The Future of Consumer Payments: An Insider's Perspective

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Good morning. It's a pleasure for me to join you to discuss the payments industry. You'll be hearing several perspectives today from a number of distinguished speakers, and it is an honor for me to be among them.

I have spent my business career within the payments industry so what I hope to offer you today is an insider's perspective.

The payments industry that I know is both global and dynamic. It is without a doubt a highly competitive industry, one that is rapidly innovating and evolving. It is an industry that exists in various stages, largely depending on geography. In some markets customer needs are simple. Products are basic and providers are few. In other countries customer demands are greater. Products are high tech and the competitive landscape is quite diverse.

But, regardless of its evolutionary stage in any given market, the purpose of the industry remains the same: to facilitate the conduct of commerce and improve the efficiency of day to day transactions among consumers and businesses.

As we all know, the global environment is evolving at an accelerated pace, not just for payments but for all businesses. So, even though I know my industry well, I also know that to stand here today and attempt to predict the future of payments is an assignment fraught with peril. I'll concede right up front there is no crystal ball in my office in New York. We have no psychics on retainer. But, while I can't predict the future with certainty for you today, I can offer you my perspective on trends that are currently underway across the industry, trends that will likely shape the evolution of payments over the short, medium and long-term.

Before I look ahead, however, I want to first take a moment to look back – specifically, to look back to how American Express became a payment company. Now, while I'm always on the lookout for opportunities to showcase our employees and our company, let me assure you this history lesson is not intended to be self-serving. It is relevant to today's topic because I believe American Express' own history offers insight into how the overall industry has evolved and how, even today, it continues to reinvent itself to meet, or anticipate, the needs of customers.

Our founders include two names that are familiar throughout the business world: Henry Wells and William Fargo. In 1850 we opened our doors as an express company, a freight company. We moved packages and currency for people across states and across territories. Think Federal Express with stagecoaches and that was us.

As the United States expanded during the latter half of the 19^{th} century so did the needs of our customers. American goods and materials were not just being shipped between states, but to the rest of the world as well. In response, we expanded our own corporate geography, setting up freight offices in a number of international capitals. As the country prospered, more and more Americans wanted to see the world, so we formed a travel agency to help them go overseas.

International journeys, whether for cargo or people, also had to be paid for. At this point in history there was no means of payment that could easily cross borders, so we created our own, inventing both the American Express travelers cheque and the money order.

By the 1950's customers demanded greater financial flexibility, both at home and while traveling. To meet this need we launched our first charge card in 1958. And this year, we're proud to celebrate the 50^{th} anniversary of our Card.

As a former history major, I always look for ways to learn from the past. And while I've gained many insights by studying my company's 158 year history, 2 are relevant for today's conversation.

The first is the importance of driving change, not only in your own company but also through your industry. We've shown the flexibility and resolve to reinvent ourselves, adapting to customer needs and to a changing marketplace. Given the dramatic pace of change we're seeing across the industry today, this capability is clearly an important asset for any payment company to have.

My second takeaway is that, at its core, the payments business is dependent on a very basic element – trust. Trust that your payment will be correctly handled. Trust that your interests and assets will be protected. Trust that someone will be there when you need help. Whether its shipping gold from New York to San Francisco, having a merchant accept a travelers cheque half a world away, or using a credit card to make an online purchase, payments is clearly a trust business.

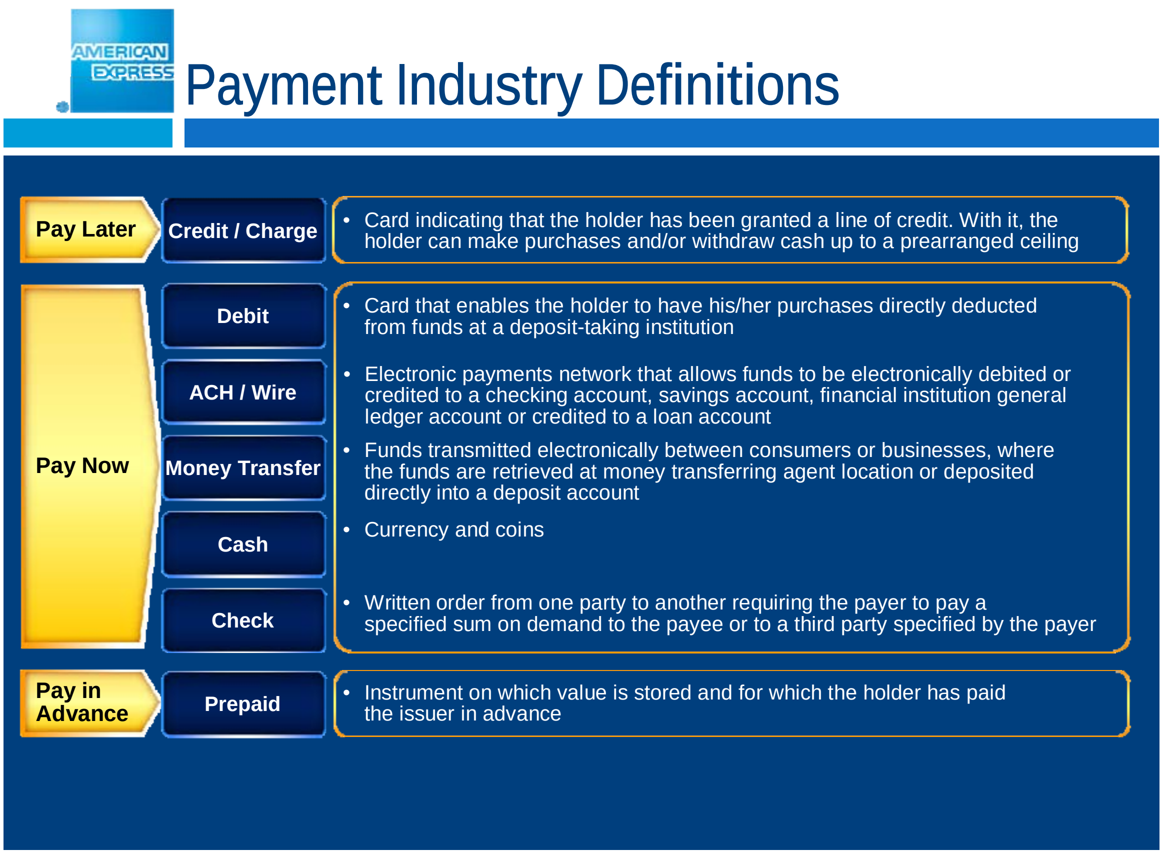
Now I will acknowledge, upfront, that confidence in the payments industry has eroded over the last couple of years. The credit card industry in particular has fallen short of the mark in some of its practices, and any assessment of the future of payments must recognize this. The Federal Reserve Bank and other regulators are working to address specific card practices, and I compliment them on their efforts. As I'll discuss later on, I recognize and support their hard work in striking an appropriate balance to protect consumers without curtailing the innovation and competition that exists across the industry.

Now, before discussing some of the trends currently underway across payments, let me first offer up some basics on the industry. The term "payments" may sound simple, but it actually covers a lot of ground. The industry today offers extensive choice. Payment transactions can involve a number of parties and take a number of forms, ranging from simple to complex.

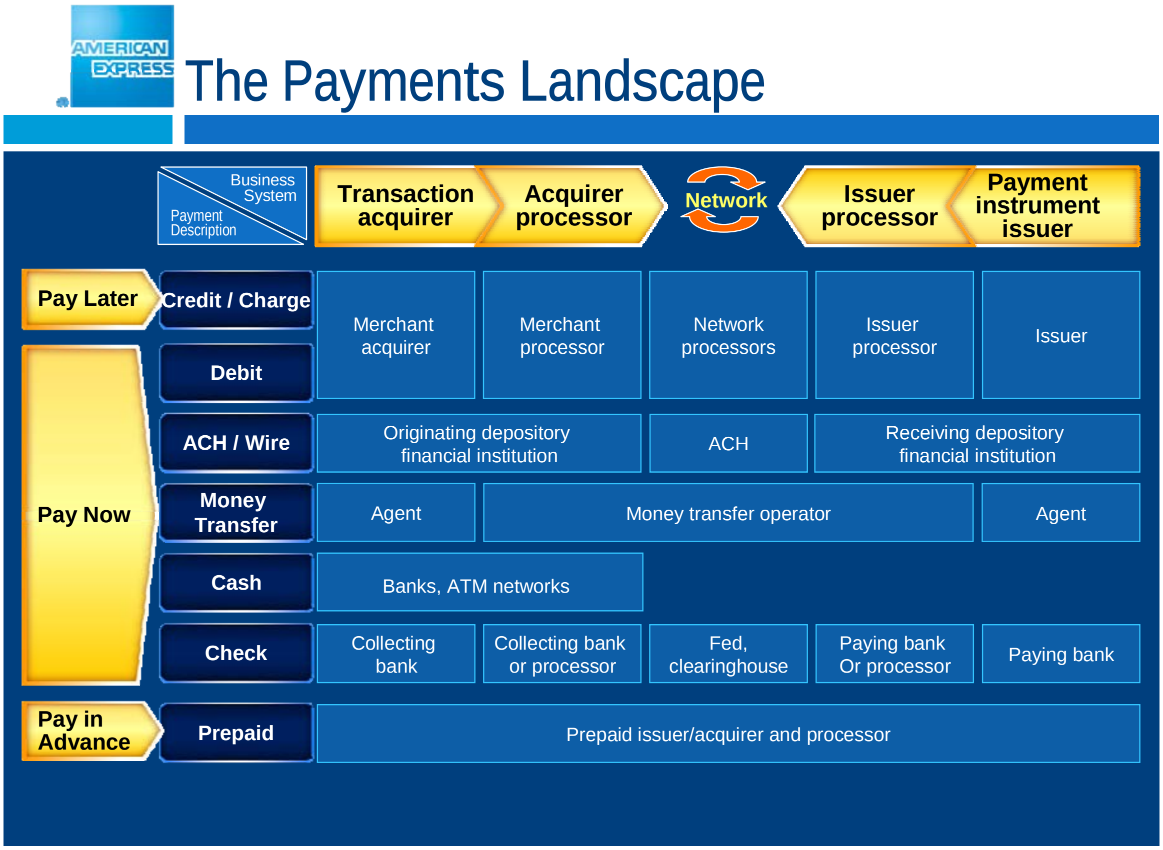
For a basic transaction between a buyer and a seller, customers can choose to pay now, pay later or pay in advance. Within each category there are then many choices of product. For example, if a buyer wishes to pay at the point of sale, they can use cash, which involves only the buyer and the seller. Or they can pay by check, which typically involves 5 parties: the customer, their bank, the seller, the seller's bank and the Fed. Or they can use a debit card, which involves a seller, a buyer, their banks, a debit network, and potentially a processor or two.

Given the broad array of choice in a typical developed market, it can be hard to keep track of what the term "payments" actually includes, so here are a couple of cheat sheets that may be helpful as you listen to our panels of experts later this morning.

First there are basic product definitions, depending on whether a payment is made now, later, or in advance. Covering everything from wire transfers to credit cards, you can see that payment users have a range of options.

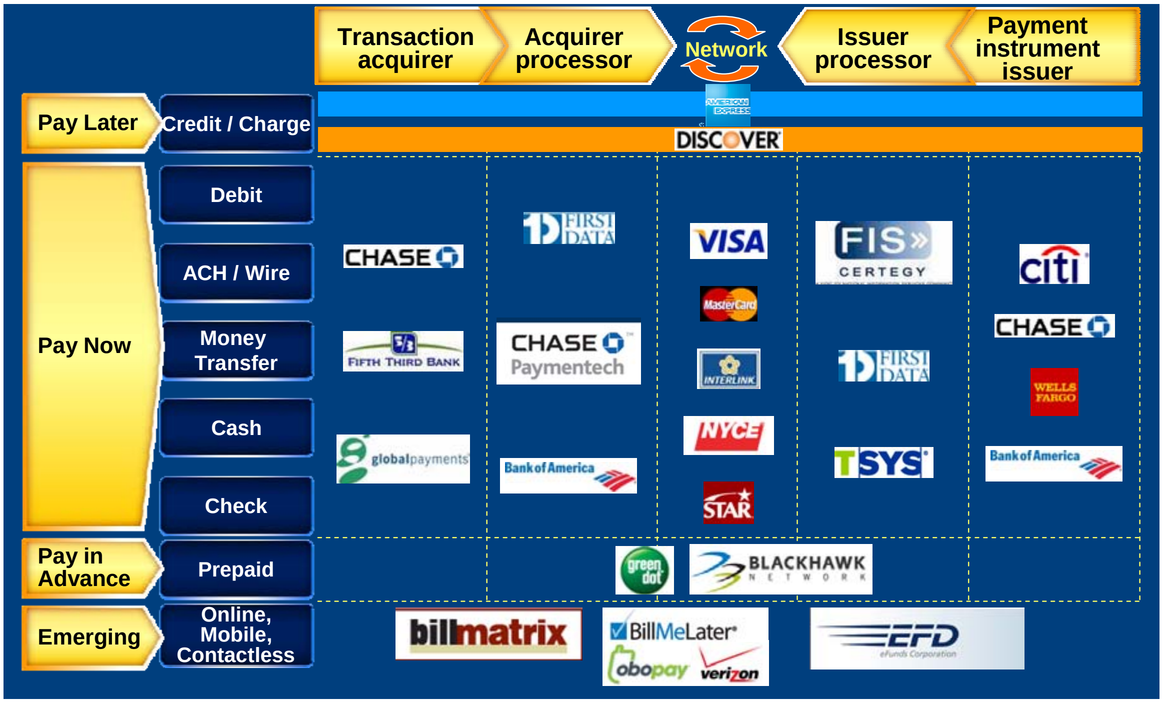


Over the past few years, I've also added an overlay to this list, that of emerging payments, which can cover all types of transactions. Payment companies, such as my own, along with other providers and technology companies, are developing new products and access devices that rethink traditional formulas. Online products, mobile devices and contactless payments – to name just a few – are responding to, or oftentimes leading, customer demand. In many cases these innovations are improving the ease and efficiency of customer transactions and they clearly have the potential to significantly impact the industry.



Another basic fact about payments is the diversity of its participants. There are many players across the industry, from large companies, providing multiple products and services, to specialty processors who perform a single function. Here's another cheat sheet of mine, which gives examples of the various parties involved in different types of transactions. In some cases, including the customer and the merchant, there can be up to 7 different participants or companies touching a single payment transaction.

The Payments Landscape – Company Examples



Just to provide perspective, here are examples of some larger players within each of these product and processing categories in the U.S. As you can see, in most cases payment transactions are sliced and diced among many companies and processors. Some have a niche within a specific area of processing and look specifically to expand their volumes and scale. Others focus on the end user, offering value and services to the payment customer – be it a consumer or a business.

Looking across this landscape, American Express and Discover are the only providers that have a material presence across multiple pieces of any payment chain. Both of us issue products, acquire merchants, process transactions and operate networks.

In our business model, for example, our objective is to serve high-spending, affluent cardmembers, providing them with premium value such as through rewards or unique merchant offers. At the same time, however, we look to improve our operating efficiencies by growing our volumes and expanding our scale. Being an issuer, acquirer and processor gives us the flexibility and means to invest in and implement a wider range of innovations and therefore meet a wider range of customer needs.

Now, this is, of course, just a snapshot of the industry today. Over time, new competitors will certainly join the marketplace, particularly in the emerging areas I mentioned earlier.

Already companies such as Verizon, BillMeLater and PayPal are adding innovations and options to the industry and to customers. Given the global growth underway across payments, there is clearly room for new approaches, and I expect new providers, technologies and geographies will further expand the marketplace.

Beyond new entrants, I also expect that we'll see more partnering across the industry. Participants will partner with each other to develop new features and technologies that can provide customized services with maximum efficiency.

Now, some people here today may not view payments as a growth industry. Maybe you saw announcements from some of my U.S. peers that they were diversifying into other product lines because they consider the U.S. credit card industry to be mature.

That's one view, but I believe it is a narrow view. It only considers one payment product within a range of product options; it only considers one market across a vast global map.

I hold a different view. I believe the payments industry as a whole offers a tremendous amount of long-term potential for reasons that fall into three categories: product penetration, technology, and geography.

There's not always a clean break across these growth drivers, but here are some examples of what I'm seeing.

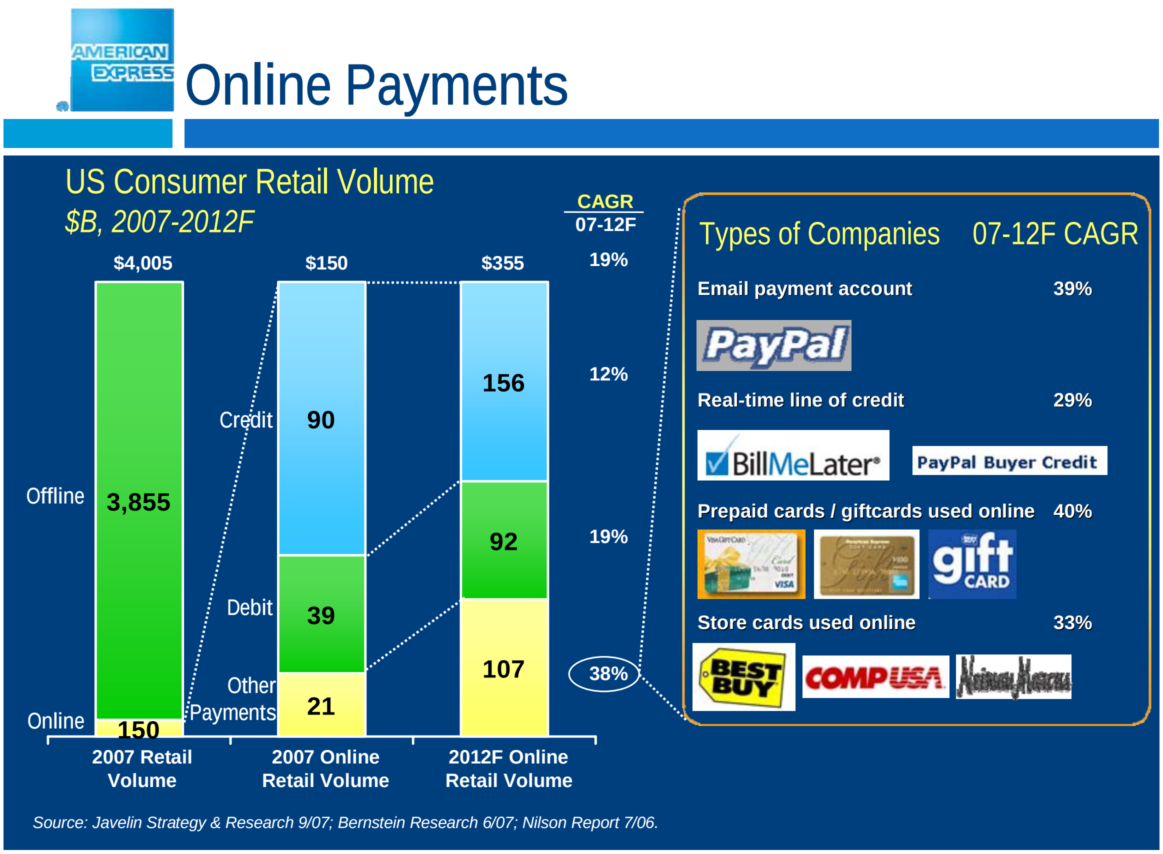
First is product penetration. Even within a developed economy such as the United States, electronic payment products still have a lot of unused runway. Among U.S. consumers, it is estimated that cash and checks still account for more than 55% of spending. For U.S. small and mid-sized businesses that number is 85%.

This translates into two business opportunities. For a product provider like American Express it means the chance for increased volumes, particularly as specific industries such as healthcare and raw materials move to accept plastic. For the financial system as a whole, it means the opportunity to further improve processing efficiencies and drive down costs by taking even more paper out of the pipeline.

The second trend that will drive growth in electronic payments is technology, the most significant example of which is the internet. For years futurists have been talking about the inevitability of a cashless society, one where a swipe or a tap will buy you a newspaper or a morning bagel. The payments industry as a whole is clearly making strides in this direction. But consumers aren't concerned with meeting predictions and, as a significant number of product pilots have shown over the last few years, they remain committed to cash for certain purchases. Just as the futurists of 50 years ago thought we'd all be in flying cars by now, a cashless society is another prediction that seems to be falling by the wayside.

The exception to this is the one truly cashless society that exists today – and that is the virtual world. Cash and checks are essentially non-players when it comes to the internet, so anyone conducting business online is automatically driving the growth of electronic payments.

Online commerce will continue to grow robustly over the next five years, albeit at a somewhat slower rate than the adoption years of the late 1990's. And this growth in online spending will clearly drive growth in payments. Here's one example from the U.S.



In 2007 U.S. retail consumers spent $150 billion online, a large number, but still a small proportion of their total spending of $4 trillion.

But, while cash and checks still account for a majority of consumer offline spend as I noted before, their online spend is 100% electronic. With online purchases expected to grow at a compounded rate of 19% between now and 2012, the opportunities for payment providers will expand significantly.

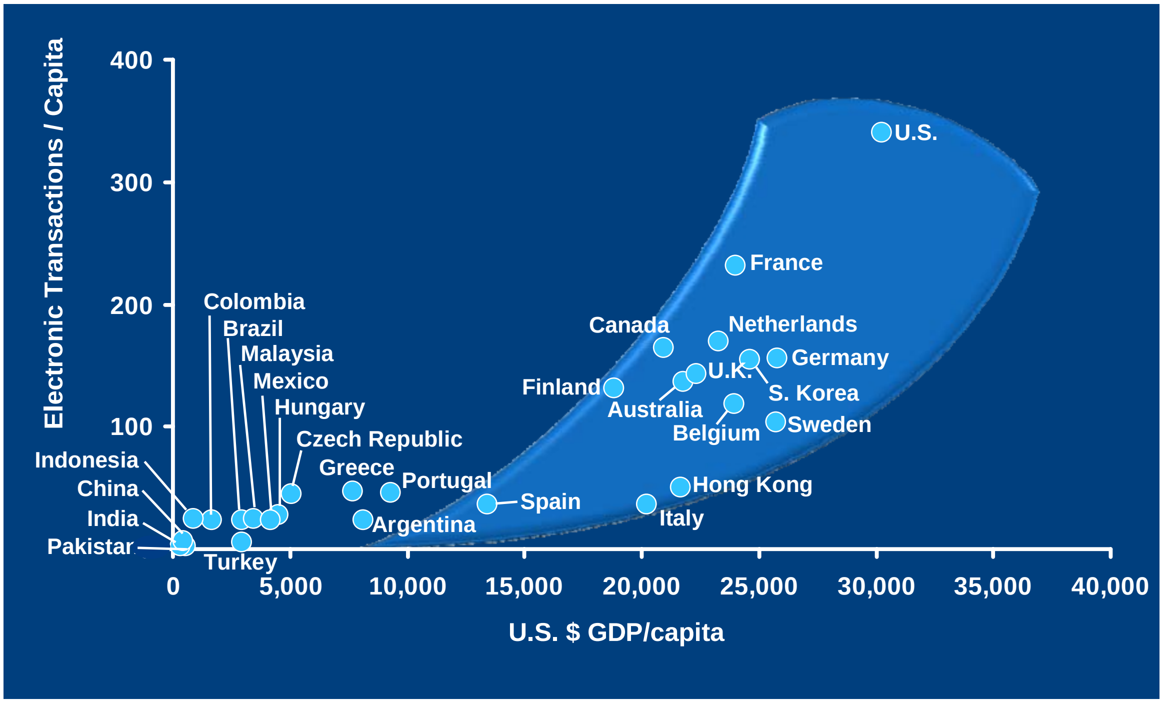
This sizable business opportunity is attracting a significant number of new players into the field, with retailers themselves, real time credit products and companies such as PayPal joining traditional credit and debit providers. This competition is bringing innovation, efficiency and growth into the payments marketplace, something we all benefit from.

The third trend that will drive the growth of payments over the medium and long-term is geography.

While certain developed economies have been using some form of electronic payments for years a number of significant economies continue to be primarily cash-centric. Among this group are the BRIC countries, which offer the broad opportunity of high economic growth, along with specific opportunities in payments.

Economies evolve differently as they develop, and that will no doubt be true for a number of these cash-centric markets. For example, new technologies may make it possible for countries such as China or India to skip the steps taken by Western economies. Instead of progressively moving from cash to checks to plastic, advances in wireless telecom may allow them to vault past the need for a physical card or check and go straight to an electronic account number. But while their devices and means of access may differ from other markets, I believe their overall development will follow a consistent trend.

Payment Growth vs Per Capita Trends



Even allowing for differences in culture and technology, this trend is quite clear. It has consistently been seen that as per capita GDP increases within a country, the number of electronic payments rises substantially. As a country's educational levels rise, as personal income grows, as technology becomes more broadly available, the use of electronic payments expands, all of which highlights the growth potential of the markets on the left side of the chart.

As a payment provider I look at the size and scope of this opportunity and want to attack it immediately. But then I quickly recognize that income growth alone will not be sufficient to drive growth in payments.

Because, as I said a few minutes ago, the payments business is not just about transactional capabilities. It also depends on trust.

Businesses and consumers are not going to generate the level of growth implied here without trust. And not just trust in payment providers such as American Express, but also in a wide array of people and institutions including taxing authorities, the banking system, the currency market and regulators.

Moving away from a cash based economy requires a basic level of government and corporate infrastructure. It requires a popular belief in the equity of national policies and their fair implementation. Without these basics in an economy even the most innovative payment product will have trouble competing with the proverbial cash under the mattress.

But more important than the impact on the payments industry is the greater impact on the country itself. Without trust in the basics, economies can be hampered, the potential of a society will be limited and individual growth and productivity can be restrained. This trust is essential. It is a prerequisite to generating and sustaining any degree of long-term economic growth.

As someone who heads a large global payments company, I spend a lot of my time on technology investments, processing costs and telecom capabilities. But one of my more significant roles is to be a steward of the American Express brand. Given our long history, we have a unique legacy to uphold. A legacy of service, of quality, of integrity. As a result we place a great deal of importance on this fundamental idea of trust. My view is that, while the global payments system must be open and flexible enough to allow for many different players, it must always be based on integrity and trust.

Payment providers therefore must be accountable for living up to relatively high standards. Providers who undermine trust clearly limit their own growth potential. For example, I don't believe a company has much of a future if it earns the majority of its revenues when customers make a mistake or don't conform to a rule. "Gotcha" pricing is not the way to build a sustainable business model, or to maintain long-term customer relationships and trust.

I believe a company's long term health is only assured when customers receive value for their money and feel they are treated well. At our company, we do take action when customers fail to pay their accounts on time or bounce a check. But, as I said earlier, because of our brand and our desire to retain customer relationships, certain practices don't make the cut.

For example, universal default. This is the practice of raising the interest rate for a customer on your own product because they're delinquent paying someone else. They remain current with you, but their rate gets raised because of problems with another lender.

A number of companies adopted this practice and generated higher short-term revenues as a result. But we made a conscious choice several years ago not to implement this practice across our card base. To us, it just didn't feel right.

Universal default and a number of other practices have attracted criticism to the industry. And, as an industry, we must respond to these criticisms if we are going to restore the trust necessary for a healthy marketplace that can foster innovation and long-term growth.

Government plays a critical role in bolstering public confidence by maintaining a reliable and balanced regulatory framework. As industries change and evolve so must this framework.

An example of this is the work currently underway at the Federal Reserve and other regulators to update rules governing the credit card industry and to strengthen consumer protections. We may not agree with all of the proposals being considered by the Fed, but we do recognize why they're taking these actions and we support their efforts.

The new rules being proposed by regulators are sweeping, and they will mark the most important regulatory change for our industry in at least twenty five years. It is our hope that these changes will bolster trust – trust in the regulatory system and trust between consumers and payment providers.

We believe regulators recognize the need for balanced action and the industry's concerns about unintended consequences. We believe the Fed will be open to industry comments and that their final guidelines will appropriately protect consumer interests while at the same time supporting appropriate access to credit within a competitive marketplace.

Our mutual goal needs to be to stop the abuses that exist today, strengthen consumer confidence, and to do so without impeding the growth and development of innovation, choice and value that will benefit customers in the future.

I believe the payments industry is at a very exciting point in its evolution. It's a journey that has been characterized by ongoing innovation, heated competition, and high customer expectations.

The industry also has enormous breadth, because it's not a pure stand alone business. Yes, it has its own products and issues. But at the same time it's embedded into multiple industries, across multiple markets, and used by multiple customers for almost every type of commercial transaction that exists.

This breadth and diversity has attracted vast numbers of providers ranging from large global companies to local banks and credit unions. Trillions of dollars, euros, yen and RMB get transferred and settled each year. Across the industry payment systems operate with exceptional efficiency and provide strong value to customers. Some providers offer low cost and large scale. Others offer high value and service. Some, like my own company, are combinations of both.

Given this range of products and providers I believe it is a misnomer to call the payments industry a commodity. The term "commodity" implies a sameness that just doesn't exist. It implies mass production and low value add.

The global payment system that exists today is far from a commodity. Today's system is a facilitator of global commerce. It is a driver of business growth. It is a means of developing national economies on behalf of all citizens. For all these reasons I believe payment systems should be viewed as economic assets, not as utilities.

To ensure future growth and continued innovation the industry should remain open and not be restricted by inappropriate barriers. Regulation will occur, but the regulatory approach to payments should be one that sustains trust, while at the same time encouraging productive, value added growth on behalf of customers.

This industry clearly has a great deal of untapped potential. And the realization of that potential is a challenge I clearly look forward to.

Thank you.