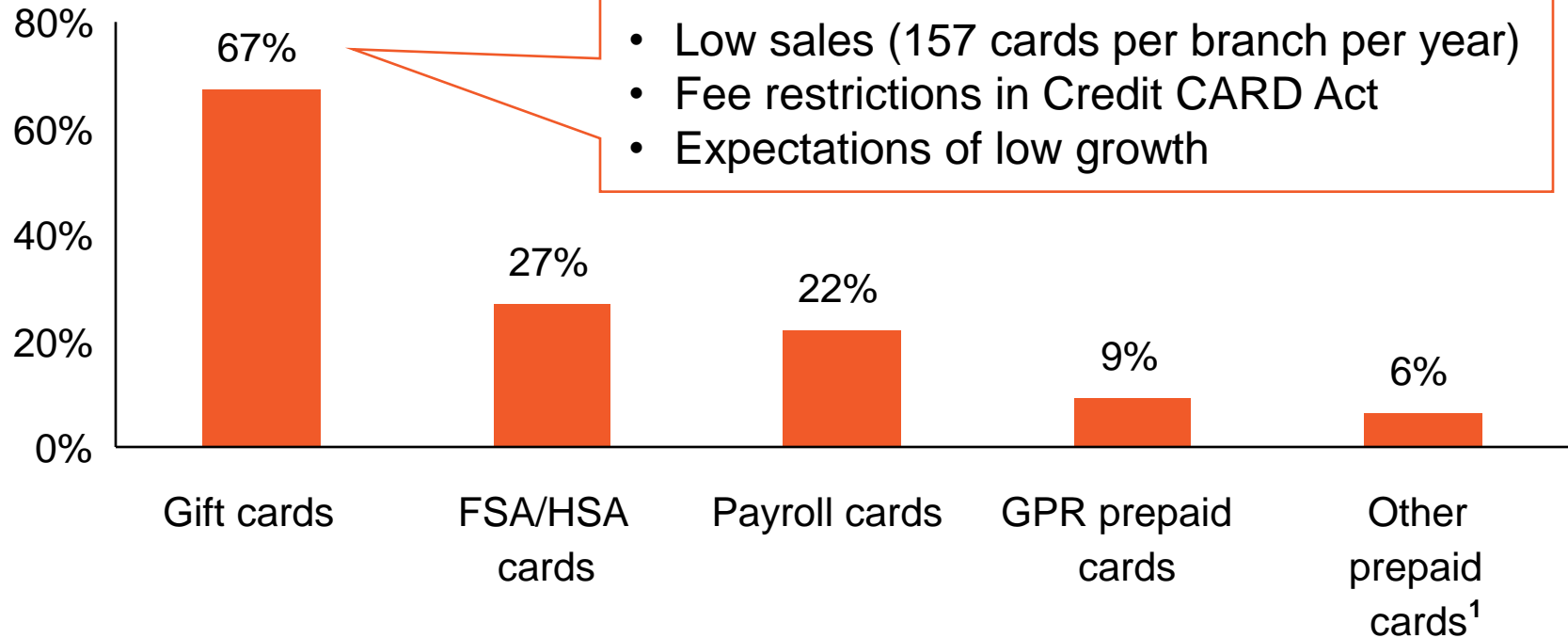
Prepaid Card Offerings



72% of FIs offer some type of prepaid card but many are reevaluating gift cards

FIs Offering Prepaid Cards

% of issuers



FIs are re-evaluating their gift card programs:

- Low sales (157 cards per branch per year)
- Fee restrictions in Credit CARD Act
- Expectations of low growth

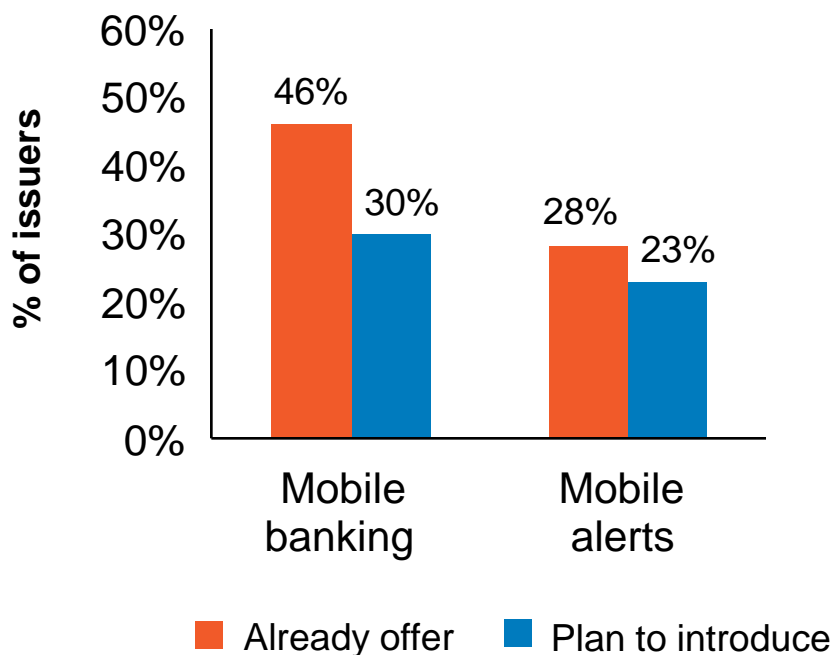
1. Other includes disaster recovery, HELOC, travel and Visa Buxx cards

Mobile Financial Services

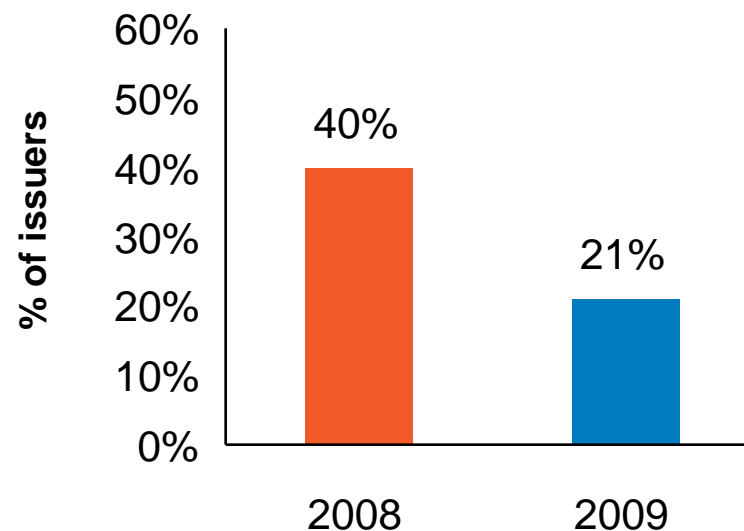


Many FIs now offer mobile banking and mobile alerts, but FI interest in exploring mobile payments is dropping

% of FIs Offering Mobile Banking, Mobile Alerts



% of FIs Exploring Mobile Payments

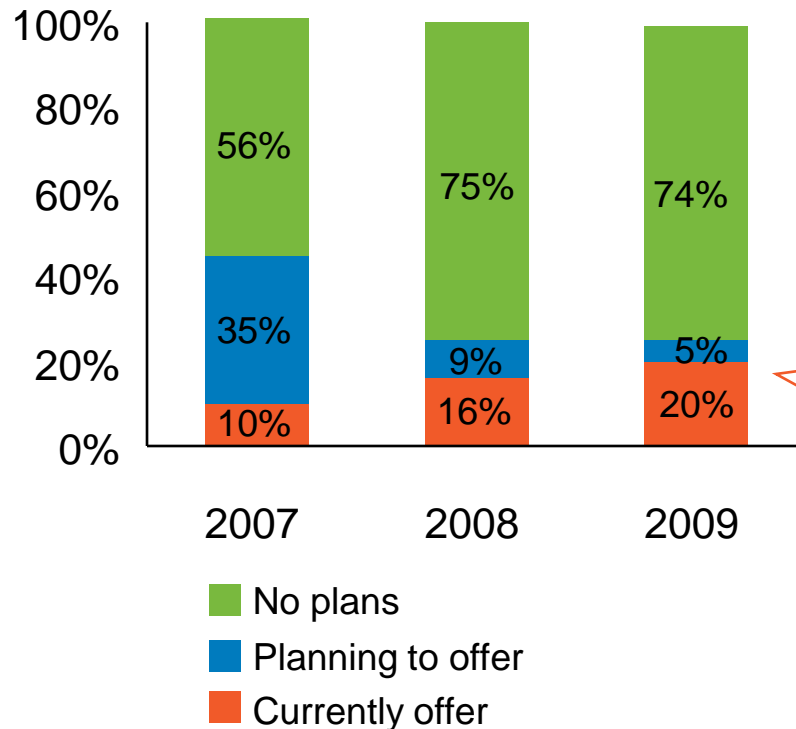


Contactless Cards



Issuers' interest in contactless cards is eroding; contactless transactions are only 0.03% of total debit transactions

FI's Contactless Debit Card Offerings



- FIs are discouraged by incremental cost, low merchant acceptance and low cardholder interest
- Issuers are replacing mass contactless issuance with specific segment targeting, or pulling out altogether

- Only 5% of contactless cards are ever used for a contactless transaction
- Total contactless transactions are only 0.03% of the total debit market

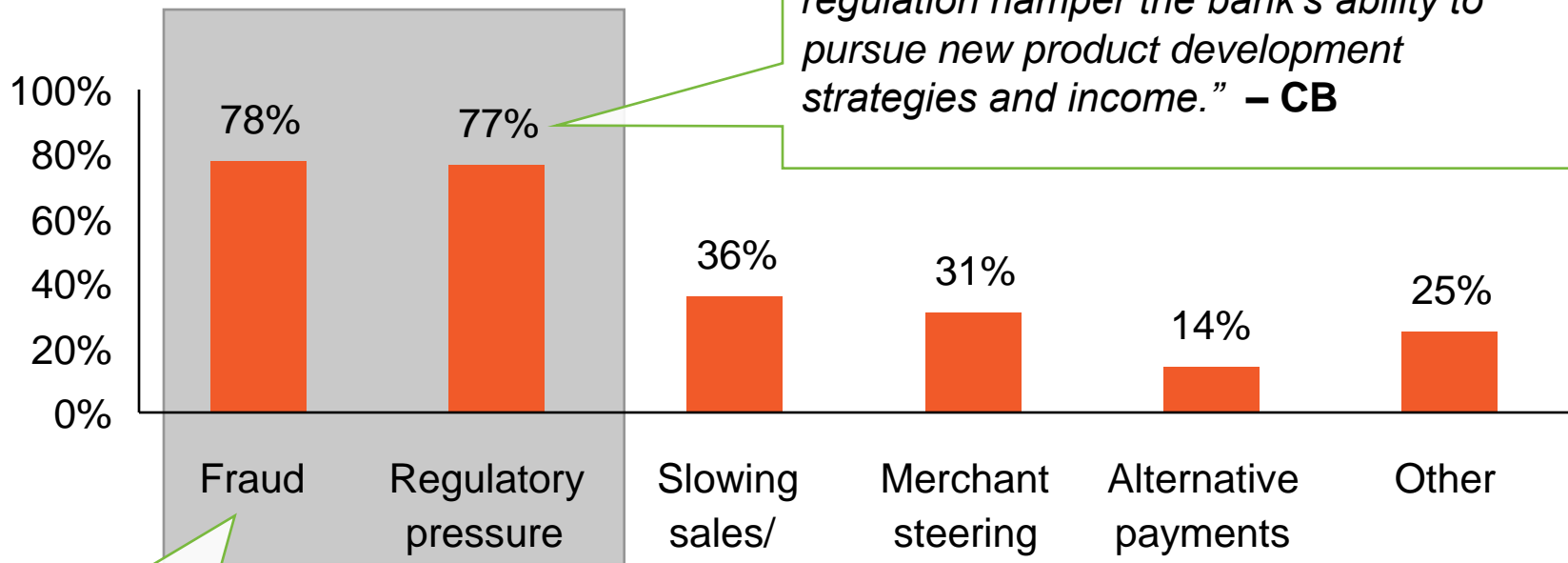
Section 2: Issuer Outlook

Key Challenges



FIs cited fraud and regulatory pressure as the two biggest challenges for 2010

Key Challenges for 2010



“Government regulations or threats of regulation hamper the bank’s ability to pursue new product development strategies and income.” – CB

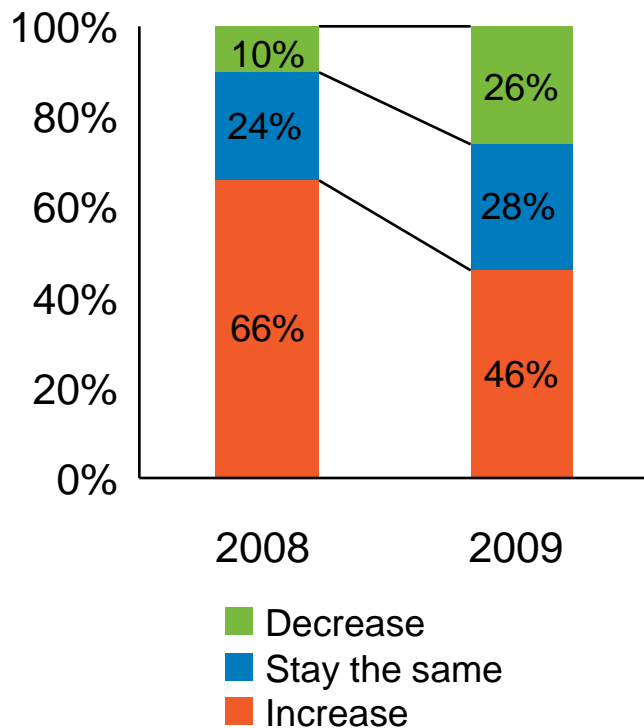
“Fraud impacts the bank both in terms of losses and customer trust.” – LB

Fraud Expectations

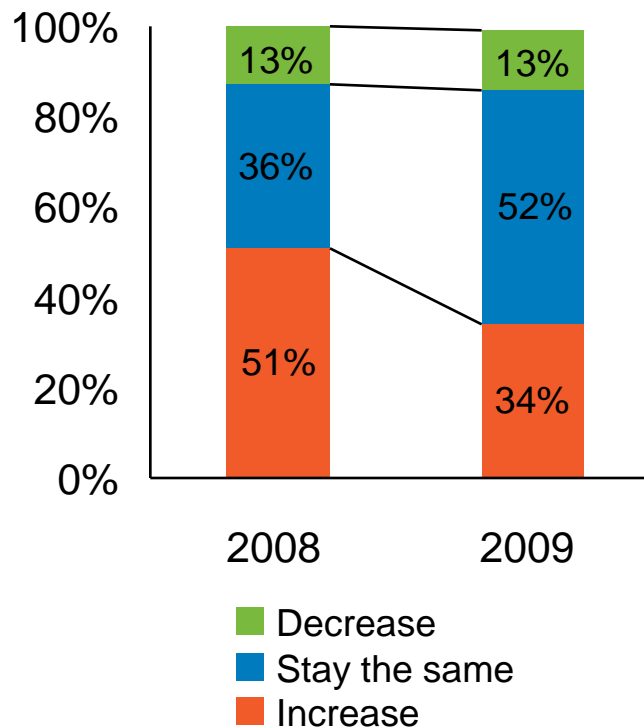


46% of FIs expect signature debit fraud to increase over the next two years, while 34% expect PIN debit fraud to increase

Fraud Loss Ratio Predictions: Signature Debit



Fraud Loss Ratio Predictions: PIN Debit



Regulatory Changes



FIs are concerned about upcoming regulatory changes and are wary about any potential new regulations

Reg E Impact

“We know that Reg E will be a pretty big hit to interchange and overdraft fees. We will need to replace some of that revenue.” – LB

Threat of Future Interchange Regulation

“The regulatory environment surrounding interchange will be a key challenge affecting the revenue model for the product.” – CB

Overall Regulatory Environment

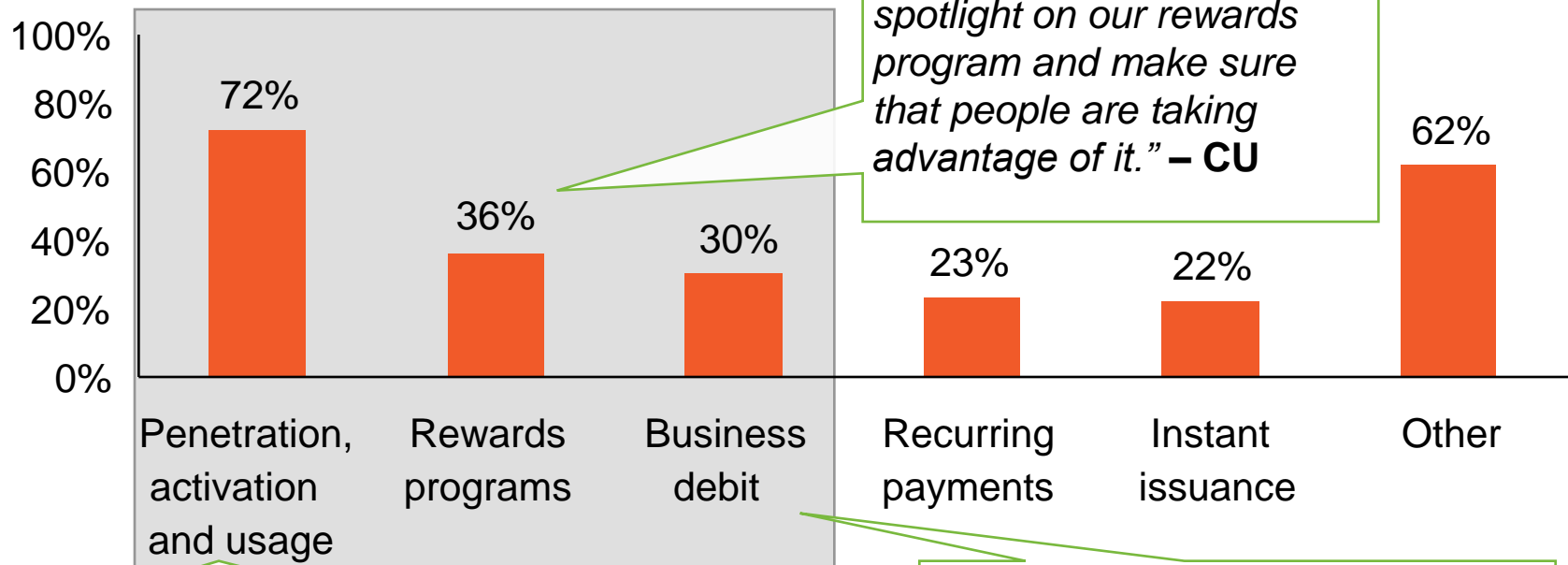
“Who knows what else will come down the pipeline. Sometimes the regulators don't understand the nature of the business.” – CU

Key Opportunities



FIs are focused on improving their debit portfolio performance; other opportunities include rewards and business debit

Key Opportunities for 2010



“We hope to keep a spotlight on our rewards program and make sure that people are taking advantage of it.” – CU

“As we grow our checking account base, we are focusing on penetration, activation and usage.” – LB

“Adding business debit cards will enable us to receive higher interchange.” – CB

Debit Portfolio Performance Improvement



Issuers are relying on marketing offers, rewards programs, and cash-based incentives to improve penetration, activation and debit card usage

Penetration

“We issue the card to everyone who opens an account.”

– CU

“Our tellers can look up whether customers have a debit card. We are trying to target customers who opened their accounts a while ago.”

– CB

Activation

“We want to enhance our active rate through selective marketing.”

– LB

“We’re giving customers bonus points for their first purchase to improve activation.”

– CU

Usage

“We ran a campaign that offered cash back for a certain number of transactions to our low-spend customers.”

– CB

“We are trying to enroll consumers in rewards checking accounts that require the debit card to be used.”

– LB

Focus on Rewards Programs



FIs are interested in modifying their debit rewards programs or in launching a checking-account rewards program

Traditional Debit Card Rewards

“We are thinking of implementing a points-based rewards program that will reward signature transactions to increase signature spend.” – CB

Enterprise/ Relationship

“We would really like to have an enterprise rewards program for debit and credit together.” – CB

Checking Account Rewards

“We are building a program for our checking accounts to reward customers with certain services (such as a higher interest rate on savings) if they use their debit card a certain number of times. We want to encourage people to use more of our products and services.” – LB

Business Debit Opportunity



The economics of business debit are attractive

Revenue per Transaction

Metrics	Consumer	Business
Gross interchange rate	142 bps	234 bps
Average ticket	\$35	\$91
Revenue per transaction	\$0.496	\$1.987

Revenue per Active Card

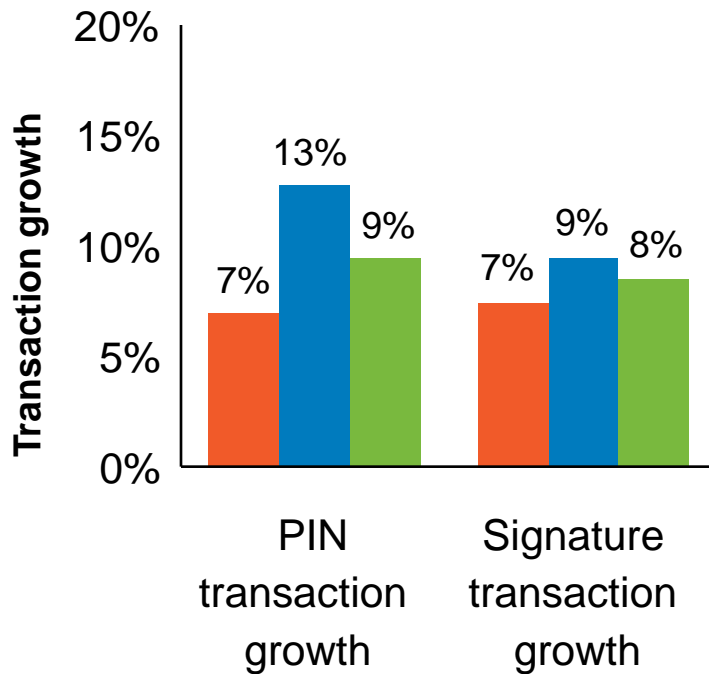
Metrics	Consumer	Business
Signature/PIN ratio	65% / 35%	77% / 25%
Txns per active card per month	17	13
Gross interchange revenue per active card	\$87	\$272

Growth Expectations for 2010



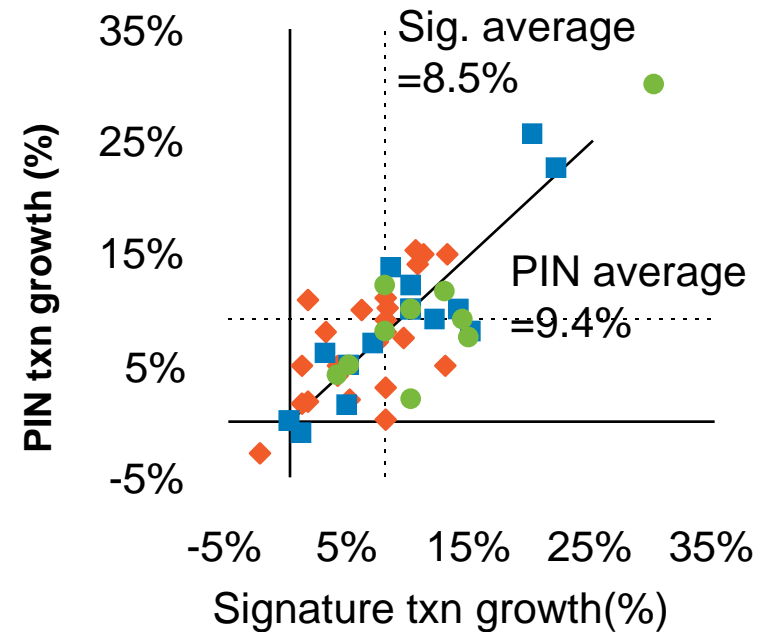
FIs have higher transaction growth expectations for 2010 than they had for 2009

Transaction Forecasts



- 2009 forecast
- 2009 actual
- 2010 forecast

Projected 2010 Growth Rates



- ◆ Large banks
- Credit unions
- Community banks

Where Do We Go from Here?



- The debit market is projected to grow more quickly in 2010 than 2009
- Debit's economics and growth make it an ever-more-critical component of the overall banking relationship
- Key opportunities to drive improved performance include
 - Continued focus on core drivers of penetration, activation and usage
 - Enhanced approaches to rewards, including tighter integration with the DDA
 - Pursuit of the attractive economics offered by business debit
- Data breaches and growing fraudulent attempts demand continued vigilance
- Most “alternative” payment propositions have not panned out

Thank You

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