

MERCATOR
ADVISORY GROUP

**Winning the Top-of-Wallet and Collections Battle
Via Multi-Channel Communications**

Sponsored by SoundBite Communications

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Introduction

Customer relationships are a defining element of the credit card product. With multiple monthly transactions, monthly statementing, periodic service interactions to handle questions, transaction disputes, and pursuit of collections, no other consumer banking product is as communications-intensive. Perhaps no other consumer banking product can be more negatively affected by under-communication in terms of potential customer attrition, marketing expense, and financial loss. But more importantly, the many trigger events inherent in the cardholder life cycle represent business opportunities to card issuers if they are able to leverage the emerging capabilities of multi-channel communications technologies.

Despite a challenging business environment, credit cards remain a key strategic product for banks, delivering a return on assets above other business lines, and building long term relationships with customers. Over eight thousand U.S. banks operate credit card programs, or work with third party providers through agent relationships. Maintaining a competitive card program is a strategic imperative for issuers of all sizes. Multi-channel communications is becoming a cornerstone capability for delivering the service.

As consumers shift both their communication channel usage and preferences, banks must shift with them. Email, web, text, and mobile communications are growing in importance far beyond their early adopters and younger

Highlights of Findings

1. The unique life-cycle nature of credit cards creates critical cardholder communication events that issuers must address to keep their card “top-of-wallet.”
2. In today’s difficult credit environment for banks and consumers, issuers must deploy multi-channel communications strategies to effectively compete for collections dollars.
3. Consumers’ use of, and preferences for communications channels are rapidly changing, notably in mobile and text communications. Issuers able to deploy multi-channel communications best practices are realizing over 300% improvement in activations and over 100% in collections.
4. Banks must deploy communications solutions with the proven scalability, security (e.g. PCI compliance), business rules intelligence, and consistent customer view to capitalize on this opportunity. Multi-channel solutions with the flexibility to support enterprise needs will enable development and deployment of best communication practices across organizational silos.

demographics. In the near term it is desirable to serve clients in their channel of choice. In the long term, it is clear that issuers will be required to fully accommodate these preferences. Plus, with increasing channel options, the ability of an issuer to select and use the most effective channel for a given message will be a major competitive advantage. With the knowledge of how to break through the consumer's increasing clutter, and the communications tools to deploy that knowledge, issuers will be in a much better position to leverage the revolution in multi-channel communications rather than to be buried by it.

Despite the mission-critical nature of communications, issuers are often challenged by the realities of their infrastructure. Siloed systems for account acquisition, account processing, credit management, customer rewards, and collections, hamper the issuer's ability to speak with a coordinated message to customers. Organizational silos built to deliver function-specific communications add to this challenge.

With all their operational and IT complexity, card issuers may naturally be inclined to delay while they develop long term plans for the ultimate integration of systems and communications tools. Yet the real-time press of competition and consumer behavior dictates today's need for multi-channel communications strategy and capabilities. Multi-channel communications solutions offering speed of deployment across business and systems silos will grow in importance as issuers seek to close today's gaps in cardholder communications, and to capture the new business opportunities they enable.

I. The Card Life Cycle and Cardholder Communications Drive New Requirements

Today's credit card issuing environment grows more challenging. Notable are:

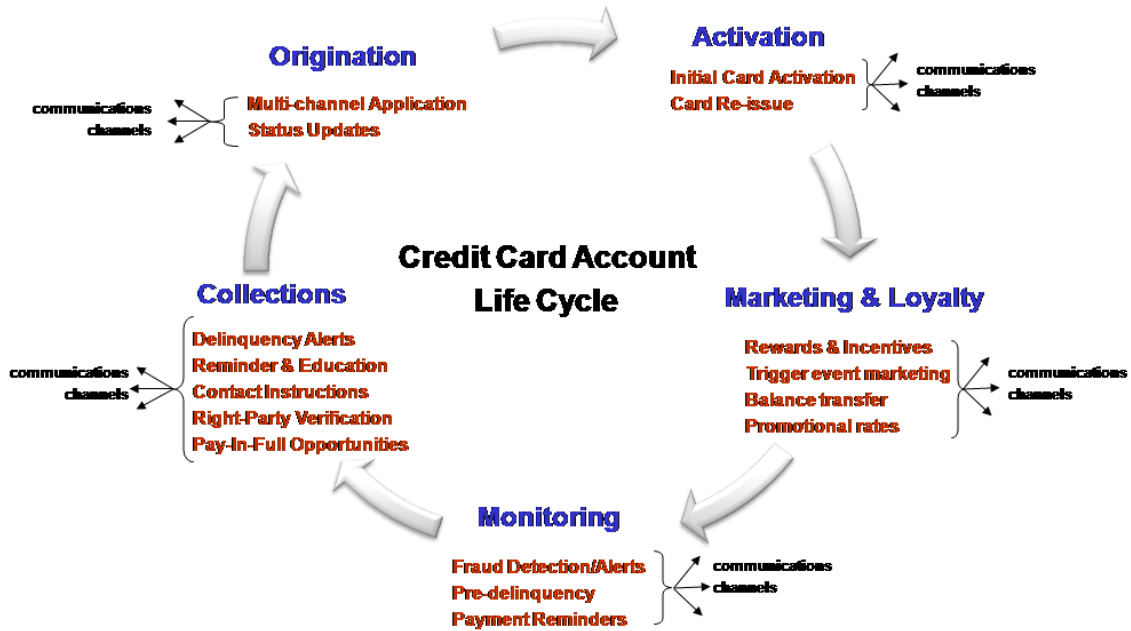
- Slowing credit card growth rates, with the last seven years seeing more single digit growth rates for the industry overall.
- Quickly-growing debit card transaction volume, exceeding credit in 2006, siphoning potential volume away from credit.
- An intensely competitive environment among credit card issuers in this mature product market, as they seek relationships with the most valuable consumers and attempt to drive their cards to the top of wallet through rewards/loyalty program innovations.
- Declining credit performance in most portfolios, with increased urgency to monitor and manage some 500 million U.S. credit card accounts with some 380 million revolving accounts.

These challenges all relate to the distinct life cycle nature of the credit card product. Each of the five high-level life cycle components noted in Figure 1 have an array of major communications requirements associated with them (noted in red). It is critical to note that these requirements are also *multi-channel* requirements, where more than one channel is required to reach the cardholder, where the client has expressed a preference for one or multiple channels, or where a specific channel mix is more effective for specific message types.

This creates a multidimensional solution requirement: each communication requirement must interface to multiple communication channels, as well as to multiple IT systems. With payment reminders, for example, the issuer may well desire to push these out to the cardholder with some urgency across escalating communications channels from the credit management platform. At the same time, records of these communications and cardholder responses need to be passed along to the collections workflow system for seamless customer interaction. The integration process to achieve this consistency of messaging could prove daunting, as could the business rules/intelligence required to manage these interconnections. And at many large issuers, these

specialized IT and operational functions are housed in distinct organizational silos, raising the degree of difficulty for coordinated communications.

Communications And The Account Life Cycle



Source: Mercator Advisory Group

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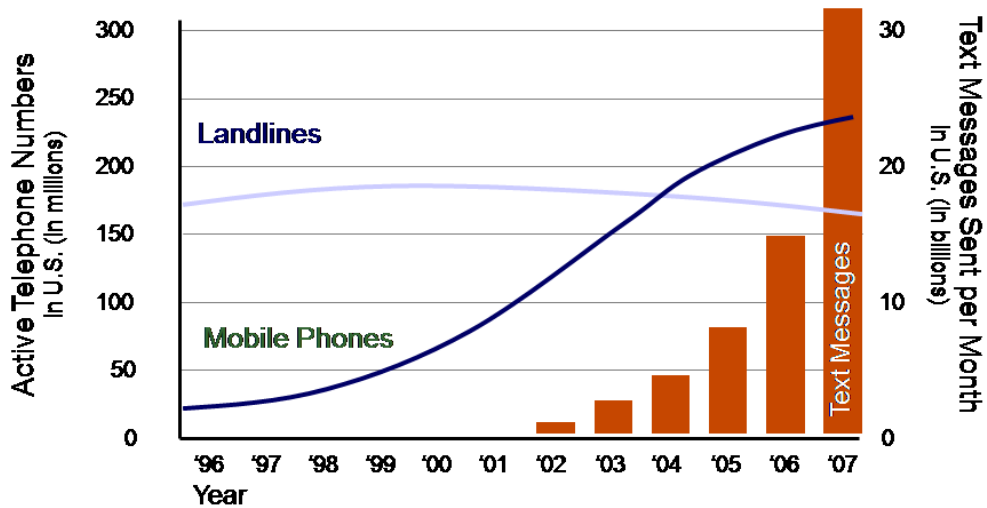
Figure 1: Communications and the Account Life Cycle

Just to add to the communications management challenge, consumers are continuously adding communications channels and modifying their preferences. The explosion in wireless communications and the decline in landlines is one example, as is the consumer's growing comfort with web transactions and dependence on email. Text/mobile messaging is just beginning its dramatic growth curve, and as Figure 2 notes.

Consumers Add Communication Channels And Alter Their Usage Patterns



Landlines Begin To Decline As Mobile Grows and Text Messaging Doubles



Source: CTIA

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Figure 2: Consumers Add Communication Channels And Alter Their Usage Patterns

While consumer channel usage patterns shift and communications needs increase, it is somewhat surprising that issuers are still playing catch-up with basic contact information for cardholders. Mercator's research indicates that issuers typically have email address records for only 15-20% of their cardholders. Collecting and updating multi-channel contact information and channel preferences is a growing operational initiative for many issuers. With the revolution in cardholder communications underway in the market, this backfilling of contact information should be considered a strategic imperative. Concurrently, issuers need to place high priority on getting cardholders to opt-in to communicate via all relevant channels, ideally starting with the application process, and many issuers will need to mount opt-in campaigns to make up for past deficits.

In the meantime, many issuers are highly dependent on cardholders' available phone contacts, and must develop multi-pass calling/messaging strategies to make initial contact or to drive consumers to make contact via 800#, web, or mobile text (see card activation example below).

Concurrently, the traditional marketing communications medium of direct mail appears to be fading in efficacy. Although consumers' mailboxes continue to be flooded by over five billion solicitations per year, the Synovate Mail Monitor data suggest issuers are reducing their direct mail volumes in favor of other channels. Still, issuers are highly dependent on the mail channel for informing consumers about offers in the marketing and loyalty phase noted in Figure 1. Email is increasingly used to push offers out to opted-in cardholders, and mobile and text offer great potential. The ability to push the right offer through the right channel, potentially at lower cost, is a growing imperative.

II. Case Example: Collections

In today's credit environment, it is an understatement to say that concerns are high regarding growth in credit card delinquencies and charge-offs. As Figure 3 illustrates, both have been on the rebound since the 2006 low point, which was driven by the post bankruptcy reform environment. And while charge-offs and delinquencies are still low by historic standards, the upward trend is indeed worrisome in today's recessionary environment. Managing collections has taken on new urgency.

Charge-Offs Trend Back Toward Historic Norms

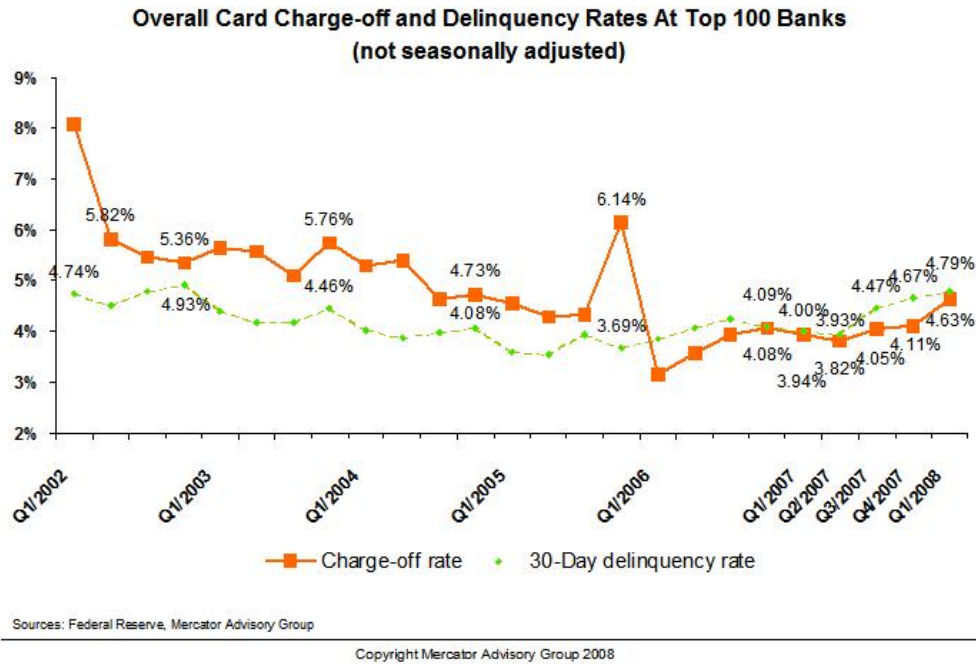


Figure 3: Charge-Offs Trend Back Toward Historic Norms

The bar is set high for communications related to collections, and encompasses seemingly conflicting goals:

- Minimizing losses
- Educating the cardholder
- Communicating urgency on a topic many will avoid
- Reaching and notifying the ID-verified cardholder quickly
- Opportunistically collecting in full during cardholder notification
- Preserving account relationships where there is business value to do so

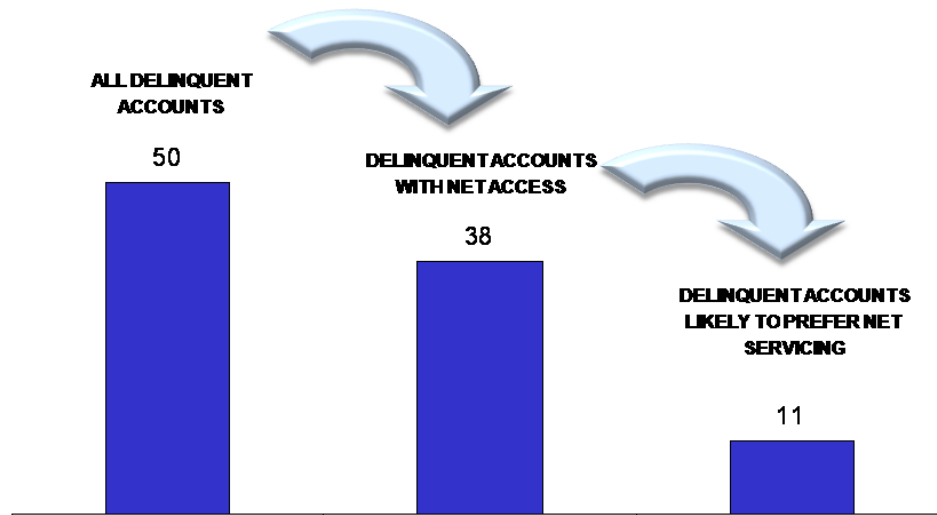
- And all within the constraints of a compliance-driven environment and the need to preserve the lender's brand

Add to these challenges a high volume of accounts and the proliferation of consumer communication channels; Mercator estimates that 50 million delinquent accounts will require servicing annually (see Figure 4). And many will prefer the anonymity and discretion of online, mobile, or IVR servicing, in contrast to the traditional collections emphasis on live, phone-based collectors.

50 Million Accountholders Require Collections Contact; Many Will Prefer Online Servicing



The Estimated Annual Pool of Delinquent Consumer Credit Card Accounts For Online Collections (millions of accounts)



Source: Mercator Advisory Group

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Figure 4: 50 Million Accountholders Require Collections Contact; Many Will Prefer

Online Servicing

Most issuers are constrained to some degree by lack of complete cardholder contact data (i.e. landline, wireless, email, mobile), not to mention data on communication channel preference. Simply finding the cardholder and verifying identity is a critical first step, often starting with messages to the landline of record for the account. Here, the phenomenon of multi-channel blending quickly becomes important, as issuers push out a message in one channel, and enable the ability to respond in another (e.g. pushing out a web address or 800# via voice or text message). If a connection is made with the cardholder during one of these early communications passes, best practices dictate that the cardholder be offered an ability to pay in full, typically via an integrated payment processor through an interactive voice response (IVR) capability at the time of contact, in some cases avoiding a costly escalation of the case to live collectors or the complexity of linking the cardholder with a collections website or other facility.

While proliferation of communications channels drives complexity, it also offers advantages to the adept issuer. As Figure 5 illustrates, an issuer with robust cardholder contact information can deploy a multi-pass escalation strategy for collections. In a recent test by a major card issuer, adding text messaging to automated voice messaging (AVM) led to a 117% lift in collections over an AVM-only group. Perhaps even more remarkable is the fact that only 25% of the text plus AVM group cardholders had known cell phone numbers at which to receive text; collections results improved 400% for those getting both voice and text. These results illustrate both the differential effectiveness of different channels, as well as an escalating sequence of messaging.

It is important to note that with experience, issuers will build customer profile-driven rules for selecting and sequencing the most effective channels for the escalation strategy. Especially in collections, the most effective channels may not be the same as those selected as preferences by the cardholder. Just as collections groups have developed best practices and business rules to govern their workflow systems and collections strategies, those with intelligent communications platforms will have the ability to deploy optimal contact strategies across channels to meet a specified communication task.

Escalation Strategies: Leveraging Multiple Channels

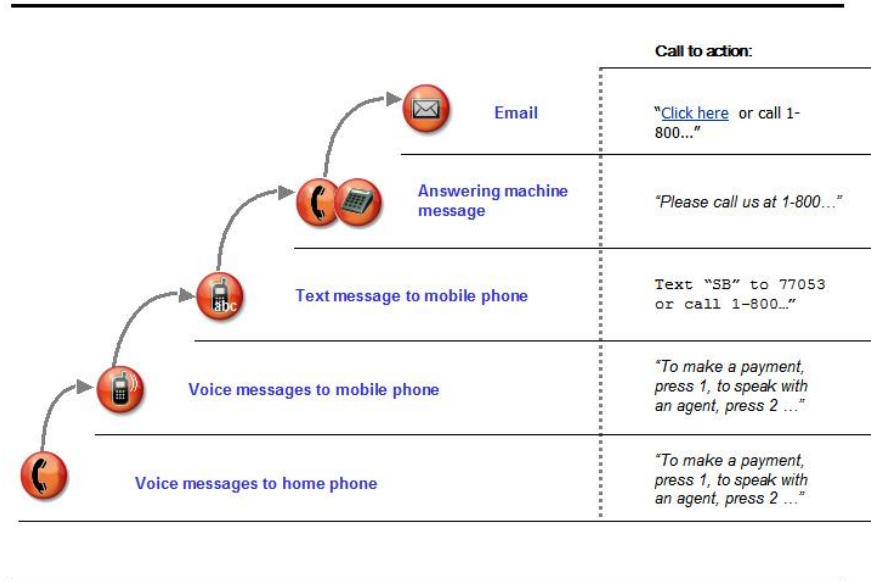


Figure 5: Escalation Strategies: Leveraging Multiple Channels

With the growing importance of contacting cardholders and resolving delinquency through any channel, the risk of being out of sync grows with offers made across multiple channels or with interactions not integrated across channels. The ability of solutions to handle multiple channels and to apply rules logic across channels is a key component for reducing this risk.

Despite the hurdles, as one large issuer put it to Mercator, in today's difficult credit environment being able to support collections is a competitive advantage. If an issuer's multi-channel communications capabilities permit them to receive a payment first, that is an advantage over less effective lenders competing for the same consumer's dollars.

III. Case Example: Rewards and Loyalty

One of the most visible manifestations of issuer competition has been the rapid escalation in the variety and value of cardholder rewards programs. Over the last twenty years, cardholders have been attracted and retained by an ever-increasing array of cardholder rewards.

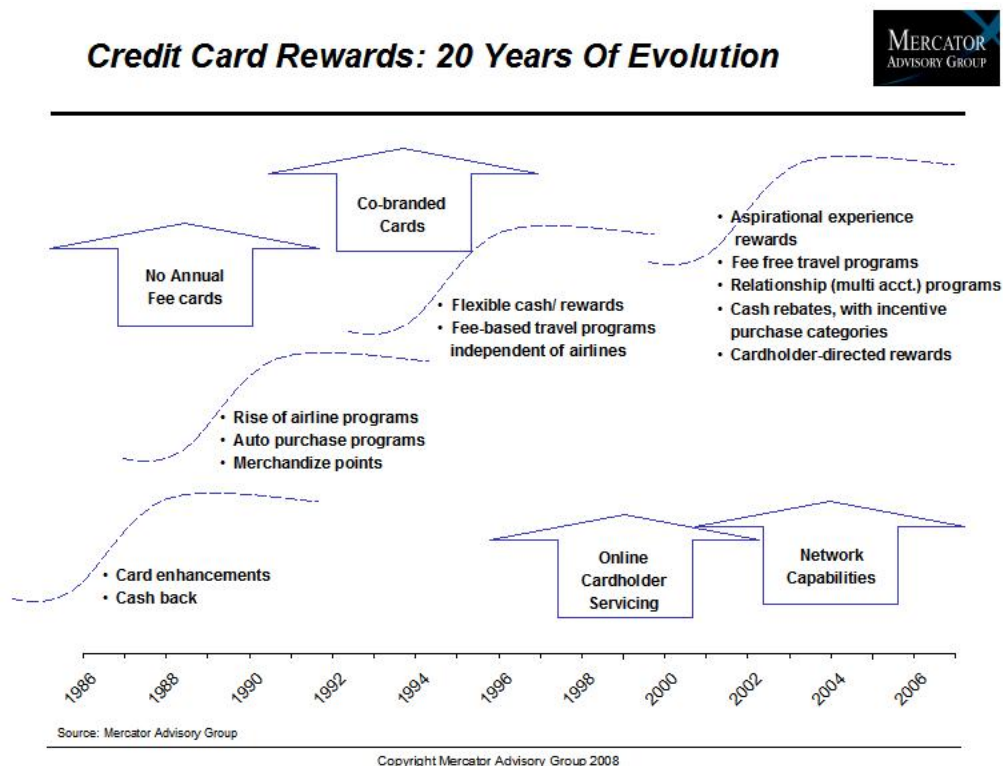


Figure 6: Credit Card Rewards: 20 Years Of Evolution

Issuers, however, have come to realize that in addition to a strong rewards offering, cardholder involvement and engagement in the reward programs are critical to retention—otherwise the cardholder could be motivated to accept a rich competitive offer elsewhere. Basic to cardholder engagement in these sophisticated rewards programs is the ability to drive communications to the consumer about special incentive categories, merchant discounts and other promotional offers, and to involve the consumer in structuring and managing their own rewards program choices.

Rewards programs are also growing more complex, as issuers with retail banking operations seek to extend and enrich rewards programs by extending them across product lines beyond credit cards (e.g. mortgage, checking accounts, etc.). Simply put, the richest reward programs are of no value if the issuer cannot effectively drive program communications the “last mile” to the cardholder.

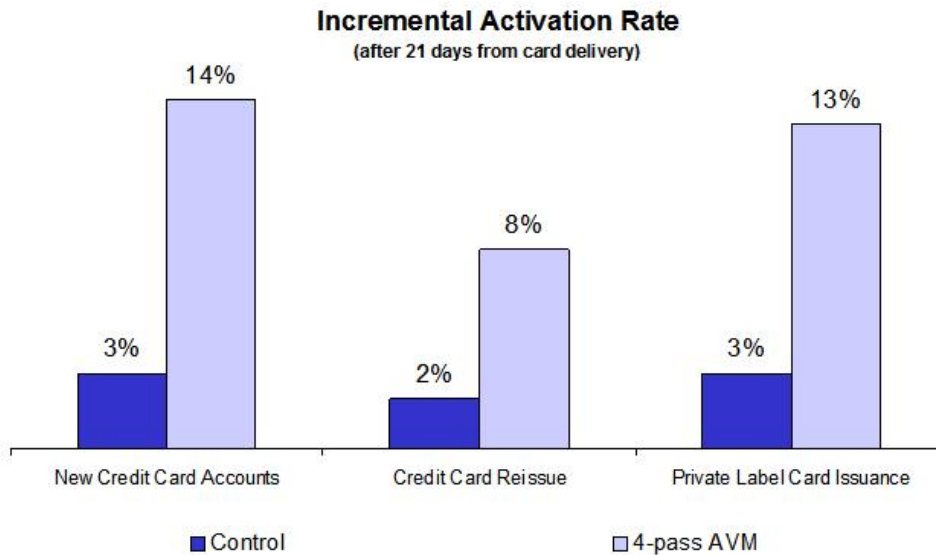
Issuers can also leverage the lifecycle nature of cards by cueing loyalty communications to trigger events. For example, timely communication of special offers and services to cardholders moving their residence after the issuer receives notification of a change in address can drive increased spend and new recurring charge opportunities. The ability to push communications about these opportunities through multiple channels to harried movers is a key success factor. One issuer deploying multi-channel communication programs targeted toward recent movers notes a 300% ROI and six month payback on their multi-channel campaign expenditures.

IV. Case Example: Activation

Consumer credit card accounts are expensive for issuers to acquire, often \$100 or more per account on a fully-loaded basis. Manufacturing, mailing, and activation of plastics can range from \$3.00 to \$4.00 per account. Visa and MasterCard issuers spend an estimated \$35 billion annually across marketing and operations to originate, deliver and operate card accounts. And in spite of the Herculean effort, many cards go inactivated--essentially a wasted expense.

It is estimated that 40%-50% of reissued cards, which are not necessarily expected by the cardholder, go inactivated three weeks after delivery. Controlled testing of an automated voice messaging (AVM) campaign consisting of four message passes consistently yields a lift in activation over 300% when compared with issuers' standard no-contact procedure. The simple addition of such a campaign not only drives potential usage of cards through activation, but also eliminates the sunk cost and potential fraud risk of cards not activated.

AVM Implementation Lifts Activation Over 300%



Sources: SoundBite Communications, Mercator Advisory Group

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Figure 7: AVM Implementation Lifts Activation Over 300%

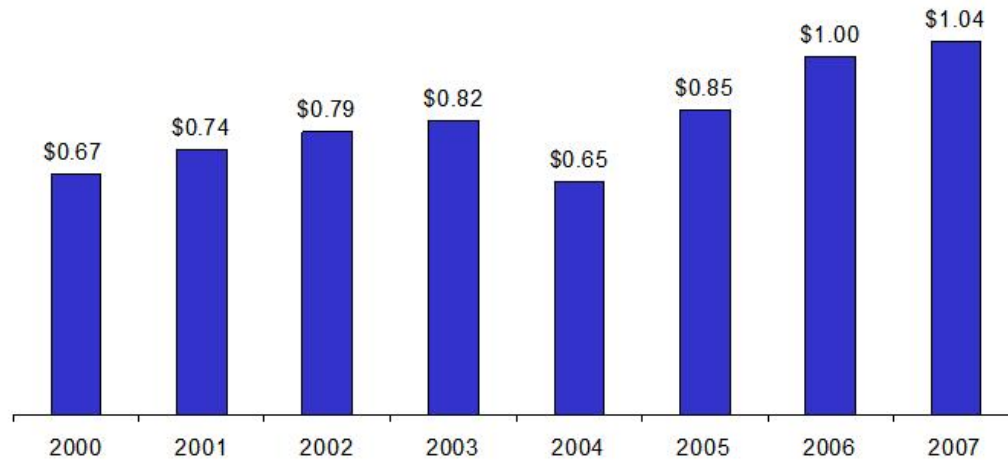
V. Case Example: Fraud

Credit card fraud remains a constant battle for issuers. While total issuer fraud expense continues to increase (see Figure 8) driven by increasing payment volume, issuer diligence has kept fraud expense close to or below 7 basis points of payment volume since 2000. Fraud, however, follows the “balloon effect”: when fraud of one type is controlled, a new type tends to pop up in a more weakly-defended spot to take its place.

Bank Card Fraud Expenses Rise With Volume



Estimated Bank Card Issuer Fraud Expenses (\$ billions)



Sources: Cards and Payments/ Credit Card Management, Mercator Advisory Group

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Figure 8: Bank Card Fraud Losses Rise With Volume

And needless to say, fraud is a growing concern for cardholders. In spite of the fact that fraud transaction detection solutions have done a good job keeping a lid on total fraud rates, consumers remain worried. As one fraud solution provider commented, in this environment “fraud detection capabilities are now a marketing feature for issuers.” It is notable that advertising by some large issuers now features fraud detection capabilities in general, and alerts in particular, as cardholder benefits.

Fulfilling consumer expectations for fraud alerts is another matter. While issuers and their partners make major investments in fraud management capabilities, cardholders have the same multi-channel communications expectations for alerts that they do for any other servicing event, but with greater urgency and importance. The issuer’s ability to push out alerts through all communications channels simultaneously reinforces both the urgency of the situation, and the

quality of service to the cardholder. And if a compromised card requires re-issuing, the ability to deliver status updates to the cardholder, card activation reminders, and follow-up messages will all work to keep an issuer's card from being demoted in the consumer's wallet.

VI. Strategic Implications

Credit card issuers are complex organizations with deep experience and technology to deliver diverse components that support the account lifecycle. Communications within these specialties have historically centered on telephone and mail media, and in many cases have not kept up with consumers' usage and preferences for other channels.

As a result, a communications gap looms for many issuers. For many, the ability to manage a campaign of multi-channel communications within a function (e.g. collections, fraud, marketing) is limited. The ability to manage multi-channel communications across functions is even further removed. And timeliness is of the essence as well, with consumer expectations for seamless, multi-channel communications being shaped by other e-commerce and mobile commerce experiences.

It is safe to say the multi-channel communications challenge in credit cards will only increase as cardholders become versed in using more communications media, including some not envisioned today. As issuers seek to make customer communications as near to real-time as possible to reduce financial risk and enhance the customer experience, the challenges of implementation and integration will also expand. Communications platforms permitting easy deployment across solutions will have tremendous value in this environment. Ease of deployment also holds the longer-term promise of a true enterprise multi-channel communications capability, enabling an issuer to develop in-house communication protocols and best practices across functions, and ensuring the cardholder a consistency of message and tone across the card organization. Software-as-a-service applications which can bridge organizational and IT silos, and offer a single customer view, will have particular benefit in these environments. At the same time, with millions of accounts being supported, and dramatic seasonal transaction volume spikes, scalability is also a key attribute of solutions serving this business.

Despite operational, IT, and organizational challenges, the potential competitive advantages of a multi-channel communications strategy for card issuers include:

- **Top-of-wallet advantage:** when cardholders are made aware of the value, security, and unique benefits of their card, increased usage will follow
- **Increased communications efficacy:** ability to target preferred or most effective channels at the customer level
- **Improved compliance:** increased use of scripted electronic channels, especially collections, reduces the chance for errors. Centralization of control across multiple channels reduces risk of inconsistent messages and brand dilution, as well as the risks of being out of compliance regarding customers' communication channel opt-ins. Operational (SAS70) and security compliance (PCI) of solutions provide a layer of assurance for these critical capabilities.
- **Cost reduction:** ability to use the right channel first can minimize use of costly channels (inbound live operators, collectors, direct mail) while delivering a service experience most appropriate to the client. Use of electronic channels helps avoid more expensive mail-based communications and maximize mail effectiveness when required (plastics delivery).
- **Retention and activation:** getting the card in the wallet through initial activation and moving the card to top of wallet through rewards promotions have relied heavily on mail communications; issuers now have less expensive electronic alternatives offering greater frequency, timeliness, and cost efficiency.

Keeping this simple piece of plastic at the front of the consumer's wallet and in good standing is increasingly dependent on a flexible and robust communications infrastructure. Issuers best able to communicate effectively with their cardholders will have a critical competitive advantage as multi-channel capabilities are deployed throughout the credit card life cycle.