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THE AGENDA IN 2009

by Harold Montgomery

2008 was a tough year in many respects. Retail chains had a tough time and many Mom and Pop stores I have spoken with faced more uncertainty than ever. The financial crisis began to trickle down to consumers and hasn't stopped working its way through the economy. I am looking forward to 2009, because it's one step closer to whatever normal is going to be in the future. As I think about what's coming this year, there are four main areas I will be watching.

Unemployment and Consumer Debt Performance

Unemployment directly affects the two main classes of consumer debt – credit cards and home mortgages. Unemployment has been inching up during the fall and winter, and some analysts predict it will hit 7.5%. That's a bad number, but if it goes higher, there's real trouble ahead. Keep your eye on unemployment figures.

Consumers start 2009 with almost \$1 trillion of credit card debt in addition to home mortgage debt. Quite a bit of that credit card debt is bad. Charge-offs were up to 6.9% by mid 2008 and rising. As a result, issuers have been pulling back on marketing initiatives and underwriting standards – two big drivers of volume on the acquiring side of the business. For

years, the acquiring side has benefitted from issuing's aggressive marketing and underwriting. As issuers scale back, it won't help drive volumes on the acquiring side of the business.

Citicorp certainly has its share of problems and has raised interest rates on about 20% of its cardholders by as much as 3% per year on carried balances. Citi also lowered credit lines for many cardholders. Simply put, that means less money that consumers can access and what's there will cost more. Issuers will continue to be cautious if unemployment rises and consumer credit weakens further.

According to a recent Wall Street Journal article, more than 12 million homeowners owe more than their home is worth. Apparently, half that number owe more than 120% of the current home value. I don't tend to get panicky about this number as long as employment numbers are solid because house prices will increase over time. These homeowners need to hang on until housing values recover. Over a 10 year time frame they will be fine. If they have to liquidate their homes in the meantime, there will be difficulty, but there are programs in place now to mitigate this problem.

Retail Sales

Retail sales in 2008 were weak. Some chains like Macy's, Abercrombie and others reported double digit sales drops from September/October 2008 compared to 2007. The weakness was most obvious in geographic areas hardest hit by the subprime mortgage meltdown. Car sales or other heavy capital goods that require financing were literally a disaster toward the end of 2008, and 2009 won't recover until consumers can finance a new car purchase. That could take well into 2009. The consequences for the country are truly unknown because so many industries depend on the car business. The ripple effects from this meltdown are real and serious and there's not much to do except watch.

It's hard to tell what happened with small retailers toward the end of the year. Some I spoke with said sales were flat from last year, others that sales were down by single digit numbers. Restaurants and other discretionary spending categories seem to have suffered more than hard goods. Recession or not, people need to buy clothes, but they don't need to eat at restaurants. For an ISO focused on restaurant or leisure, now would be a good time to develop another vertical market niche to balance the portfolio.

Continued on page 9

THE AGENDA IN 2009

Continued from page 8

Legislative Initiatives

I am expecting legislative initiatives regarding interchange and issuing practices to revive under an Obama Administration and a Democratic Congress. The Congress has been considering changes in credit card issuing practices which are more favorable to consumers. These changes come at a bad time for issuers, but they're going to be politically popular in a recessionary period.

Interchange will be back on the Congress's agenda as well. Expect some action on at least one of the various bills that came up in 2008 which move toward limiting interchange fees. Interchange reduction is popular with a well-organized group (retailers) because it puts more money on their bottom line. The political message on interchange reduction is different, however, and suggests that a reduction in interchange will result in lower prices to consumers. I think the retailers will tend to get the benefit of interchange reductions, not consumers.

ISO Competitive Forces

These trends mean that the ISO business becomes more and more competitive in 2009. If the natural factors which have lifted credit card usage and therefore ISO revenues over the years weaken, then we could be in for a difficult year. Since I started in the business 22 years ago, this is the first year I have seen issues serious enough to diminish revenues on the acquiring side of the business.



Many ISOs are staffed and set up for growth, but revenue growth will be hard to come by. ISOs should have contingency plans that take into account the changing circumstances and the possibility that revenues may be weak and that merchant attrition could go up.

It's a good year to make your operation lean and get ready for growth to come back in 2010. Retail won't stay down forever and you want to be well-positioned when it comes back. Small retailers who don't make it through 2009 will open market niches for new stores and that means more ISO opportunity. The great thing about our economy is its powers of renewal. Things get tough, and the weak succumb, to be replaced by new concepts. Keep an eye out for the new tend setters and growth opportunities being born in the middle of a recession.

Correction

In my article entitled "The Candidates, Taxes, and the ISO World" I included a

pro forma calculation of the tax impact of a portfolio sale. In an email to me, reader Thomas Lambert pointed out that I made a mistake in the calculations: "As stated in the article, it is proposed that the top rate for income above \$349,700 is projected to increase from 35% to 39.6%. An increase of 4.6% (the article states the increase is 4.9%, which is also incorrect). But the article totally fails to take into account the fact that income under \$349,700 is completely unaffected and remains taxed at the current rates. The result of this error in the article is that the projected increase is calculated as $4.6\% \times \$500,000 = \$24,500$. This is wrong. The increase applies only to the amount above \$349,700, which is $\$150,300$. So the correct calculation is $4.6\% \times \$150,300 = \$6,914$."

I am grateful to Mr. Lambert for pointing out my error, and I apologize to my readers for this mistake. ■

Harold Montgomery is the CEO of Calpian, Inc., a Dallas, Texas-based provider of financing opportunities to merchant acquirers. In 2008 Montgomery submitted expert testimony to Congress regarding Acquiring Industry Legislation, including the Credit Card Fair Fee Act of 2008 (HR 5546.1H) and the Credit Card Interchange Fees Act of 2008 (HR 6248 introduced June 11 by Rep Peter Welch, D-VT). In August 2008 Montgomery was named the most Influential Acquirer by Transaction World Magazine for 2008. You can contact Harold at 800.589.1173 or portfolio@calpian.com.

