



# CREDIT UNION INNOVATION

PLAYBOOK

## Challenger Banks Edition

The 2020 Credit Union Innovation Playbook series, a PYMNTS and PSCU collaboration, analyzes the evolution of the innovation trends in the financial ecosystem. The Challenger Banks Edition draws from a data sample of 3,908 consumers, 100 credit union leaders and 50 FinTech executives to examine which payment product innovations CUs and FinTechs plan to prioritize in the near future.







# CREDIT UNION INNOVATION PLAYBOOK

The Credit Union Innovation Playbook was done in collaboration with PSCU, and PYMNTS is grateful for the company's support and insight. PYMNTS.com retains full editorial control over the following findings, methodology and data analysis.

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# INTRODUCTION

**K**alamazoo, Michigan-based Consumers Credit Union installed drive-thru interactive teller machines (ITMs) in place of its existing ATMs in 2019. The move was aimed at allowing its approximately 100,000 members to interact with human tellers via on-site videoconferencing portals. Such portals have become the “temporary centers” of its branch operations in the face of strict, statewide lockdown orders, providing face-to-face banking services

for members who are unwilling or unable to schedule in-person consultations with tellers.<sup>1</sup>

ITMs are one of the many technologies credit unions (CUs) are using to extend their services to members stuck at home as the COVID-19 pandemic heightens the desire for digital banking solutions. Such technologies serve the dual purpose of meeting members’ mounting remote banking needs and providing CUs with a way to gain competitive edges over dig-

ital-first or digital-only challenger banks — institutions that offer consumers access to banking or banking-like services.

Not all CUs are well-prepared for the digital transformations that stay-at-home orders have mandated. Credit unions that cannot provide the services their members need in an increasingly digital-centric ecosystem risk losing them to competitors that can.

What can credit unions learn from challenger banks and their emphasis on digital-first banking solutions? How can CUs use innovations to enhance their own digital banking capabilities and pro-

vide the full range of solutions necessary to meet their members’ needs?

The PYMNTS Credit Union Innovation Playbook: Challenger Banks Edition analyzes more than 4,000 United States consumers’, CU leaders’ and FinTech executives’ perceptions of challenger banks to gauge the scale of the competitive threat they pose not only to credit unions, but also to competing FinTechs — particularly now that digital channels have become the primary ways FIs interact with their customers.

**This is what we learned.**

<sup>1</sup> Orem, T. ITM investment is paying off for one credit union. Credit Union Times. 2020. <https://www.cutimes.com/2020/04/02/itm-investment-is-paying-off-for-one-credit-union/>. Accessed May 2020.



01

### **One out of five CU members is interested in challenger banks — and CUs know it.**

Our research shows that 19.4 percent of CU members are at least “somewhat” interested in using challenger banks, while 1.7 percent already use their services in conjunction with their current CUs. Credit union decision-makers are aware of the competitive threat challenger banks could pose. Thirty percent of CU executives believe it is “very” or “extremely” likely that their members would leave their organizations for challenger banks, and 41.4 percent believe challenger banks will be “very” or “extremely” significant competitors during the next three years.



02

### **CUs and FinTechs alike perceive challenger banks to be better, faster innovators.**

CU and FinTech executives see challenger banks as competitive threats for many of the same reasons, and foremost is the perception that they are better and faster innovators. Our research shows that 80.5 percent and 77.8 percent of CU and FinTech executives who see challenger banks as threats, respectively, feel that way because they believe challenger banks can innovate better and faster than their organizations can, making it the most-commonly cited reason for concern.

CU and FinTech executives see challenger banks as threats for many reasons, but they largely believe that the latter can offer their customers better app and member experiences, better products and more convenient experiences.

03

### **Other CUs, PayPal and large retailers are CUs' biggest competitors.**

The term challenger bank may refer to traditional financial institutions (FIs) like banks and credit unions, but it also describes technology firms or even retail businesses that offer banking services or banking-like services. A wide variety of challenger banks are available, yet CU members would likely choose to bank with other credit unions before considering using banking services from any other type of challenger bank. Our research shows that 42.1 percent of CU members believe that the challenger banks in which they are most interested are actually other credit unions. PayPal is a distant second, as 30.9 percent of CU members say they would be most interested in using it as a challenger bank.

04

### **Low fees and high interest rates on deposits are challenger banks' two biggest draws.**

CU members who believe challenger banks might be able to improve upon their current banking experiences usually cite low fees and high interest rates on deposits as their reasons. Our research shows that 25.4 percent of CU members believe challenger banks would be able to improve upon their current banking experiences by offering lower fees, and 19.7 percent believe they could do so by offering more interest on their deposits. CU members also have an affinity for challenger banks for their more convenient, easier-to-use services and better online services. These benefits are cited by 19.1 percent, 18 percent and 15.6 percent of all credit union members, respectively.

05

### **CU members want digital-first — not digital-only — banking.**

CU members show a strong desire to access digital banking services, but before the COVID-19 pandemic forced many CU branches to close, they also liked having the option of visiting brick-and-mortar locations. This is evident in the fact that CU members cite the inability to visit brick-and-mortar branches as the biggest drawback of using challenger banks. Our research shows that 41.5 percent of CU members say being unable to visit branch locations represents one way in which using challenger banks would make their banking experiences worse. CU members are also concerned that using challenger banks might not be cost-effective and might result in them facing financial fraud. These concerns are cited by 27.4 percent and 26.8 percent of CU members, respectively, as areas in which challenger banks' services would fall short of those they experience with their current credit unions. It will be crucial for credit unions to monitor how their members' financial needs continue to change as the pandemic progresses.

# 25.4%

OF CU MEMBERS  
BELIEVE CHALLENGER  
BANKS COULD OFFER  
BETTER BANKING SERVICES  
THAN THOSE THEY  
CURRENTLY RECEIVE  
**BY OFFERING  
LOWER FEES,**

COMPARED TO **19.7 PERCENT** WHO  
BELIEVE THEY COULD DO SO BY OFFERING  
MORE INTEREST ON THEIR DEPOSITS.

# BLINDSIDED: CREDIT UNIONS AND TECHNOLOGY FIRMS

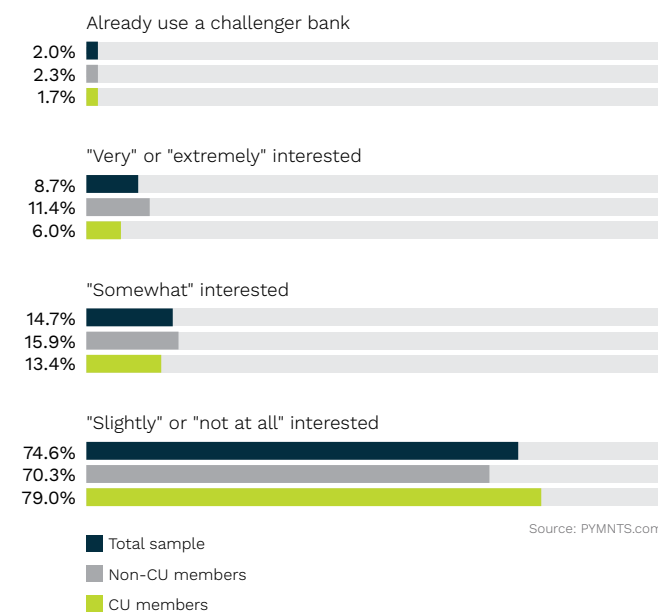
Challenger banks may not be the primary means through which consumers access banking services, but many consumers see challenger banks' digital services as appealing alternatives to those offered by traditional FIs. Our research shows that 23.4 percent of all consumers are at least "somewhat" interested in using challenger banks. This share is even higher among non-CU members, with 27.3 percent saying they would be interested in using them.

Credit union members are not as interested in challenger banks as other consumers, but 19.4 percent still say they would be at least "somewhat" interested in using their services. This goes to show that even among CU members, the idea of digital-first or digital-only banking solutions can be an interesting proposition — enough that a significant share would even consider leaving their CUs.

**FIGURE 1:**

**Consumers' interest in switching to challenger banks**

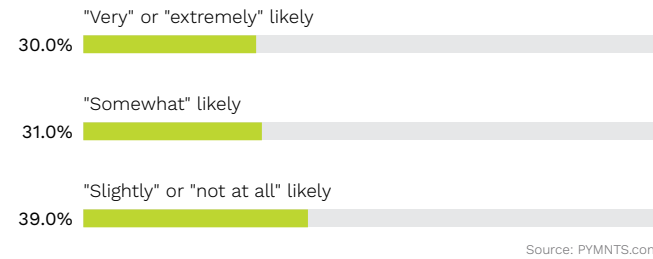
Share of CU members and non-CU members who express interest in switching to challenger banks





**FIGURE 2:**  
**How much CUs believe they should worry about challenger banks**

Share of CU executives who say their members are varying degrees of likely to switch to challenger banks



Source: PYMNTS.com

Credit union decision-makers are aware of the competitive threat challenger banks present, as 30 percent say they believe their members are “very” or “extremely” likely to switch to challenger banks during the next three years. Another 31 percent believe they are “somewhat” likely to do so.

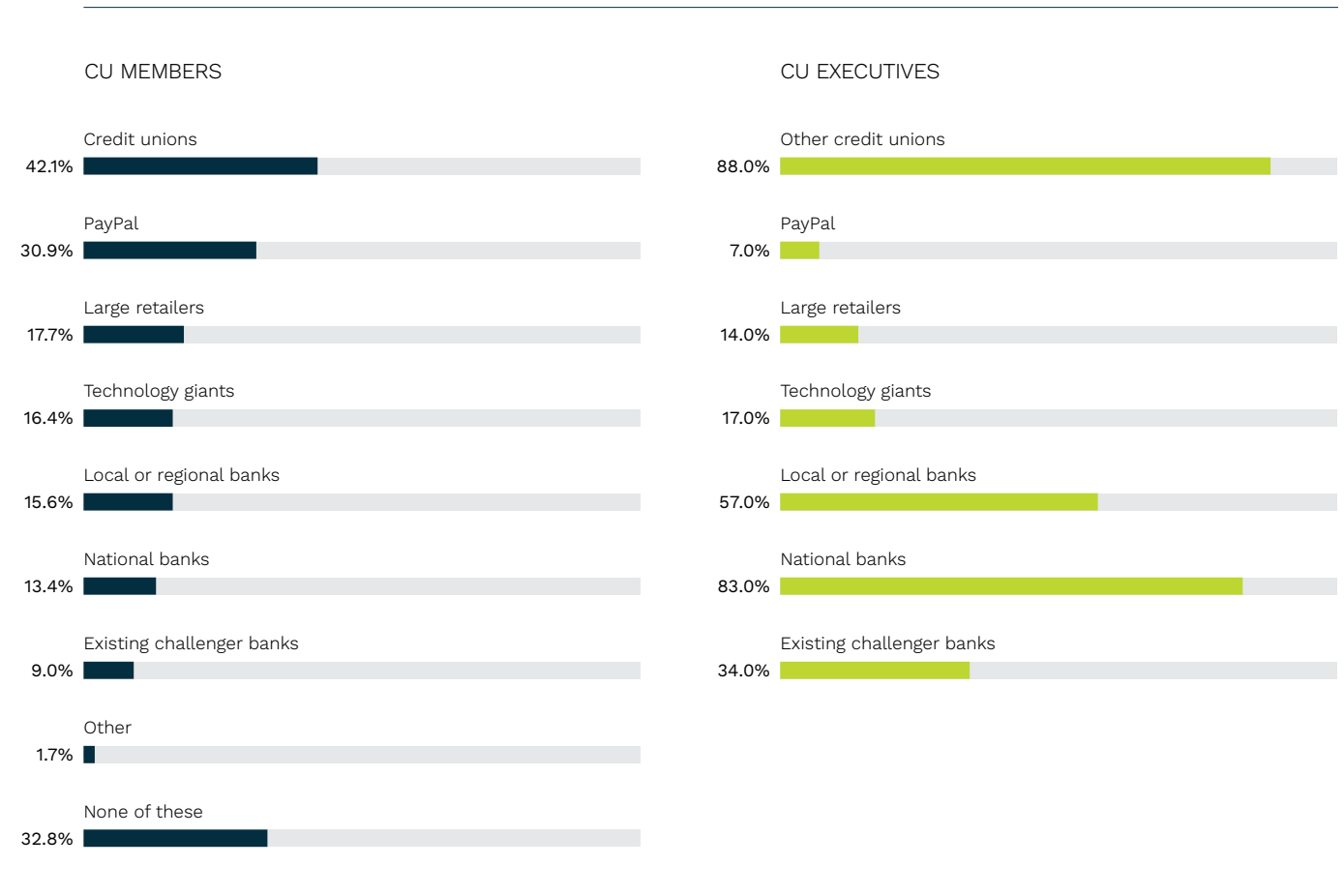
Many CU executives appear to be ill-informed about which types of institutions these challenger banks might be. They are unconcerned about the threat posed by PayPal, large retailers and large technology firms, for example, even though many of their organizations’ members express a great deal of interest in banking with them. PayPal is the most notable example. Our research shows that 30.9 percent of CU members cite PayPal as a potential challenger bank that they would be most interested in using, yet only 7 percent of CU executives consider PayPal to be a competitive threat.

We also find that 17.7 percent of CU members say large retailers would be the most likely to create challenger banks that would be valuable to them, and that 16.4 percent say the same about large technology firms. Only 14 percent and 17

**30%**  
 OF CU EXECUTIVES BELIEVE THEIR MEMBERS ARE **"VERY" OR "EXTREMELY" LIKELY TO SWITCH TO CHALLENGER BANKS.**

**FIGURE 3:**  
**Institutions most likely to create challenger banks that would interest CU members**

Share of CU members and executives citing select institutions as those most likely to create challenger banks that might be interesting and likely to compete for members



Source: PYMNTS.com

percent of CU executives say they believe large retailers and large technology firms would pose competitive threats, respectively.

Credit union executives are not out of touch with their members’ preferences for different types of challenger banks, however. They correctly identify other credit unions as the institutions in which their members have the most interest in using, with 88 percent saying they believe other CUs could pose a competitive threat. This compares to 42.1 percent of CU members who believe that credit unions would make interesting challenger banks.

# THE TRIAD: CUS VERSUS FINTECHS VERSUS CHALLENGER BANKS

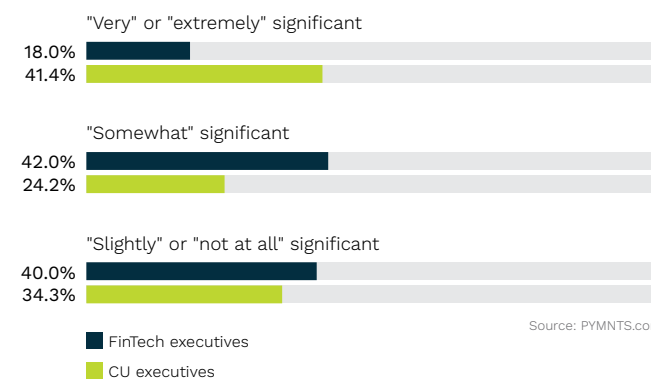
**C**redit unions are not the only financial service providers that worry challenger banks might be able to sway their customers. FinTechs also see challenger banks as potential competitors for many of the same reasons cited by CU executives.

The difference is the degree to which each type of institution believes challenger banks could lure their customers away. FinTech executives are less concerned about the threat of challenger banks, as 18 percent say they believe challenger banks pose “very” or “extremely” significant competitive threats, while 41.4 percent of CU executives say the same.

Credit union and FinTech executives who are worried about the threat posed by challenger banks are concerned for many of the same reasons. Their biggest worry is that challenger banks could be better, faster innovators than their organizations. This concern is cited by 80.5 percent of CU executives and 77.8 percent of FinTech executives who feel that challenger banks might make “very” or “extremely” significant competitors.

**FIGURE 4:**

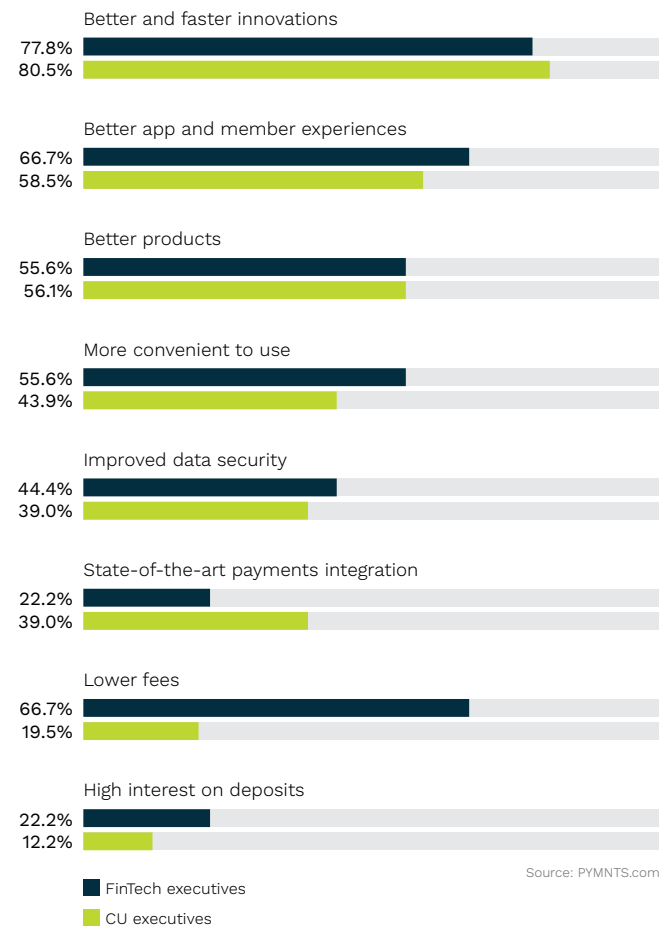
**CUs' and FinTechs' concerns about challenger banks**  
Share of CU and FinTech executives who believe challenger banks will represent select levels of competitive threat in the next three years





**FIGURE 5:**  
**Why CUs and FinTechs worry about challenger banks**

Share of CU and FinTech executives who believe challenger banks will become “very” or “extremely” significant competitors citing select reasons for their worries



CUs and FinTech executives also cite many similar reasons for worrying about challenger banks: their abilities to offer consumers better app and member experiences, better products and more convenient services. Our research shows that 58.5 percent of CU executives and 66.7 percent of FinTech executives believe challenger banks could offer their members better overall app and member experiences. We also find that 56.1 percent of the former and 55.6 percent of the latter are concerned that challenger banks would be able to provide better products. Similar shares of both groups cite concerns that challenger banks would be able to offer more convenient products and products with better data security, rounding out the top five for each. This underscores the pervasive belief in challenger banks’ ability to provide superior digital banking services.

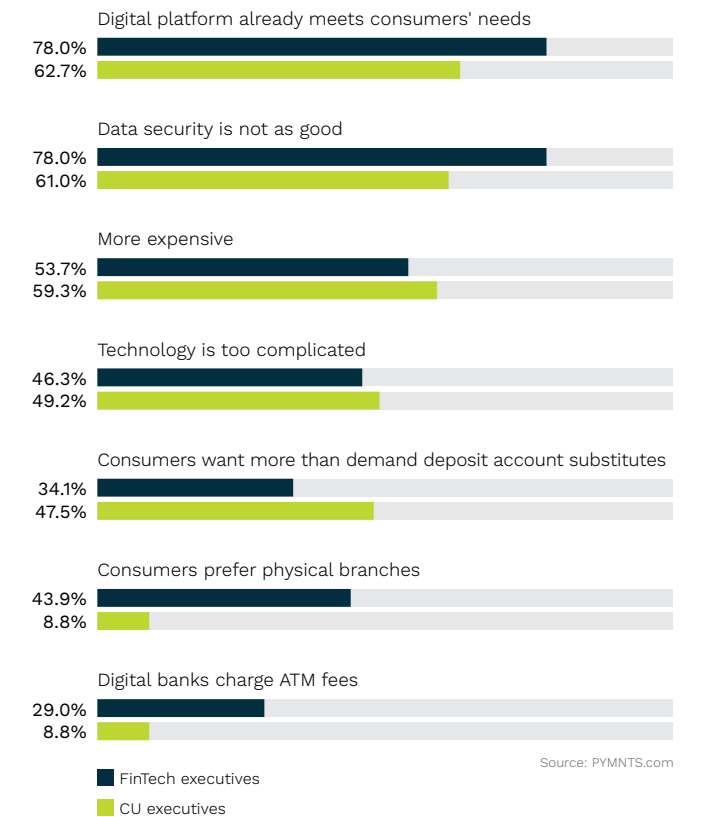
It is worth noting, however, that neither credit unions nor FinTechs believe that having superior digital banking services will be enough for challenger banks to

steal their customers. Strong majorities of both CU and FinTech executives who believe that challenger banks will become less than “somewhat” significant competitors feel that their current digital banking offerings meet their members’ and customers’ needs, with 62.7 percent and 78 percent saying so, respectively.

Other common factors that CUs and FinTechs believe might make challenger banks less competitive include inferior data security and higher costs. Sixty-one percent of credit union executives and 78 percent of FinTech executives who see challenger banks as less than “somewhat” significant competitors say they believe challenger banks’ data security is not as strong as theirs and that this makes them less likely to pose competitive threats. The fact that challenger banks tend to be more expensive is cited by 59.3 percent of CU executives and 53.7 percent of FinTech executives who are not concerned as reasons they might feel less worried that their customers could switch to challenger banks.

**FIGURE 6:**  
**Why CUs and FinTechs do not worry about challenger banks**

Share of CU and FinTech executives who believe challenger banks will be less than “somewhat” significant competitors citing select reasons for their beliefs



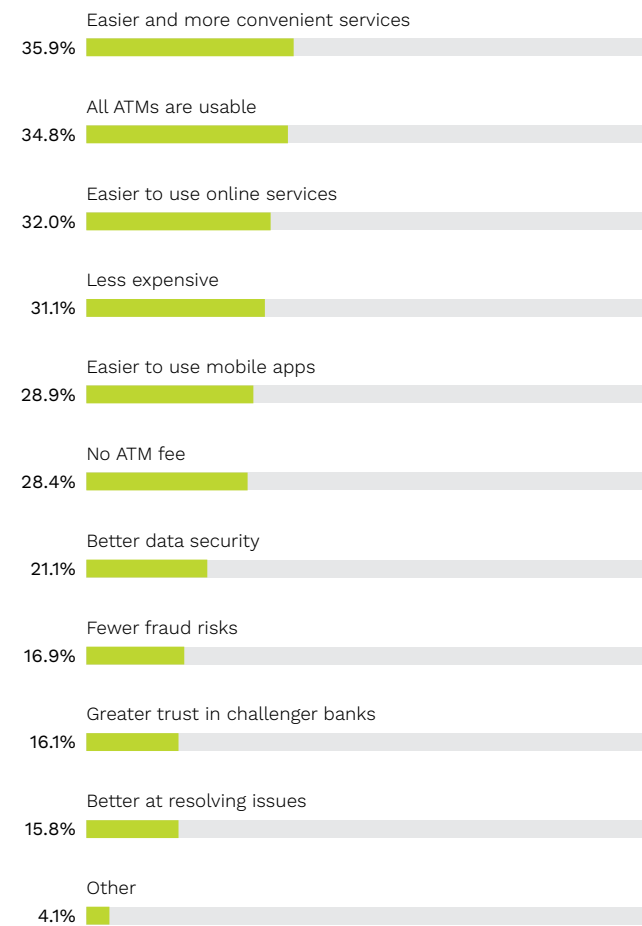
# IN THE EYES OF THE CONSUMER:

# THE BENEFITS OF CHALLENGER BANKS

**FIGURE 7:**

**Why CU members may be interested in challenger banks**

Share of interested members who cite select reasons for their interest



Source: PYMNTS.com

Credit unions' concerns about challenger banks' digital banking capabilities are not unfounded. Many CU members report being interested in challenger banks precisely because they believe their digital banking services would be easier and more convenient to use. Our research shows that 35.9 percent of members who are interested in using challenger banks say it is partially because they believe using challenger banks' services would be easier and more convenient, and 32 percent say they believe challengers' online services in particular would be easier to use.

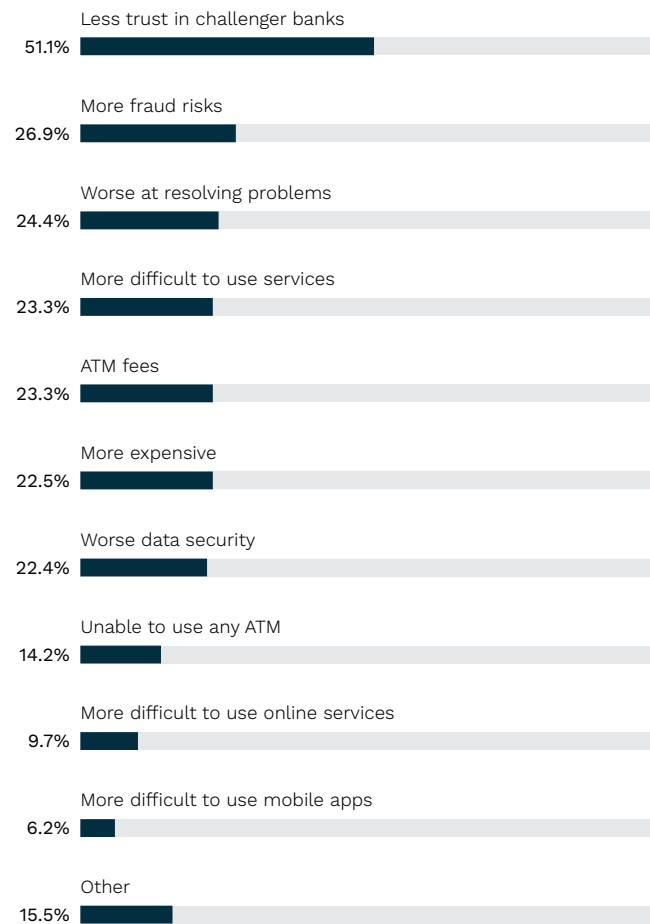
Other common reasons CU members cite for being interested in challenger banks include the ability to use any ATM (cited by 34.8 percent), believing they would be less expensive (31.1 percent) and expecting their mobile apps to be easier to use (28.9 percent).

There is one major reason many CU members are not interested in challenger banks, however, and that is that they do not trust challenger banks as much as they trust their current CUs. Our survey shows that 51.1 percent of members who are not interested in using challenger banks are not interested for this reason.



**FIGURE 8:**  
**Why CU members may not be interested in challenger banks**

Share of uninterested members who cite select reasons for their lack of interest



Source: PYMNTS.com

This is by far the most commonly cited reason for CU members' lack of interest, with the next most common being the fear that challenger banks come with more fraud risks. This is cited by just 26.9 percent of uninterested members, by comparison.

It is also interesting to note the concrete ways in which CU members believe challenger banks could provide better banking services than those they currently receive. One of the most common areas in which members expect challenger banks to excel is in offering lower fees, which is cited by 25.4 percent. This shows that members, CUs and FinTechs have very different ideas about how expensive challenger banks are, as more than half of CUs and FinTechs cite their high prices as a reason for not feeling that challenger banks might pose a competitive threat.

Different generations have very different ideas about how challenger banks could improve their banking experiences, as well. Younger CU members are more likely to believe that challenger banks can provide better banking services than their current CUs — in nearly every way.

**TABLE 2:**  
**Where CU members expect challenger banks to excel**

Share of all CU members who cite select areas as those in which challenger banks may deliver better service than their current CUs, by generation

AREAS WHERE THEY EXCEL	AVERAGE	GENERATION				
		Generation Z 23 or younger	Millennials 24 to 39	Bridge millennials 32 to 41	Generation X 40 to 55	Baby boomers/seniors 56 or older
Cannot be improved	38.1%	22.7%	27.4%	27.4%	32.1%	49.8%
Lower fees	25.4%	30.8%	31.1%	29.2%	28.5%	19.5%
High interest on deposits	19.7%	27.3%	20.8%	19.7%	19.4%	18.4%
More convenient to use	19.1%	25.3%	24.8%	27.3%	21.1%	13.9%
Easier to use	18.0%	26.4%	25.4%	30.0%	20.3%	11.6%
Better online experiences	15.6%	26.8%	19.4%	21.6%	21.1%	8.1%
Better and faster innovations	13.6%	25.5%	19.0%	17.4%	13.2%	9.6%
Better products	12.9%	18.6%	16.2%	16.2%	17.1%	7.9%
Better mobile app experiences	12.7%	19.6%	18.3%	18.5%	15.7%	6.7%
Improved data security	11.9%	19.5%	14.5%	13.6%	13.0%	8.6%
Less financial fraud	11.5%	23.0%	12.0%	12.8%	13.5%	8.2%
State-of-the-art payments integration	9.8%	11.0%	11.9%	12.3%	11.7%	7.1%
Other	3.6%	0.0%	2.0%	1.7%	2.4%	5.7%

Source: PYMNTS.com

Our research shows that 27.3 percent of Generation Z members and 20.8 percent of millennials say challenger banks would be able to offer higher interest on deposits, for example, while only 18.4 percent of baby boomers and seniors say the same. Millennials and Gen Z members are also the most likely to say they believe challenger banks would be better innovators, with 19 percent and 25.5 percent saying so.

There is not a single area in which Generation X or baby boomers and seniors are the most likely to say challenger banks would be preferable over their current CUs.

Baby boomers and seniors are the demographic group most adamant that challenger banks cannot make any improvements upon their current banking

experiences, however, with 49.8 percent saying so. This compares to just 27.4 percent of millennials and 22.7 percent of Gen Z who say the same.

It is clear that CU members of all ages perceive challenger banks as uniquely capable when it comes to digital banking services, and that many see value in their ability to offer such services. The trouble is that their digital-only business model,

which goes hand-in-hand with their high-quality digital services, is also the factor most likely to hinder their adoption.

CU members want to access digital banking options, but they also want to be able to visit brick-and-mortar branch locations if they need to. Being unable to visit brick-and-mortar branches is CU members' biggest issue with challenger banks.

Our research finds that 41.5 percent of CU members cite being unable to visit physical branches as an area in which challenger banks fall short of the banking services they currently receive.

This makes a lack of physical bank branches CU members' most commonly cited area of concern with challenger banks, by far. The next most common factors they cite are increases in the chance for fraud and higher expenses, cited by 27.4 percent and 26.8 percent of CU members, respectively.

We see strong generational trends when it comes to CU members' likelihood of seeing these factors as negatives, as well. Baby boomers and seniors are the most likely age groups to say that being unable to visit bank branches and the increased risk of financial fraud are drawbacks of using challenger banks. Our research shows that 48.9 percent and 29.8 percent of CU members in this age group cite these drawbacks, respectively, compared to the 32.6 percent and 23.8 percent of millennials who do the same.

Millennials and Gen Z members are more likely to cite high ATM fees as drawbacks of using challenger banks. Our research

**41.5%**

OF CU MEMBERS CITE **BEING UNABLE TO VISIT BRANCHES** AS A REASON CHALLENGER BANKS WOULD OFFER INFERIOR SERVICE COMPARED TO THEIR CURRENT CUs.

shows that 29.3 percent of millennial and 34.6 percent of Gen Z CU members we surveyed say paying high ATM fees is an issue with using challenger banks, respectively.

A large portion of Gen X members also say that challenger banks are more expensive, and 29.5 percent say that price is one of the areas in which challenger banks' services are not up to par with those they receive from their current CUs.

**TABLE 2:**  
**Where CU members expect challenger banks to fall short**

Share of all CU members who cite select areas as those in which challenger banks may deliver worse service than their current FIs, by generation

AREAS WHERE THEY FALL SHORT	AVERAGE	GENERATION				
		Generation Z 23 or younger	Millennials 24 to 39	Bridge millennials 32 to 41	Generation X 40 to 55	Baby boomers/seniors 56 or older
Unable to visit branches	41.5%	23.9%	32.6%	37.3%	40.7%	48.9%
More financial fraud risks	27.4%	22.1%	23.8%	26.8%	27.5%	29.8%
More expensive	26.8%	28.3%	24.9%	27.7%	29.5%	25.6%
Digital banks charge ATM fees	25.3%	34.6%	29.3%	28.7%	24.8%	22.5%
Services are not as good	24.4%	22.8%	21.5%	21.8%	23.0%	27.0%
Data security is not as good	23.0%	25.8%	20.4%	22.4%	22.1%	24.5%
Technology is too complicated	16.2%	27.4%	14.9%	14.8%	14.9%	16.2%
Online features are difficult to use	13.3%	14.0%	14.9%	15.0%	12.9%	12.7%
Need additional services	13.0%	19.4%	16.5%	17.4%	12.7%	10.7%
Mobile apps are difficult to use	11.7%	19.7%	16.1%	15.7%	12.2%	8.0%
Innovations are not as good	10.8%	22.4%	14.9%	10.9%	10.0%	7.8%
Other	5.9%	1.0%	3.2%	3.6%	4.6%	8.9%

Source: PYMNTS.com





# CONCLUSION

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**C**hallenger banks pose a very real threat to all FIs, including credit unions, with a significant portion of consumers expressing interest not only in the digital-first banking services they provide but even in leaving their current FIs to obtain them. The COVID-19 pandemic has led to a remarkable shift in the ways consumers want to bank — away from brick-and-mortar branches — making it much more crucial to improve digital banking services.

There are nonetheless several other areas in which CUs, FinTechs and other

FIs enjoy a competitive edge over challenger banks, however, and they include the perception of greater data security and a stronger degree of trust from their members and customers. These factors provide a solid ground for the formation of strong CU-member relationships but may not be enough to keep members from straying if CUs cannot provide the digital services that are becoming paramount as the pandemic progresses. Innovating new digital products that will allow their members to bank from the safety of their homes will be key to strengthening that bond going forward.

## METHODOLOGY

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**T**he 2020 Credit Union Innovation Playbook series, a PYMNTS and PSCU collaboration, examines survey data collected from 4,058 respondents to gauge the state of innovation in the financial ecosystem. We surveyed respondents from three sub-samples — 3,908 U.S. consumers, 100 decision-makers at various U.S. CUs and 50 FinTech executives — about their FIs' recent and upcoming innovation plans, their awareness of various financial and payment product innovations and their interest in taking on their own innovation efforts. The Challenger Banks Edition focuses on the allure of digital-first financial service providers and the competitive threat they pose to CUs, FinTechs and other, more traditional FIs.

# ABOUT

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