January 2015

Dear Friends,

I'd like to start our 2014 annual letter by saying Happy New Year! For the second time in 23 years, our year-end recap is being delivered in January. The reason behind this could actually be our first topic of the year. That is, 2014 was a difficult year! At ACG, we were fortunate to achieve the highest revenues in the firm's history. But it wasn't easy by any stretch. As I've heard from many of you… lenders, vendors, competitors… the environment proved difficult for operating effectively. Virtually every activity required more approvals, more "process", more "compliance", and therefore more time. Often, much more time. For many of us, it felt like the incline on the treadmill got turned up… we worked harder to maintain the same pace. Below, we'll touch on some of the market factors that led to this effect.

Another thing that got more challenging in 2014 was writing a single, meaningful update to all of ACG's clients and prospects. Our mailing list for this annual letter now numbers over 6,000 people in over 20 countries. I think the first year's list included fewer than 100 recipients! We have struggled increasingly over the years to draft a letter that was relevant to readers in a growing number of industries, functional roles, and geographies. For the last few years, we found ourselves writing longer and longer updates in an attempt to be more inclusive. But that invariably meant some of you had to slog through sections that were irrelevant to you.

This year, we decided to try a new approach. You'll notice we've been briefer in our recap of what we think are the "hot topics" facing the consumer payments and lending ecosystems. Rather than opine on each, we've tried to simply plant some seeds for future discussion. Each topic below could warrant a full letter, or even a full day of discussion. So, we invite you to reach out to us to discuss the issues you find most compelling… or most confusing! Without further ado, here is our list:

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- The pace of economic growth in the Western world diverged sharply, with increasingly gloomy prospects for continental Europe, while the UK seems to be on the path to recovery. In the US, the University of Michigan's Consumer Sentiment index hit an 8-year high, on the heels of the Federal Reserve's confirmation that household debt burdens have settled at their lowest level in more than a decade. Classic economic theory and past experience suggest that the stage is set for a rise in **consumer spending and borrowing.** However, widespread migration to debit card usage may indicate that the financial crisis left permanent scars, just as the Depression of the 1930s marked the attitudes of that generation.

- All the industries we serve share a growing concern with **customer service and workforce management**. Contact centers are caught between a relentless focus on CSAT scores and pressure to reduce costs while observing strict regulatory guidelines. At the same time, the composition of the workforce is changing, increasingly staffed by Millennials who value work/life balance issues, such as schedule flexibility and workplace amenities, over job security. Their expectations for rapid career advancement are challenging management to devise job enrichment and horizontal career paths to retain skilled agents.

- The burdens of **compliance** permeate all aspects of the payments, mortgage and auto finance industries. Executives complain of vague and contradictory guidance from multiple agencies, retroactive punishments for candor, and a chilling effect on product innovation. **Vendor management** adds to the headaches as regulators extend their audits to the myriad of service suppliers whose activities are a potential liability to their clients.

- Regulated industries (which now include prepaid cards and captive auto finance, both newly brought under CFPB oversight in the US) face another balancing act: actions previously viewed as exemplary customer service, such as offering deferred payment or waiving late charges, are now being examined for **disparate impact.** Companies find themselves having to defend the basic premise of segmenting customers by their value and differentiating service levels: will loyalty and reward programs face additional scrutiny?

- Consumers' **privacy concerns**, initially confined to fear of being victimized by cybercriminals, have been exacerbated by revelations of the massive scale of data-mining by both government entities and social media giants. Consumers' willingness to barter personal information for convenience is beginning to come under question, with implications for marketing and customer service as companies try to walk a tightrope between helpfulness and intrusiveness.

- Sony and Apple aren't the only victims of hacking, of course. **Payment card fraud** has gone from being a persistent but manageable annoyance to being one of the most pressing concerns in the industry. While previous conversations about fraud had mostly revolved around online security, waves of highly-publicized data breaches at brick-and-mortar merchants have finally created the tipping point for EMV adoption.

- **EMV** conversion is finally underway, even though many issuers privately concede that the decision to convert is driven more by PR considerations than by belief in EMV's efficacy. What's more, we seem to have only gone part of the way down the road as most issuers have decided to support chip & signature vs. chip & PIN. Credit cards going out well in advance of debit cards, owing to the latter's long road to consensus on a standard compatible with Durbin requirements. Debit cards are now on track for EMV conversion as well, but issuers are struggling with customer communications: does describing a new credit card as "safer" imply that the mag stripe debit card from the same bank is not secure?

- In the UK, credit cards are facing sharply **lower interchange rates,** a difficult adjustment that debit cards in the US have already had to make. There seems little chance that a Republican-controlled Congress will legislate lower credit card interchange rates in the near future. Alternate payment products may achieve the same end through market forces, however, either skimming basis points off the issuer's share (Apple Pay) or seeking to bypass the network rails altogether (MCX's CurrentC, real-time ACH authorization). Will issuers respond by transforming the card back to being a lending vehicle, with the creation of no grace period products?

- **Auto lenders** are feeling the tailwinds of the highest level of US auto sales in nearly a decade. That increase in volume, however, could result in operational challenges for those that aren't fully prepared. **Mortgage lenders**, meanwhile, are also seeing an increase in volume. Recent reports of artificially inflated appraisal values make one pause and consider the potential consequences of these actions.

- Probably THE biggest story in the payments world in 2014, was the long-awaited introduction of **Apple Pay.** I don't think we've had a single client conversation since September 9th that didn't at least touch on this rollout, its likelihood of success, and the implications for merchants, issuers, processors, and every other player in the payments ecosystem. ACG has responded to the challenge with the launch of an ambitious and rigorous research program to track consumer adoption among iPhone 6 owners --- and we'd love to tell you more about it.

- Thirty years ago, our firm was founded predominantly to help forge **co-brand alliances**. Today, while lots of other lines of business have taken root and grown at ACG, serving the co-brand market continues to be a thriving practice for us. This year the co-brand market continued to evolve. Some issuers purposely contracted. Others got into the business or increased their appetite for deals. Yet others struggled to maintain their status quo. Given ongoing pressure on interchange, entitled and empowered consumers, and stiff competition among banks, what does the short-term future hold for co-brand?

As I said earlier, this letter, by design, can only scratch the surface of industry shaping subjects. Hopefully, you think we touched on the most relevant ones. If not, please let us know what's on your mind. Either way, we'd really appreciate a more detailed discussion with you about any of these issues… whether or not you think you need help solving or navigating them.

Before signing off, I'd like to say how touched I was in November and December by the number of people calling to ask where our 2014 letter was! It is rewarding to know our tradition has become one that many of you have embraced as well.

Here's to a healthy, happy, and prosperous 2015.

Michael Auriemma