Debit Portfolio Optimization

Rising to the Challenge –

Leveraging Data to Improve Performance

A White Paper from PULSE InSights,® the consulting practice that supports Discover® Debit

Executive Summary

Financial institutions are experiencing intense pressures that are necessitating significant changes in debit card programs. Regulations are constraining interchange, fraud losses are mounting, EMV card migration is under way with its related costs, and competition among financial institutions is fierce. The big question isn't whether to change and evolve your debit card program, but how to change in order to achieve the greatest return on investment. Using portfolio analytics to examine the wealth of information accessible through debit cards can help financial institutions make the right choices that result in short-term and long-term success. Every financial institution has access to the basic information needed to track portfolio performance. This paper will provide a road map for assessing your debit program's overall portfolio health, identifying trends and developing actionable steps for improvement.

Section 1 – The Big Squeeze

Debit card programs are being pressured from multiple directions: regulations, fraud and response to fraud, and intense competition.

According to the *2014 Debit Issuer Study*, commissioned by PULSE,® a Discover® company, both regulated and unregulated financial institutions are seeing impaired debit interchange despite continued growth in transaction volume. Regulation II's implementation of the Durbin Amendment capped interchange for regulated issuers and, in turn, created competitive pressures, leading to declines in interchange rates for exempt institutions.

The Debit Issuer Study also found that data breaches and fraud loss are growing concerns, straining consumer confidence in payments products and biting into debit program profitability. To rebuild cardholder trust and stem fraud losses, many issuers departed from existing policies and reissued all compromised cards at significant cost. Despite major strides in advanced fraud detection tools, issuers expect merchant data breaches to become more frequent in the future.

EMV cards, the global standard for inter-operation of integrated circuit cards developed by Europay, MasterCard and Visa, represent a third factor pressuring debit card programs. Over the long term, chip card migration is expected to have a positive impact on fraud prevention. According to Financial Fraud Action UK (Fraud the Facts 2013), fraud from counterfeit and lost/stolen cards declined dramatically following the shift to EMV cards in the U.K. However, EMV cards are more expensive and issuers will bear this added expense with every reissuance. Moreover, issuers that delay EMV migration could face additional costs from fraud losses as a result of the upcoming liability shift.

Finally, competition — both among financial institutions and between financial institutions and new players in payments — has issuers looking over their shoulders. With technology companies such as Apple, Google, Facebook and Amazon all at various stages of pursuing payment solutions, it seems likely that today's debit programs will seem quaint by the end of this decade. Meanwhile, large banks and best-in-class issuers are utilizing sophisticated data analytics tools to maximize debit program profitability and apply even more competitive pressure on financial institutions without such capabilities.

These intense pressures require every financial institution to change how they approach their debit card program. What is the best way to assess your debit program's overall portfolio health, identify trends and develop actionable steps for improvement? Data analytics can help maximize revenue, segment and incentivize customers, and protect interchange and overall debit program profitability.

Section 2 – Analytics Basics

Improving data analytics capabilities can help financial institutions adapt to and address these pressures. In fact, every financial institution has the information readily available; payment cards provide a wealth of information. Through analysis, it is possible to discover new ways to encourage revenue-driving cardholder behaviors, retain profitable card users and increase the ability to target customers, or even devise strategies to introduce new products such as EMV cards.

In this increasingly competitive marketplace, it has never been more important to close the gap between having information and fully leveraging that information to seize opportunities.

As most who have experimented with analytics are aware, the biggest challenge can be getting started. With data volume growing exponentially, the sheer breadth of information can be overwhelming. The first step can be like walking into a pitch-black room. You might find something wonderful that leads to new actionable conclusions, or you might fall into an abyss of wasted time, energy and precious resources.

To jump-start your data analytics efforts, we recommend a few simple tools issuers can start using immediately to establish benchmarks and draw actionable conclusions.

At the most fundamental level, if a financial institution is not already closely tracking portfolio performance today, we recommend a basic portfolio scorecard such as the one shown in **Figure 1** below to track penetration, activation, usage, attrition, revenue and expenses.

This basic scorecard is a great dashboard to provide a glimpse into overall portfolio health and can help identify trends and develop actionable steps. With a deeper analytic perspective, issuers can begin to set internal and competitive benchmarks.

Figure 1 A sample basic portfolio scorecard.

BASIC PORTFOLIO SCORECARD	Benchmarks	Actual
Penetration		
Active Rate		
Usage – Transactions		
Average Ticket		
Usage – Volume Per Active Card (monthly)		
Attrition		
Total Interchange Revenue		
Total Expense		

A more robust scorecard can open up even more opportunities. As **Figure 2** shows, refining the metrics even further reveals a wider range of benchmarks to target. For example, segmenting active card volume between signature and PIN-based transactions revealed that signature transactions could present opportunities with higher potential.

Figure 2 A sample of a more robust portfolio scorecard.

ROBUST PORTFOLIO SCORECARD		
ACCOUNTS	**Benchmarks**	**Actual**
Gross Accounts		
Number of Accounts Acquired		
Acquisition Rate		
Number of Accounts Closed		
Attrition Rate		
PENETRATION	**Benchmarks**	**Actual**
Cards on Books		
Percent of Accounts with a Card		
Number of Accounts with a Card		
Average Number of Cards Per Account		
ACTIVATION	**Benchmarks**	**Actual**
Number of Active Cards (last 30 days)		
Active Rate		
USAGE	**Benchmarks**	**Actual**
Average Number of Transactions Per Active Card		
Total Number of Signature Transactions		
Total Number of PIN Transactions		
Number of Sig Transactions Per Active Card		
Number of PIN Transactions Per Active Card		
SALES (Amount $)	**Benchmarks**	**Actual**
Average Ticket		
Total Signature Sales Monthly		
Total PIN Sales Monthly		
Signature Spend Per Active Card		
PIN Spend Per Active Card		
INCOME (Interchange)	**Benchmarks**	**Actual**
Total Signature Income		
Total PIN Income		
Monthly Signature Income Per Active Card		
Monthly PIN Income Per Active Card		
FEES	**Benchmarks**	**Actual**
Total Fees Per Account		
Total Monthy Fees		
FRAUD	**Benchmarks**	**Actual**
Net Fraud Loss Per Transaction (PIN and Signature)		
Total Fraud Amount		

Section 3 – Analytics at Work

As the *2014 Debit Issuer Study* reveals, debit growth is resilient, driven by consumer preference for debit cards. Yet, revenue is holding steady or declining. Protecting interchange will come from continuing to increase volume and ensuring debit remains the consumer payment method of choice. We have found that focusing on everyday spend — non-discretionary purchases — is a great strategy to make this happen.

The TSYS *2013 Consumer Payment Choice Study* found strong preference for debit as a method of payment, particularly at supermarkets and gas stations. Along with utility payments, groceries and gas are the pillars of the everyday spend category. Whether the economy is booming or in deep recession, consumers will need to pay for gas, groceries and utilities. Therefore, establishing debit as the payment method of choice for these purchases can have long-term benefits.

The first step in assessing a debit portfolio's everyday spend performance is to compare it with industry benchmarks. For instance, according to the National Association of Convenience Stores and other sources, Americans, on average, purchase gas five to seven times per month. If cardholders are only using debit twice per month for gas, an issuer has a great opportunity to double that number.

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There are numerous free sources online that offer accurate and regularly updated data on consumer spending. Here are a few places to start:

- Bureau of Labor and Statistics Consumer Expenditure Survey:
  http://www.bls.gov/cex/
- Consumer Reports:
  http://www.consumerreports.org/cro/magazine/2014/11/how-america-shops-now/index.htm
- National Retail Federation Retail Insight Center:
  http://research.nrffoundation.com/Default.aspx?pg=2#.VK17PNLF8a4
- Gallup:
  http://www.gallup.com/
- Marketing Charts:
  http://www.marketingcharts.com/

Spend and Get

How can an issuer increase everyday spend? We have seen incentives work wonders. One type of campaign is “Spend and Get.” First, identify a specific target, such as those who only occasionally use their debit card for groceries. Next, determine a reward they will find compelling. We have found that relatively simple incentives can be effective, such as a gift card or a credit to their account. Therefore, if targeted cardholders are rewarded for using their debit cards more frequently for groceries, you can move the needle in everyday spend.

We recommend tailoring any incentive for a minimum of three months — the time it takes to achieve “sticky behavior” — so the consumer will keep exhibiting the behavior even without the incentive.

The *2014 Debit Issuer Study* reported that 55 percent of issuers now offer merchant-funded rewards and more (75 percent of exempt issuers and 100 percent of regulated issuers) are planning to launch new rewards programs in 2015. Analytics are one of the most attractive components of merchant-funded rewards, as merchants can tailor offerings to consumers that represent incremental spend based on criteria such as new customers, higher ticket size and slow days of the week, among others.

75% *of exempt issuers* **&** **100%** *of regulated issuers*

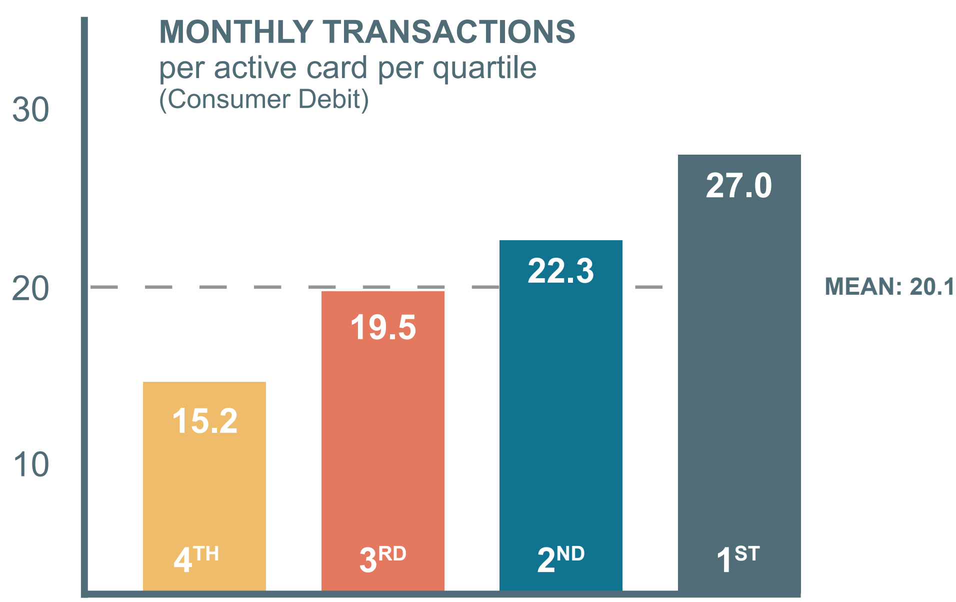
are planning to launch new rewards programs in 2015

Debit rewards program data as reported by the *2014 PULSE Debit Issuer Study*.

Customer Segmentation

Data analytics also helps you identify cardholders who present the greatest opportunity. Through customer segmentation, issuers can target incentives and establish new habits that bring your customers’ debit cards to the top of the wallet. For example, the *2014 Debit Issuer Study* found the mean number of monthly debit card transactions per cardholder is 20.1, which you can see in **Figure 3**. If your portfolio is at 15, an easy segment to target would be cardholders who average fewer than 15 everyday spend purchases per month using their debit card.

Figure 3



Cardholder data segmented by monthly transaction volume.

Developing an EMV Card Issuance Strategy

The *2014 Debit Issuer Study* reveals that financial institutions are considering a variety of strategies for rolling out EMV cards. Just as offering a premium credit card to customers with bad credit scores is likely a bad strategy, rolling out EMV cards to all customers at the same time and in the same way may not be the best approach.

Data analytics can help determine the approach that is right for you. We recommend examining fraud rates, cardholder spending habits and frequency of international travel. This simple assessment can help determine if it would be best to do mass reissuance, incremental reissuance via the regular card expiration cycle or issuance to specific segments of cardholders. This analysis can also assist you in developing a communications and education plan to help consumers understand the benefits of chip cards.

Fraud Loss Ratio

Fraud loss ratio is typically higher on signature than on PIN. The *2014 Debit Issuer Study* found signature fraud was 5.7 basis points (bps) per gross dollar of volume (GDV) transacted, which was nearly eight times greater than PIN's fraud loss rate of 0.73 bps. Therefore, even if an exempt financial institution is benefiting from the higher interchange for signature, their higher fraud loss ratio could be eating up that difference and influencing overall profitability of the portfolio.

Data analysis can quickly identify looming threats to profitability in your debit portfolio. We recommend comparing the number and amount of PIN transactions per active card with the number and amount of signature transactions per active card. If PIN is falling behind, your reliance on signature could put you at greater risk of fraud losses. As a counter measure, a financial institution may want to promote PIN, especially to those cardholders who primarily use signature debit. What is in it for the consumer? Put simply, security. Card fraud is a top concern for your cardholders, as well, and one that we have seen impact spending behavior in the past.

Section 4 – Conclusion

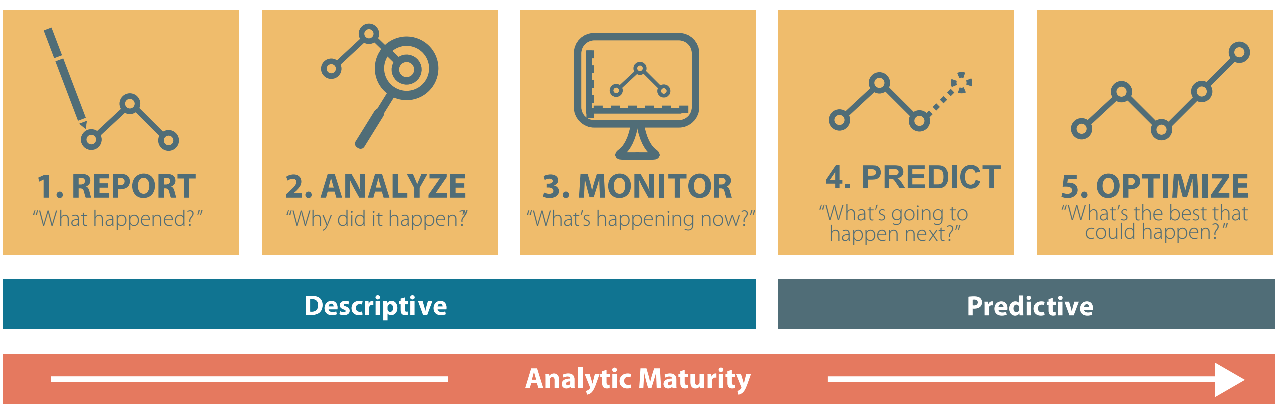
We have touched on a few initial steps that every financial institution can immediately take to start realizing the benefits of the debit program data that is accessible. In that data are the answers to virtually all the questions about your debit card program that you can imagine. As we have described, some questions can be easily answered. Others are more complicated and require more robust data analytics tools and methods.

All financial institutions use analytics in some form. As shown in **Figure 4**, we think in terms of analytics maturity that starts with “descriptive analytics,” which encompass examining events that have happened and moves into “predictive analytics,” which look into — and change — the future. In this paper, we have focused on the “report, analyze and monitor” areas of the model.

Earlier, we provided a basic portfolio scorecard to track penetration, activation, usage, attrition, revenue and expenses in order to assess overall portfolio health (**Figure 1**), and a more robust scorecard that dives deeper into the metrics to reveal a wider range of analysis (**Figure 2**).

We consider both to be necessary for establishing a solid foundation, and they set the stage for more complicated predictive/optimization strategies.

Figure 4



Stages of data analysis organized from least mature to most mature capabilities.

Whether you dip your toe in or dive in head first, the time to start using the powerful data at your fingertips to grow and improve your business is now. The first step is to access key metrics, such as debit card penetration, activation, average number of transactions, average ticket, average monthly volume per card and attrition. Compare your financial institution’s performance to benchmarks and then develop your strategic plan to move the needle.

If your financial institution has had difficulty getting started with data analytics, it is not surprising. We anticipate that, over time, these sophisticated techniques will become integrated into just about every business and organization.

Just remember, even small tweaks to what you are currently doing can deliver big results.

For more information and to explore data-driven optimization recommendations and diagnostic tools for your organization, please contact:

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ABA-endorsed Discover Debit provides a fresh approach to debit cards. It's the only program that delivers greater revenue opportunities, puts the bank's relationship with its customers first and simplifies billing and operating procedures. For customers, Discover Debit offers fraud protection and convenience. With Discover Debit, you can develop a more profitable debit program for your bank. Brought to you by the Corporation for American Banking, an ABA subsidiary.