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Dear Friends,

This is our 25th annual letter to clients and as usual, there's no shortage of hot topics to discuss. The major news items are easy to tick off: Brexit, Wells Fargo, the U.S. Presidential election, and now Yahoo, just to name a few. It was a banner year for bombshells, pessimists, and the doomsday crowd. So, it wouldn't be hard to fill this letter with downbeat stories. But those stories have been covered ad nauseam in the press and around the water cooler. Instead, I've decided to take a step back and consider the other side of the coin… the upside… the positive stories that surrounded us every day but seemed to get lost in the news cycle. When I stepped back, I realized there was plenty of positive change, innovation, and growth about which to be optimistic.

The upbeat theme for this letter wasn't reflexive, though. Rather, the inspiration came to me while in Rio for the Olympics with my children.

Each day, my kids and I were blown away by the pride and enthusiasm among the athletes, their coaches, and the fans. We saw ten events, and purposely avoided many of the more mainstream offerings. Instead, we witnessed indoor cycling, weightlifting, decathlon, Tae Kwon Do, and others. We found that media hype had no correlation to the enthusiasm of the participants or their cheering sections. In fact, it seemed that if you bought a ticket for Olympic wrestling (for example), there was a strong likelihood that you knew someone competing in the event. So, perhaps the cheers were even louder!

There were countless amazing moments – hearing the Japanese fans chanting for their female gold-medalist... watching the Brazilian grounds keeper wave his flag from the tractor between equestrian events… witnessing the martial artist from Ivory Coast fall to the mat in tears upon winning gold… hearing the loudest EVER rendition of a National Anthem when the Brazilian boxer won gold… stomping our feet and chanting along with the Kazakhstan team as their compatriot narrowly missed medaling in weightlifting. These and countless other moments brought goose bumps to even the most jaded spectator.

Being surrounded by such positive energy was contagious and uplifting. It made me wonder: how do we infuse some of that amazing energy into our industry? The more I thought about it, the more I realized, we already have lots of very positive and exciting things to cheer for. Perhaps they just needed a light shone upon them more directly. So, below are some of the accomplishments that I think we should look back on with pride as we reflect on 2016.

Let's start with a quick example. In the post-recession era, how many times have we heard that customers don't want another credit card? Don't tell that to JPMorgan Chase which successfully debuted the Chase Sapphire Reserve card with a whopping $450 annual fee. The card has been a resounding success, particularly among millennials – a demographic that countless news stories told us was particularly credit-averse and unlikely to be wooed by card providers.

Chase found a winning combination for a customer who is primarily motivated by rewards. This hunger for rewards, which has been covered often in ACG's proprietary consumer research, has in turn meant that the co-brand industry is thriving and flourishing, with a wide range of large programs making strides of late.

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Perhaps the most sought after co-brand deal of the year was Cabela's, one of the last major retail self-issuers, which resulted in a watershed $5 billion deal for Capital One. American Airlines was also in play this year due to its recent merger with US Airways. Just as in Rio, where only one Gold medal is awarded, conventional wisdom would have expected one of the two incumbent issuers to land the combined deal. Instead, the Airline wound up maintaining programs with both Citi and Barclays, leveraging each for its strongest acquisition channels. Time will tell if that was two Gold medals or a Gold and a Silver.

Although Costco chose its new partners in 2015, the deal rolled out to consumers early this year. After reports of some conversion headaches, the results have been extremely positive for Citibank, Visa, and the Retailer.

In the U.K., where interchange has been cut to roughly 30 basis points, many experts worried about the future of co-branding. ACG has been hard at work helping both issuers and partners to determine a deal structure that could survive in the new environment. Perhaps the first manifestation can be seen in BNP Paribas' Creation Financial Services' recent deal with InterContinental Hotel Group. The partners have managed to create a successful program and even improve the customer value proposition by taking a fresh look at the business model. Not only was the card nominated as the Best Credit Card Product of the Year by The Card & Payments Awards, but it is proof that co-branding can still work in Europe. You simply need partners that are pragmatic and willing to work together to drive value for the consumer.

Co-brand competition will continue well into 2017. Hilton will perhaps be the first to watch as it determines which of its two current issuers will manage its program into the future. A couple of recent mergers will also likely cause a stir as Marriott/Starwood and Alaska Airlines/Virgin America come together and sort out their various card programs. On top of this, other marquee programs will be up for renewal and several very interesting names have signaled their desire for de novo programs.

We'll also have to keep an eye on Washington as we try to read the tea leaves for 2017. Economists are fond of the Latin phrase "ceteris paribus" which roughly translates into "all other things being unchanged." If you are a banker (or own bank stock) and apply that phrase, you are probably feeling pretty good since the U.S. Presidential election. Your stock is likely feeling the effect of the "Trump Bump," and you may be anticipating a near-term environment of higher interest rates, lower tax rates, and less regulation.

While less regulation would be welcomed in certain quarters, it must be said that, even in the face of an increasingly stringent regulatory environment, our industry has found ways to innovate and excel. For example, regulations like the TCPA hindered the efforts of the Collections industry. The restrictions it set forth necessitated changes to the business model and in time the industry adapted. Enhancements in self-service, proactive client interactions, and "opt-in" mechanisms for communications, all led to a net positive for issuers and their customers.

The CFPB started supervising non-bank auto finance companies in 2015. Our clients quickly built capable Compliance teams and developed a rapport with the examiners. When you consider the speed at which these lenders expanded and invested in Compliance operations to handle large-scale audits with a brand-new regulator, the progress is impressive.

Mortgage lenders have also successfully navigated the ever-more-challenging scrutiny by regulators, often having State and Federal auditors onsite simultaneously. Meanwhile, they continued to emphasize staffing, processing, and technology improvements to keep customer experience paramount. Going forward, these lenders can look forward to HAMP coming to an end, property values gaining strength, reductions in modifications and short sales, and an uptick in originations.

Over the summer, the CFPB released an outline of proposals under consideration to overhaul the debt collection market. The agency limited the scope of its actions, saying it would address first-party creditors and third-party debt collectors in separate proceedings. This is exactly what ACG had recommended in comments to the CFPB when the rulemaking process began in 2013. The overhaul, which will include new requirements on debt substantiation, expanded disclosures, and limited "excessive" communications, represents the first major refresh for the industry since the Fair Debt Collection Practices Act was enacted in the 1970s. The CFPB's willingness to listen to the industry and hone the application of its rules was widely appreciated. Perhaps it was even an example of how regulators and lenders can work together to meet their respective objectives.

Earlier this year, the FCA recognized the nuances of the card business as well. The U.K. agency released its Credit Card Market Study, and while many anticipated the report would be a wide-ranging critique of the industry, it instead focused on the needs of consumers with persistent debt. The FCA is currently conducting research on how to improve consumer repayment behavior, with everything from behavioral cues and statement language on the table. This is an opportunity for the U.K. credit card market to creatively serve the needs of these customers, as well as to proactively help improve consumers' financial health.

The lessons learned from the Great Recession continue to inform industry decisions. All our lending clients have been watching closely for signs of pending trouble. Indeed, there are some signs of a potential cyclical downturn afoot. Delinquencies and credit declines are both on the uptick, for example. However, the fact that we are so keenly watching the landscape is a major improvement from previous cycles. It wasn't long ago that in the wake of a credit crisis, a large number of bankers admitted to American Banker that their credit models had failed to accurately predict losses. Our current vigilance suggests an industry that is better prepared than ever.

After years of hesitancy and skepticism, EMV is finally coming of age in the U.S. By now, over 85% of our clients' portfolios have been converted. In 2017, nearly all issuers will have migrated, dealing a blow to counterfeit fraud. Some clients have even reported that they've already recouped the expenditure of reissuing their chip cards.

Meanwhile, the continued increase of chip-on-chip transactions should help reduce the customer experience challenges still evident at POS, where customers often must quiz store employees if they should be swiping or using the chip. The uneven acceptance strategies across some of the nation's biggest retailers have left customers cold – and tweeting thousands of jokes at the payment industry's expense.

Retailers who were not EMV-compliant saw an uptick in card-present chargebacks due to the liability shift. But as more retailers expand their EMV acceptance, that chargeback category will decline. We anticipate rates should begin to normalize and then improve over pre-EMV rates, which is good news across the board.

While EMV migration has blunted fraud in face-to-face transactions, the fraud has shifted elsewhere. Card-not-present and old fraudster favorites like check, wire, and ACH fraud are on the rise. It may be hard to see the good news here – unless you're a criminal. However, the industry is working together in unprecedented ways to curtail some of the newer strands of fraud that are emerging. For example, ACG just launched a roundtable for retailers to address the challenges of payments fraud in a post-EMV world.

Fraudsters are also increasingly deploying synthetic fraud, an esoteric fraud type that uses stolen data (often from children and the elderly) to open new accounts. This fraud is nearly impossible to proactively identify, since current consumer privacy concerns hamper efforts by credit bureaus to validate social security numbers. The key to defusing this fast-growing fraud is industry cooperation. Earlier this year, ACG gathered more than 30 representatives from issuers, industry associations and networks, and credit bureaus to discuss how to tackle the problem. The path forward will require navigating a legislative thicket, but at least the conversation is underway.

Mobile payments have also gained ground this year. When Apple Pay hit the market two years ago, the headlines decried the imminent death of credit cards. Two years later, the headlines have reversed, calling mobile a major flop. Both sides of the spectrum are wildly exaggerated. While 2016 certainly wasn't the "Year of Mobile Payments," we never really expected it to be. Nor do we expect that 2017 or even 2018 will earn that title. Instead, consumer adoption will be gradual as consumer preference evolves and technology matures.

Issuers lament the lack of enough mobile volume to impact their overall results. But, according to ACG's Cardbeat® research, just over half of cardholders have the option of using Apple, Android or Samsung mobile payments, due to their phone's capabilities. Of those, 31% are doing so at least some of the time. That's a pretty good take rate for a brand-new product. Additionally, there's a small universe of mobile payments invisibly thriving via apps such as Uber, Starbucks, and Venmo.

Players like PayPal have also continued to make major strides in the digital and P2P spaces. In our most recent Cardbeat research, PayPal beat out the major banks to be the favorite P2P service for consumers. While consumers claim to trust their banks more implicitly with their financial information, 69% say PayPal's technology is superior to the banks' ability to protect their information. Banks are coming to grips with this in a variety of ways. Citi recently hired over 40 employees from start-ups and tech companies to start its own FinTech division. Others, like BBVA and USAA, are forging partnerships with FinTech companies to develop new solutions and stay nimble. Even auto lenders are contemplating FinTech acquisitions to bolster their capabilities in credit verification and decisioning.

The global political landscape of 2016 can be characterized by shock and upheaval. Voters from the U.S. to the U.K. to Italy to Colombia, have surprised the world with their decisions. The status quo has been upended, and what this means for our industry and markets is still being decided.

ACG's mission is to provide guidance for challenging decisions in challenging times. While we may not be able to change the behavior of regulators, consumers, or fraudsters, we can help clients to influence outcomes and deal with ramifications. We can help to decipher trends, prepare a good offense and/or a strong defense.

In 2017, you can expect ACG to unveil several initiatives in our ongoing effort to enhance our offerings. In addition to improving the analytical tools and customer experience in our proprietary VIZOR platform, we'll be debuting a research portal for our Payments Insights data called CAMBER. Both of these platforms demonstrate our commitment to providing the rich data necessary to make meaningful decisions.

We'll also be altering our physical and digital footprints. A new website with refreshed branding is in store for release later in the year. Our Twitter account will be more active. And, after years of managing our growth in creative ways within our current spaces in the Financial District of New York City and Farringdon in London, we'll be making changes to both offices. Our London team will be re-locating to new and upgraded offices, while our New York headquarters will be renovated to make room for a larger team. Both offices will see new and exciting designs meant to enhance our ability to work effectively. We look forward to hosting you at our new facilities before long.

As we wrap up 2016, it's obvious that the world's events can't be boiled down into a letter any more than they can be squeezed into 140 characters on Twitter, a snapshot on Instagram, or a shaky video that disappears on Snapchat. These are complex times, and I've fielded hundreds of phone calls and hosted scores of clients in our offices, all to dissect these topics. We are always happy to engage in discussions with you at any point, as well as to share the direction our data and intelligence say the winds are blowing.

Let’s kick-start 2017 by talking a little more about the sheer ingenuity, innovation and optimism that permeates our industry. Let’s stomp our feet, wave our flags, and cheer on our competitors. Here’s to a productive, positive and, most importantly, happy and healthy year.

Best,

Michael