AURIEMMA CONSULTING GROUP
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Dear friends,

I've had a lot of time to think lately.

Like, the other day, when my normally eight-hour flight home from London turned into a 12-hour trek. It was a miserable end to an otherwise productive business trip. First, the Uber driver dropped me off at the wrong terminal. Then, the British Airways gate was devoid of employees, even 30 minutes after our flight was scheduled to leave. An hour later, we were hustled onto the plane – only to languish on the runway for two more hours without explanation.

The flight couldn't have been more of a contrast to my recent 900-mile motorcycle trip with friends through New England. The trip was pure pleasure – plenty of laughs, practical jokes, and good times. There were blue skies and changing leaves, the colors of which would take your breath away.

Combined, these trips gave me an opportunity to sit back and reflect on some of the events we've witnessed in our industry throughout 2015. But like many of those events, the beautiful foliage of New England left me wondering… should these harbingers of change be cherished? Or, were they just a reminder of colder and bleaker times ahead? Certainly, there are parallels to be seen everywhere in our industry these days – often, just as things start to look brighter, something crops up to dampen the mood.

To wit, the global economy continued to struggle this year, despite showing signs of improvement and feeling, to many, as if it was finally trying to resume robust growth. It seems as though we are in the midst of the world's longest economic hangover! To be sure, there were many mixed messages. With countless unicorns roaming around (you do know what a unicorn is, right?), it is hard to suggest we aren't in another tech bubble. The question is whether or not this one will burst, and if so, when? While some markets were doing well in their own right, they couldn't help but be dragged down by those in dire straits… would Greece spiral to the point of being another "Lehman moment?" Would it tip other vulnerable economies in the EU and beyond into chaos? What about China's currency devaluation, which sent markets tumbling?

I won't opine about what happens next. Even an august group like the US Federal Reserve can't make up its mind. Just as a strong jobs report seemed to signal that rates would finally increase, deterioration in the EU or China would delay it. And so it continues: Will they or won't they? What effect will an increase have? What effect will it have if they don't? Isn't any decision better than no decision?

Regulatory intervention continues to be a topic that cannot be avoided. It permeates every conversation we have with clients. Just a few days ago, I spoke to a CMO who told me she spends 90% of her time on compliance issues. Clearly, the regulators are well-intentioned. And many of the ills they attempt to cure should indeed be remedied. But, not everything they do is helpful. For sure, they are driving up costs and driving down the industry's appetite for much-needed innovation. And, their positive actions are often creating unintended side effects.

This was evident as the CARD Act neared its fifth anniversary. In ACG's comment letter to the CFPB, we noted that the Act indeed secured victories for consumers, including reduced fees, fewer interest rate hikes, and card agreements that rely more on plain English and less on legalese. But the Act also unleashed consequences, including reduced access to credit, and fewer products available for under-served customers. Not only do these borrowers have fewer products to choose from, but all borrowers must help offset banks' risk by paying higher prices.

We saw another example in July, when the FCC released clarifications of the Telephone Consumer Protection Act (TCPA). The FCC's interpretation of the law effectively restricts cell phone contact for debt collection – a decision that affects the card, auto, and mortgage industries. As cell phones become the primary method of communication for consumers, these laws show how legislation sometimes fails to reflect modern behavior. And when contact rates decline, so do repayments – which translates to long-term financial distress for consumers. Not to mention that creditors are less able to rehabilitate distressed borrowers when they can't even have a conversation.

Given the scope of our services, ACG enjoys a 360-degree view of the most contentious issues facing the financial services and payments landscape. In our roles as intermediaries and advocates, we often try to find common ground between the industry and its regulators. Through continuous and open dialogue, we've tried to bring to light the need for balance and a complete understanding of the implications of even the most well-intentioned actions.

Either despite or because of the economic and regulatory environment, competition among lenders is heating up. One area in which this can be seen clearly is the subprime credit card market. Nearly one-third of consumers have FICO scores under 650, but when regulators cracked down on issuers, many abandoned the subprime market. Now, with high demand and strong (though risky) profit potential, we've seen a wave of new entrants to the market. In addition to the recently launched Build card, we are aware of at least three other significant players preparing to compete for their slice of the market. Meanwhile, even big issuers have been tip-toeing back into the sub and near-prime markets.

We are also witnessing the rapid rise of marketplace lenders. In the case of marketplace lenders though, I wonder: Are they all aware of the risk management issues at hand? Surprisingly, the answer isn't clear from some of the conversations we've had.

A particularly hot segment is auto lending which has become one of the fastest growing sectors of consumer finance. Auto loan volume is the highest it's ever been, according to American Banker and as witnessed in our auto lending roundtables. Auto lending emerged from the recession faster than other areas, thanks to relatively healthy credit quality. In response to this growth however, there's been a surge of new subprime lenders backed by private equity firms like Blackstone and Blue Mountain. It will be interesting to see what happens next, as some buyers keep their cars longer on average, while Millennials are showing a reduced interest in owning a car in the first place.

Another area in which competition has intensified is co-branding. A raft of new US market entrants has brought the competition for deals to levels not seen in quite some time. This has increased the price of deals, though so far, not to the unsustainable levels we've seen in the past. It is also creating a bit of an arms race as issuers strive to develop rich value propositions to attract attention in already crowded wallets.

After a pause, even the UK seems ready to carry on with co-branding. Who could have been blamed for doubting if that would happen, as interchange (I refuse to say "swipe fees") is headed to 30 basis points? But, the industry has recognized the value of the product, and found a way to restructure partnership economics in hopes of keeping co-branding alive and relevant. After all, why wouldn't they, when the alternative is 37-month introductory rates? All this has led 2015 to be our partnership team's busiest in the history of our firm (and we've been doing this since 1984!).

This year, the long awaited US EMV migration finally happened… kinda, sorta. In the three months leading up to the October 1st "deadline", all four of the cards in my wallet suddenly sprouted chips. We understand that 47% of consumers say at least one of their cards has been converted. But how often can those chips be used? Are retailers prepared? Do the cashiers at the point of sale even understand what is involved?
What affect will EMV ultimately have on fraud? As anticipated, there was an uptick in fraud prior to the liability shift, as fraudsters tried to cash in while they still could. In 2016, we'll be closely monitoring two areas that have been pinpointed for potential vulnerabilities – card-not-present (CNP) and account takeover (ATO). We have already witnessed an uptick in the debit space, with CNP fraud growing 20% in Q2, according to our Debit Fraud Benchmark Study. ATO, a relatively smaller fraud category, jumped 280%!

Our Payments Insights group's research has found that when consumers use chip cards, 48% say that the transaction requires noticeably more time than swiping a mag stripe. Combined with shopper insight studies that have linked longer queue times with lost sales, this is a metric to watch. What will happen over the coming holiday season? And, what impact could lower-than-anticipated sales have on the aforementioned shaky economy? We expect the learning curve to smooth out, once more retailers enable their EMV-ready terminals and cashiers know how to better educate consumers. But in anticipation of a busy holiday season, some retailers aren't taking any chances – they've turned off their EMV capabilities to avoid long lines; others aren't migrating their systems until January.

For now, the US consumer experience is wildly inconsistent and will remain so well into 2016. This is unlike the UK, where consumers and retailers all made the migration simultaneously. I look forward to the day that my New York experience rivals that of London, where I've successfully used a chip-and-PIN card for quite some time. Last week, I used both my UK chip-and-Pin card and my US chip-and-signature cards (let's not even mention THAT debate!) seamlessly throughout London. How long will it be before the US catches up? Will it even happen before mobile wallets make the card itself obsolete?

Our friends at Apple, Android, and Samsung are certainly placing their bets on mobile technology. The same holds true for Chase and MCX. In my 2012 annual letter, I declared a bright future for MCX and the influence it might wield. But earlier this year, I began to admit defeat. It seemed the retail consortium was about to be laid to rest. Now, just days before this letter, comes their biggest announcement yet: Chase has joined ranks with merchants in the mobile wallet battle. Chase Pay promises to reduce costs for merchants by eliminating network fees and eschewing expensive NFC technology. Will it be enough to compete with tech giants like Apple, Android, and Samsung?

Apple burst onto the scene a little over a year ago with great fanfare. Much has been written about the product, including our own Apple Pay Tracker consumer research. Consumers certainly love it – conceptually, at least. Banks have embraced it (or at least supported it). As such, you have a product that could finally bring some traction and credibility to mobile payments. But retailers have been slow to get onboard for one reason or another. Despite the promise, to date, the numbers are still all but impossible to find in issuers' portfolios and economics.

No sooner had Apple Pay launched, than Android Pay followed. Much the same story, but for different hardware. Then, just moments later, Samsung announced its entry to the market, albeit with a very interesting twist. Thanks to its LoopPay acquisition, some of Samsung's Galaxy phones can communicate with mag stripe readers, making the payment method compatible with approximately 90% of US retail locations! It is early days, but I've had three conversations just this week with executives claiming that the numbers on Samsung Pay are "for real." We intend to track Android, Samsung, and Apple in our modified Apple Pay Tracker (which will be re-christened Mobile Pay Tracker), starting early next year.

With so much change afoot… with so many external influences shaping what lenders can and cannot do… with each decision leading to potentially significant (positive or negative) results, today's industry participants find themselves clamoring for more and more information and data. I am often reminded of the quote (by Christopher Cherniak): "A society where members could only seek first-hand knowledge, would be profoundly crippled." This thirst for information has proved fortuitous for ACG, as our roundtables are the perfect prescription for clients' need for insights. We now offer over 30 groups to executives in three countries, covering seven products and 20 functions (see the full list at acg.net).

In 2015, leaders recognize that what worked yesterday often doesn't work today. And, what works today likely won't work tomorrow. Our groups allow executives with common concerns to come together in a controlled environment to talk about the issues that challenge them the most. They are discussing millennials (in our Retirement Customer Service Roundtable), PSD2 (in our UK Card Fraud Operations Roundtable), Uber (in our Auto Originations Roundtable), QRPC (in our Mortgage Collections Roundtable) and hundreds of other topics that we debate and benchmark extensively. In each of these roundtable communities, executives are learning from past mistakes, finding new ways to stay ahead of fraudsters, and discovering innovative ways to improve efficiencies and lower costs.

So, is it time to sit back and enjoy the scenery as the changing autumn leaves put on a dazzling display? Hardly. Nor do we think it is time to hunker down for winter with a six-month supply of firewood and canned goods. The times they are a-changin', for sure. And while confusing, and perhaps stressful, it can be quite exciting as well. It will take both self-awareness, as well as situational awareness, to navigate successfully going forward. We are thankful to everyone who asked ACG to stand by their side over the last year as they made challenging decisions. We look forward to doing so again in 2016, and beyond.

Thanks for listening and thank you for your confidence and support.

Michael Auriemma