



2010 Study of Consumer Payment Preferences

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 - Targeting the **Millennial Generation** is the key to growth in emerging consumer payments
 - Significant barriers exist to consumer adoption of **mobile payments**
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 - **Payment product proliferation** poses a threat to financial institutions
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Key Contacts

Jim Neckopulos

Managing Vice President

JNeckopulos@hitachiconsulting.com

(415) 740-1320

George Simotas

Director

GSimotas@hitachiconsulting.com

(760) 809-7265

John Hansen

Director

JLHansen@hitachiconsulting.com

(510) 290 4131



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www.hitachiconsulting.com.





Key Contacts

Ajay Nagarkatte
Managing Director
anagarkatte@bai.org
(312) 683-2486

Dan Hough
Director
dhough@bai.org
(312) 683-2432

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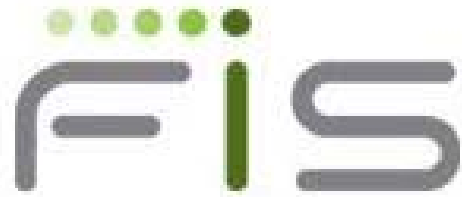
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PULSE, a Discover Financial Services (NYSE: DFS) company, is a leading debit/ATM network, serving more than 4,400 banks, credit unions and savings institutions across the United States. The network links cardholders with ATMs and POS terminals at retail locations nationwide.

Through its global ATM network, PULSE provides worldwide cash access for Diners Club and Discover cardholders through hundreds of thousands of ATM locations. The company is also a source of electronic payments research and is committed to providing its participants with education on emerging products, services and trends in the payments industry.

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The 2010 Study was designed to provide financial institutions, processors, and associations with information to create or enhance strategies for generating income, prioritizing investments, and identifying marketing initiatives to meet current and future consumer needs.

Study Questions

- How are consumers paying today?
- Why do they make these payment choices?
- How will they pay in the future?
- What payment methods will gain at the expense of others and why?
- How have consumer payment preferences changed over the years?

Will Help You Better Understand . . .

- What types of payments are used, for what purpose, and in what situations?
- What are the drivers causing consumers to prefer one payment method over another?
- How adaptive are consumers to new payment choices?
- What may cause consumers to switch to and adopt new payment methods in the future?

. . . And Help You Develop

- Strategies and tactics for generating income and increasing shareholder value
- Knowledge of where to invest capital and resources for payments products and channels
- Differentiated yet surgical marketing campaigns geared towards current and future needs

The sixth in a series of studies, the 2010 Study of Consumer Payment Preferences tracks the evolution of the consumer payment preferences landscape.

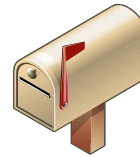
- The 2010 Study monitors the evolution of consumer payments preferences and perceptions of usage across four primary payment venues:



In-Store



Internet



Bill Payment



Mobile

- The study also includes in-depth looks at a number of individual payment methods: cash, credit cards, debit cards, and prepaid cards.
- The 2010 Study is an updated and expanded follow-on to studies conducted in 1999, 2001, 2003, 2005, and 2008.

The 2010 Study is the definitive national primary research study delving into how and why consumers use various payment methods in different venues.

The 2010 data set is statistically significant and representative of the U.S. population; as such, study findings can be projected to the population overall.

Gender

Gender	Respondents (Unweighted)	U.S. Population (18 yrs and older)
Male	48%	49%
Female	52%	51%

Income

Income	Respondents (Unweighted)	U.S. Population (18 yrs and older)
Under \$25K	16%	25%
\$25-49K	20%	25%
\$50-74K	16%	18%
\$75-99K	11%	12%
\$100K+	20%	20%
N/A	17%	--

Age

Age	Respondents (Unweighted)	U.S. Population (18 yrs and older)
18-24	13%	13%
25-34	18%	18%
35-44	20%	18%
45-54	20%	19%
55-64	14%	15%
Over 65	16%	17%

Education

Education	Respondents (Unweighted)	U.S. Population (18 yrs and older)
< High School	5%	15.1%
High School	56%	49.8%
College	30%	25.0%
Graduate	9%	10.2%

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This year's Consumer Payments Preferences Study, like those in the past, produced some interesting insights as well as unexpected results.

Key Findings

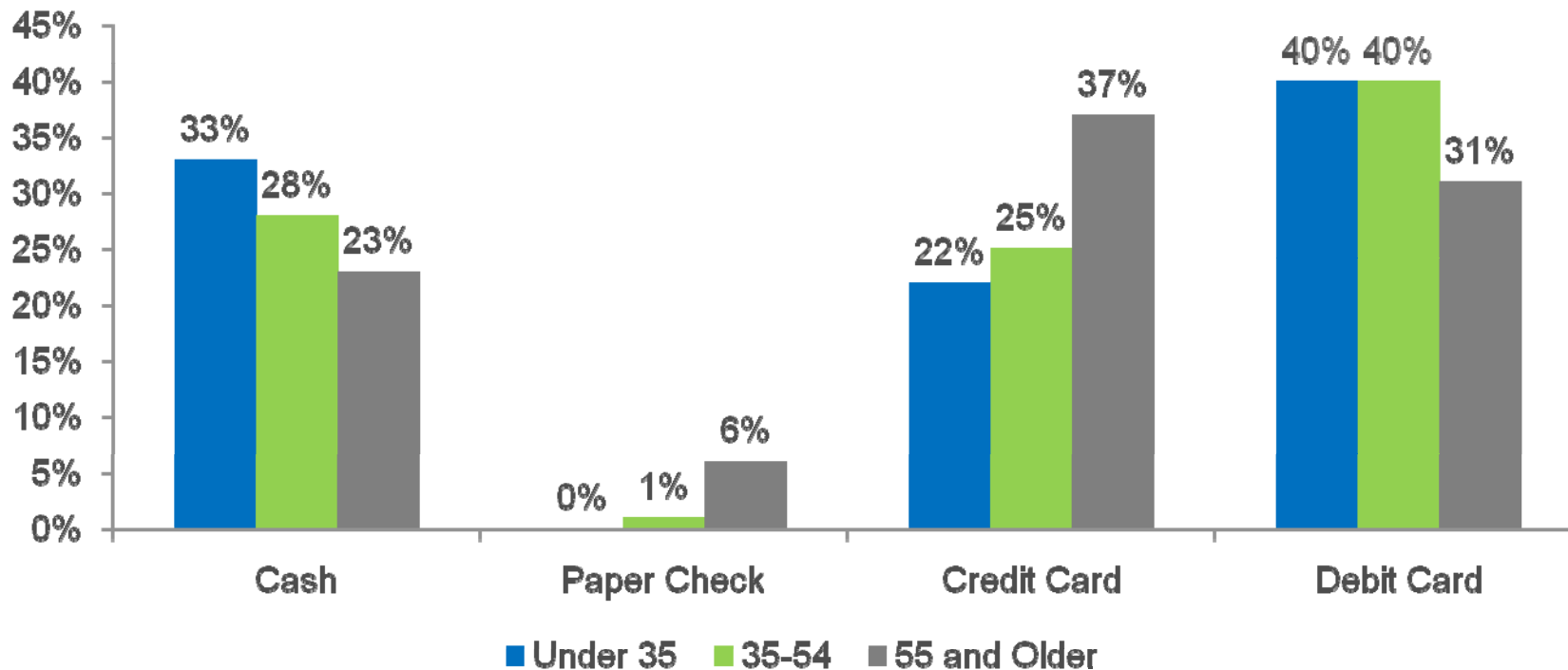
1. The Millennial Generation presents a good opportunity for growing low cost payment volume
2. Mobile and contactless will take time to become a mainstream payment product
3. Debit and prepaid have increased at the expense of credit cards, checks, and cash
4. Fast food, coffee shops, cinema/theater, and transit are prime opportunities for increasing debit
5. Online bill pay for recurring and occasional payments are opportunistic for growth
6. Micropayments have large potential for growth in Internet purchase volume

Implications

1. Target debit, micropayments, gift card, and perhaps mobile to this segment to generate fee income
2. Delay major investments until consumers become more comfortable with safety and security features
3. Continue to focus on debit, migrate customers away from cash and checks, and align operations to lower costs
4. Work with stakeholders to expand acceptance for increasing debit volume and fee income
5. Invest in consumer education and incentives
6. Develop alternatives and/or partner with companies like PayPal to generate additional fee income

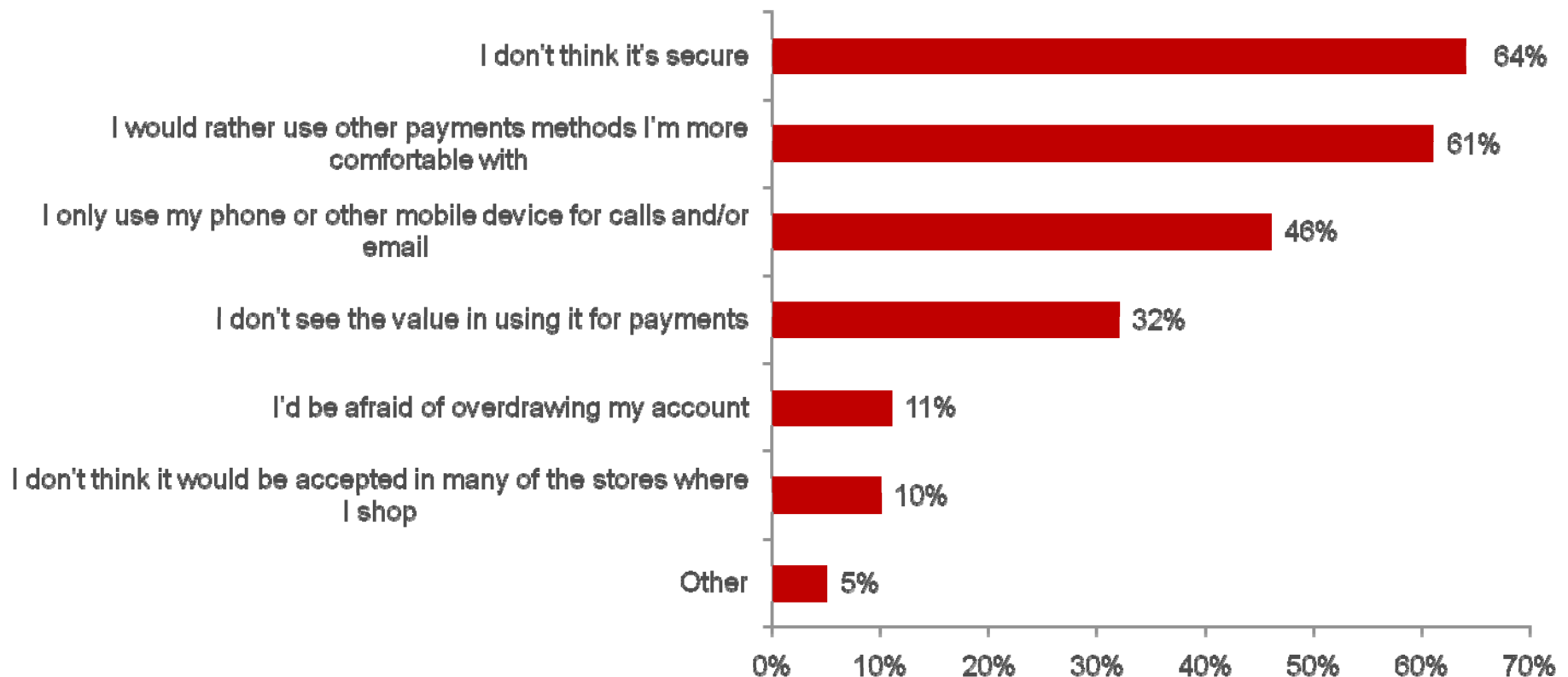
The Millennial Generation is a prime target for financial institutions as they do not use checks, have a preference for debit, and present the largest opportunity for migrating them from cash to debit.

Payment Product Preference (by Age)



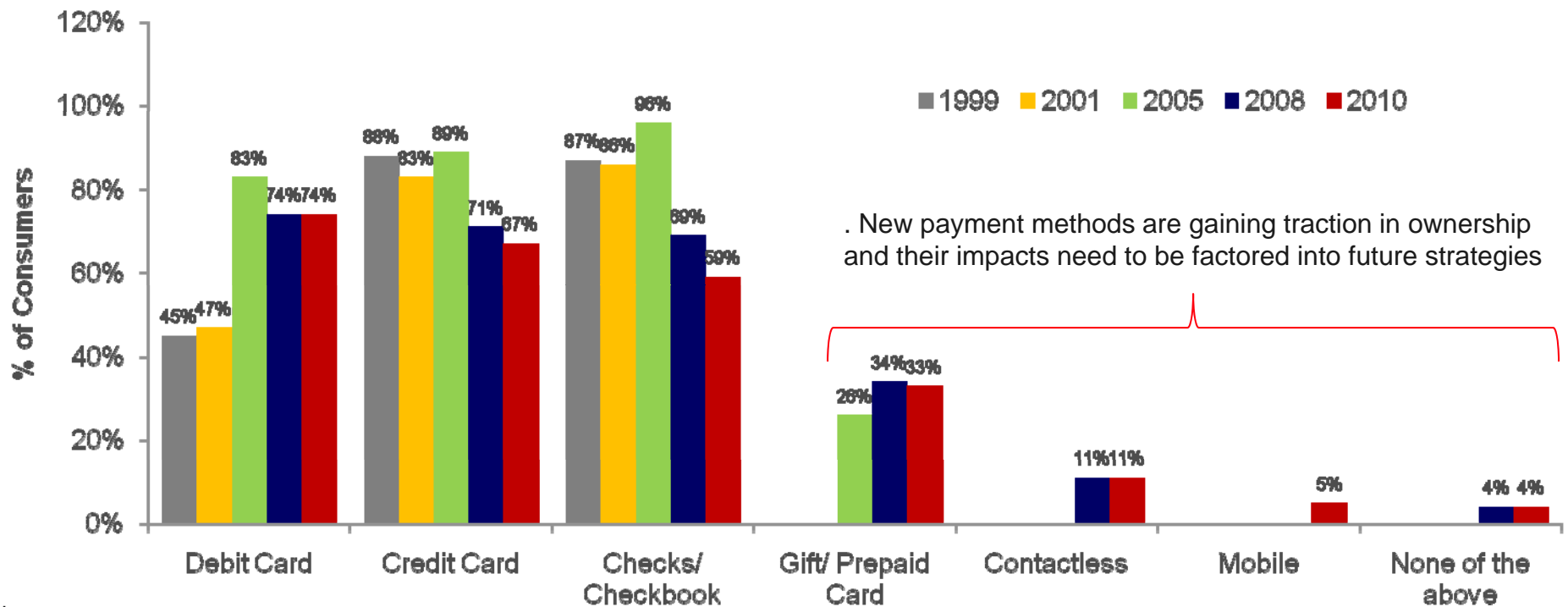
Consumers overall have limited interest in using mobile and contactless payment services. A significant investment in education aimed at alleviating security concerns may be required to gain consumer comfort with using a contactless payment service.

Concerns about Mobile Contactless Payments



Debit card ownership remains highest at 74%, unchanged from 2008. Ownership of check (-39%) and credit card (-24%) has decreased the most since their peaks in 2005.

**Payment Product Ownership
(1999-2010)**

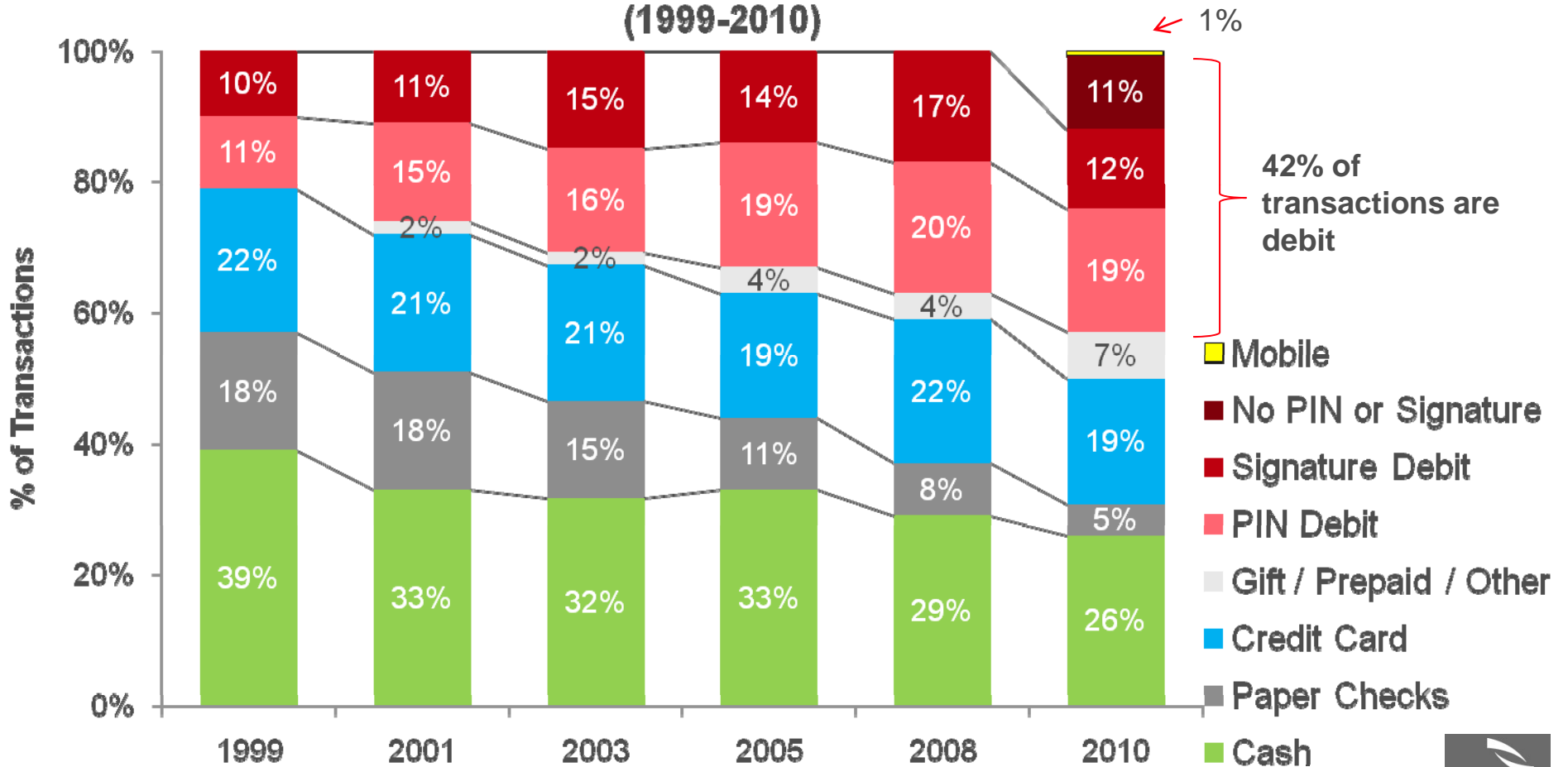


Notes:

- 1) Participants were asked to disclose all of the payment products that they owned.
- 2) Debit in 2005 and prior included both ATM Cards and Debit Cards
- 3) "Mobile" was based on having access to mobile payments through a mobile payments device. Examples include Smartphones and Blackberries.

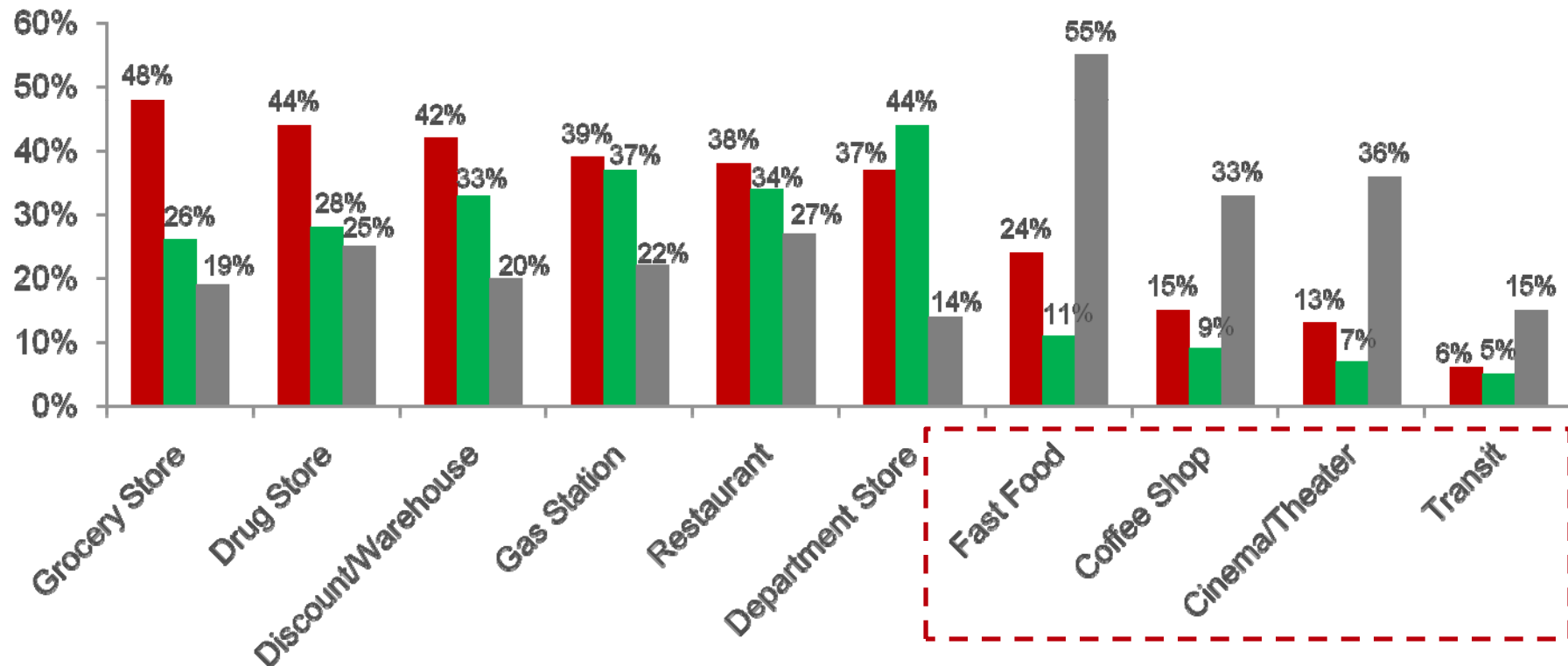
Debit and prepaid usage increased at the expense of credit cards, checks, and cash. Changes in the marketplace coupled with consumer expectations suggest the rise of debit will continue.

**In-Store Transaction Usage
(1999-2010)**

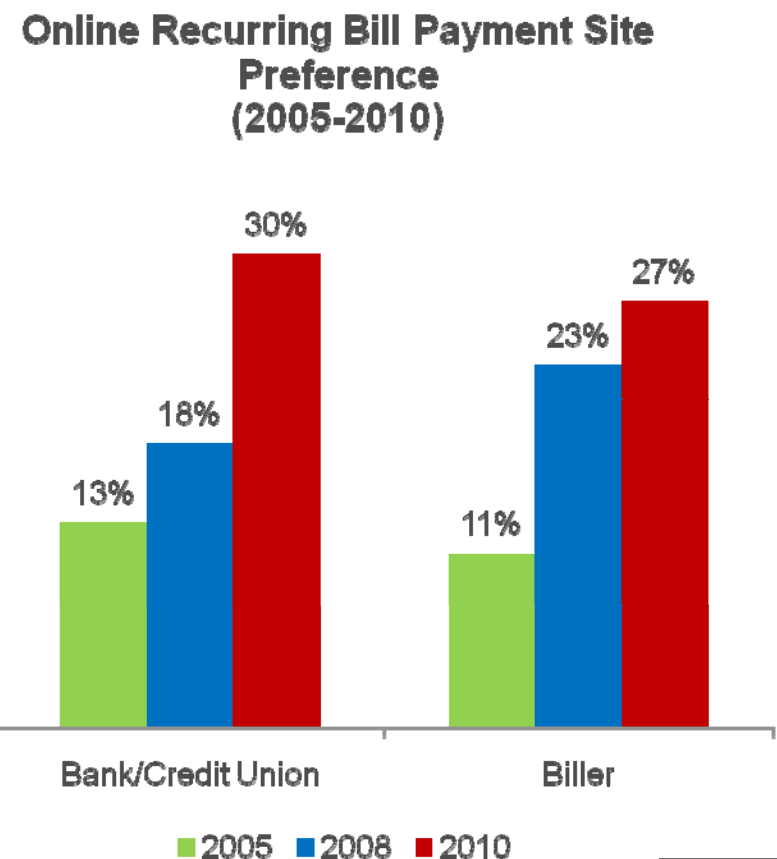
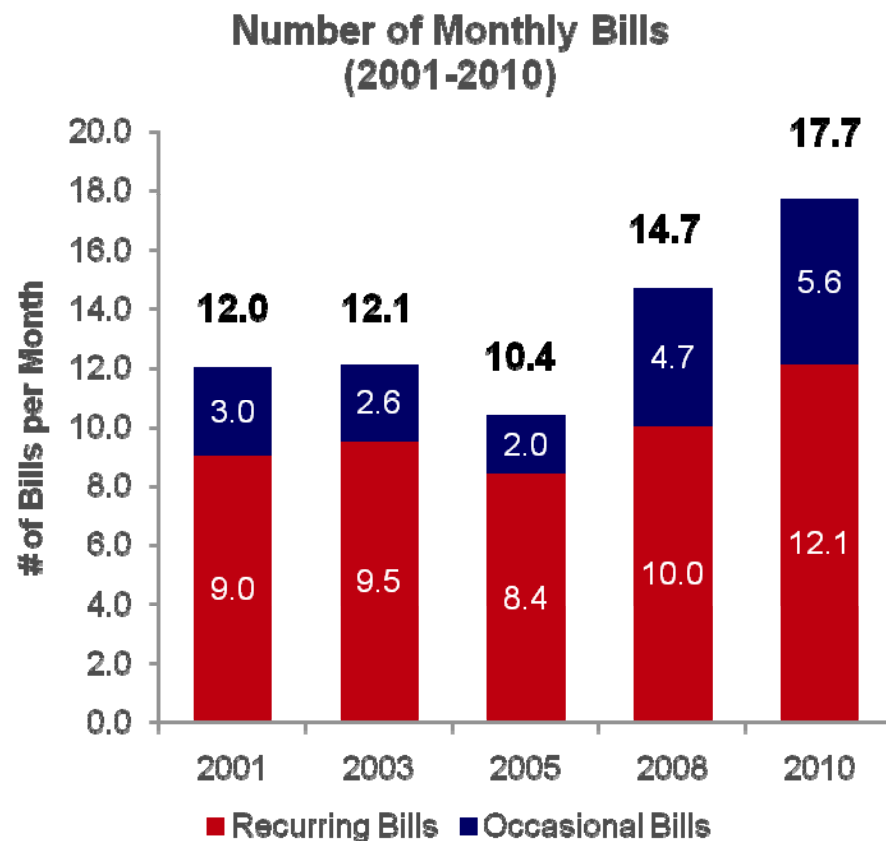


Fast Food, Coffee Shops, Cinema/Theater, and Transit are merchant categories where cash is the most preferred payment method and, potentially, could be targets for increasing debit acceptance.

**In-Store Payment Preference
(by Merchant Category)**



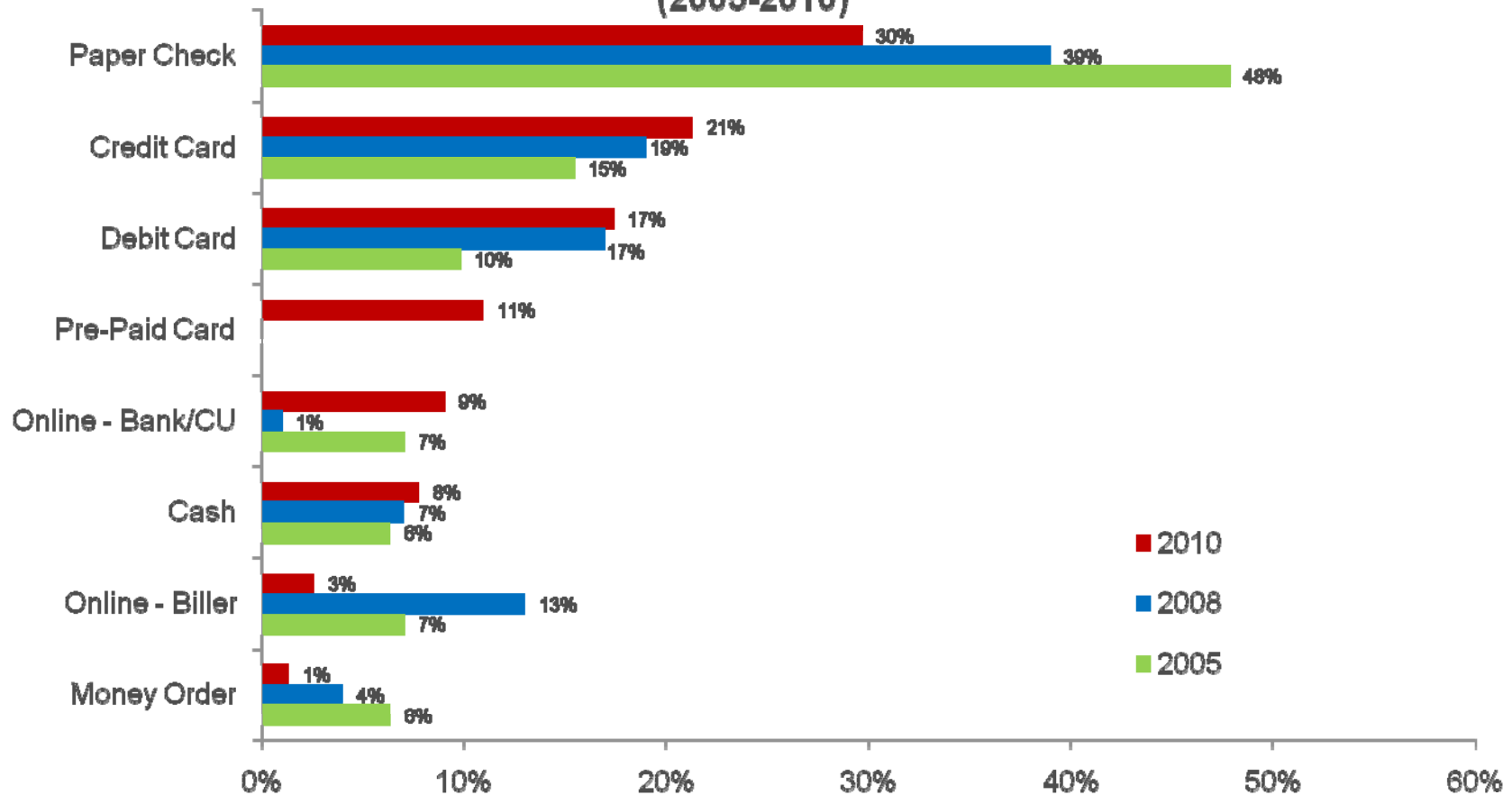
70% of consumers pay their monthly recurring bills using means other than at their financial institution's web sites. Capturing a higher share of the monthly recurring bill pay volume may be possible by focusing marketing programs and messages on time, cost and convenience.



Note: Recurring bills are those that come every month, such as credit card bills and utility bills. Occasional bills are those that come at irregular intervals such as magazine subscriptions, membership renewals, or charitable contributions.

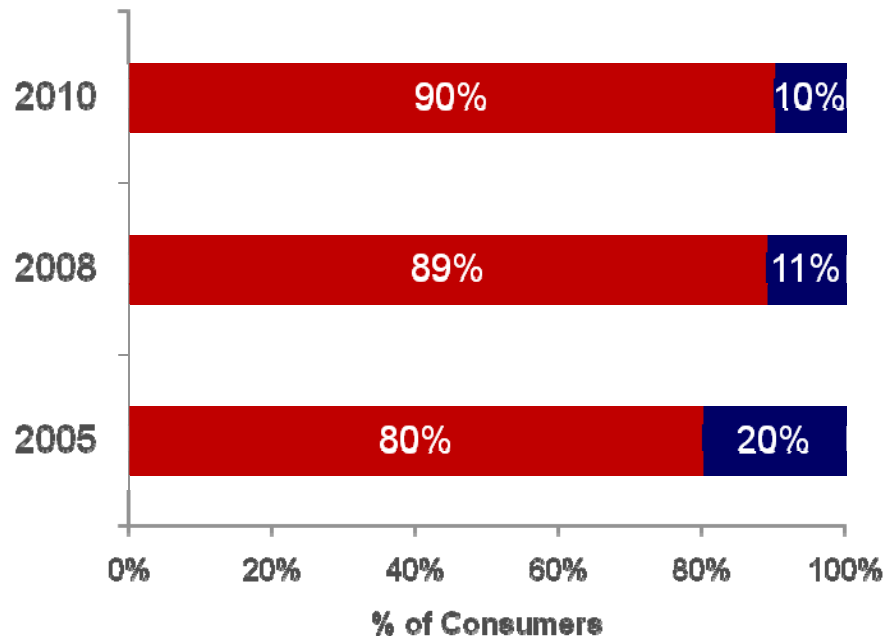
Few consumers use online bill pay sites for paying occasional bills, 9% at a financial institution's site and 3% at a biller's site. An opportunity exists to increase volume by targeting marketing programs and messages about ease of use, cost and convenience.

**Most Used Payment Method for Occasional Bills
(2005-2010)**



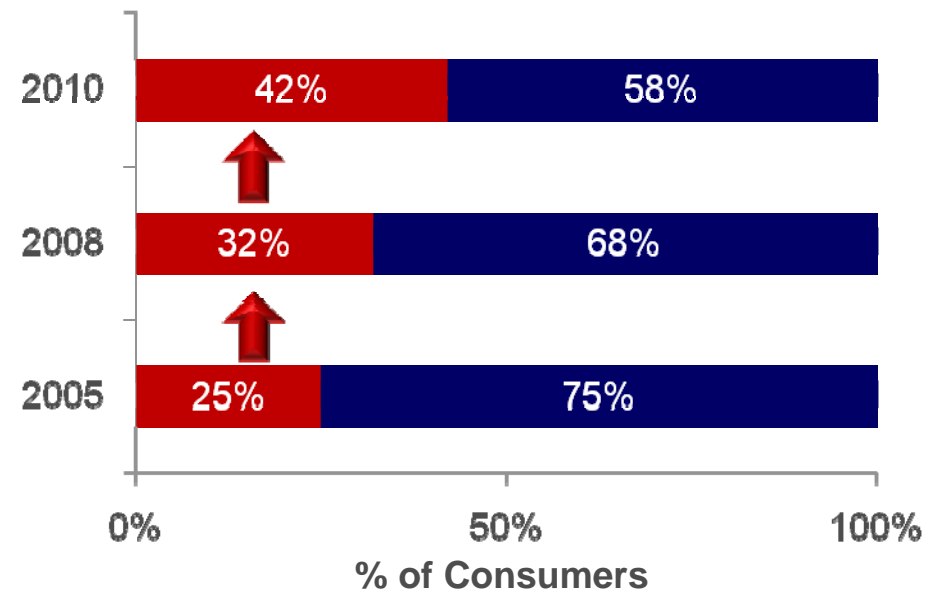
While Internet purchase penetration appears to have reached a plateau, opportunities exist for channel growth by focusing marketing efforts on micropayments and increased utilization by existing users.

**Internet Purchase Penetration
(2005-2010)**



- Have Made a Purchase Over the Internet
- Have Not Made a Purchase Over the Internet

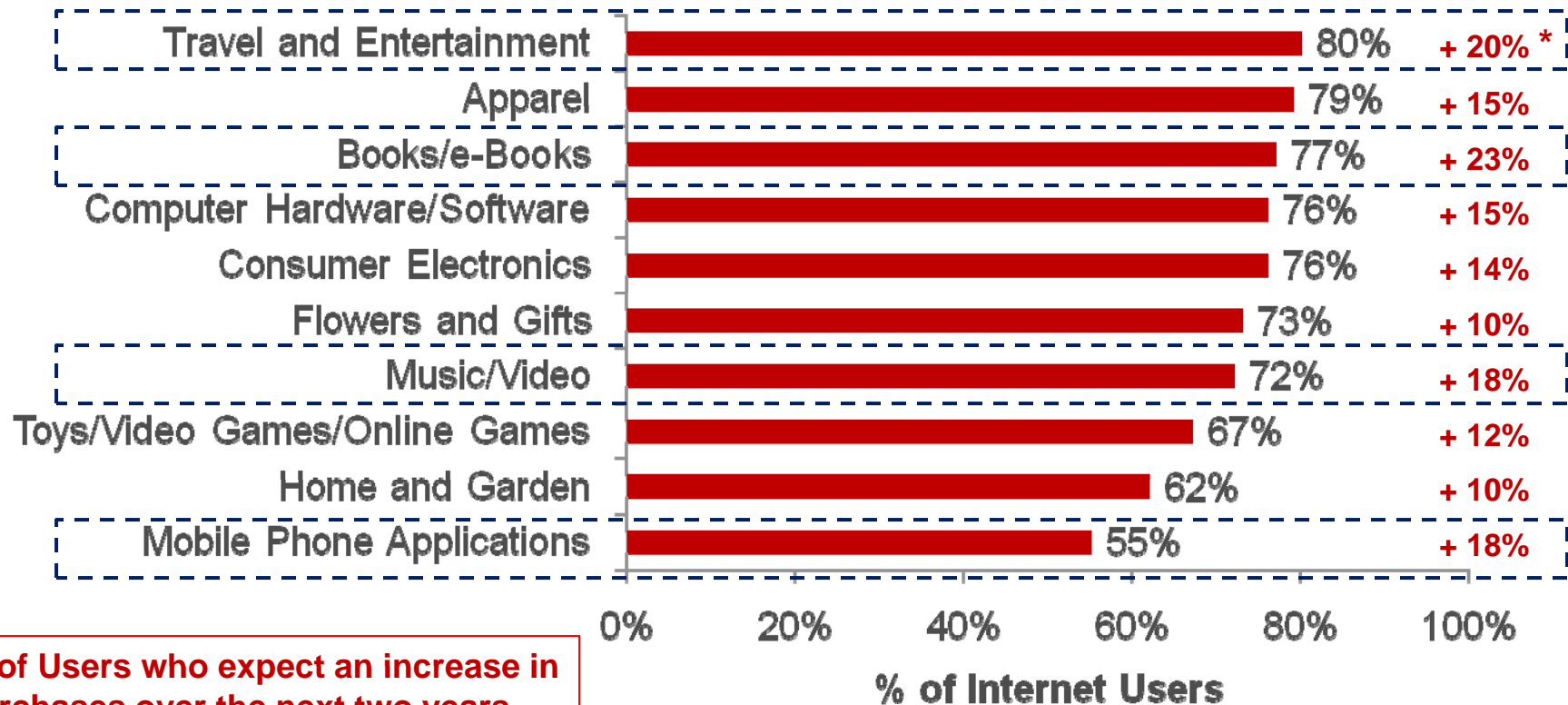
**Micropayment Penetration
(2005-2010)**



- Have Made a Payment Over the Internet Less Than \$5
- Have Not Made a Payment Over the Internet Less Than \$5

Travel and entertainment, books/e-Books, music/video, and mobile phone applications represent the largest areas of expected growth for Internet purchases. Companies should incorporate these trends into their planning efforts.

Current Purchases and Expected Increases (Internet Users)



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Understanding key characteristics of the Millennial Generation will offer financial institutions a number of opportunities to increase their use of payment products and channels.

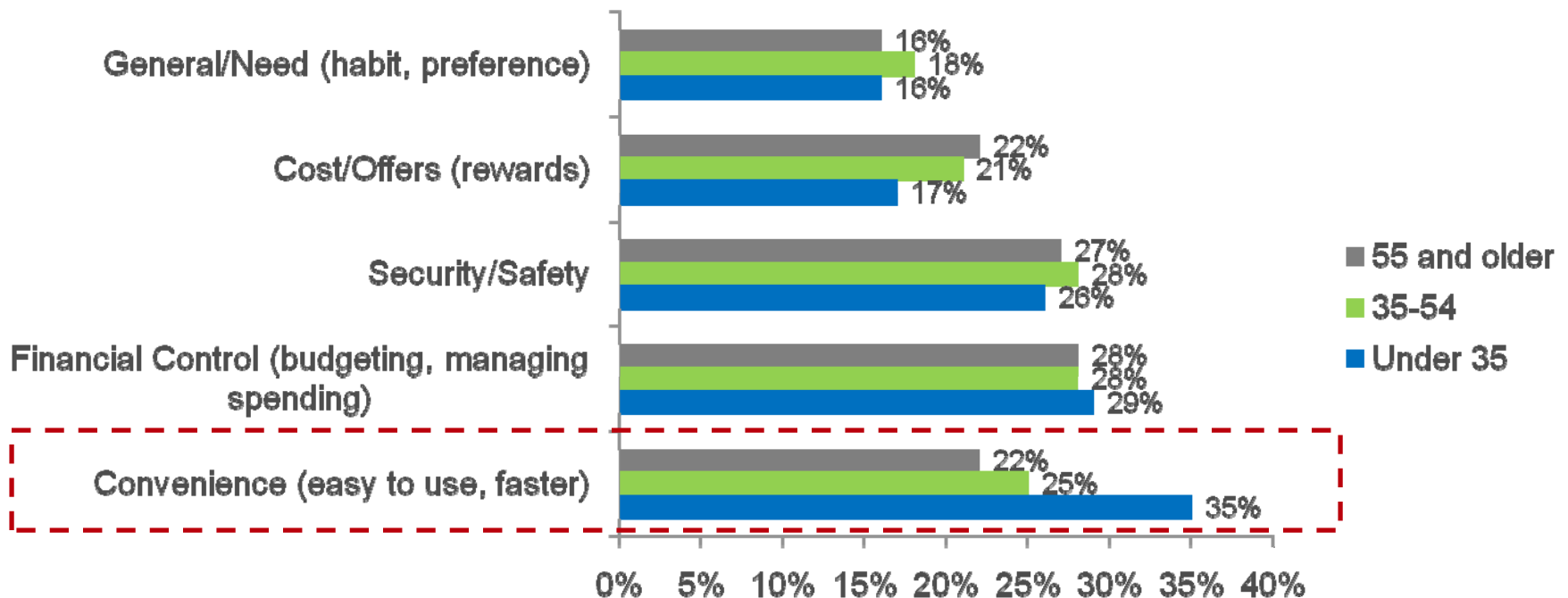
Key Characteristics Compared to Other Age Groups

- Ease of use and convenience are more likely to drive payment method usage
- Debit is the preferred payment method
- Using credit for making Internet purchases is more likely to increase
- Micropayment purchases are more likely to be made
- Emerging forms of payment are more likely and more quickly to be adopted



35% of consumers under 35 cite convenience as their primary reason when choosing a payment method, significantly higher than the proportion for any other reason or age group.

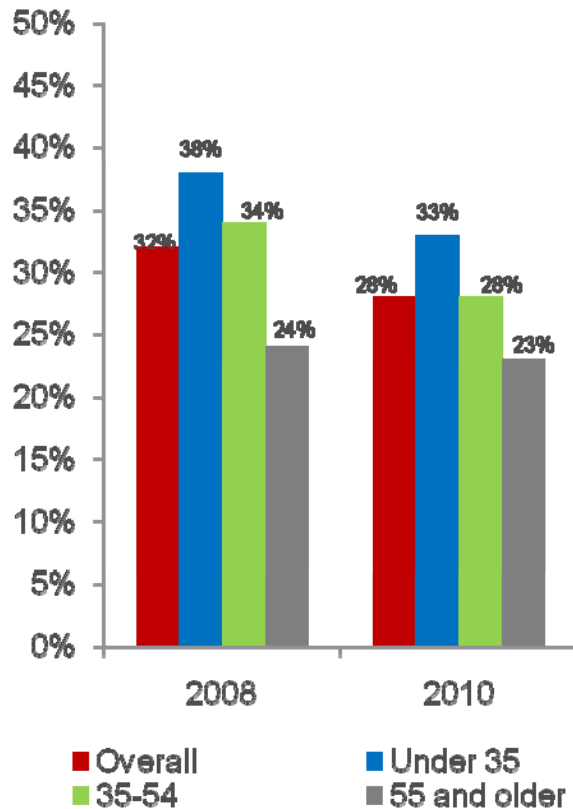
Reason for Preferring One Method over Another (by Age)



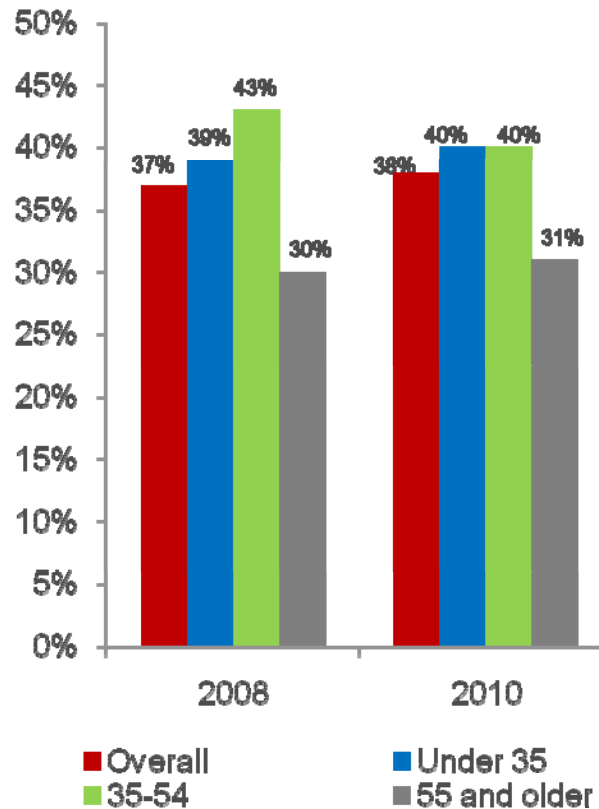
Millennial Generation – Most Preferred for In-Store Payments

While other generations prefer credit cards, consumers under 35 prefer to pay with cash and debit, which are perceived as fast, accessible, and convenient.

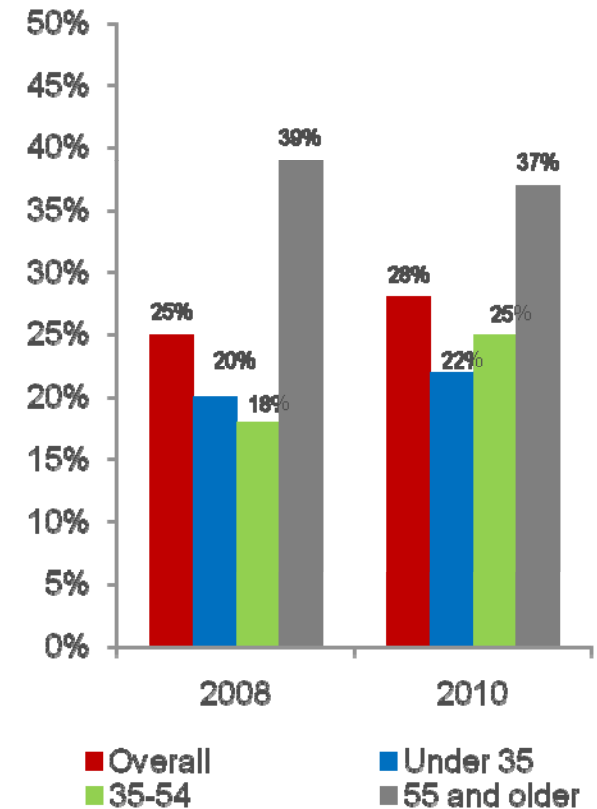
Cash Preference (by Age)



Debit Preference (by Age)

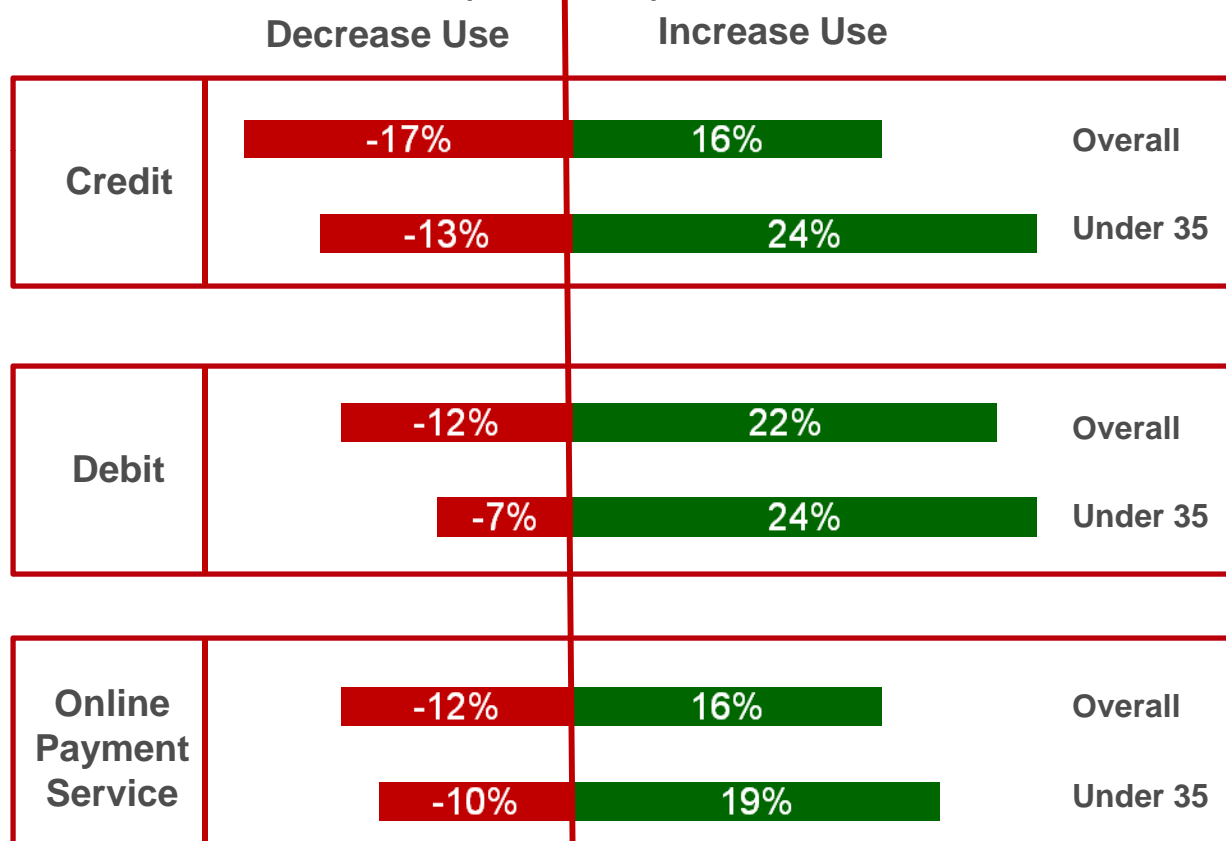


Credit Preference (by Age)



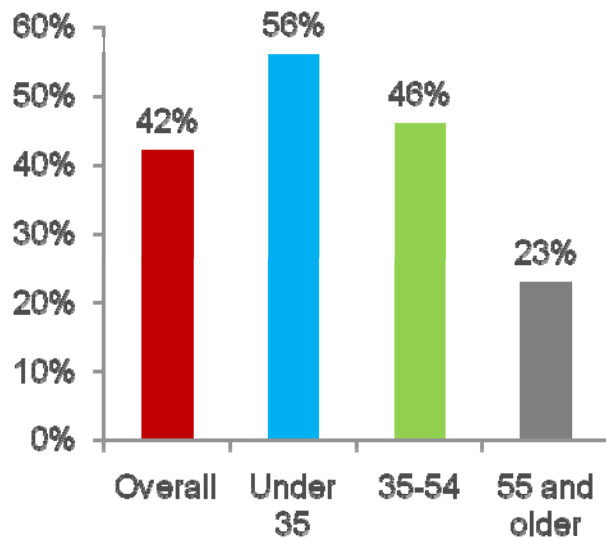
Compared to other age groups, more consumers under 35 expect to increase usage of credit, debit, and online payment services for making purchases over the Internet.

**Projected Change in Internet Payments Usage
(2010-2012)**



The under 35 bracket uses debit, prepaid, and application store accounts to make micropayments more often than the other segments.

Micropayment Penetration (by Age)

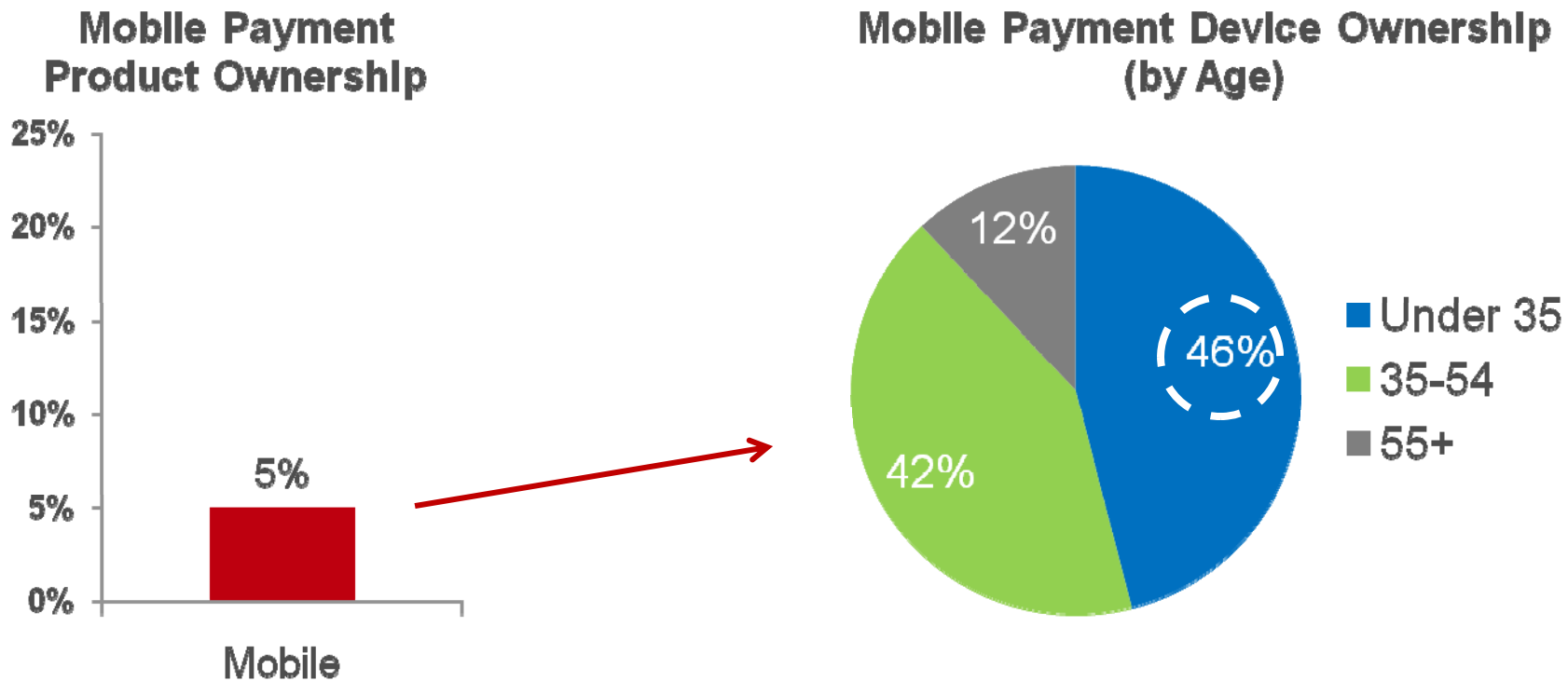


Micropayment Consumer Preferences (by Age)

	Debit	Credit	Prepaid	PayPal	App Store	Mobile Phone
Overall	23%	27%	13%	19%	13%	3%
Under 35	25%	22%	18%	17%	15%	2%
35-54	21%	28%	10%	21%	12%	4%
55 and older	20%	43%	6%	20%	10%	1%

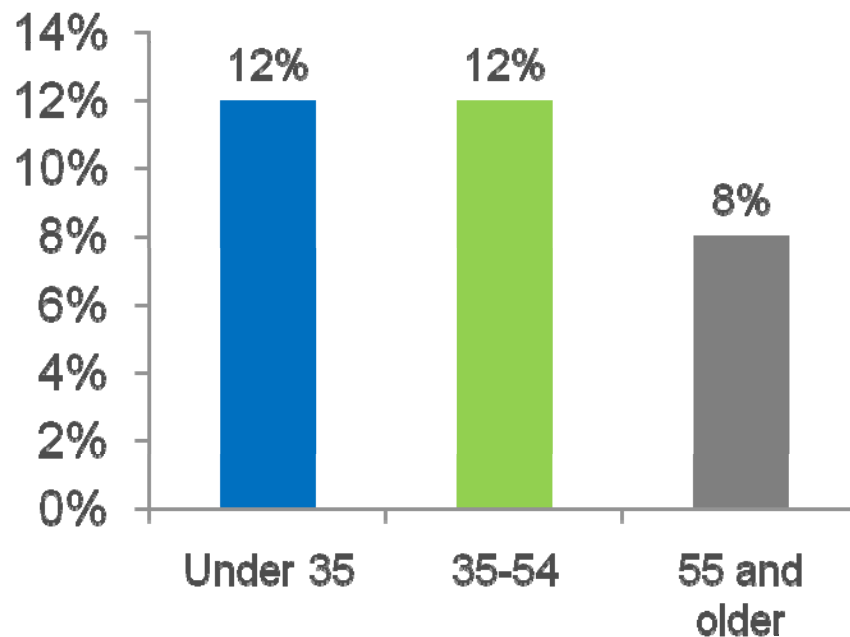
Banks may want to evaluate the revenue and float benefits for targeting prepaid products to the Millennials for making small purchases.

Rather than introducing widespread mobile payment products, financial institutions should consider piloting mobile payments programs first with the Millennial Generation given their ownership of mobile devices and higher likelihood of usage.

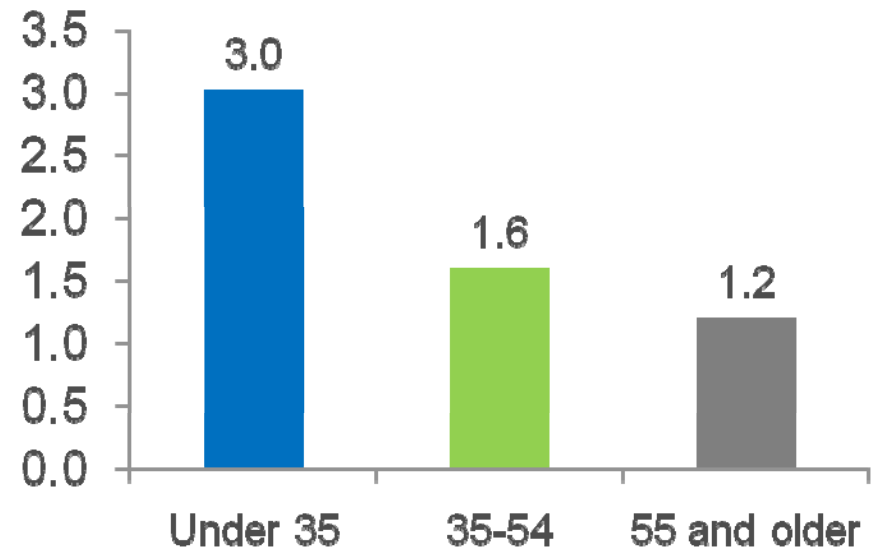


The 35 and under segment uses contactless methods twice as often as other segments and should be considered a preferred target market for new contactless products.

Contactless Device Ownership (by Age)



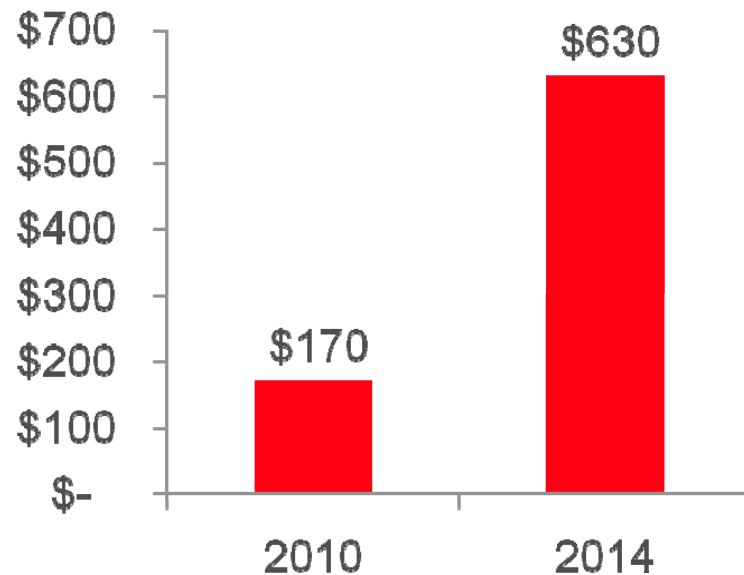
Average Weekly Contactless Usage (by Age)



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The mobile payments market is expected to grow nearly 300% worldwide in the next four years, but barriers to adoption remain for users in the United States.

Worldwide Mobile Payments Market (In billions)



Source: "Mobile Payment Markets Strategies & Forecasts 2010-2014", January 2010, Jupiter Research,

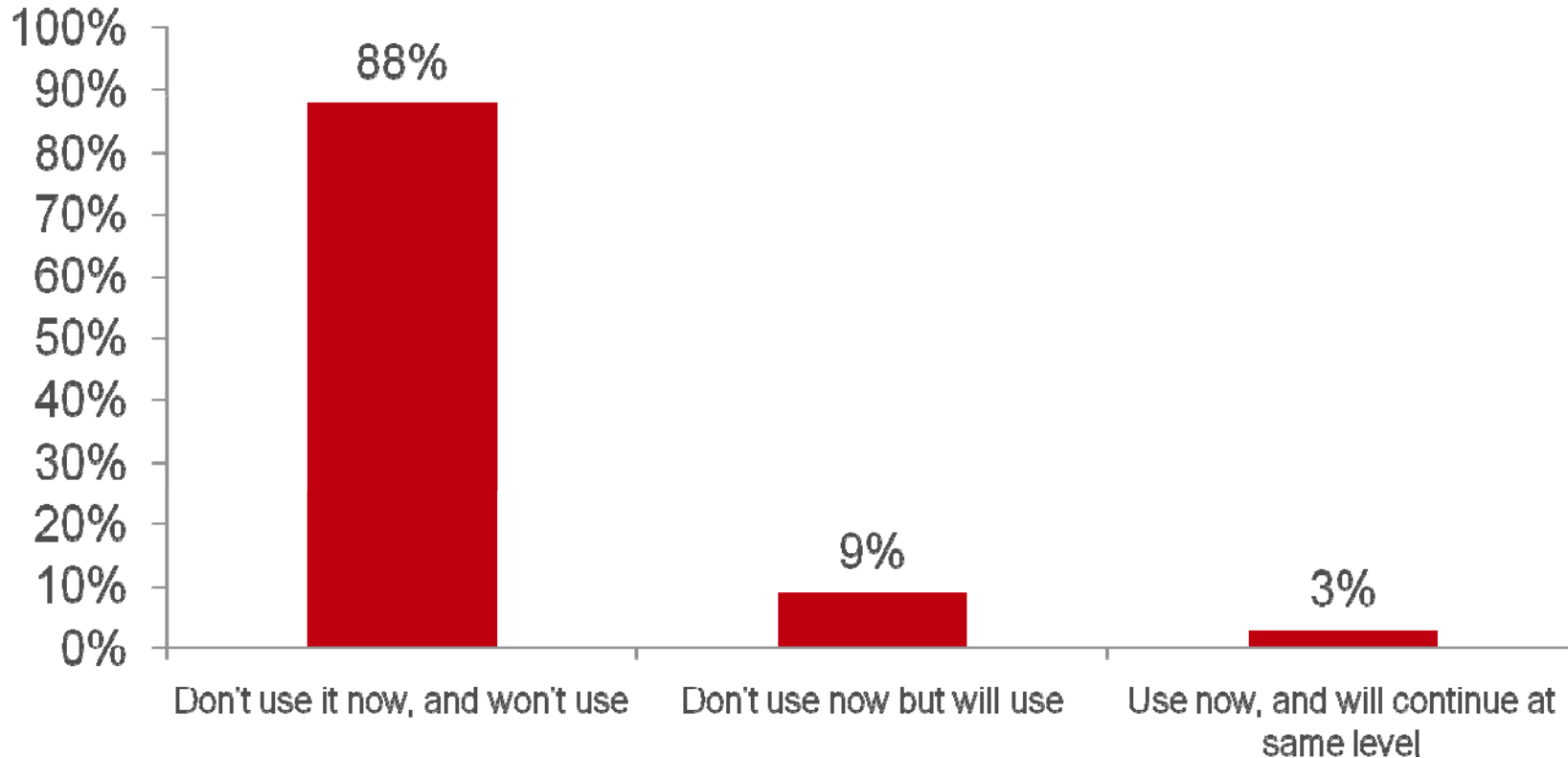
Key Characteristics of Mobile Payments

- 88% of US consumers do not use now nor do they plan to use mobile payment devices within the next two years
- Meeting forecasted mobile payments growth targets will be challenging
- Security of data is a primary concern for consumers
- Significant investments in consumer education will be required to overcome barriers to adoption

Mobile Payments – Expected Future Adoption Rates for Using a Mobile Phone for an In-Store Purchase

88% of consumers indicated that they are not interested in using a mobile payment device for an in-store purchase. 18% of the Millennials expect to use mobile in the next two years, which is 2 times greater than the other age groups combined.

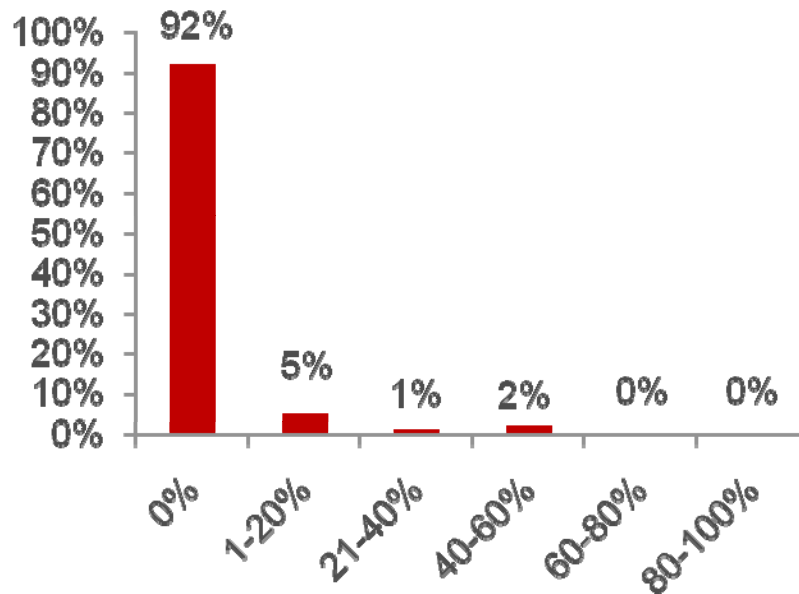
**Expected Change in Mobile Payment Usage
(2010-2012)**



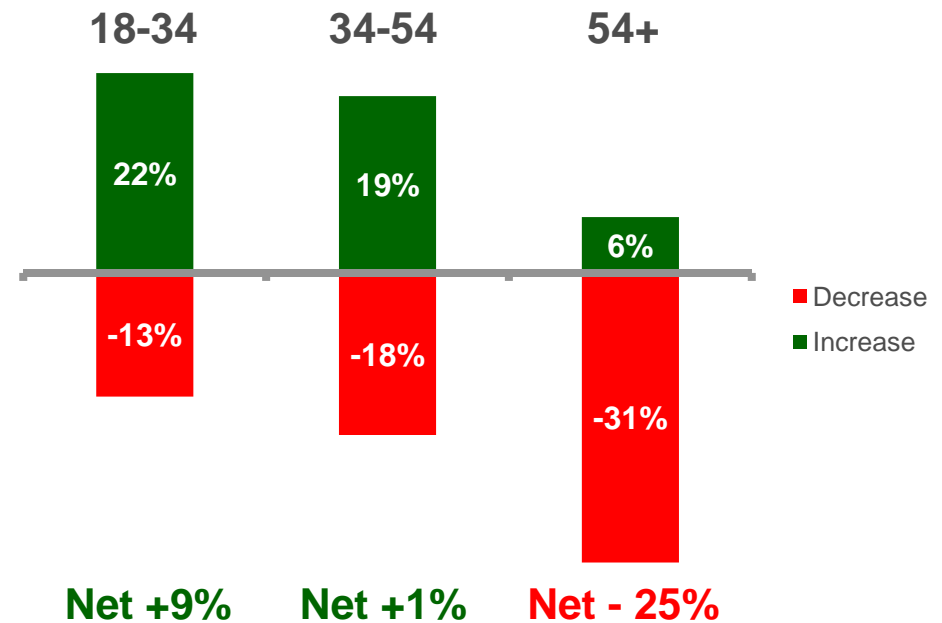
Mobile Payments – Usage of a Device Capable of Making an Internet Purchase

While 92% of consumers have not used their mobile devices to make purchases over the Internet recently, 16% of consumers overall feel they will likely increase their usage over the next two years, with the Millennials leading the way at 22%.

% of Internet Purchases Made Using a Mobile Phone (Within the Past Three Months)



Change in Internet Purchase Mobile Usage (2010-2012)*

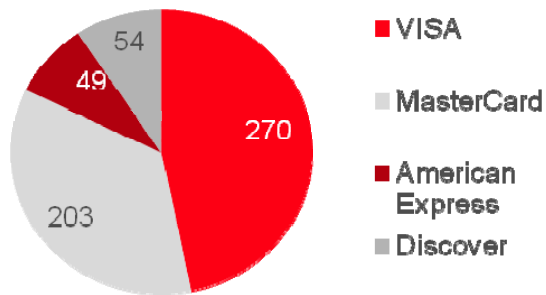


* Excludes no change in usage

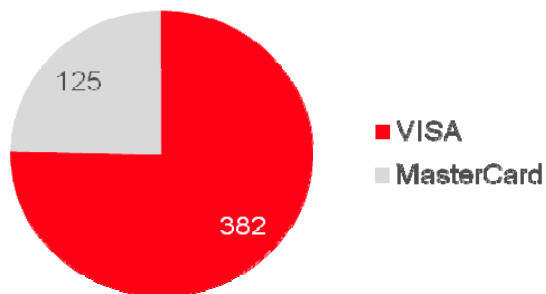
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VISA and MasterCard branded debit cards in circulation exceed credit cards 507 million to 470 million and are the preferred payment choice for consumers.

Credit Cards In US In circulation as of 2009 (In millions)



Debit Cards In US In circulation as of 2009 (In millions)



Key Characteristics of Credit vs. Debit Usage

■ Spending

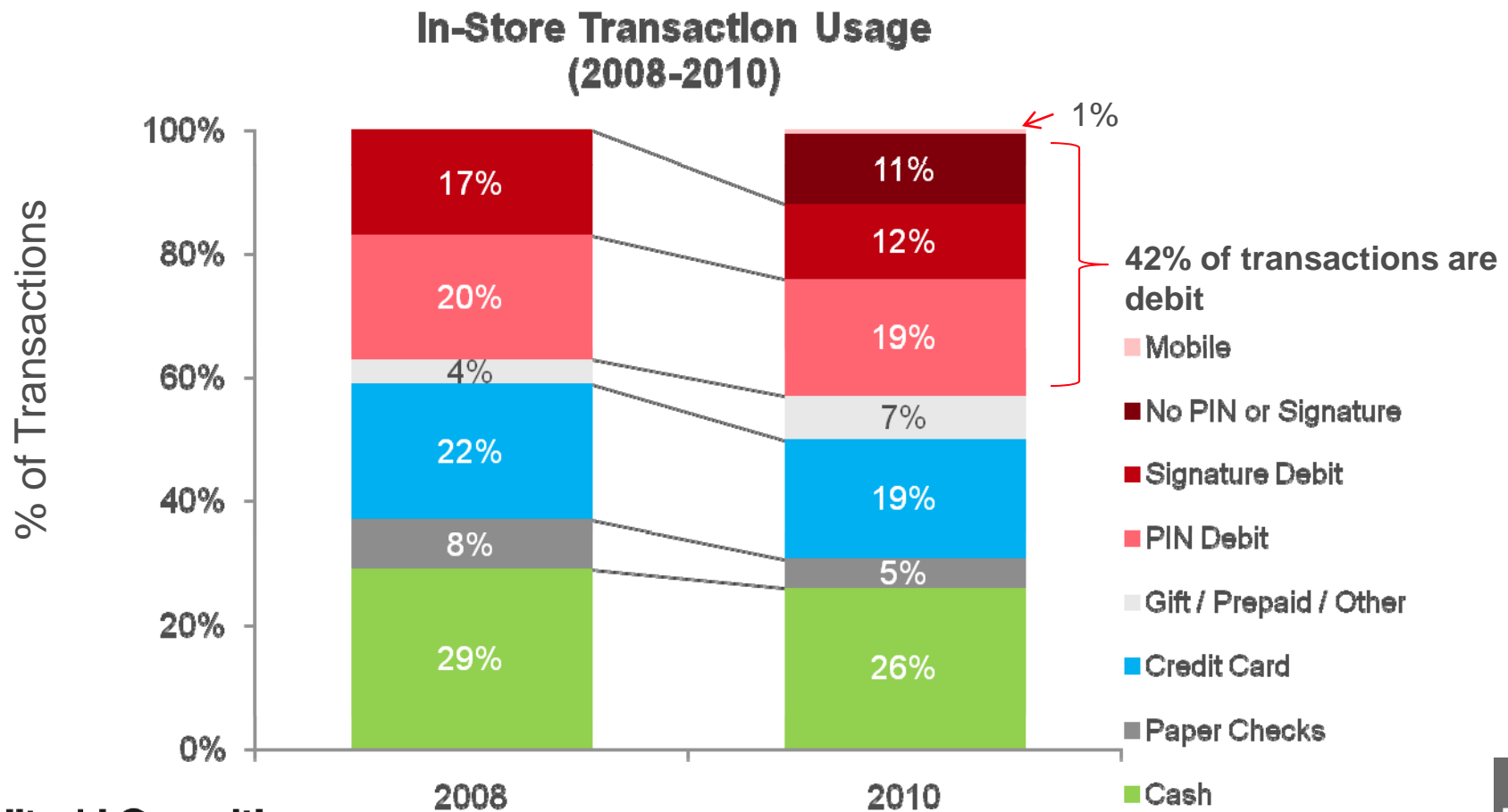
- Debit helps manage spending better
- Credit is better for large purchases and facilitating returns

■ Rewards

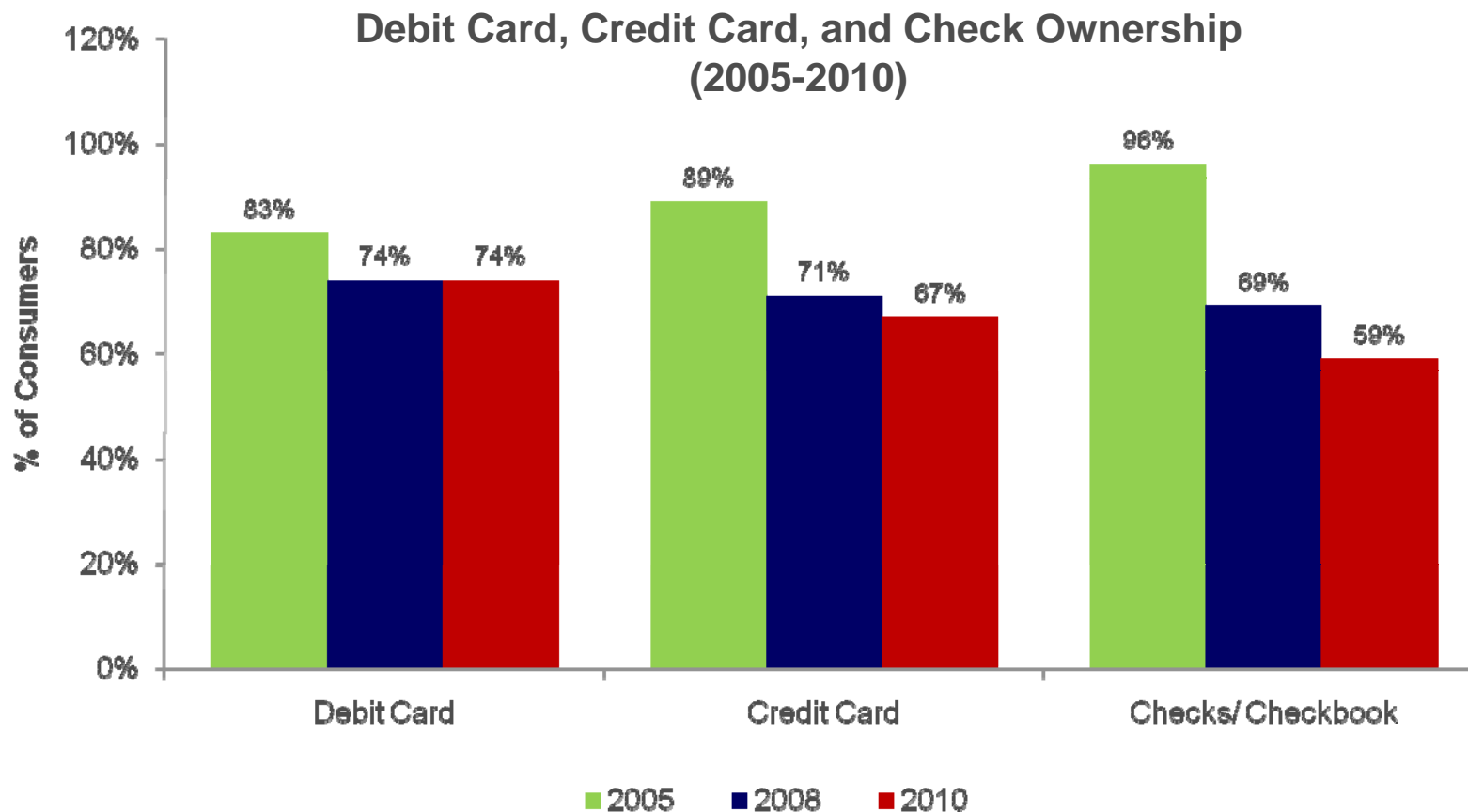
- Influences credit card usage more than debit card
- May be impacted by potential interchange legislation
- Changes could have more of a negative impact on credit card usage than on debit card usage

Source: <http://www.creditcards.com/credit-card-news/credit-card-industry-facts-personal-debt-statistics-1276.php>

Debit card usage increased 14% at expense of credit card and cash (declined 15% and 12%, respectively). Market changes and consumer expectations suggest the continued increase in debit card usage to the detriment of credit cards and cash.

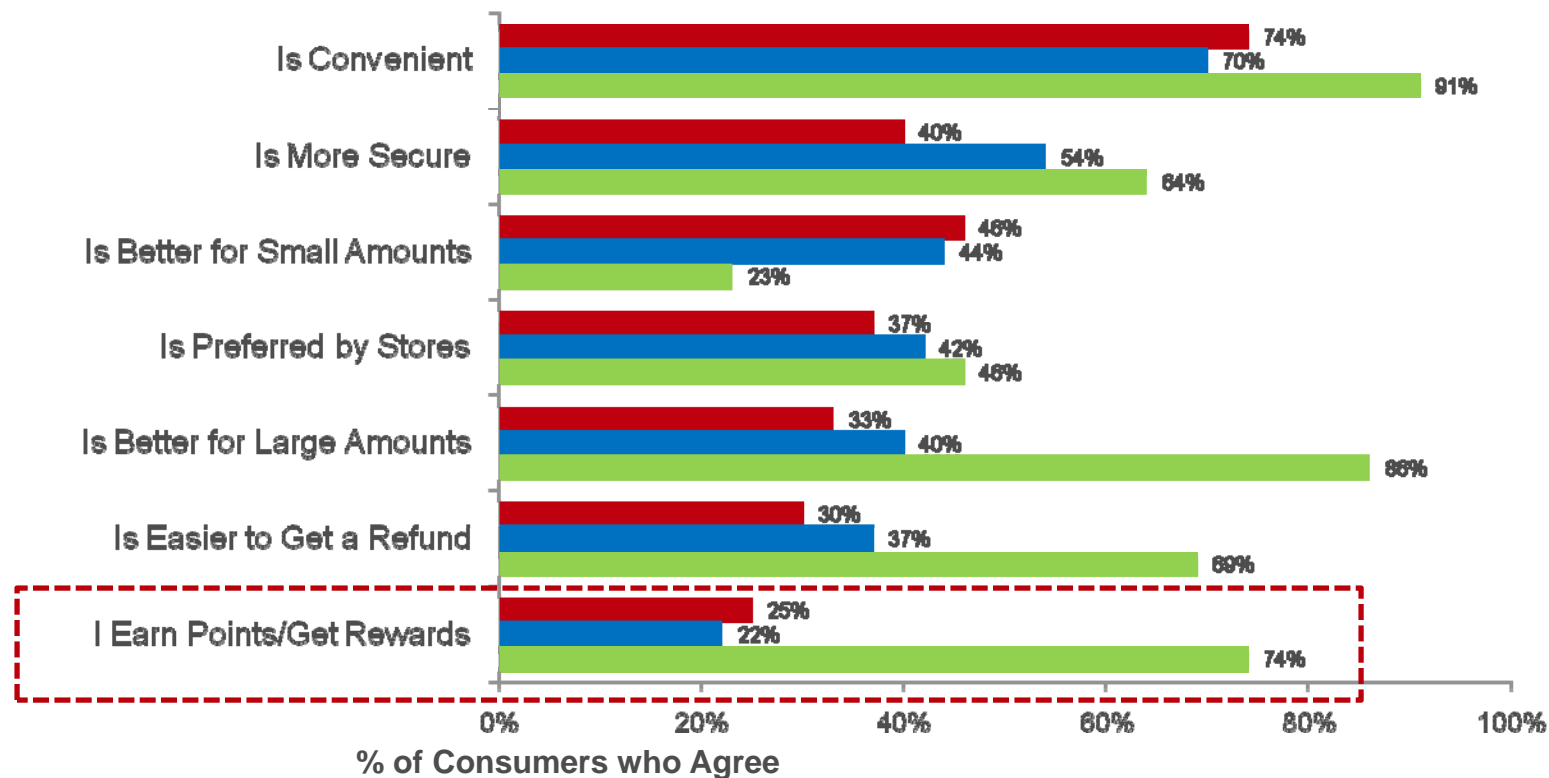


Debit card ownership remains highest at 74%. Checks and credit card ownership have decreased the most (39% and 24%, respectively) since their peaks in 2005, the latter caused, perhaps, by card consolidation due to rate and line changes.



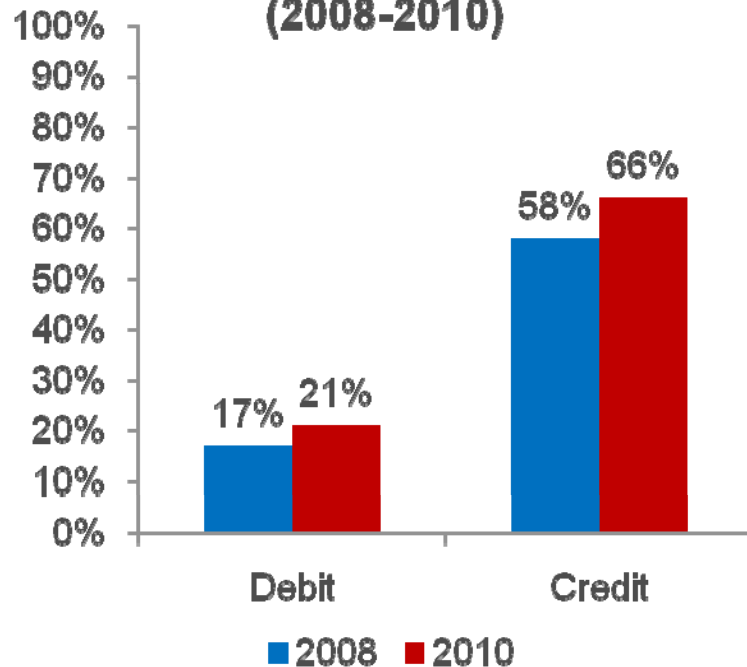
Credit is perceived to be better than debit in a number of ways, however, one of its biggest draws is rewards. This is likely an unsustainable competitive advantage in light of new card regulations and increased pressure on interchange rates.

Perceptions of Debit vs. Credit

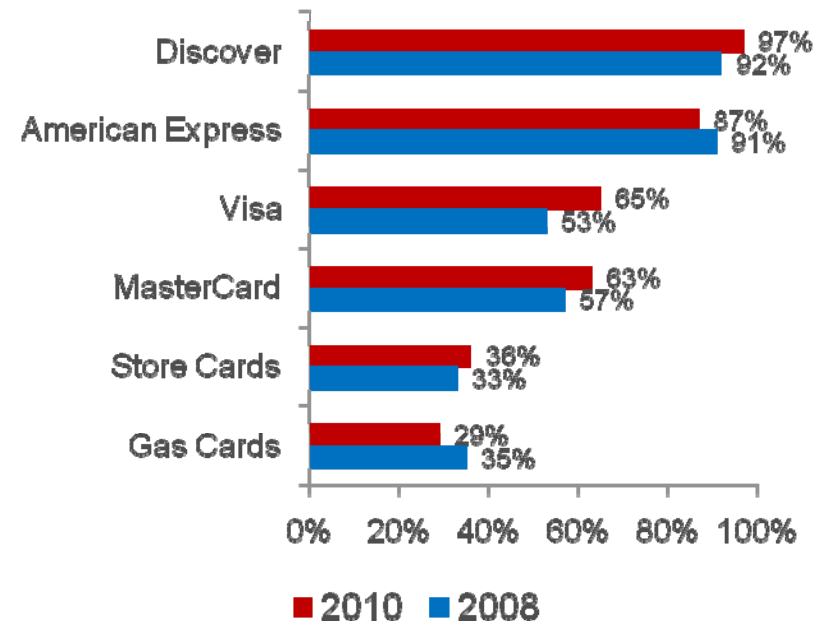


Credit card users receive rewards three times more often than debit card users. With the exception of American Express and gas card holders, all other credit cardholders experienced an increase in receiving rewards since 2008.

Percent of Consumers Receiving Rewards (2008-2010)

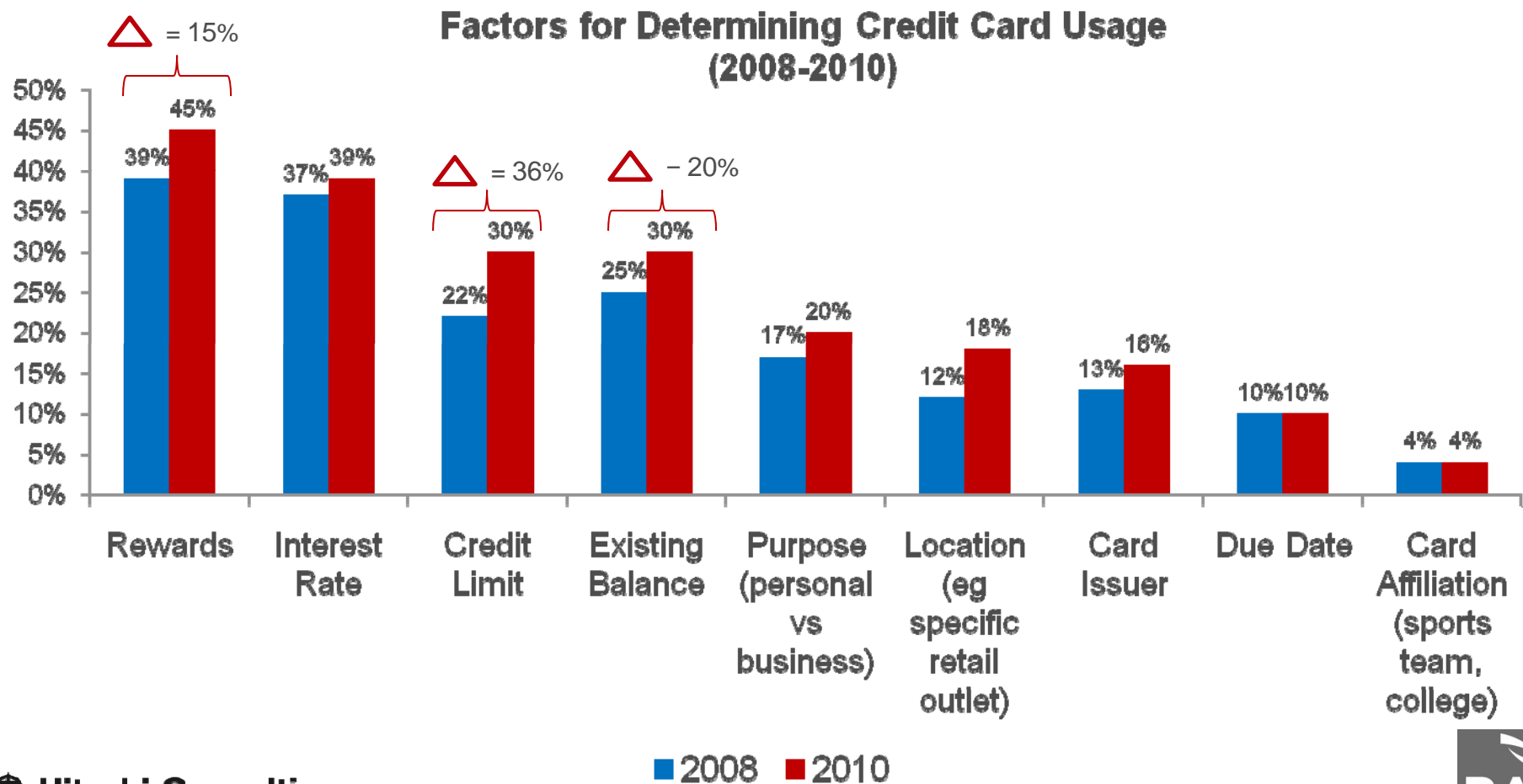


Percent Receiving Rewards by Credit Card Type (2008-2010)



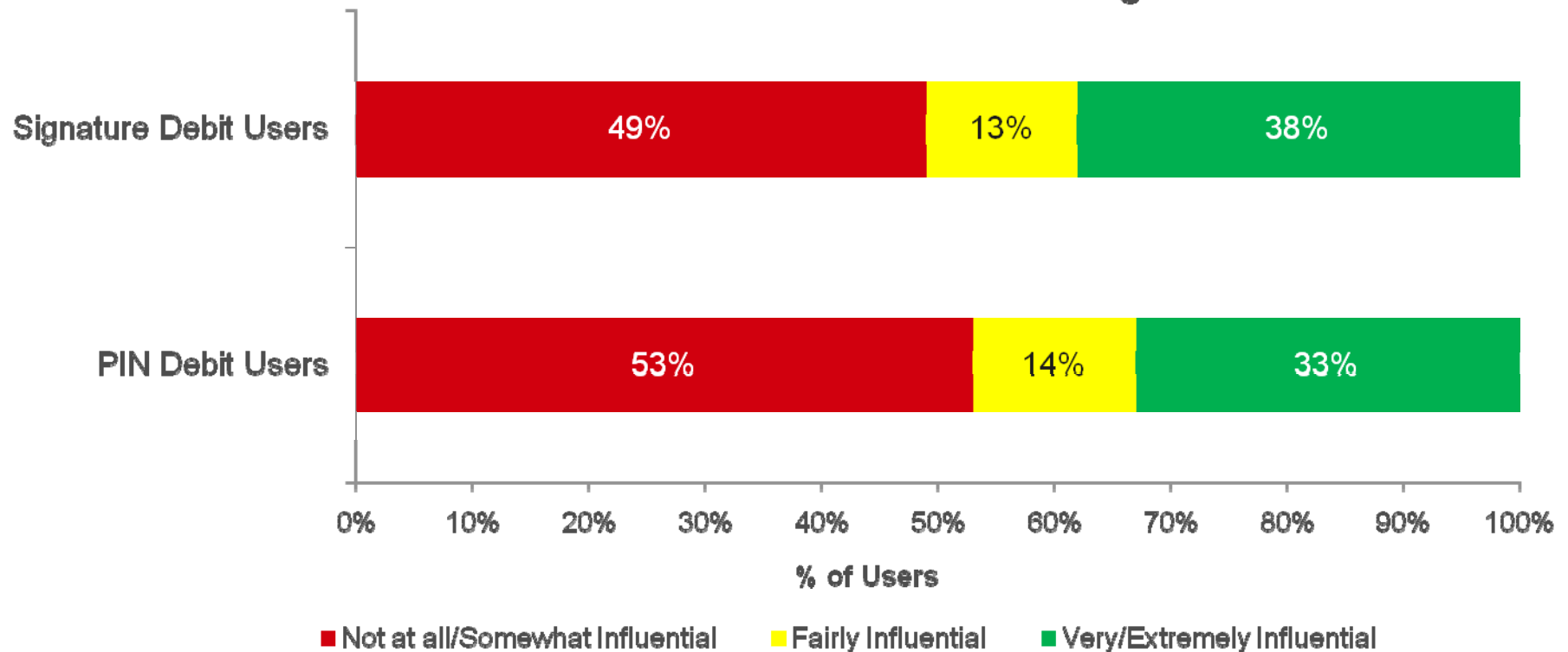
Note: Gas cards may include MasterCard, Visa, or Private Label

Rewards are the most significant factor for determining credit card usage, increasing 15% since 2008. Given the likely downward pressure on interchange, issuers' reward programs may be unsustainable in their current form.



Over half of debit card users are not influenced by rewards. Financial institutions could reduce costs by understanding which segments are influenced by rewards and target their programs accordingly.

Influence of Rewards on Debit Usage



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 - **Payment product proliferation** poses a threat to financial institutions
- In Conclusion

Consumers are making use of an increasing variety of available payments options. Understanding where and how to participate is critical to success.

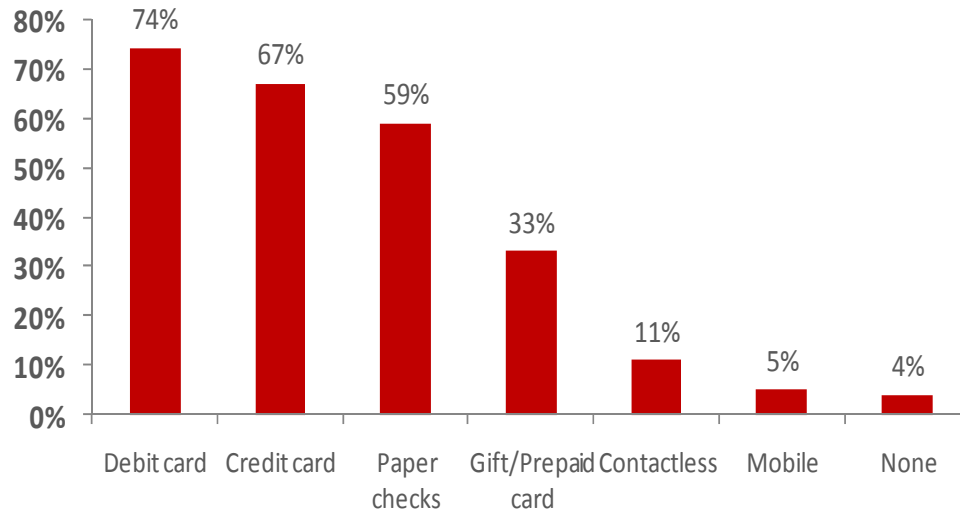


Key Considerations

- Consumers will likely choose the options that are the most convenient and bring them the greatest benefits
- Credit and debit card market share is shifting to other forms of payment, such as PayPal, iTunes, and mobile carriers
- Emerging payments options, such as PayPal, pose potential threats as well as opportunities

Consumers are making use of an increasing variety of available payments options and will likely choose the options that are the most convenient and bring them the greatest benefits.

**Payment Product Ownership
(2010)**



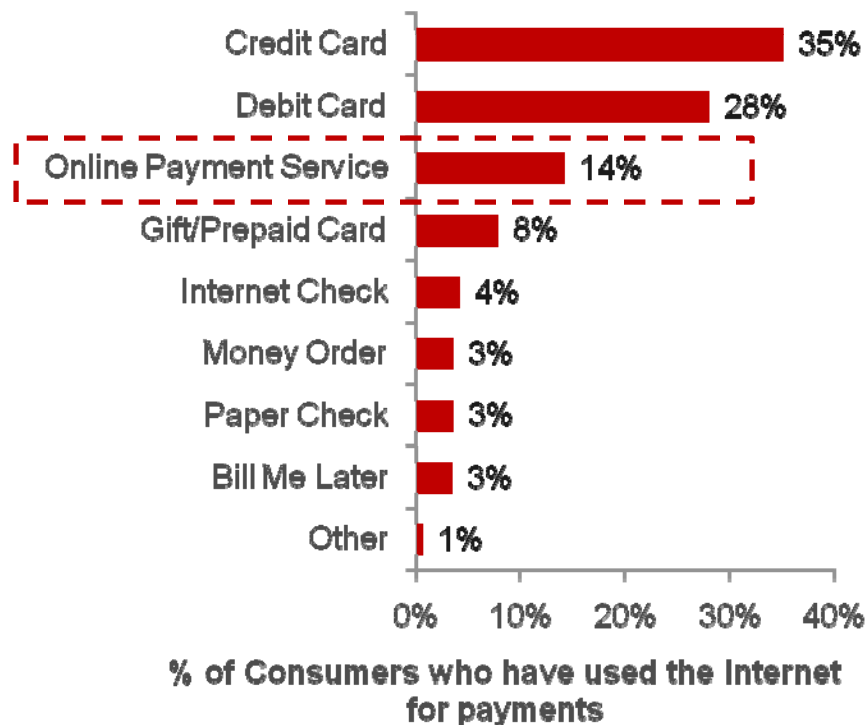
Perceptions of Debit vs. Credit



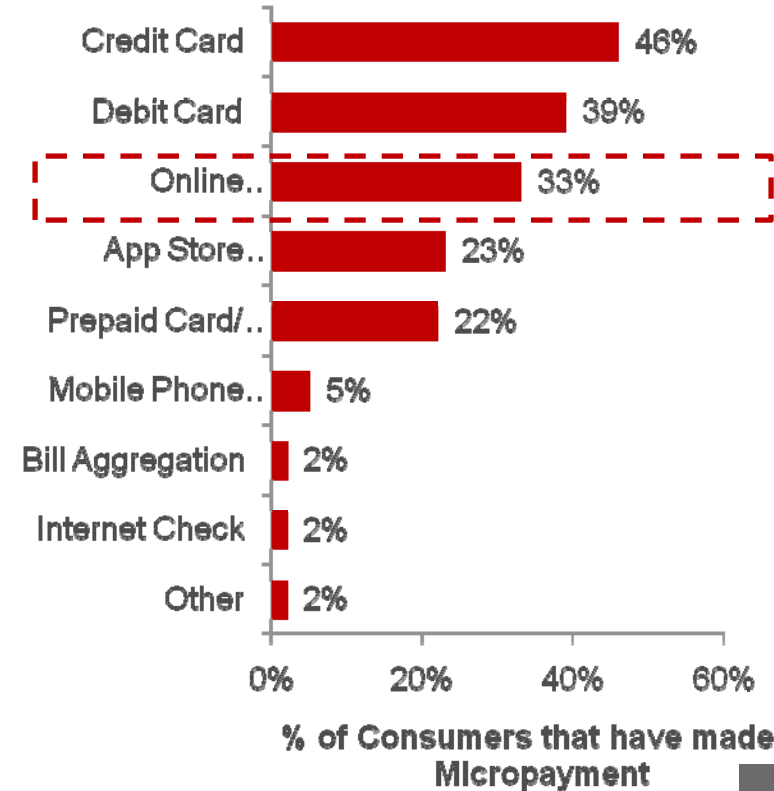
Note: Participants were asked to disclose all of the payment products that they owned.

Market share for online payment services, such as PayPal, has increased which could impact the ability of financial institutions to access and understand customer purchase data for marketing and risk management purposes.

Internet Payment Method Usage

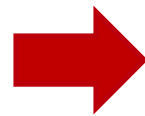
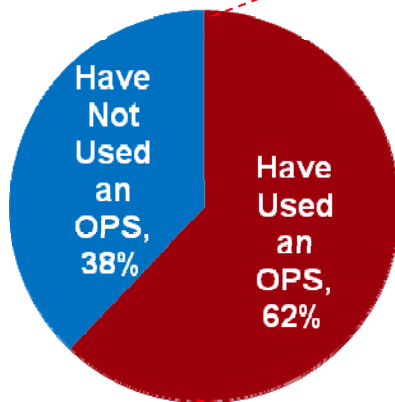


Use of Micropayment Methods

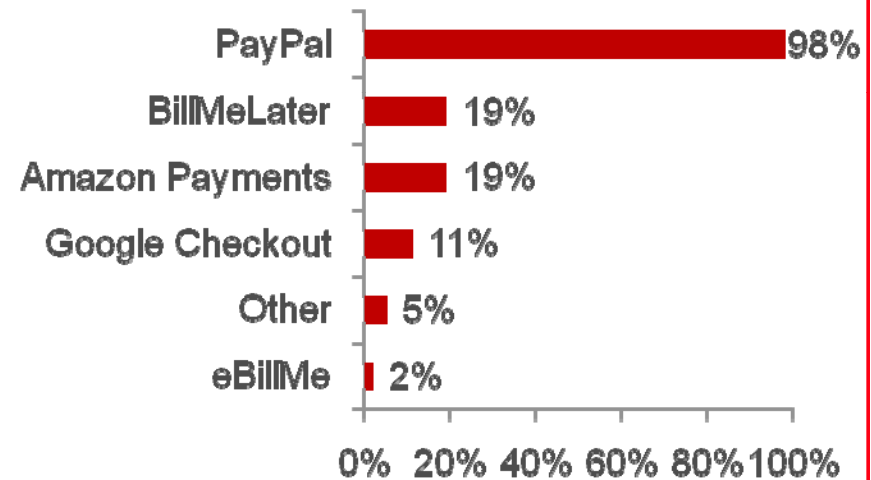


PayPal makes up the majority of online payment service transaction volume and has become a significant threat to other payment models as it begins to branch outside of the Internet for payment acceptance and usage.

Online Payment Service Penetration



Payment Method Penetration



Financial institutions need to determine whether PayPal is someone they need to resist or partner with

- Study Partners and Sponsors
- Introduction
- Overview
- Research Findings
 - Targeting the **Millennial Generation** is the key to growth in emerging consumer payments
 - Significant barriers exist to consumer adoption of **mobile payments**
 - Financial institutions can capitalize on understanding the different consumer preferences and biases between **credit and debit**
 - **Payment product proliferation** poses a threat to financial institutions
- **In Conclusion**

The questions posed by the 2010 Study and the resulting findings that we have presented today provide some specific conclusions that will benefit all stakeholders in the payments business . . .

Study Questions

- How are consumers paying today?
- Why do they make these payment choices?
- How will they pay in the future?
- What payment methods will gain at the expense of others and why?
- How have consumer payment preferences changed over the years?



Conclusions

- Debit is the preferred payment choice since 2008
- Consumers prefer debit due to convenience, ease of use, and budget control, but are not influenced by rewards
- Consumers expect to increase their usage of debit, credit, and online payment services over the next two years, this is especially true with the Millennial Generation
- Consumers have decreased the use of cash, checks and credit cards since their peaks in 2005
- Consumers are more concerned today about:
 - Spending restraint and staying within a budget
 - Safety and security as it relates to misuse of customer information
 - Fraud

. . . and as a result, key areas of focus for the next few years to generate income, make investments, and identify marketing initiatives to meet current and future consumer needs.

Study Objectives

- Develop strategies and tactics for generating income and increasing shareholder value
- Understand where to invest capital and resources for payments products and channels
- Identify differentiated yet surgical marketing campaigns geared towards current and future needs



Areas of Focus

- Develop plans to attract the Millennial Generation with products and services that have appeal to them, such as debit, micropayments, gift card, and perhaps mobile
- Delay major investments in mobile until consumers become more comfortable with safety and security features
- Continue to focus on debit, migrate customers away from cash and checks for purchases, and align operations with the declining volumes
- Seek out ways to level the field with potential threats, such as PayPal, by developing alternatives or partnerships with them to generate additional fee income

- Contact the Hitachi Consulting Team with any additional questions or to learn more about how Hitachi Consulting can help you apply information from the Study to help your market responsiveness:
 - Jim Neckopulos (JNeckopulos@hitachiconsulting.com)
 - George Simotas (GSimotas@hitachiconsulting.com)
 - John Hansen (JLHansen@hitachiconsulting.com)
 - Kim Allin (KAllin@hitachiconsulting.com)
 - Stanley Lam (SLam@hitachiconsulting.com)
- Sign up for the Hitachi Consulting *On Financial Services* newsletter to stay up-to-date on the latest FSI trends and their impact on your business (<http://www.hitachiconsulting.com/financial.cfm>)
- Thank you for the opportunity to present findings from the 2010 Consumer Payment Preferences Study to you today