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**McGovern Smith**  
— ADVISORS, LLC —

*Expert Payments Advisors*

**Maryland Financial Bank Advisory Board Meeting**  
*“Payments Sleeper Risk”*

*September 30, 2014*



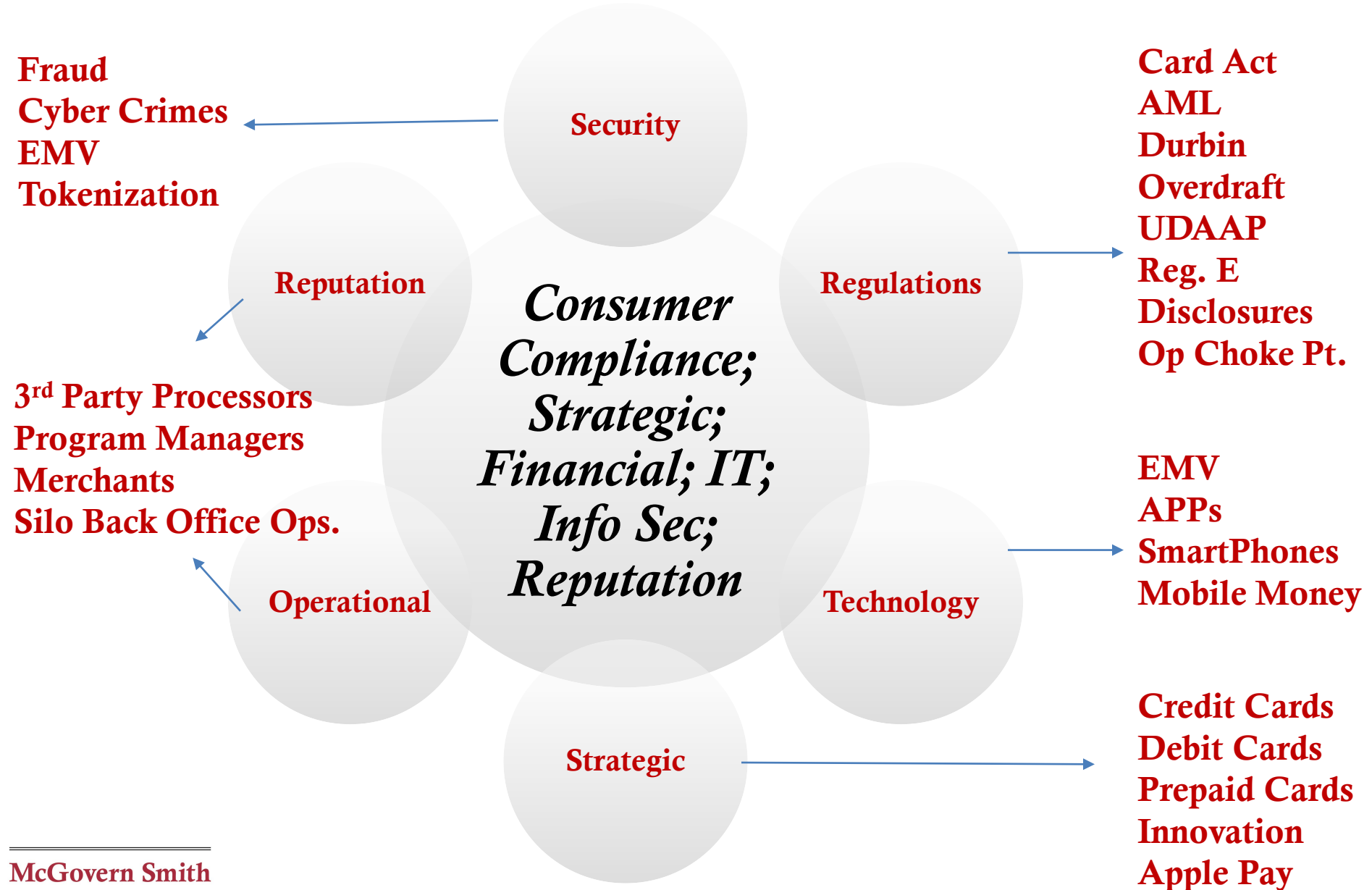
- Financial industry regulatory expert
- Co-author of Gramm-Leach-Bliley Act (GLBA), Data Protection Regulation
- 28+ years compliance & risk experience (13 with Department of Treasury in D.C.)
- Visionary behind outsourced management compliance products & services

**Paul Reymann**

**Partner, McGovern Smith Advisors**

*Payments system risk come from regulations, technology, cyber criminals, fraudsters, consumers, 3<sup>rd</sup> party vendors, merchants, competition, & innovation.*

# Payments Sleeper Risk



### Consider your payments strategy:

- ✓ Build one branch or build a national solution.
- ✓ EMV is coming, but Swipe continues.
- ✓ SmartPhones reaching critical mass.
- ✓ Understand your members' needs.
- ✓ Consolidate payments silos.
- ✓ Analyze member transaction data.
- ✓ Security will always be paramount.
- ✓ Vendor management is the next frontier of efficiency.

## A Prepaid Example – Understanding Success Factors

### Life of a Card?

- Fees
- No load vs Reloadable (i.e., type of reload)
- Other factors (e.g., alerts, email, OD)

### Socio-demographic?

- Gender
- Nationality
- Age & Education Levels

### Transaction Frequency?

- Direct Deposit (21X/mo.)
- Monthly fee (17X/mo.)
- Over Draft (23X/mo.)

*Source: FRB of Kansas City.*

*“General Purpose Reloadable Prepaid Cards: Penetration, Use, Fees and Fraud Risks” (Feb 2014)*

# Credit Card Sales Volume Growth Exceeds Debit Volume



## Credit Card Profitability “After Tax Income”

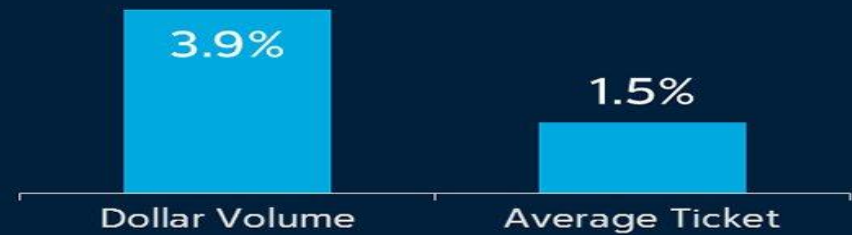
2010	1.8%
2011	4.2%
2012	3.9%
2013	4.4%

*Source: FDIC QTRLY Banking Profiles – Institutions with managed credit card loans exceeding 50% of total assets.*

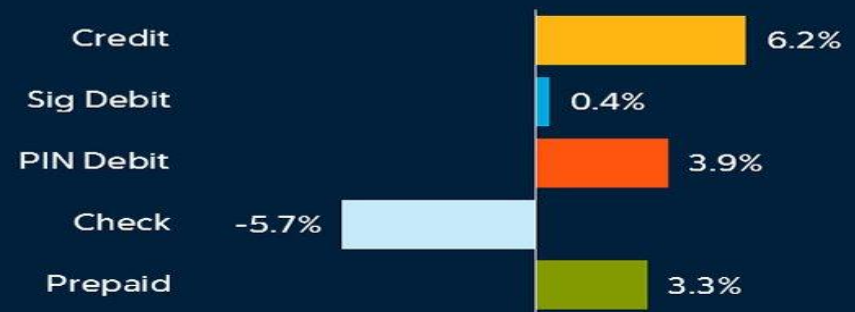
## SpendTrend®

JULY 2014

July’s dollar volume growth of 3.9% remained healthy and marked an improvement over June’s growth of 3.0%. Consumer spending was strong as the job market steadily improved and retail sales gained traction.



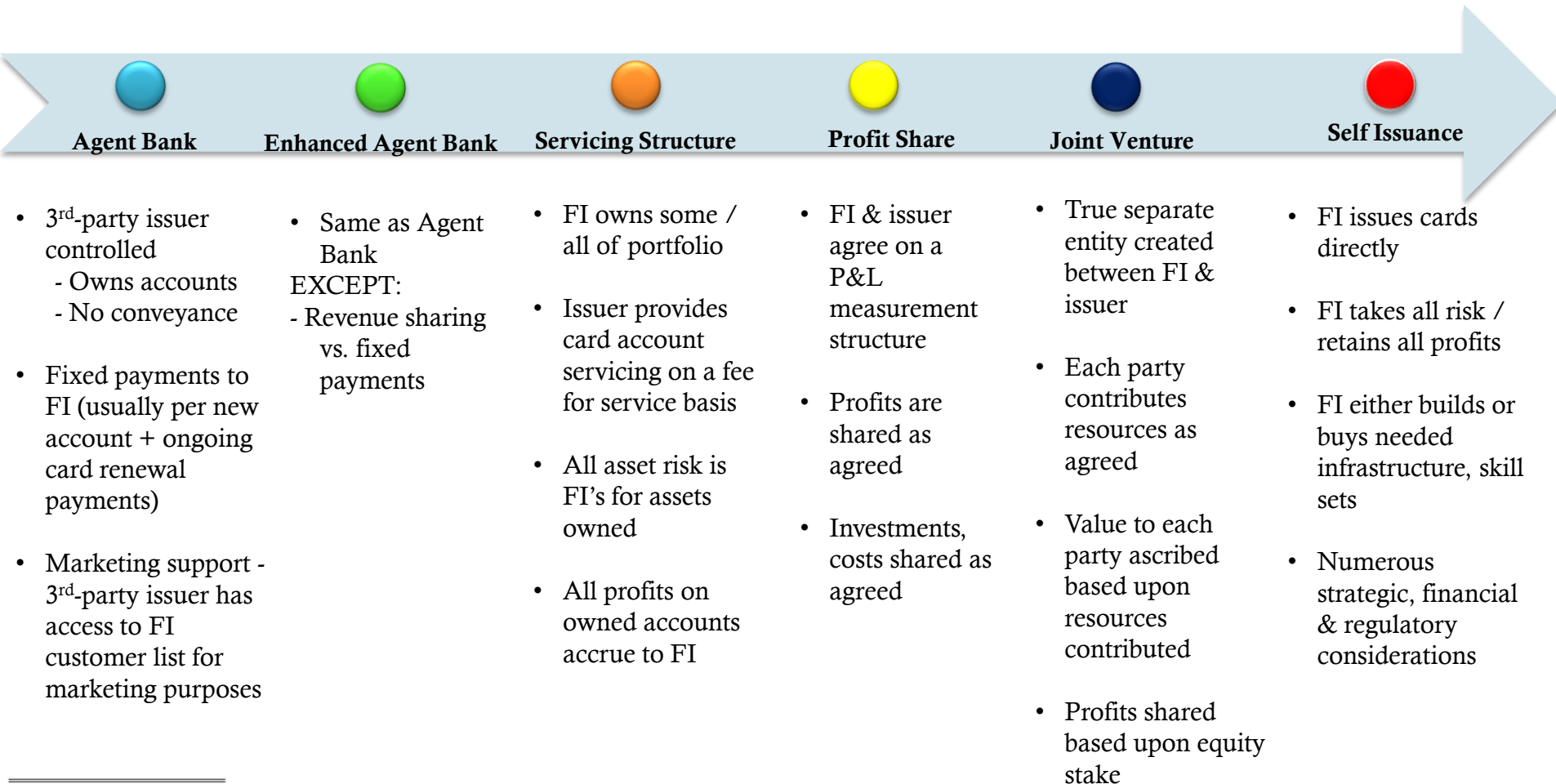
### SAME STORE DOLLAR VOLUME GROWTH BY PAYMENT TYPE



Data reflects year-over-year growth rates. First Data SpendTrend growth rates do not represent First Data’s financial performance.

# Align Credit Card Issuing Options & Bank's Goals

## Card Issuing Infrastructure Spectrum



# Evaluate Key Parameters of Card Option

## Economics

- ✓ Investment
- ✓ Ongoing Commitment

## Risks

- ✓ Operational
- ✓ Credit
- ✓ Regulatory
- ✓ Financial & IRR
- ✓ Reputation
- ✓ Strategic

## Ease of:

- ✓ Implementation
- ✓ Management

## Bank's Resources

- ✓ Dedicated
- ✓ Accounting
- ✓ Marketing

## Controls

- ✓ Customer Experience
- ✓ Pricing
- ✓ Underwriting
- ✓ Rewards
- ✓ Network Relationships
- ✓ Marketing



## Investments in Debit Issuing

- Consumers like debit cards
- Attractive DDA-based payment
- Debit issuers are likely to return to a growth agenda to match consumer demand
- Current interchange rates will remain intact

## Thumbs Up for EMV

- MC, Visa, & PIN debit networks for cross-line applications, opens gates for EMV enabled debit cards
- Home Depot, Target and other data breaches push fraud agenda and EMV

## Competition

- Prepaid has emerged as competitive DDA alternative
- Prepaid and credit card are Durbin exempt
- Debit cards still favored for security & control

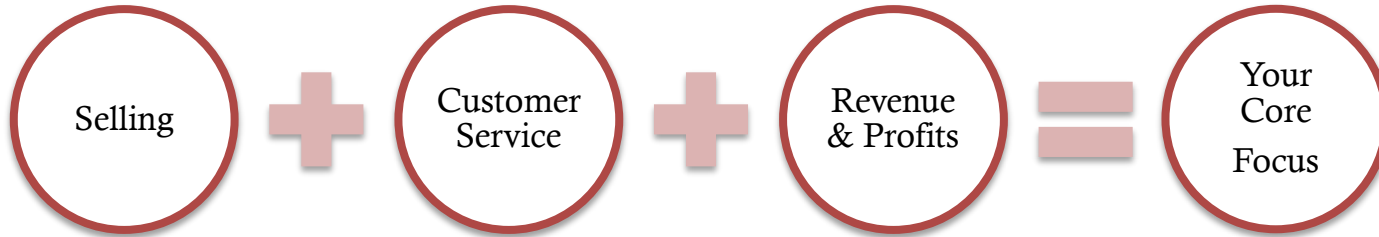
# Top 10 Banker Reasons for Apple Pay Success

1. One more means to make payments
2. Growing percentage of iPhone users
3. Bankers will want their card to be loaded
4. Works with over 50% of cards issued today
5. Drives more credit card transaction volume
6. Credit cards already stored with iTunes & Apple Store
7. NFCCommunication enabled
8. TouchID – Finger print scan on iPhone 6
9. Tokenization – Assigns 1-time codes
10. EMV retrofits likely to include mobile communications

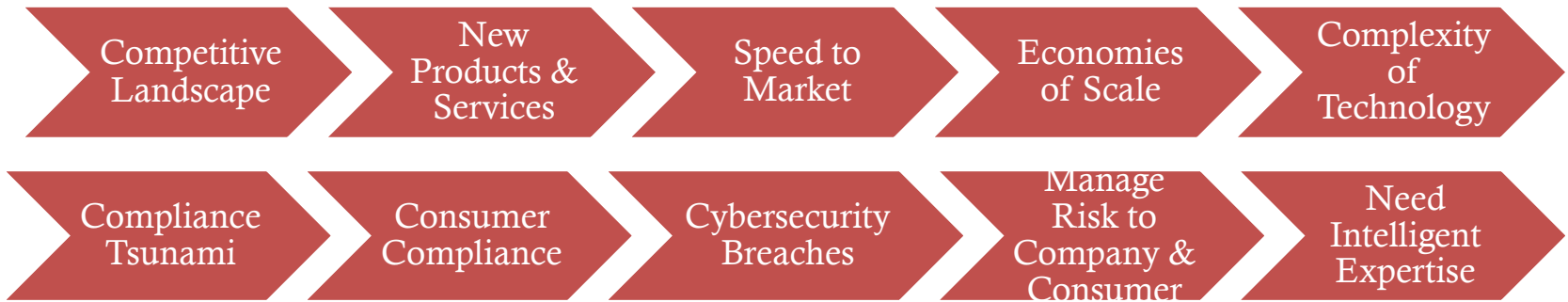
## PR Newswire

Up to 63% of security infractions & business disruptions attributed to suppliers & vendors.

## The Next Frontier of Operating Efficiency



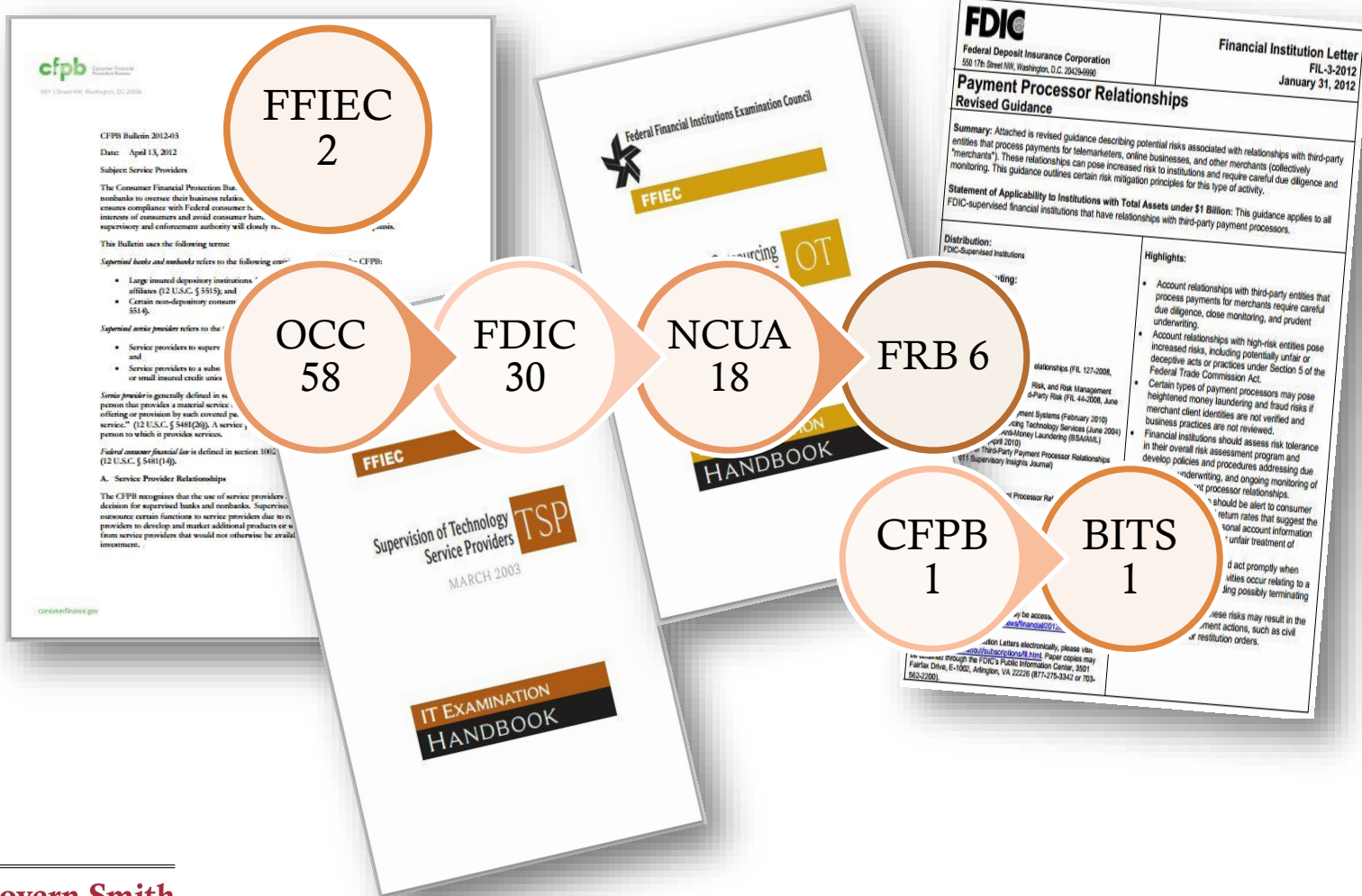
**New Challenges**



**Increasing enforcement activity from third party relationships.**

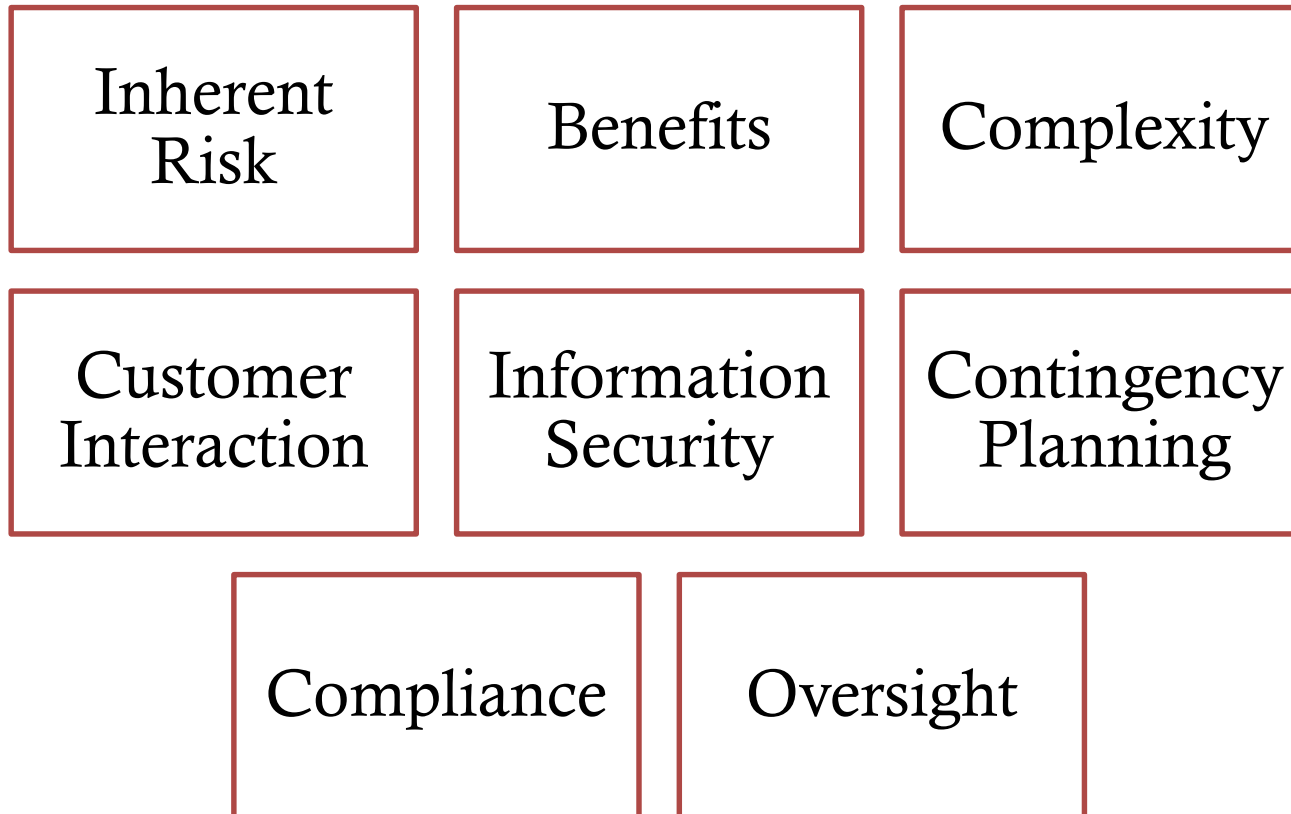


# Approx. # Regulatory VM Publications



# Strategic Validation of 3<sup>rd</sup> Party Business Needs

Develop a plan tailored to:



# Contract Development, Review, & Performance Monitoring

- Develop and **negotiate** contracts that address the **18 elements** outlined by the OCC.
- Identify and incorporate mutually beneficial **performance indicators and key risk indicators** into contracts to enable effective quantitative monitoring of performance against anticipated outcomes.
- Review existing contracts on **critical vendors**, as material changes warrant.
- Renegotiate at the earliest opportunity, if problems are identified.

# 3rd Party Relationships

Information Gathering



Contract Management



Due Diligence



High-Risk Vendor Evaluations



Vendor Program Gap Analysis



Issues Management Framework



# Quick Reference Resources

- [CFPB RFI on Mobile Financial Services \(June 2014\)](#)
- [FRB of Boston Payment Strategies](#)
- [FRB of Boston Mobile Payments Industry Workgroup](#)
- Other Fed Payments Groups & Research:
  - [FRB of Atlanta Retail Payments Risk Forum](#)
  - [FRB of Philadelphia Payment Cards Center](#)
  - [FRB of Kansas City Banking & Payments Research](#)
  - FRB of Kansas City - General Purpose Reloadable Prepaid Cards: Penetration, Use, Fees and Fraud Risks (Feb 2014)

Paul Reymann

P: 410-212-5955

[preymann@mcgovernsmithadvisors.com](mailto:preymann@mcgovernsmithadvisors.com)

[twitter.com/paulreymann](https://twitter.com/paulreymann)

[www.mcgovernsmithadvisors.com](http://www.mcgovernsmithadvisors.com)