

December 3, 2007

Dear Sir or Madam:

Leadership.

Leaders are a rare breed. They must inspire people, grasp complex issues, distill them to their essence, make difficult decisions, and communicate concisely.

2007 was an opportunity for leaders to prove their worth in businesses around the world.

In our industry, growth is flat, losses are rising, key players are undergoing changes in control, and no two economic forecasts seem to agree. No one knows the breadth and depth of the subprime crisis, how far the cost of oil will rise, or how far the dollar will fall.

Leadership will require even more enthusiasm, energy, information, and tough decision making in 2008 – which is why leadership is the theme of Auriemma Consulting Group's annual update this year.

Given the ever expanding nature of ACG's customer base and the multitude of issues to address, our update takes a slightly different form this year. In the attached report, you will find a synopsis of some of the many topics on our radar screen, as we move into a new year. We suspect that at least some of these thoughts will be of interest to you.

As always, we hope this update sparks some ideas for our valued clients – areas to investigate, pursue further, or re-visit from a new perspective. Ideally, this effort will serve to enhance your leadership experience next year. Know that we look forward to spending time with you to hear your thoughts and expand upon ours.

Thank you for taking the time to review the document, and thank you for your ongoing confidence in the Auriemma Consulting Group.

Sincerely,



Michael Auriemma

MJA/jq
Enclosures



AURIEMMA
CONSULTING GROUP
NEW YORK · LONDON

ACG Annual Update

December 3, 2007

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LEADERSHIP ENVIRONMENT

The theme of this year's message is leadership. And we would be remiss not to begin by commenting on some of the upheaval taking place in the senior leadership ranks at various industry players.

This past year we have seen many companies that are vital to our industry undergo changes in ownership structure, with varying effects on their leadership. As is always the case, these structural changes will create opportunities for new leadership strategies, whether from existing executives embracing their new paradigm or because of a regime change.

Three of the four major card networks are in various stages of new ownership models. For Discover, MasterCard, and Visa, independence from their respective "parent" organizations will enable them to think differently about their place in the payments space and to make strategic investments that may otherwise have been impossible. We expect game-changing ideas to emanate from each of these institutions that will alter the competitive landscape and challenge our previous notions of the payments business.

Meanwhile, both of the dominant third party processors are facing new, yet contrasting, ownership structure changes as well. When its spinoff from Synovus is complete, TSYS will have an enhanced ability to set its own course. It seems that international business will be a major priority and that the firm will be led by much the same management team as today. A more significant management overhaul is underway at TSYS' main rival. First Data has attracted significant attention in our industry and in the investment community, as a result of its privatization by Kohlberg Kravis and Roberts (KKR). KKR believes that taking FDR private will enable its new leadership team to "do the right thing" for the long-term interests of FDR in an environment unencumbered by Wall Street's quarterly expectations.

Virtually all of the top card issuers have new or reconfigured leadership teams as well. Players are changing. Organization charts are changing. Some are just settling in and others are in the midst of overhauls. It will be interesting to see which of the paths will prove most successful in the difficult environment of 2008 and then beyond.

CREDIT ENVIRONMENT

Without a doubt, the biggest issue on everyone's radar screen right now is the credit environment. You can't have a conversation on virtually any subject without discussing the credit outlook. For a while, most people were optimistic—the feeling seemed to be that we would avoid a major downturn. But lately, the outlook has gone from “partly cloudy” to “chance of thundershowers”. Almost everyone agrees that 2008 will be a rough year and while there is still disagreement about how bad things will get, the consensus is not good.

The subprime mortgage/home equity fallout hit that industry hard this year. While conventional wisdom may have suggested that unsecured loan and credit card delinquencies would have been the leading indicator of credit problems, this wasn't the case. This is due, in part, to a shift in consumer behavior. Credit cards are now viewed as a more valued instrument in a consumer's wallet. Regardless of the reasons why, consumers are using cards for more everyday purchases and have become reliant on their utility. A recent survey conducted by ACG, and validated by some of our industry colleagues, has confirmed that credit card payments, unsecured loan payments, and auto loan payments have increased in importance in the consumer's psyche.

We have analyzed a number of industries and have not yet seen a dramatic shift in delinquency rates year over year. There have been significant fluctuations on an individual lender basis, but not industry wide. We are, however, seeing more delinquent accounts, once in delinquency, rolling straight through to charge-off. Some of the contributing factors that we have discussed with our clients are the changes made to minimum payment calculations, reduced home values, ARM rate adjustments, and rising gas and oil prices.

Meanwhile, since the bankruptcy law changed in 2005, national filings have crept up but are still running at 1994 levels. 2006 was a good year, 2007 is on edge, and 2008 is going to be a year in which leaders will need to act skillfully in order to counteract this credit cycle and minimize exposure. They are going to be challenged to balance continued growth with protecting profit margins.

Changes in consumer and market behavior will make loss forecasting an increasingly difficult task. If one thing is clear, it's that yesterday's tools and tactics are not going to be effective tomorrow!

LEGAL AND REGULATORY ENVIRONMENT

As regulatory influence and pressure increases in most facets of our society, it comes as no surprise that the financial services industry continues to experience greater levels of scrutiny. Many of these legislative reviews and changes are impacting companies financially and, in some instances, forcing them to modify strategies and operational norms. Over the past few years, there has been a focus on large scale issues which impact the credit card environment, often leading to class action lawsuits. The most notorious, are the issues brought to the forefront in the American Express and Wal-Mart lawsuits against Visa and MasterCard. Slightly less prominent have been the multiple challenges to foreign exchange fees imposed on international card transactions. And, there have certainly been, and will continue to be, many others.

More recently, however, the day-to-day activities of credit card operations are also being closely examined and questioned. Currently Regulation Z, the Truth in Lending Act which governs disclosure on credit card terms to consumers, is being amended by the Federal Reserve. Based on information recently provided by a regulator at an ACG roundtable, the modifications most likely will require large scale changes to all credit card statements, over the next several years. This will inevitably drive up costs and critically impact systems and resources. Though we need to wait until the final changes are issued, understanding potential implications now is crucial.

On another note, the data compromises which occurred at TJX Companies this year have led to the increased importance of PCI compliance in the market. Problems like this are one of the downsides of our technologically advanced society. Identity theft and fraud are on the rise and, though technology is focused on minimizing incidents, there are no perfect solutions. As a result, MasterCard, Visa, American Express, Discover and JCB decided to take a proactive approach rather than waiting for legislative intervention. Standards were issued governing security measures required for all parties that handle personal account numbers. Now merchants, processors, issuers, acquirers and others are rushing to comply.

We are excited to see the networks banding together to take this proactive stance. To be honest, it seems to us that our industry often lacks a common voice that is necessary to stave off issues. We don't often develop and communicate the case for our actions. Perhaps if we did, the severity of action against us could be reduced.

LEADERSHIP DEVELOPMENT

As the operating environment in which our clients find themselves continues to grow more complex, it is increasingly important and difficult for organizations to attract, nurture, and retain key talent. Many individuals have become incredibly skilled in the functional disciplines with which they are most comfortable. But in order to prepare these valuable people for increasing responsibility, and in an effort to enhance succession planning, our client's have begun to seek ways to broaden the horizons of key managers. In other words, to turn these contributors into skilled leaders.

We are thrilled that a number of these organizations have turned to ACG to help them develop and execute strategies to address this new reality. In response, we created a Leadership Development practice in 2007.

Nearly every one of our clients admits to struggling with what they need to do differently in order to continue to engage the best possible talent. The “people are our greatest asset” rhetoric from annual reports is very quickly becoming more real. There are a number of ways in which ACG can help with the development and retention of world-class leaders. A few possibilities include:

- Strategic decision-making courses
- Executive coaching for teams and individual leaders
- Talent management strategy development
- Talent management process assessments, and
- Performance management assessments.

AUTO LENDING

This year, the auto lending market has been challenging for both captive and non-captive loan providers. U.S. vehicle sales have decreased, fuel prices have risen to historic highs and the economy continues to make sure we all work hard to earn our money. Driven by these declining vehicle sales and intense competition, several lenders are broadening their underwriting policies to encompass prime, near prime and subprime borrowers in order to find new sources of revenue.

Auto lenders have also experienced a difficult credit environment in 2007. As disposable income decreases, consumers are seeking longer loan terms to fit their budgets. 60% of buyers are seeking loan terms greater than 60 months and some loans now extend to 80 or 90 months. This trend is causing consumers to be “upside down” on their loans which may have an impact on future vehicle sales. Although the industry does not relish venturing into these terms, the market is so competitive that once a few lenders begin to offer extended terms, others will feel compelled to follow.

2007 was highlighted by acquisitions by Cerberus Capital Management LLP. In April, Cerberus purchased a majority stake in GMAC. Then in May, it purchased Chrysler Financial. These acquisitions have created uncertainty about how captives will operate in the future and the potential impact on the non-captive lending environment.

While the market is constantly evolving, so is ACG. In late 2007, the Auto Servicing Roundtable was launched in response to our clients’ request for best practices and industry data in servicing operations. This new group complements our already successful Auto Collections Roundtable and Auto Originations Roundtable. ACG is proud that our clients find value in our support of the auto lending arena and that they would ask us to do more. We look forward to finding additional ways to add value to these lenders in the future.

EUROPEAN CARD MARKET

With SEPA-related issues largely in hand, what will 2008 bring for the European card market? One thing we expect to see is an enhanced focus on partnerships, as lenders develop co-branded products with increasingly compelling value propositions. These types of products that inspire customer usage are necessary in the European market, considering that credit card market share continues to decrease, especially among younger consumers.

However, ongoing wariness of the subprime fall-out will most likely encourage European lenders to continue to tighten their belts. A recent APACS study showed that new credit card application approval rates in the U.K. dropped to 50% in 2007, from 70% in 2006. Considering this decline and the waning interest in credit cards among the younger generation, lenders must consider changes to their marketing strategies to ensure the future success of card-based lending. While profitability has continued to be elusive, issuers are making strides in adding and stimulating revenue streams such as fee income to offset other declining portions of their P&L. Issuers will also need to monitor the recent increase in average balance per account to make sure this is healthy growth rather than foreshadowing of trouble.

ACG's European consulting efforts continue to be based out of our London office, which is already nearly 18 months old! We appreciate the warm welcome that we have received from U.K. clients. In the last year, we have successfully launched a U.K. edition of Cardbeat® and have enjoyed comparing and contrasting consumer behavior on both sides of the Atlantic. We have spun off a Recovery roundtable from our U.K. Collections roundtable. In early 2008, we are preparing to launch groups in the Finance and Compliance arenas as well. Currently, we are looking to hire a Managing Director for the office and hope to add another associate soon thereafter. Our most recent addition to the office is Megan Bramlette, our Knowledge Management team leader, who has relocated to London to focus on expanding our global research and market intelligence efforts.

By the time you read this update, we will have moved to new office space in The City, as our beloved Mayfair offices are being demolished to make way for a larger building – no doubt in anticipation of even more hedge fund companies!

EMERGING PAYMENTS

As the two biggest network brands make the transition from member-owned associations to publicly traded companies, perhaps the most serious challenge yet to their dominance has emerged in the form of a wide range of alternative payment products.

One of these, PayPal, has captured a significant share of the online payments market. PayPal's recent moves – acquiring a European bank license, striking a deal with MasterCard to create a virtual debit card that extends its reach to non-PayPal merchants, launching PayPal Mobile in Australia – signal the Company's determination to become a major global force in retail banking.

While no single other player has achieved the same scale of success, the field is not for want of competitors. The sheer number and range of these ventures is impressive:

- eWallets and aggregators (Google Checkout, Amazon Flexible Pay, Bill Me Later)
- ACH-based systems that avoid the network rails altogether (Tempo, National Payment Card)
- partial network avoiders (Pay By Cash, Virtual Debit, Payment One), and
- aspiring new networks (Gratis/Revolution Card).

Individually, each of these entities is dwarfed by Visa, MasterCard, American Express, and Discover. Collectively though, they are starting to make serious inroads in capturing consumer payments. We find the situation to be highly reminiscent of the television industry a quarter-century ago. Even now, few cable TV channels can claim as large an audience as any one of the major networks, but collectively they have taken away large numbers of the most desirable viewers. Will MasterCard, Visa, and American Express become the equivalents of ABC, NBC, and CBS?

The coming months and years will be critical as the traditional payment networks decide which of these upstarts to acquire, embrace, ignore, or dispatch. Our team has been spending much effort investigating these new payment options and determining our point of view regarding their viability. We would enjoy trading viewpoints with you at your convenience.

DEBIT CARD

The debit card market has taken an interesting turn. The most noteworthy industry events this year emanated from players that don't have retail delivery networks. Institutions that until recently were considered to be shut out of the debit market and unable to capitalize on the double digit growth occurring in debit spending.

First, DebitMan, a rather small entity in the debit space, became accepted at all Wal-Mart stores. This added credibility to the product, which bypasses the associations, and precipitated both a name change to Tempo and investment by HSBC.

Next, a rather innovative product was introduced by Capital One – the “de-coupled” debit card. This card is not attached to a Capital One DDA account. It requires (or rather, allows) a consumer to provide their existing routing and account numbers to Capital One. In essence, the consumer can have a Capital One debit card that draws on any bank's deposit account. The product required tremendous back-end capital investment in systems and does not bypass the associations.

While much of the market is taking a wait and see attitude to determine what material effect the product will have both on debit volume attrition and movement of DDA accounts, Capital One is forging ahead in hopes of capitalizing on its competitive advantage. Not to be outdone, Tempo has already responded by offering parts of its back-end system, for a fee, to any institution wanting to duplicate the Capital One approach and avoid the capital expense. Its parent, HSBC, has just launched its own foray into the arena, called OptiPay, using the Tempo platform.

One likely consequence we see from the development of this new product is the emergence of more co-branded debit cards. The new paradigm eliminates many of the obstacles faced by traditional co-brand partnerships and serves up the ability to increase product offerings, expand relationships, offer a solution to those not interested in credit, and potentially go deeper into the risk pool.

2008 will be a defining year in the debit arena. If these new approaches are successful, it will be interesting to see how conventional issuers react.

OPERATIONAL EFFECTIVENESS

Over the last decade, financial institutions have worked to re-tool their systems and processes to support integrated customer views, rather than account views. In practice, few have fully achieved the promise and most companies continue their awkward dance with customers that have multiple accounts. As a result, we are helping issuers conduct comprehensive reviews of their customer experience, from the acquisition process through to charge-off and recovery. These companies seek to understand their relative advantages and weaknesses in meeting customers' needs. Our work in this area tends to focus on sharpening the alignment between strategic intent and execution.

A related shift is happening in the world of business process outsourcing, and particularly offshoring. The gold rush days have passed, yet growth offshore continues to progress at an impressive clip. And, new markets have emerged to challenge India's position as the "destination of choice". Canada, Mexico, South Africa, the Philippines, and others are enjoying growth in this area. During this stage of the industry's life cycle, leaders are seeking a greater knowledge of the benefits and pitfalls of performing various tasks offshore. We are also seeing a growing use of segmentation to determine which work types are best suited for completion in the different overseas markets.

In 2007, ACG made great strides in strengthening our ability to support clients with their operational functions. Our client engagements on this front covered almost every aspect of the value chain, and allowed us to demonstrate our broad and deep experience in the operations strategy domain.

INDUSTRY ROUNDTABLES

It seems that every year there are new issues and challenges facing our clients. Whether it's new bankruptcy laws, economic turmoil, legislative oversight, changes in consumer behavior, new technologies, natural disasters, or simply the need to find new ways to increase shareholder value.

As the environment gets more complex, leaders need more detailed information. They need to understand best practices in each functional discipline and how various strategies and tactics can be combined to create economic benefit. ACG's forums continue to be a venue in which leaders can gather, vet out strategies, compare and contrast practices, and measure outcomes. Our roundtables are used as a roadmap to best practices, an entryway for new strategies and technologies, as well as a simple way to help justify and rationalize current practices.

Additionally, as our groups have matured, members have found ways to put them to use for industry-wide concerns as well as their own individual needs. Here are two quick examples of how our roundtables addressed timely issues:

- In 2007, a number of merchants went bankrupt without delivering the promised goods and services. This affected many lenders and a large number of consumers. Our Chargeback Forum met offline to discuss the most effective way to minimize write-offs, maximize recovery and keep consumers happy. The results were ideas that wouldn't have been possible had each issuer worked independently.
- In the auto industry, fraudulent dealerships are a known problem. But, there is currently no central repository of bad dealerships. Our Auto Lending Forum members have banded together to address this issue and create a solution. You should expect to hear more about these efforts in the coming months.

Today, we have 18 forums across retail banking, credit card and auto lending in the U.S. and the U.K.. Virtually all of our groups are the result of feedback from our clients. In 2006 and 2007, we launched 8 new groups in areas such as Offshoring, Auto Originations and Prepaid cards. More launches are planned for 2008 in areas suggested by financial institutions that are looking for a venue to identify best practices. We appreciate the feedback and hope that you keep it coming. We are convinced that ACG Roundtables are an essential resource for financial services leadership.

BENCHMARKING

Organizations have focused substantial effort over the years to run more efficient operations while reducing expenses. Yet, the pressure continues to find even greater efficiencies. Given the size of the leading players, even small changes can have a significant effect on the bottom line. Understanding how competitors are performing in the industry, and how results compare, is becoming critical to successfully manage the business.

Developing and conducting benchmarking studies has become a core business at ACG. We continue to secure our status as the premier source for benchmark data. We've done this by adhering to our mission of providing clients with accurate data that provides actionable insights that effective leaders demand. We strive to provide the kind of timely and detailed knowledge that is necessary to maintaining an edge in a challenging environment. And, we pride ourselves in producing reports that sit on leaders' desks, not on their shelves.

This year we expect to complete over 160 benchmark studies through our Industry Roundtables. From design, to validation, to the creation of custom reports, we are able to provide clients with data that is not available elsewhere in the marketplace. An example that comes to mind is how one particular client was able to leverage one of our benchmark reports. This ad-hoc study analyzed how others in the industry were planning to staff during a holiday season. As a result, the client changed its outbound calling strategy which led to a dramatic reduction in expenses and no competitive disadvantage.

ACG's benchmark studies help clients understand the key performance indicators of each functional area and how strategic business decisions affect overall productivity and profitability. Whether it's a 40-page study on collection operations, or a three question survey on interpreting regulatory requirements, ACG has the resources needed to gather the information necessary to support sound business decisions.

KNOWLEDGE MANAGEMENT

ACG is pleased to have grown its Knowledge Management practice significantly over the last year. Whether consumer research, market scans, or industry intelligence gathering, we are adept at compiling actionable information for leaders to use in making decisions on product design, market entry, or competitive reaction. We are also able to use our vast library to answer vexing questions in short order.

Given the threats, both existing and expected, to profitability and traditional operating models, many of our clients investigated new markets in 2007, and enlisted ACG's help in making strategic entry decisions. Some clients defined new markets geographically so we worked to help decide which countries to enter and how. Others defined new markets by consumer segment. This year, those clients asked us to help them explore best practices in the non-prime market at one end of the scale, the experiential rewards programs that are increasingly being used to target the super-affluent on the other, and several in between. New markets have also been defined by product set, and clients have engaged us to look at product and marketing opportunities such as affinity cards and recurring payments.

2007 was the 13th year of publication of Cardbeat (our consumer behavior tracking study) in the U.S.. The product is not only widely read by subscribers, but is increasingly referenced by industry press as a source of insightful and accurate data. Subscribers have also begun to ramp up their customization of the Cardbeat platform. By asking proprietary questions or running proprietary analyses, they are able to gather unique consumer insights. In 2007, we also launched a U.K.-focused edition of the product. Already, the publication has proved to be a hit in the U.K. market. Lenders holding more than 70% of U.K. credit card outstandings are subscribers to the report. Notable topics explored over the past year include Credit vs. Debit Card Usage, Contactless Technology, Consumer Valuation of Rewards Programs, and Recurring Payments.

Other interesting studies conducted by ACG this year included a variety of co-branded and private-label opportunities, international card market reviews, credit and debit card activation practices, and recurring billing activity. ACG research and analysis was frequently cited by publications including the Wall Street Journal, Kiplinger's Business Report, Cards & Payments, and the American Banker, as well as by industry analysts like Bear Stearns and Credit Suisse.

The successful leaders of 2008 will continue to monitor trends and explore a variety of expansion opportunities that will allow them to capitalize on the possibilities that constant changes create.

ALLIANCES

The face of co-branding is changing. The nature of deal structures is moving toward a more non-traditional one. Brand partners are seeking more control, unrestrained access to customer data, a more significant share of program profits, and sometimes complete or shared ownership of the accounts receivable. In exchange, these brand partners are showing a willingness to take on a greater share of the financial risk. This new structure isn't for everyone. Many partners lack the appetite for such increased responsibilities. For organizations planning to make the move, we recommend detailed analysis of the options, risks, rewards, cultural fit, and management commitment.

Recent rumors suggested that American Airlines was considering partnering with American Express to begin a Global Network Servicing (GNS) deal. This wouldn't have surprised us, as airlines have been considering how to capitalize more significantly on their hugely successful co-brand programs. Shortly thereafter, a Citibank – American Airlines card with an American Express logo on it appeared in our mailbox. While that may be the extent of the switch, it might also be a transitional step as American seeks greater control and profits.

The potential divestiture by Target of its card program, however, could be an example of the opposite effect. In the footsteps of many other significant retailers, Target has undergone (albeit reluctantly) a review of its strategic alternatives. Spurred by a dissident shareholder, Target finds itself in the position of possibly giving up some control in exchange for the monetization of its asset. There has been tremendous speculation around whether Target will actually consummate a transaction. If it does, we suspect it will look quite different than what was contemplated at the outset of its review.

The shakeup in the retail and private label card markets has continued unabated in 2007. Examples include the proposed purchase of Alliance Data by the Blackstone group and the purchase of Lord and Taylor by NRDC with the credit card portfolio subsequently being sold to GE. We suspect that Alliance Data will become a more formidable competitor in the issuer arena and reach for more, larger, and more significant deals. If the change in ownership of retailers and their card programs slows, it will only be because all of the deals have already been done!

The offering of spend centric products (e.g. Signature and World) to certain segments has become increasingly necessary because of their ability to generate incremental revenue. So important are these programs that several of the largest issuers have altered their organization charts to accommodate and nurture this segment of the market.



Last year, many in the industry were shocked at the unexpected turnover of the entire senior leadership team at Barclaycard U.S.. Many predicted the issuer's immediate demise. However, based on Barclays' recent successes in winning new deals, it seems they have not missed a beat. There is also a new entrant to the market, called Partners First, which warrants attention. Founded by several former MBNA executives, this new addition to the partnership landscape claims to have already signed six deals.

It seems that rumors of the death of co-branding have been greatly exaggerated!

ACG MOTORSPORTS

ACG's involvement in motorsports has grown significantly over the last few years. Our association with Marcus Motorsports and Grand-Am have proven to be quite successful. Of course, as a driver, I always enjoy a day at the track. But, lately I've been learning the business benefits as well. "A day at the races" is a fantastic environment to meet and entertain clients and prospects. And, the buzz extends beyond race day as the stories and excitement last for days and weeks after each event.

In 2008, we'll continue our racing activities under the new corporate banner-ACG Motorsports LLC. We'll still be involved in racing Porsches at tracks across North America and BMW's in Germany. We look forward to doing more business at the track, and to adding to our collection of three trophies. Not bad for our first 10 races!

But, perhaps the most exciting news for 2008 is our affiliation with TRG Motorsports. TRG is a top-level team in U.S. sports car racing. They have decided to enter the exciting world of NASCAR and have acquired the assets of Daryl Waltrip Racing's Craftsman Truck Series team. We'll compete in the full season of Craftsman Trucks next year and have already shown some terrific results in a few tests in 2007.

If you are interested in attending a race as a spectator, hosting your own clients, prospects or employees, gaining brand exposure, or just following along via my monthly racing blog, let me know. I enjoy talking about racing almost as much as I enjoy talking about credit cards!