
2013 ICBA Community Bank Payments Survey: Key Findings

About the Study

Since 2007, the Independent Community Bankers of America (ICBA) has conducted a biennial Community Bank Payments Survey, designed to track community bank trends and strategies in payments. This year's survey, sent to 7,000 community banks in June 2013, yielded 821 responses or an 11.7 percent response rate.

Key Findings:

Rising payments costs outpacing payments revenue growth.

Payments revenue bounced back from a lull in 2011; however, these increases in revenue were outpaced by rising costs.

On the consumer side, the percentage of community banks experiencing payments revenue growth increased above those that achieved revenue growth in 2011 (36 percent versus 31 percent) but remained well below the percentage of community banks that increased their payments revenue in 2009 (50 percent). In 2011, 7 percent of community banks experienced significant decreases in overall payments revenue and 10 percent experienced significant decreases in consumer payments revenue. In 2013, these figures were down to 4 percent and 1 percent, respectively, and were more in line with the 2009 figures of 2 percent for overall payments revenue and 2 percent for consumer payments revenue. However, increases in revenue are mostly driven by business payments products, where 42 percent of survey participants reported revenue increases in 2013 (up from 27 percent in 2011 and better than the 37 percent posted in 2009). Community banks with less than \$100 million in assets were least likely to experience revenue increases this year and were most likely to experience a revenue decline.

Simultaneously, payments-related spending rebounded, with 55 percent of community banks increasing spending this year compared with only 44 percent in 2011. Spending on consumer payments increased more than spending on business payments. While slight increases in spending were equal at 45 percent, 8 percent reported significant increases in spending on consumer payments compared with only 5 percent on the business side.

About ICBA

The Independent Community Bankers of America®, the nation's voice for nearly 7,000 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services. For more information, visit www.icba.org.

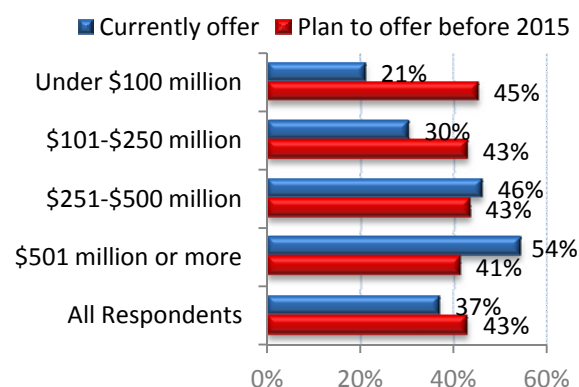
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Large community banks with more than \$500 million in assets were most likely to report increases in spending (68 percent), including significant increases (9 percent).

Most community banks have products and plans in place to compete in emerging payments.

The number of community banks that offer mobile payments is increasing, with 37 percent now offering mobile payments, an increase of 23 percentage points over 2011. Another 43 percent intend to offer mobile payments to their customers by 2015 (Figure 1).

Figure 1: Mobile Payments

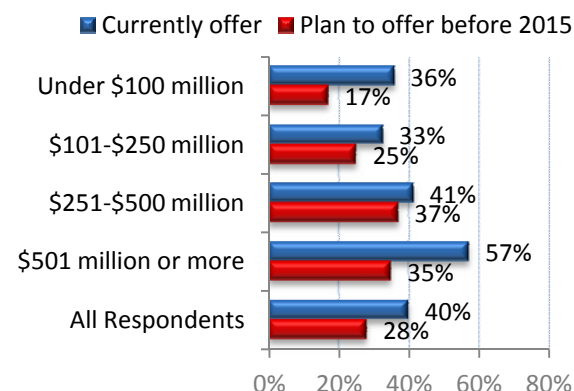


Larger community banks are leading the way, with the majority with \$501 million or more in assets offering mobile payments (54 percent). Banks with \$251 million to \$500 million in assets are not far behind (46 percent offer mobile payments). While only 30 percent of banks with \$101 million to \$250 million in assets and 21 percent of banks with less than \$100 million in assets currently offer mobile payments, more than 43 percent of smaller banks plan to offer mobile within two years.

Among banks that offer mobile payments today, 95 percent do so using a mobile app, 85 percent facilitate mobile payments via the Web and 36 percent continue to use SMS/text to offer mobile payments (a decline of 4 percentage points from 2011).

Electronic person-to-person payments (P2P) are now offered by 40 percent of community banks and present a slightly different adoption path compared with mobile payments (Figure 2). Large banks still lead the way at 57 percent, but 36 percent of banks with less than \$100 million in assets offer P2P, more closely in line with banks with \$101 million to \$250 million in assets (33 percent) and those with \$251 million to \$500 million in assets (41 percent). Only 28 percent of community banks planned to implement P2P in the next two years, with higher rates of planned deployment among larger institutions.

Figure 2: Electronic P2P Payments



The implementation of consumer remote deposit capture (RDC) seems to have peaked among community banks overall. The percentage of community banks offering consumer remote deposit capture declined 20 percent (down 5 percentage points from 2011 and just 1 percentage point above the level of 2009). Despite this downward trend, 43 percent of

community banks still plan to offer the service with the lion's share of RDC implementations (53 percent) planned by community banks with more than \$251 million in assets. While the majority of smaller banks have no plans to implement RDC – 57 percent of banks with less than \$100 million in assets and 50 percent of banks with assets between \$101 million to \$250 million – roughly one-third plan to do so. These results suggest that many banks have determined that the risks related to this product outweigh the rewards, while others seem to be waiting for the product to mature before making the decision to offer RDC to their customers.

While few community banks currently offer cards and/or devices with EMV chips, a significant percentage plan to do so within the next two years – 42 percent for debit cards, 27 percent for on credit cards and 18 percent for prepaid cards.

The evolution of payments: relationship-builder rather than revenue source.

Payments continue to be viewed as a revenue source, but not nearly to the extent it was in 2011. Only 59 percent of community banks say increasing profitability is one of their most important payments strategies, down from 70 percent in 2011. Only 46 percent now look to payments to create new revenue streams, down from 54 percent in the last payments survey. While many banks (55 percent) continue to see payments as a source of efficiency, a greater number now see payments as a way to improve customer service (up 5 percentage points to 52 percent) or create/improve customer access channels (up 9 percentage points to 45 percent). While still seen as the least important strategy by most community banks, some are using payments to penetrate target markets or expand their geographic footprint (both up 4 percentage points over 2011, to 12 percent and 11 percent, respectively). In short, community banks see payments as a way to build lasting customer relationships.

Responsibility for payments strategy moved out of the office of the president/CEO from 2011 to 2013, and into the hands of a SVP/VP, COO or CFO title at 57 percent of community banks compared with 53 percent in 2011. This could be a consequence of community banks in the study's sample growing in average size over the period. Few community banks have a chief payments officer. In terms of setting their strategic direction in payments, community banks are spending more time listening to their customers (55 percent in 2013 compared with 43 percent in 2011). Community banks most frequently describe their approach to investing in payments products and services as "customer driven" for both consumers (30 percent) and businesses (31 percent).

Profitability does not necessarily correlate with importance. Online bill payment is described as unprofitable by 50 percent of respondents but rated as important by 88 percent. Mobile payments are described as unprofitable by 43 percent of respondents but rated as important by 73 percent.

Debit cards are seen as essential to community banks' customer relationships with 99 percent rating them as important and 87 percent rating them as very important.

Community banks are responding to their customers' overdraft needs.

The ICBA survey results suggest that community banks are responding to their customers' needs with respect to overdraft services and altering their products accordingly. A smaller percentage of customers are choosing to opt-in to ATM and point-of-sale debit card coverage (49 percent, down from an average of 57 percent in the 2012 ICBA Community Bank Overdraft Study) and fewer community banks offer overdraft coverage for ATM and POS debit card transactions. Only 56 percent of community banks provide coverage for ATM and POS debit card transactions, down 20 percentage points from 2011. At the same time, average opt-out rates for coverage of checks and ACH transactions have also increased to 35 percent, up from 25 percent in 2012 and 22 percent in 2011. This suggests consumers are making effective use of their options to utilize only the overdraft services that are right for them.

Transaction processing has changed only slightly since the 2012 ICBA Community Bank Overdraft Study was conducted. Transaction types continued to be processed in a typical order, with deposits (87 percent) and ACH credits (82 percent) processed first or second, POS debit card transactions (69 percent) and ATM withdrawals (68 percent) processed third or fourth, and ACH debit (59 percent) and check transactions processed (82 percent) fifth or sixth. Community banks that diverge from that order typically push ACH debits further up in the clearing process. More community banks are processing checks in the order they were received (25 percent, up from 14 percent) with a matching decline in processing checks from low-to-high transactions amount (33 percent, down from 40 percent) and check number order (33 percent, down from 35 percent). Checks are processed in order of high-to-low transaction amount by 8% of respondents.

While overdraft services continue to be an important revenue source for community banks, 32 percent rated overdraft as very profitable, down 10 percentage points from 2011. The majority (52 percent) rated their overdraft services as somewhat profitable. Community banks continue to see overdraft as one of their most important payments products, with 83 percent rating it as important and 38 percent rating it as very important.

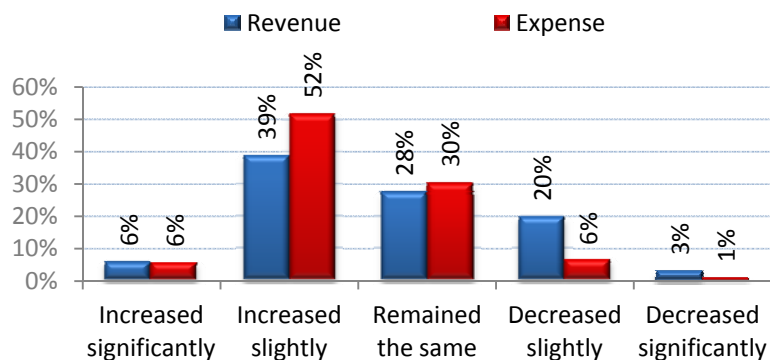
Automated overdraft services are offered by 26 percent of respondents while 20 percent offer hybrid services¹. Roughly half (48 percent) pay overdraft transactions on an *ad hoc* basis while 5 percent of community banks indicate they don't pay any overdraft transactions. The percentages of community banks that offer alternative services were consistent with previous findings: 65 percent offer transfers from a line of credit, and 90 percent offer transfers from another deposit account to cover overdraft transactions.

¹ An automated application that analyzes and suggests approval of overdrafts for payment which are then analyzed by a bank employee for a final decision.

Debit card costs outpace growth in revenue.

Payment card-related expenditures increased while generated revenues remain unchanged for many community banks (Figure 3). Community banks are more likely to see increases in expenses related to their debit card program (58 percent overall) than in revenue from debit cards (45 percent overall). Large community banks with more than \$500 million in assets are outpacing other asset size peer groups with their ability to increase revenue from debit cards (67 percent overall, 19 percent significantly).

Figure 3: Debit Card Revenue and Expense Trends



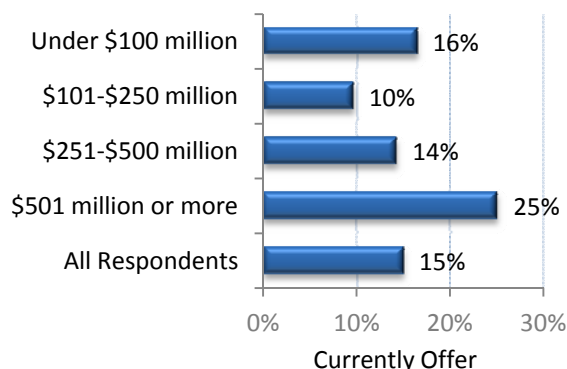
While most community bank debit card programs remain profitable, community banks rate their programs as somewhat profitable (62 percent) with relatively fewer banks rating their program as very profitable (17 percent).

Changes in payment cards: the decline of gift cards marks the rise of GPR prepaid cards.

Fewer community banks now offer prepaid cards with only 39 percent indicating they would offer prepaid cards, down 10 percentage points from 2011 and down a whopping 30 percentage points from 2009. For most community banks, prepaid cards still mean gift cards (35 percent of banks overall offer prepaid gift cards).

Figure 4: General-purpose Reloadable Prepaid Cards

While all other types of prepaid cards are in decline, general-purpose reloadable (GPR) prepaid cards are on an upward trend (Figure 4). Among all community banks, 15 percent offer GPR prepaid cards, up 4 percentage points from 2011. Community banks that offer GPR prepaid cards consider them to be slightly more profitable and slightly more important to their consumer relationships than those banks that do not offer those cards.



However, prepaid cards still rank at the bottom of the profitability and importance tables. The percentage of community banks not planning to offer prepaid cards in the future is up to 46 percent. Among those banks that do not offer prepaid cards, most cite a lack of customer demand (74 percent), regulatory compliance concerns (45 percent) or lack of profitability (36 percent) as reasons.

Other Notable Findings:

Increased regulation threatens community banks' payments strategies.

The increased costs of compliance continue to threaten the development and success of community banks' payment strategies. However, the percentage of banks citing it among their top three threats to their payment strategies was down 9 percentage points from 2011, to 68 percent. While community bank interchange revenue has yet to significantly decrease, there are signs of a long-term erosion of interchange revenue resulting from the interchange fee cap and exclusivity-and-routing provisions contained in the Durbin Amendment.

"Free checking" still offered at most community banks, but on the decline.

Most of community banks (84 percent) offer "free checking" – a basic demand deposit account with no monthly account maintenance fee. But some banks (18 percent) are planning to reevaluate this product in the next two years. Nine percent used to offer free checking but no longer do so. Only 7 percent of banks have never offered a "free checking" product. Most community banks (64 percent) offer fee waivers for minimum balances. Among free checking accounts mentioned above, 12 percent limit check-writing privileges, but only 5 percent do not have checks at all.

Card/check fraud: an ongoing challenge for community banks.

There were no changes related to fraud losses on payments cards since the 2011 ICBA Community Bank Payments Survey. Once again, nearly every bank surveyed was affected by debit card fraud losses, with 94 percent indicating they have suffered a monetary loss due to debit card fraud. The percentage of respondents reissuing debit cards as a result of these losses, however, was down to 84 percent in 2013, compared with 92 percent in 2011. On average, community banks reissued 11 percent of debit card portfolio. Debit card fraud equally affected all community banks, regardless of their asset size.

Card rewards and benefits vary by card type.

Community banks differentiate account features among their card products. Roughly half (46 percent) of community bank credit card programs have a point-based rewards program, while only 16 percent of debit cards and 1 percent of prepaid cards feature rewards. Credit cards also incorporate travel/entertainment discounts (15 percent). Around one-third of community bank debit cards offer third-party ATM surcharge reimbursements as a feature. Debit cards and credit cards are near parity when it comes to features such as identity protection (13 percent and 12 percent, respectively) and merchant discounts (8 percent for credit cards and 6 percent for debit cards).

Community banks ease the pain of ATM fees for customers, deploy new ATM technologies.

Community banks charge non-customers and average of \$2.40 per transaction to use their ATMs and charge customers an average of \$1.50 per transaction to use third-party, out-of-network ATMs. Almost half (48 percent) of community banks belong to a fee-free ATM Network. Functionality at community bank ATMs varies – 55 percent offer envelope deposits on all or some of their ATMs while cash deposit is offered by 22 percent and slated for implementation at 7 percent of community banks. Check image deposit is offered by 13 percent of community banks and an additional 12 percent plan to implement this functionality within two years. ATMs are not a profit center with only 46 percent indicating they are profitable. However, they are seen as essential to the community bank's customer relationship, rated important in this way by 94 percent of community banks.

Changes in payment cards: Credit cards – why risk it?

Fewer community banks are offering credit cards (67 percent, down 7 percentage points from 2009) and, among those that do, fewer are underwriting, funding and assuming credit and fraud losses on the credit cards they offer (31 percent, down 5 percentage points from 2011). MasterCard card issuings are offered by 34 percent of community banks, an increase of 3 percentage points since 2011. Visa card issuings are down by 3 percent, but are still offered by 87 percent of community banks.

Electronic payments usage continues to eclipse paper checks.

In 2013, community banks reported only half (50 percent) of their transactions were check transactions (paper or imaged), down 5 percent from 2011. For community banks with more than \$250 million in assets, the majority of their transactions are electronic (more than 51 percent). For community banks with less than \$250 million in assets, the majority of their transactions are still checks (48 percent electronic transactions). Community banks still see checks as one of the most important payments instruments, with 92 percent rating them as important and 55 percent rating them as very important.