

New Strategies for Credit Card Issuers

Credit card issuers are facing severe profit challenges as a result of the economic downturn: consumers are spending less on their credit cards; bankruptcy filings have escalated sharply, and delinquencies and write offs continue to climb. To make matters even worse for issuers, the Credit Cardholder Bill of Rights will restrict pricing options and will result in lower credit lines and fewer credit cards issued. The newly proposed regulatory structure would be a further restriction on credit granting, as higher capital requirements and product regulation make the traditional credit card issuing business less attractive.

Banks competing in the card issuing business must compete going forward on several fronts. Credit cards will still be offered, but the aggregate number of cards will be less and line sizes lower than previously available. Consumer purchases will be increasingly supported by debit cards, pre-paid cards (both declining balance and reloadable), charge cards (where the

outstanding balance is settled at the end of the monthly billing cycle), and online bill paying directly from DDAs.

Credit card product design before the Credit Cardholder Bill of Rights was based on promotional pricing, with teaser interest rates, relatively low standard rates, and low or no annual fees. Card issuers protected profits with penalty pricing, namely late and overlimit fees and higher interest rates triggered by delinquencies. In the future environment, the design will be reversed. The rack rate for cards will be relatively high interest rates and annual fees, but consumers who exhibit good payment behavior and who will deepen their relationship across a series of banking products will qualify for discounts on the credit card.

Tomorrow's winners will package the credit card in a relationship account that includes the DDA/checking account. DDAs support debit cards and online bill paying today and can easily be linked to pre-paid cards and

charge cards.

Tomorrow's successful card issuers will be institutions which have:

- ◆ A core competency in consumer deposit gathering, particularly DDAs.
- ◆ Experience in relationship banking and a strong sales culture.
- ◆ Proven success in cross selling financial products.
- ◆ Systems architecture which supports the integration of customer accounts both for cross-transactions and for consolidated statements.
- ◆ Strong branch or store distribution networks to support face-to-face sales, particularly to explain to consumers how they can qualify for the best card pricing.
- ◆ The ability to leverage distribution networks and payments to support the needs of micro and small business.

Opportunities Ahead

Segment/ LOB	Key Trends/Considerations
Small Business	<ul style="list-style-type: none"> ◆ Deposit growth opportunity remains significant; sector remains under-served ◆ High-growth sectors include healthcare, professional services, business services, women-owned, Hispanic, and SOHO ◆ Packaged offers on the rise; convenience is major concern but becoming easier to deliver remotely
Commercial	<ul style="list-style-type: none"> ◆ Loan demand down significantly; credit problems likely to continue through 2010 ◆ Enormous market turmoil creating opportunities for CRE refinancing, C&I lending, leasing, treasury services ◆ RMs increasingly positioned as advisors, not lenders
Wealth Management	<ul style="list-style-type: none"> ◆ Turmoil on Wall Street creates opportunity for smaller, more focused competitors; expect increase in number of RIAs ◆ Demand for best-in-breed investment options increasing driving move to more open architectures ◆ Demand for automated, self-service delivery technologies and financial planning/advice on the rise
Brokerage	<ul style="list-style-type: none"> ◆ Annuity sales up significantly and fees are on the rise ◆ Fee-based brokerage model is slowly replacing the commission model ◆ Remains very difficult to integrate brokerage into the branch-based relationship model and align strategy with Wealth Management and Trust strategies
Insurance	<ul style="list-style-type: none"> ◆ Consumers and businesses increasingly reassessing needs in wake of economic downturn, which creates opportunities ◆ Premiums falling significantly; scale now more important ◆ Compliance costs high; margins relatively low; outsourcing to third-party providers likely to increase
Leasing	<ul style="list-style-type: none"> ◆ Total demand down significantly in recent months, but demand expected to be strong as economy stabilizes ◆ Consolidation of large, weakened competitors expected to create opportunities for smaller, focused players ◆ Can combine leasing with RDC and other services to extend footprint territory

Organic Core Deposit Growth, 3/31/2008 to 3/31/2009

Between 1Q2008 and 1Q2009, banks benefited from a significant inflow of core deposits. As the stock market became increasingly volatile in 2008, consumers looked to move their money into relatively more stable transaction, money market, and savings accounts. The largest beneficiaries of this trend among banks with total assets of \$20B or more (identified based on growth in balances in these three accounts, excluding deposits acquired through M&A transactions) are listed below:

Rank	Institution	City, State	Total Assets (\$000) as of 3/31/2009	Core Deposits ¹ (\$000) as of 3/31/2008	Core Deposits ¹ (\$000) as of 3/31/2009	Core Deposits ¹ Growth (%) 1Q08-1Q09
Industry Statistics						
	All FDIC Insured Institutions			3,586,993,191	3,847,124,424	7.25
Peer Group Statistics						
	75th Percentile		178,251,931	56,954,015	66,389,141	17.08
	Median		64,883,195	27,112,531	32,150,133	6.70
	25th Percentile		33,474,992	10,524,451	11,047,230	-0.98
Peer Group: Publicly Traded Institutions with Total Assets of \$20B+						
1	Hudson City Bancorp, Inc.	Paramus, NJ	56,569,758	4,868,640	6,315,396	29.72
2	PNC Financial Services Group, Inc. ²	Pittsburgh, PA	286,422,000	57,680,572	73,058,363	26.66
3	Wells Fargo & Company ²	San Francisco, CA	1,285,891,000	259,979,000	327,213,289	25.86
4	M&T Bank Corporation	Buffalo, NY	64,883,195	26,169,440	32,150,133	22.85
5	Zions Bancorporation ²	Salt Lake City, UT	54,545,012	27,112,531	32,557,963	20.08
6	Associated Banc-Corp	Green Bay, WI	24,349,725	9,168,555	10,920,217	19.11
7	BB&T Corporation ²	Winston-Salem, NC	143,425,000	45,833,282	54,490,198	18.89
8	Citigroup Inc.	New York, NY	1,822,578,000	209,311,000	241,261,000	15.26
9	New York Community Bancorp, Inc.	Westbury, NY	32,402,552	5,761,112	6,549,980	13.69
10	Capital One Financial Corporation ²	McLean, VA	177,387,459	53,298,048	59,719,919	12.05

Source: CPG analysis of data from SNL Financial, LC. 1. Transaction, savings, and money market account balances. 2. Deposit totals adjusted to exclude acquired deposits.

The Outlook for Branch Banking

CPG asked executives representing seven banking institutions across the country, ranging in size from \$1.5 billion to over \$60 billion in assets, how their banks are adapting their branch networks to the current marketplace and their vision for the future.

The short answer: the branch role is not changing. If anything, the last several months have only reemphasized the branch as the superior channel for collecting core deposits. In addition, as electronic payment channels and technologies like remote deposit capture continue to peck away at bank check processing volumes, customer growth has effectively kept branch teller transaction volumes flat at many institutions.

Despite BofA's recent announcement to shed 10% of its current branches, most bankers appear more focused on making their existing networks more productive than either opening de novos or closing existing branches. Across the industry, from July 2008 to June 2009, the total number of de novo branches declined by almost 20% on a projected basis to the lowest industry total since 2003. Altogether, while the

ratio of de novo branch openings to branch closures in 2009 will be about 2:1, or close to the average for the decade, the aggregate number of openings and closures will be the industry's lowest for the past eight years.

We see banks implementing both short-term and longer-term initiatives to help transform the performance of their branches. Many of the banks that have been able to weather the recession and banking crisis relatively well have implemented programs specifically intended to steal customers from struggling and distracted competitors. For example, as part of broad, bank-wide initiatives, a number of institutions have installed CPG's Competitive Tracker sales tool to enable branch sales staff to explain, concisely and consistently, their bank's strengths relative to those of each major competitor in the market.

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CPG Announcements

- CPG Consulting Associate Michael Flores testified on the impact of proposed NSF/OD fee policy changes before the subcommittee on Financial Institutions and Consumer Credit in Washington on April 2. Michael also represented CPG in hosted dinners with Chairman Gutierrez, who is sponsoring HR 1214, the Payday Lending Reform Act, Congresswoman Carolyn Maloney, Chair of the Joint Economic Committee and member of the Financial Services Committee who sponsored H.R. 1456: Consumer Overdraft Protection Fair Practices Act, and Congressman Gregory Meeks who sits on the House Financial Services Committee and who Chairs the International Monetary Policy and Trade subcommittee.
- Gary Stein's article "Branch Growth: Flat, Branch Future: Strong" is the cover story for the August issue of the *ABA Banking Journal*.
- Claude Hanley and Sandy Spring Bank's Phil Mantua will present "The Nuts & Bolts of an Effective Bank-wide Efficiency Program" at AMIFs Annual Profitability & Performance Measurement Conference on Thursday, Sept. 10th in Atlanta.
- Mary Beth Sullivan and Sandy Spring Bank's Jim Burrows will present "Deposit Strategies That Work!" at the ABA Marketing Conference on Sept. 14th in San Antonio.
- Mary Beth Sullivan and BBVA Compass Bank's Bill Hippensteel will present a session on non-interest income strategies at the ABA Annual Convention on Oct. 26th in Chicago.

Capital Performance Group, LLC

1025 Thomas Jefferson St., NW, Suite 310 East, Washington, DC 20007 phone: 202/337-7870 www.capitalperform.com
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