




If You Can Stomach It: Re-Evaluating Your Third Party EFT Processor Relationship

Although many of the largest financial institutions process their ATM and debit transactions in-house, the vast majority outsource their Electronic Fund Transfer (EFT) processing to third parties. And although often viewed as a commodity service, financial institutions' processing relationships have important implications for their product offering, internal operations, and customer experience—and can have a direct impact on their bottom lines.

The landscape for EFT processing has changed significantly over the past several years.

Debit		<ul style="list-style-type: none">▪ Debit volumes have increased significantly, eclipsing ATM as the primary EFT processing service▪ The interchange model—for both signature and PIN debit—has become increasingly complex▪ Debit rewards and other incentives have become commonplace, requiring integration and management▪ The nature of fraud has evolved, necessitating the use of advanced fraud tools to mitigate risk and protect against systemic breaches
ATM		<ul style="list-style-type: none">▪ Declining variable revenue and increasing fixed costs have put pressure on ATM deployers' profitability▪ The sunsetting of OS-2 has catalyzed a migration to Windows-based ATMs▪ Advancements in hardware and software are expanding deployers' management capabilities and improving the user experience
EFT Providers		<ul style="list-style-type: none">▪ Processing is a scale-driven business that has become intensively competitive▪ Consolidation and changes in ownership among the leading providers—most recently Fidelity and Metavante—has created “swirl” in the industry▪ Processors are becoming more vertically integrated, increasingly offering EFT processing bundled with core processing and/or network services

Given these changes, we conducted a small research study in the spring of 2009 to explore trends in financial institutions' use of third-party EFT processors. We spoke with nine financial institutions to better understand how they are currently using third-party processors, what drives their buying decisions/satisfaction levels, and what their priorities are for future investment. Based on these conversations, and our own experience, we have put together some of our key takeaways and thoughts for financial institutions that are (or perhaps should be) in the process of evaluating their processor relationship(s).

FI Processing Capabilities

Given our focus on third-party processing, most of the financial institutions interviewed outsource their debit processing—although what that means in terms of the services provided varies from financial institution to financial institution. Some use their processors as a one-stop-shop; others use multiple providers and/or a combination of third-party and in-house solutions to achieve the desired output.

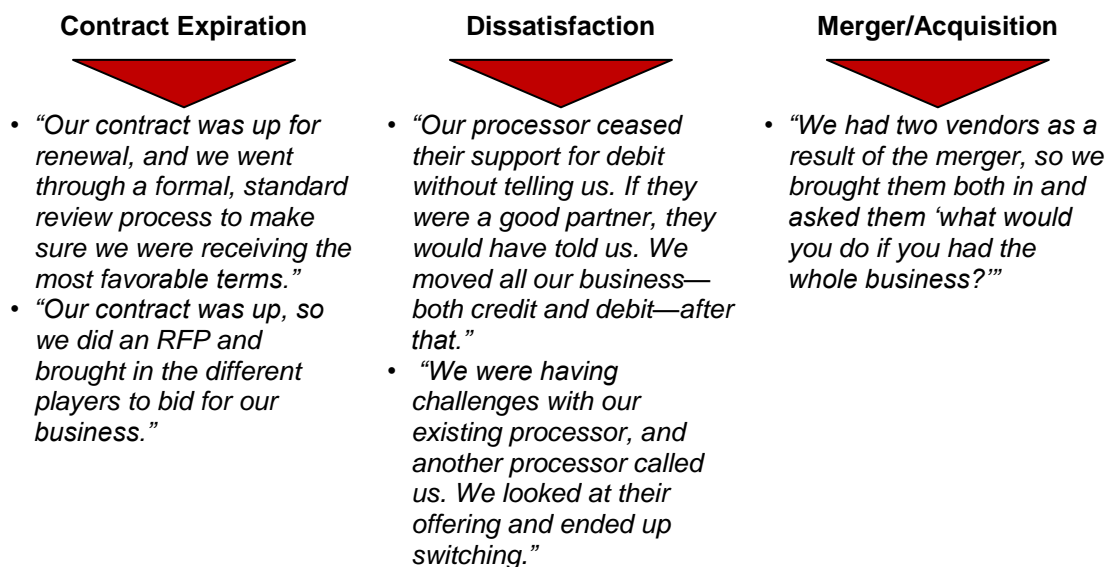
Looking forward, few financial institutions indicated plans to significantly change their EFT-processing capabilities in the next 12-18 months. For some participating financial institutions, their current focus is on broader system changes that may pave the way for changes in the longer-term future (e.g., core conversions, ATM fleet upgrades, channel integration). Others are concentrating on upgrading their capabilities in areas outside the EFT space, including teller image capture, online banking and bill pay, and mobile banking.

Rather than introducing new EFT features and capabilities per se, financial institutions seem to be focusing on securing the most advantageous terms from vendors and deriving the maximum benefit from their processors' value-added services.

Satisfaction and Processor Selection

Most of the financial institutions we spoke with indicated they are satisfied with their EFT processor—which is good, given that many of them had recently negotiated (or renegotiated) their processing relationship.

In discussing the impetuses that led them to re-evaluate their processor relationship, financial institutions' motivating factors tended to fall into one of three categories:



Depending on their individual circumstances, financial institutions' objectives for evaluating their processing relationships—and their corresponding selection criteria—varied, but most of them were looking to secure one (or all!) of the following:

- **Better financial terms.** Given that baseline processing capabilities are largely assumed, particularly among the largest processors, cost is usually one of financial institutions' key deciding factors. We heard from many financial institutions that the winning processor *“made us an offer we couldn't refuse,”* whether it came in the form of up-front incentives, cost savings, or significant discounts.
- **Better relationship.** A number of financial institutions said they were looking for a partner that would really help them grow their business. The things they looked for during the evaluation process included subject matter expertise, dedicated relationship support, marketing support programs and/or consultative services, and the opportunity to participate on advisory boards.

- **Improved integration and efficiencies.** For an increasing number of financial institutions, selecting an EFT processor is not a stand-alone decision, but one that is made in concert with other business units. For some financial institutions, selecting a single provider for both processing and network, for both credit and debit, or for both core and EFT provides significant benefits in the form of preferred pricing, greater buying power, simplified vendor management, and/or greater integration and consistency across functions.

In many cases, the financial institutions we spoke with went through the process of evaluating vendors and decided it was in their best interest to remain with their existing provider(s). In others, the financial institutions opted to switch processors, whether from First Data to Visa, Visa to Metavante, or Metavante to Fiserv. In every case, however, whether the financial institution switched processors or not, they benefited from systematically evaluating their existing processing arrangements—and we would advise all financial institutions to make the most of their opportunity to do the same.

Evaluating Your Third-Party Processing Relationship

We have worked with a number of financial institutions to help them evaluate their processor and/or network relationships and select the optimal partner. Based on our experience, and that of the financial institutions interviewed, we recommend that financial institutions that are—or will be—in a position to evaluate their existing processor relationship consider the following advice:

- **Take stock of your current situation.** When does your current contract expire? What rates are you currently paying? How do those rates compare with market rates today? What are your “points of pain” with your current processing relationship? Where would you like to see improvement?
- **Consider your future needs.** What kind of growth do you anticipate? What products or services would you like to introduce? What capabilities would you like to have? What are your key priorities for the future?
- **Take a holistic look at your processing business.** When evaluating your current situation and future needs, expand your focus beyond EFT processing and include other elements such as network services; credit card processing; merchant acquiring; core banking; online banking and bill pay. Many processors today have a full suite of processing capabilities, and will offer financial incentives for bundled services, as well as other potential benefits in the form of system integration and process efficiencies (e.g., a single-point relationship manager for all services).

Although it takes additional coordination and effort the first time, strive to align your contract termination dates and put your whole book of business out to bid at once. Whether you choose to consolidate your business with a single provider or select a different provider for each service, it will give you the opportunity to evaluate both à la carte and bundled options and make a strategic choice as to which arrangement best suits your needs (versus being forced to make a default decision).

- **Orchestrate a competitive bidding process.** The processing business is scale-driven and highly competitive. Secure bids from the different providers and, if necessary, go through multiple rounds of bidding. This will ensure that you achieve the maximum financial benefit in the current market; it may also create an opportunity to ask for non-financial benefits (e.g., a dedicated relationship manager or a seat on an advisory committee) that provide additional value.
- **Conduct a full-blown financial comparison.** Each processor will have a different pricing model. Once the bids are in, model the “total cost of ownership” over time for each bidder—not just a line-item comparison. Some processors will offer upfront cash incentives; others will offer significant volume discounts based on future growth. Some

may have a lower authorization fee, but charge a higher fee for accounts on file, or vice versa. Modeling the financial value over the term of the contract will help ensure an apples-to-apples comparison.

- **Choose the vendor that will best meet your needs as an organization.** Although the financial analysis will no doubt play a significant role in your evaluation process, do the due diligence to ensure that the processor will meet your needs in terms of both specific capabilities and overall strategic fit. While most processors' baseline capabilities are on par, advanced functionalities vary, so consider specific requirements you may have or capabilities you may desire, as well as the processors' roadmaps for the future.

This will be particularly important—and challenging—should you decide to go with a bundled solution, as there may be difficult trade-offs to be made between lines of business. Although the benefits can be significant, choosing a single provider requires internal negotiation and management, commitment from senior-level executives, and a careful focus on the overarching needs of the organization as a whole.

Conducting a comprehensive evaluation of your processor relationship(s) can be time consuming. And there's no doubt that actually switching processors can be quite an undertaking. But as one financial institution keenly observed, *"there's nothing wrong with going through a conversion every eight to 10 years, if you can stomach it."*

We would contend that whether you ultimately switch processors or not, the value of actively assessing your options—particularly in today's environment—is worth the time and effort.

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