

**BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, DC 20268-0001**

**WMB-T-1**

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**RATE AND SERVICE CHANGES TO  
IMPLEMENT BASELINE NEGOTIATED  
SERVICE AGREEMENT WITH  
WASHINGTON MUTUAL BANK**

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**Docket No. MC2006-3**

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**REVISED DIRECT TESTIMONY  
OF  
MICHAEL RAPAPORT  
ON BEHALF OF  
WASHINGTON MUTUAL BANK**

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**TABLE OF CONTENTS**

AUTOBIOGRAPHICAL SKETCH..... 1

I. PURPOSE AND SCOPE..... 1

II. HISTORY OF WMB CARD SERVICES ..... 2

III. WMB CARD SERVICES’ MAIL TYPES..... 2

IV. FIRST-CLASS MAIL AND STANDARD MAIL VOLUME HISTORY ..... 2

V. FIRST-CLASS MAIL AND STANDARD MAIL VOLUME FORECASTS ..... 4

VI. AFTER RATES VOLUME AND THE IMPACT OF THE NSA..... 7

VII. CAPPING DISCOUNTS AT COST SAVINGS IS NOT ECONOMICALLY VIABLE..... 9

VIII. ADDRESS HYGIENE AND RETURN MAIL VOLUMES ..... 10

CONCLUSION ..... 11

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**8 AUTOBIOGRAPHICAL SKETCH**

9 My name is Michael Rapaport. I manage the Marketing Services Group for  
10 Washington Mutual Bank's Credit Card business ("Card Services"). My group's  
11 responsibility includes direct marketing campaign execution and marketing analysis. I  
12 have been in my current role for 3 years. Prior to that, I spent 14 years at Fair, Isaac and  
13 Company in a variety of roles including developing some of the earliest FICO scoring  
14 models and ultimately managing the FICO Score line of business for North America.  
15 (The FICO Score is used by most lenders to determine a consumer's creditworthiness  
16 prior to granting additional credit). I graduated from Stanford University with a degree in  
17 Mathematical and Computational Sciences.

**18 I. PURPOSE AND SCOPE**

19 The Postal Service and Washington Mutual Bank ("WMB") have entered into a  
20 baseline Negotiated Service Agreement ("NSA") with respect to WMB's Card Services,  
21 which is now the subject of this proceeding. My testimony will provide a brief history of  
22 WMB Card Services, explain Card Services' approach to marketing, its use of Standard  
23 Mail and First-Class Mail and demonstrate why the NSA will encourage Card Services to  
24 shift its usage from Standard Mail to First-Class Mail. My testimony will also provide  
25 information on Card Services' address hygiene practices and return mail volumes.

26

1 **II. HISTORY OF WMB CARD SERVICES**

2 WMB Card Services was created on October 1, 2005 when Washington Mutual,  
3 Inc. successfully completed its acquisition of Provident Financial Corporation  
4 (“Provident”). At the time of its acquisition, Provident was the eighth largest card issuer  
5 with 9.7 million customers and \$20 billion in managed credit card receivables. After its  
6 acquisition, Washington Mutual established the Card Services group as its fourth  
7 business line in addition to Retail Banking and Financial Services, Home Loans and  
8 Commercial Banking. The proposed NSA applies only to WMB’s Card Services  
9 business.

10 **III. WMB CARD SERVICES’ MAIL TYPES**

11 While WMB’s other three business lines use multiple marketing channels  
12 including television, radio and print advertisements, WMB Card Services relies virtually  
13 exclusively on direct mail and telemarketing to promote its business. Like other card  
14 issuers, WMB Card Services mail types can be generally divided into two (2) kinds of  
15 mail: operational mail and marketing mail. Operational mail usually includes periodic  
16 statements, communications with customers regarding their card account and mailings of  
17 new or replacement cards. Marketing mail generally includes marketing materials  
18 designed to attract new customers or encourage existing customers to utilize their credit  
19 card and related products and services. While operational mail is sent using First-Class  
20 Mail, marketing mail may be sent via either Standard Mail or First-Class Mail.

21 **IV. FIRST CLASS MAIL AND STANDARD MAIL VOLUME HISTORY**

22 As shown in Table 1 below, WMB Card Services’ total mail volumes grew  
23 consistently from 2003 to 2005. WMB Card Services’ total mail volume

1 grew from 410 million pieces in 2003 to 543 million pieces in 2004 and 647 million  
2 pieces in 2005.<sup>1</sup> The increase in total volume from 2003 to 2005 was largely a result of  
3 the success of Providian's restructuring efforts which commenced in 2001. As recently  
4 as the first calendar quarter of 2003, Providian experienced a 17% charge-off rate which  
5 directly impacted mail volumes by: 1) reducing the total number of active accounts; 2)  
6 reducing the total marketing budget; 3) requiring significant portfolio sales, which also  
7 reduced the number of active accounts; and 4) yielding regulatory limitations on the types  
8 of customers to whom Providian could solicit. Also, as part of the restructuring,  
9 Providian developed a new marketing strategy, testing of which began in the second half  
10 of 2002, and was fully rolled out throughout 2003. By 2004, Providian's "turnaround"  
11 was largely successful and the company's new marketing strategy was fully implemented  
12 with an increased budget allowing total mail volume to increase from 410 million in 2003  
13 to approximately 543 million in 2004.

14 In 2005, total mail volume increased to 647 million due to several factors.  
15 Increased growth in the card portfolio prompted an increase in the marketing budget for  
16 2005, thereby enabling more marketing mail. Additionally, as the credit quality of the  
17 portfolio improved, there were more existing customers to whom marketing materials  
18 could be sent. Specifically, marketing mail to our existing customers rose from 35  
19 million pieces in 2004 to 70 million pieces in 2005 (exclusively First-Class). Also,  
20 notably, Washington Mutual's acquisition of Providian was completed in October, 2005  
21 and as a result a one-time merger notification to existing customers was mailed using  
22 First-Class Mail. Further, and in connection with the merger, management made

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<sup>1</sup> Note that these historical volumes and those in Table 1 do not include a small amount of Standard Mail fulfillment volumes (an average of about 3-5 million pieces per year) because they would be unaffected by the NSA.

1 additional marketing budget available to cross-sell the new WMB credit card to existing  
2 WMB customers. Table 1 summarizes the Historical Mail Volumes.

3

4 **Table 1: Historical Mail Volumes (in millions)**

5

Mail Class/Type	CY 2003	CY 2004	CY 2005
<b>First-Class Mail</b>	<b>393</b>	<b>362</b>	<b>524</b>
Operational	118	119	121
Marketing	275	243	403 <sup>2</sup>
<b>Standard Mail Solicitations</b>	<b>17</b>	<b>181</b>	<b>123</b>
<b>Total Mail Volume</b>	<b>410</b>	<b>543</b>	<b>647</b>

6

7 **V. FIRST CLASS MAIL AND STANDARD MAIL VOLUME FORECASTS**

8 To understand how WMB Card Services arrived at its volume forecasts for the 3

9 years of the proposed NSA, some background into the Marketing Strategic Planning

10 Process may be useful. Next, I will discuss the methodology we employed to determine

11 our forecasts, and more specifically, to demonstrate the cost-effectiveness of the

12 proposed NSA.

13 WMB Card Services' process begins by establishing yearly account goals

14 consistent with the business' strategic growth targets. With account goals established, we

15 determine a marketing budget by estimating the costs to acquire an account. Factors

16 which affect these 'account acquisition costs' include competitive pressure, an economic

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<sup>2</sup>This figure is approximately 124 million pieces higher than the estimate included in my testimony as originally filed. There are two major reasons for this discrepancy. First, the 2005 volumes that were originally reported inadvertently excluded all solicitations (70 million pieces) sent to existing cardholders. Second, the original 2005 volumes did not reflect the additional volumes – including a one-time merger notification sent to the bank's credit cardholders (11 million pieces) and cross-sell solicitations sent to Washington Mutual customers (20 million pieces) – that resulted from the merger with Washington Mutual Bank. The 403 million piece First-Class Mail marketing volume figure included in this revised version of my testimony includes all of these volumes.

1   downturn or higher solicitation costs, all of which increase the acquisition costs, and  
2   improved response models, new market expansion or lower solicitation costs, which may  
3   reduce the acquisition costs.

4           During the year, WMB Card Services monitors its performance with respect to its  
5   account goals. Should account acquisition costs change, Card Services re-optimizes its  
6   mail strategy within the same budgetary constraint. Thus, if the account acquisition costs  
7   increase such that the established marketing budget is no longer adequate to obtain the  
8   account goal, Card Services will reallocate its spending among marketing campaigns  
9   most likely to achieve meaningful results. If account acquisition costs decrease such that  
10   unused marketing budget is available, Card Services will consider investing the  
11   additional spend in development efforts such as testing.

12           Based on our analysis of past response and booking rates as well as the  
13   competitive environment, to meet our account goals for Year 1 (2006) acquisition efforts,  
14   Card Services estimates that we will mail a total of 564 million acquisition mail pieces  
15   (which do not include solicitations sent to existing cardholders) (or approximately 118  
16   million more acquisition mail pieces than we sent in 2005) using a combination of  
17   Standard Mail and First-Class Mail. While this mail volume forecast is derived from  
18   2006 account goals, not prior year volume, we note that the 118 million piece change in  
19   total acquisition volumes from 2005 to 2006 is larger than the 57 million piece change in  
20   the previous year. It is the account goals for Year 1 (2006), and not the prior year's  
21   volume which drives the 564 million total acquisition mail volume estimate.

22           Next, to forecast the mail class mix, we used the mail class mix from the last two  
23   (2) quarters of 2005 (58% First-Class, 42% Standard) and applied it to this estimated total

1 acquisition mail volume to determine mail class volumes for 2006 (327.1 million First-  
 2 Class, 236.9 Standard), as shown in Table 2.<sup>3</sup>

3 Next, Card Services assumed a 5.4 percent postal increase for all mail classes,  
 4 beginning in January, 2006. To cover the increased postal costs, we would either have to  
 5 reduce our total mail volume or shift volume to Standard Mail from First-Class Mail and  
 6 our strategy is to perform the latter. Therefore, in order to keep mail volumes constant  
 7 without additional marketing budget, Card Services shifted more than 20% of the First-  
 8 Class volume to Standard, thereby reducing the First-Class volume to 250 million mail  
 9 pieces, as shown in Table 2. Additionally, in 2006, the use of First-Class Mail for  
 10 acquisition mail is expected to be heavier in the first half of the year, and as marketing  
 11 budget is expended, Standard Mail volumes are expected to increase.

12  
 13 **Table 2: Year 1 Acquisition Mail Volumes**

Acquisition Mail Volumes	Total	Standard	First
Baseline Acq Mail	564,000,000	236,880,000	327,120,000
Mix Adj.- Postal Increase	564,000,000	314,000,000	<b>250,000,000</b>

14 \*The figures in this table do not include solicitation mail pieces sent to existing customers.  
 15 These 80 million pieces are included in Table 3 below.  
 16

17 Our operational mail volumes and the volume of marketing mail that we send to  
 18 our cardholders are also a result of our account goals. Given our account goals, we  
 19 expect 2006 operational and customer solicitation volumes to be similar to 2005 volumes.

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<sup>3</sup> We excluded cross-sell marketing mail pieces to Washington Mutual customers when calculating this mail class split percentage. This is because, when we began these mailings immediately after the Washington Mutual acquisition in 2005, we mailed all of the cross-sell pieces using First-Class Mail while, in 2006, we expect to mail these pieces using a similar mail class split as all other marketing pieces.

1 To determine Before Rates volumes for Years 2 and 3 of the proposed NSA, Card  
2 Services assumed that volumes would grow by approximately five (5) percent annually.<sup>4</sup>  
3 This assumption was driven by 2 factors: 1) internal projections forecasting account  
4 growth of five (5) percent per year for each of Year 2 and Year 3; and 2) expectation of  
5 higher acquisition costs per account due to increased marketplace competition and “list  
6 fatigue” which occurs when the same prospects are mailed repeatedly without any  
7 development efforts, resulting in lower response rates over time. Table 3 shows the Card  
8 Services' three (3) volume forecasts without the rate discount provided by the NSA.

9  
10 **Table 3: Mail Volume Forecasts (Before Rates)**

Mail Class/Type	Year 1 <sup>5</sup>	Year 2	Year 3
<b>First-Class Mail</b>	<b>450</b>	<b>475</b>	<b>500</b>
Operational	120	125	130
Marketing	330	350	370
<b>Standard Mail Solicitations</b>	<b>314</b>	<b>330</b>	<b>345</b>
<b>Total Mail Volume</b>	<b>764</b>	<b>805</b>	<b>845</b>

11  
12 **VI. AFTER RATES VOLUME AND THE IMPACT OF THE NSA**

13 Card Services expects that the NSA will cause it to mail virtually all, if not all, of  
14 its solicitations as First-Class Mail. As discussed in Section V, at current rates, it is cost  
15 effective to mail a significant portion of our acquisition mail as Standard Mail. This is  
16 because, for much of our acquisition mail, the lift (i.e., the higher response rate) from

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<sup>4</sup>Note that, after increasing the volumes by five percent annually, Years 2 and 3 volumes were rounded to the nearest five or ten million pieces as deemed appropriate.

<sup>5</sup> Note that the reduction in total First-Class Mail volume from 524 million pieces in 2005 to 450 million pieces in 2006 is driven by the change in the mail class split for acquisition mail discussed above, not by reductions in total mail volume. In fact, Card Services plans to mail nearly 117 million more mail pieces in 2006 than in 2005.

1 using First-Class Mail rather than Standard Mail does not justify the average ten-cent  
2 higher First-Class Mail postage.

3 We performed a breakeven analysis using our targeting engine. The targeting  
4 engine found that reducing the postage difference between First-Class Mail and Standard  
5 Mail to six cents (a four-cent reduction) would justify switching all of our acquisition  
6 mail to First-Class Mail. Our targeting engine found that at a four-cent discount (the  
7 “breakeven discount”), the response rate lift from using First-Class Mail (nearly 20  
8 percent) offsets the higher First-Class Mail postage cost. At the breakeven discount and  
9 assuming a constant budget, Card Services would mail less acquisition mail pieces  
10 (approximately 84 pieces of First-Class Mail would replace every 100 pieces of Standard  
11 Mail), but the lift from using First-Class Mail would allow us to acquire the same number  
12 of customers.

13 The response rate lift from using First-Class Mail is the result of two different  
14 sources. First, as mentioned above, consumers simply respond more to First-Class Mail  
15 than to Standard Mail. Second, sending a smaller volume of First-Class Mail (than if the  
16 acquisitions were sent as Standard Mail) allows us to mail only to the better prospects on  
17 our list.

18 Applying this analysis to the NSA, the discounts (which average slightly more  
19 than four cents per incremental piece of First-Class Mail) will cause WMB to replace 314  
20 million Before Rates Standard Mail pieces with 263 million First-Class Mail pieces in  
21 Year 1. As shown in Table 4, similar shifts would occur in Years 2 and 3.

22 The NSA would also produce a secondary effect on Card Services acquisition  
23 mail volumes. Card Services plans to reinvest the discount above four cents in additional

1 acquisition First-Class Mail. Table 4 summarizes Card Services' After Rates forecasts.  
2 Exhibit A attached hereto provides additional details.<sup>6</sup>

3 **Table 4: Mail Volume Forecasts (After Rates)**

Mail Class/Type	Year 1	Year 2	Year 3
<b>First-Class Mail</b>	<b>713</b>	<b>750</b>	<b>785</b>
Operational	120	125	130
Marketing	593	625	655
<b>Standard Mail Solicitations</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Total Mail Volume</b>	<b>713</b>	<b>750</b>	<b>785</b>

4

5 **VII. CAPPING DISCOUNTS AT COST SAVINGS IS NOT ECONOMICALLY**  
6 **VIABLE**

7 As discussed above, I fully expect that the NSA discounts will induce Card  
8 Services to mail all of its solicitations as First-Class Mail. This will increase our First-  
9 Class Mail volumes by 250 to 300 million pieces per year and thereby significantly  
10 increase the contribution of our mail to Postal Service institutional costs.

11 We are aware that the Commission has conditioned approval of previous NSAs on  
12 the imposition of a cap on the total amount of the discounts. However, those NSAs were  
13 functionally equivalent to the Capital One NSA. Our NSA is not. This is a baseline  
14 agreement that depends on its own internal values and economics, and not on the fact that  
15 it is like some previously approved NSA.

16 In this case, capping discounts at cost savings will significantly reduce, if not  
17 entirely eliminate, the increased contribution. To induce the desired change in behavior,

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<sup>6</sup> I did not update the analysis shown in Exhibit A and the resulting After Rates forecasts based upon the renegotiated declining block rate schedule because the new schedule will not have a significant impact on our After Rates volumes. While the renegotiated schedule reduces the economic benefit of the NSA to Card Services (e.g., by \$100,000 in Year 1) that can be reinvested into additional First-Class Mail, it still provides enough total discount to make it cost effective for us to migrate all of our marketing mail to First-Class Mail.

1 the Postal Service will need to offer Card Services postal discounts in excess of \$10  
2 million per year. I understand from the Postal Service that a cost savings cap would be  
3 about \$10 million over the entire three-year duration of the NSA. Thus, the NSA  
4 discounts would be exhausted one year into the deal. Once the cap on discounts is  
5 reached, WMB Card Services would revert to its lower-contribution “Before Rates”  
6 mailing patterns. This is because once the cap is reached and WMB is ineligible for  
7 additional NSA discounts, First-Class Mail postage will again be about ten cents higher  
8 than Standard Mail postage. As discussed in Section VI, for much of our acquisition  
9 mail, the lift from using First-Class Mail does not justify the ten-cent higher postage cost.

10 Further, since the NSA as negotiated just exceeds breakeven for WMB Card  
11 Services, I believe that implementing the agreement’s requirements would not be  
12 economically justifiable if Card Services only received postage discounts for a year.  
13 Given this, if the Commission imposes a cap of approximately \$10 million on postage  
14 discounts, the economic rationale for WMB Card Services’ participation in the NSA  
15 would be lost. This would be unfortunate because I believe the NSA as executed benefits  
16 both parties.

17 **VIII. ADDRESS HYGIENE AND RETURN MAIL VOLUMES**

18 As required under the NSA, Washington Mutual will continue its practice of only  
19 using addresses that have been processed against National Change of Address / Coding  
20 Accuracy Support System databases within the 90 days prior to mailing. Based upon this  
21 practice, our recent return rates were approximately 1 percent for operational mail and  
22 4.5 percent for marketing mail.<sup>7</sup> Also, as part of the agreement, WMB Card Services has

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<sup>7</sup> These return rates were calculated using 2005 data for acquisition mail and 2003-2004 data for mail (including operational and marketing pieces) sent to existing customers.

1 agreed to update its databases for soliciting non-cardholders using ACS data. While  
2 using ACS data could reduce our return rate, thereby reducing Postal Service costs and  
3 increasing the value of the agreement to the Postal Service, I conservatively estimate that  
4 our return rates for the duration of the NSA will be similar to our recent return rates.  
5 While these requirements have value to the Service, the principal value of the NSA to  
6 USPS is the significant increase in First-Class Mail volumes and net contribution to  
7 institutional costs.

8 **CONCLUSION**

9       The proposed NSA creates strong economic incentives to Card Services to  
10 redirect Standard Mail volume to First-Class Mail. We are not asking the Commission to  
11 approve this NSA because of the incidental cost savings that are part of the deal; rather,  
12 this NSA is a baseline agreement; it is not functionally equivalent to previous  
13 agreements; and it should be judged on its own merits. We believe that the volume  
14 projections before- and after-rates are quite realistic and, because of that, should mitigate  
15 concerns about potential losses to the Postal Service. In the deals struck in previous  
16 NSAs, where caps were imposed in order to limit potential losses to the Postal Service,  
17 the cap still permitted the agreements to have economic viability for the partners. That is  
18 not the case here. This deal will not work for Card Services if the amount of the  
19 discounts is capped so that no discounts are available in Years 2 and 3. As we testify,  
20 that would kill this deal for Card Services. There would be no economic incentive to  
21 convert Standard Mail to First-Class and, therefore, there would be a reversion to the  
22 *status quo ante*, and a very large conversion of First-Class Mail to Standard Mail in Years

- 1 2 and 3. That makes no sense for Card Services and it certainly would make no sense for
- 2 the Postal Service. We urge the Commission to approve the deal that we made.

**Exhibit A. Calculation of After-Rates First-Class Mail Volume (in Millions)**

Year	Before Rates Volume			Migration From Standard to First-Class Mail			Reinvestment of Benefit		After-Rates FCM Volume
	Total	First-Class	Standard	Incr. FCM Vol	Total Discount	Discount/Pc	Benefit	Incr. FCM Vol	
	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]	[9]
Year 1	764	450	314	263	\$10.7	\$0.041	\$0.2	0.4	713
Year 2	805	475	330	274	\$11.4	\$0.041	\$0.4	1.1	750
Year 3	845	500	345	283	\$11.9	\$0.042	\$0.6	1.5	785

[1],[2],[3] WMB-T-1, Table 3

[3] All of these pieces are acquisition mailpieces.

[4] Approximate number of acquisition First-Class Mail pieces required to obtain the same number of responses as the Standard Mail pieces in [3]. Further, with 4-cent discount, these First-Class Mail acquisition pieces can be mailed at about the same total cost as the Standard Mail pieces in [3].

[5] NSA discount for mailing combined First-Class Mail volume in [2] and [4]. (Calculated assuming 5% per year increase in the volume threshold.)

[6]=[5]/[4]

[7]=[4]\*([6]-\$0.04)

[8] Approximate First-Class Mail volume that can be sent with "benefit" in [7].

[9]=[2]+[4]+[8]

Note: To protect confidentiality, numbers in this exhibit are approximations.