

TRK ADVISORS

**Credit Card Management Series
Bonus Session**

**Credit Card Agent Programs
(*& How Best to Explore Them*)**

Timothy Kolk
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CALLAHAN
ASSOCIATES
the credit union company

Knowledge. Insight. Strategy.

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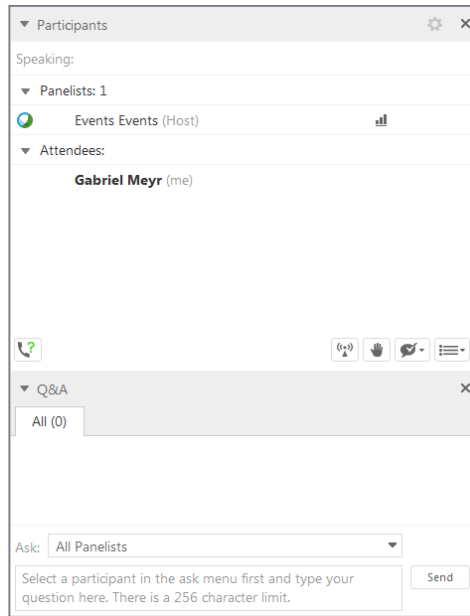
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Slide Link

Today's slides can be found online at:

<http://bit.ly/2019-10-16-agent-cards>

We Encourage Questions



Use the

Questions Box

located on the right side of the screen, to type your comments or questions.

Tell Us What You Think!



Please take our post-event survey. We value your feedback!

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Why This Add-on Session?

1. We've received more than a few "Hey Tim, tell me about..." calls.
2. This year we have already helped two establish this type of program, and three more are in the middle of an evaluation.
3. All credit union and portfolio sizes.
4. We have also talked to others who started this process without enough information, and have boxed themselves into a bad position.
5. It's planning season; this can be a natural fit to those strategy and financial forecasting discussions.
6. Callahan & Associates is committed to keeping this community informed and forward looking.

TRK Advisors Background

- Head of a \$300+ million bank card portfolio which made this choice in 1995. Early in the agent program history. Two year negotiation, closed in 1997. Very tricky portfolio.
- Cofounded card consulting and advisory firm in 2000. In 2009 founded TRK Advisors to focus on regional and smaller card issuers: mostly program improvement consulting.
- Since 2000 have personally evaluated hundreds of card portfolios; have negotiated over 100 agent relationships.
- Advised on more than \$1 billion in portfolio sales

Today's Topics

- When CUs tend to be interested
- What is an agent program?
- Market trends: how many?
- Why the increasing interest lately?
- The evaluation process: It Matters
- What does an offer include? What is the math?
- The legal agreements
- Position yourself for success

Throughout

How to avoid making mistakes you don't even see.

The Basics: What is an Agent Program

1. Another credit card issuer will be the source of credit cards for your members.
2. They issue cards with your name and logo.
3. Partner is responsible for all product development, technology, reward program, marketing investments, fraud, credit risk...everything, really.
4. Credit union supports marketing efforts: web site, new account marketing (lists for partner, branch/similar efforts), employee promotions,...
5. Credit union receives up-front payment for existing accounts and ongoing revenues on transferred portfolio and new accounts.
6. Reverse Loan Loss Allowance and Reward Accrual, free up capital, eliminate credit, fraud and operational risk.
7. Trade a mostly interest income product for a fee income product.

CU Interests: Strategic Reasons

Often Examined When ...

1. CU has tried to grow and found it too difficult and/or expensive
 - a) CU market average program growth rate has been 6-8%/yr
 - b) But 50% have actually been getting smaller, 80% growing less than average
 - c) Falling short signals competitive weakness in the card product
2. Changes to the card product necessary to keep it competitive are not within the resources/budget of the credit union
3. New accounts just aren't coming in like they used to
4. Members express disinterest/dissatisfaction in the program
5. Processing contracts are coming up and a full option analysis is desired
6. Staff or processor skills are hard to find

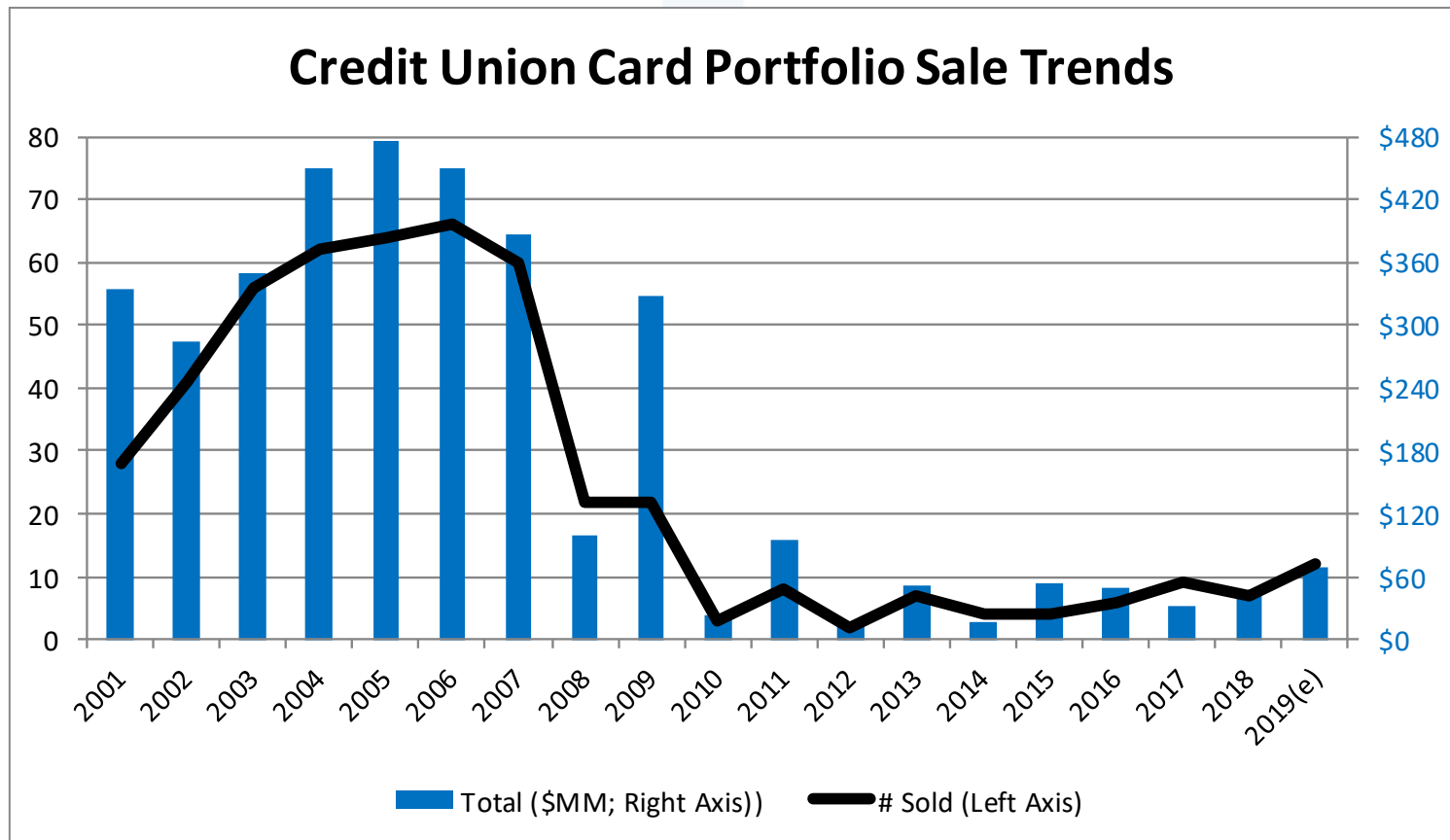
CU Interests: Financial Reasons

Or When ...

1. Capital is needed or capital ratios need improvement (e.g. RBC)
2. Net Income is needed
3. Prioritizing fee income over margin-driven revenues
4. Looking to improve efficiency ratios/lower expenses
5. Concerns about overall credit risk and/or fraud risks mount
6. There are other higher priorities for limited investment funds
7. Regulatory and related burdens become too challenging

How Many Have Chosen This?

- Before the last recession 60-80 per year were making this choice



We have identified 471 who did this, with \$3.5 billion in balances.

Why This Trend Line?

Reasons for strong interest from 2001-2008

- 1) Large banks innovated products, value & technology. Rewards became necessary.
- 2) Credit union processing community struggled to keep pace: expenses & capabilities.
- 3) Strong loan demand on other 'more substantial' loan products.
- 4) Liquidity and capital constraints forced priority choices.

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What happened from 2008-2010

- 1) Recession: Almost no agent providers wanted to add card assets.
- 2) CARD Act caused major disruptions in processing environments & attention

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Since the recession ended: 2011-2018

- 1) Weak loan demand; every balance sheet loan was a good loan
- 2) Very low cost of funds; margins on card were never better
- 3) Credit losses at historic lows; felt safe (aside from fraud...)
- 4) Processors made good strides in technology and member-facing tools

Today: Back to the Future?

Competitor innovation is very difficult to keep up with

- *Strong Products:* Signature/World, Promotional terms are hard to match
- *Reward Value:* 1.5% base rate for cash back, accelerators abound
- *Unique Propositions:* Amazon Card, Airline & Hotel Cards, Disney
- *Niche Penetration:* Uber Card, Savor Card, Petal ...

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New Competitors: FinTechs Taking Balances Where They Can

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New Competitors: FinTechs Taking Balances Where They Can

Processors:

- Challenge to stay functionally competitive with a client base that tends to pick lowest cost option.
- Parade of acquisitions and transitions makes it hard to stay aligned and focused on growth.
- Full-service vs. In-house is a fundamental strategy decision. Pros and cons to each, but neither solves every desire

Today: Back to the Future? (cont)

Economic Conditions

- Liquidity becoming an issue again, Funding costs up
- Prime moving down, lowering Yield each time
- Credit Union card charge-offs at all time high except for recession
- Profitability was buoyed by rising rates and declining charge-offs. Now the opposite is true.
- Card market growth rates are slowing. Tomorrow tougher than yesterday.

Today: Back to the Future? (cont)

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Regulatory/Audit

- CECL could force substantial Reserve expense recognition at any time
- Risk-based Capital burdens credit card most (capital against unused lies)
- Would a more progressive regulatory regime impose further burdens?
- Many are finding that their reward accrual rates (e.g. 35%) are too low, catch-up adjustments can be painful (more of an audit finding, but still)

Evaluating The Agent Option

There are many pitfalls: This is not a casual process

Your priorities should include:

1. Maintaining your leverage and negotiating power
2. Controlling the flow and use of information
3. Ensuring any proposal prioritizes your priorities
4. Do not bind yourself to anything before you need to

Maximizing your outcome requires:

1. A little internal discussion and work before you get started
2. Identifying your reasons for initial interest in this option
3. Ensuring that you don't get lose leverage yourself by mistake
4. Taking the time to understand the trade-offs clearly
5. Set up a few 'off ramps' to protect your options all along the way

The Worst First Step

“With a little information we can tell you what your card program is worth*, do you want to know? And it’s free!”

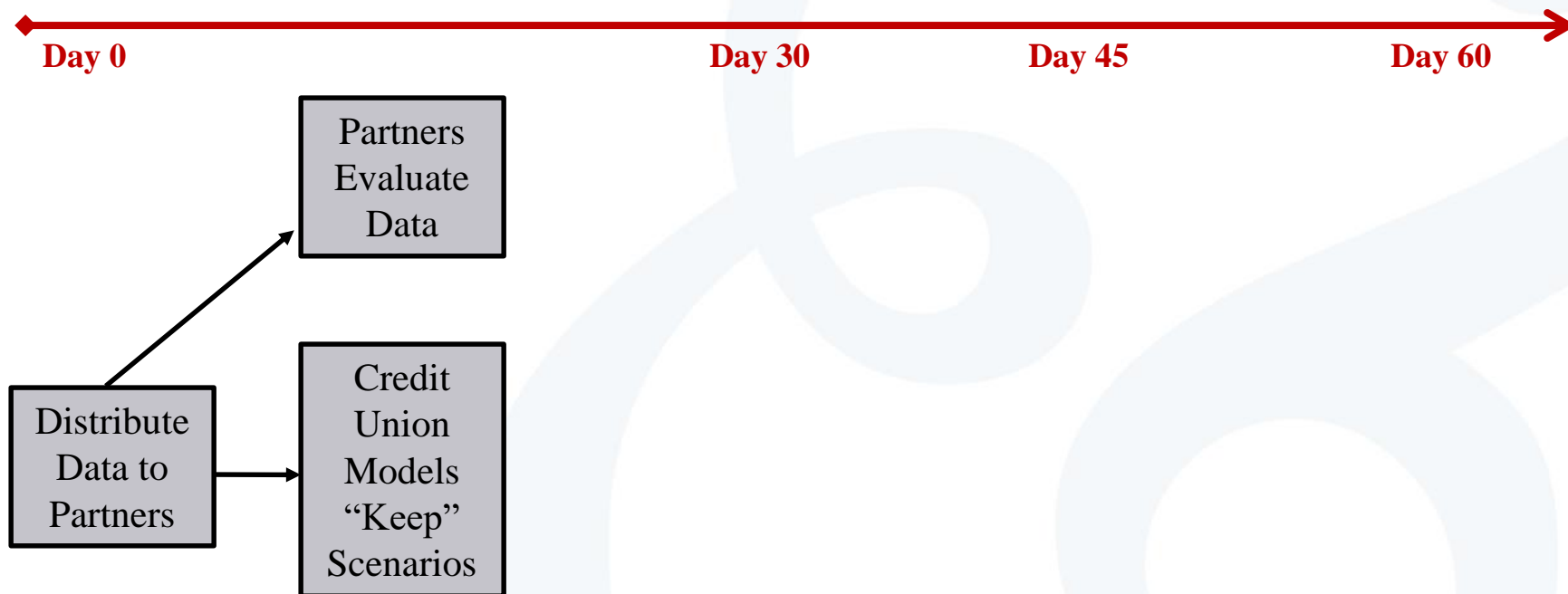
- Often proposed by investment advisors
- Often represent only one potential partner: yikes!
- They have no expertise in card program management, evaluating member impact, negotiating the contracts.
- It’s just another trade to them.
- Disruptive to the organization, often for no positive outcome.
- You will never know if you got the best offer, as you abandon every piece of leverage you could have.

** The most aggressive may even give you some #s.*

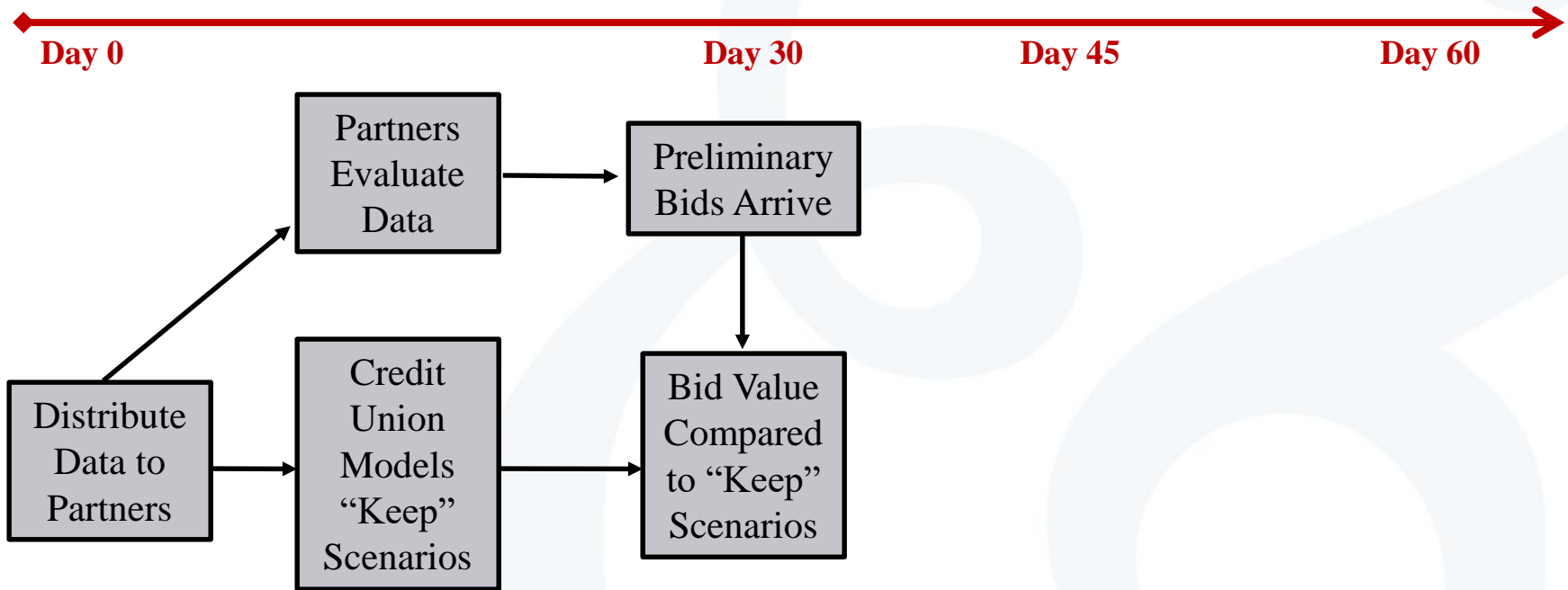
The Proper Path Forward

- Charter a small team to discuss: finance, member experience officer, operating officer, risk manager, lending manager
- Develop a narrative and data package of what partners need to know. Emphasize opportunities for growth (new accounts or better portfolio management), clarify outcome priorities, explain any history or issues that will impair value. Tell a story of opportunity!
- Identify qualified partners and distribute to all. Impose a timeline for responses. Require financial proposal, initial description of products, transition plan and cardholder experience, timeline, post-contract relationship management plan, marketing calendars...
- Review written responses before any on-site presentation. Determine if any are good enough for further work. If not, jettison. If yes, move forward.

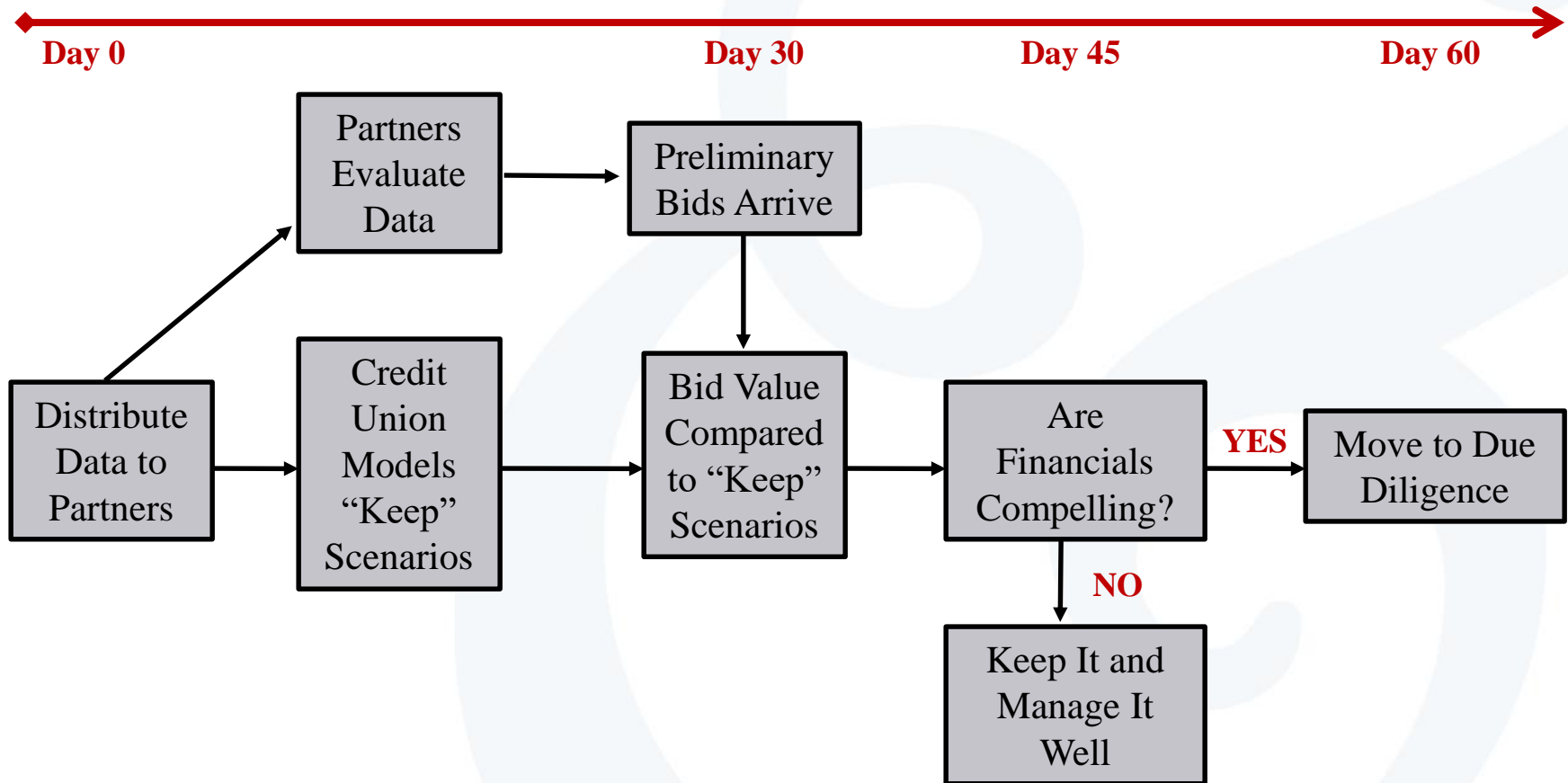
Typical Evaluation Timeline



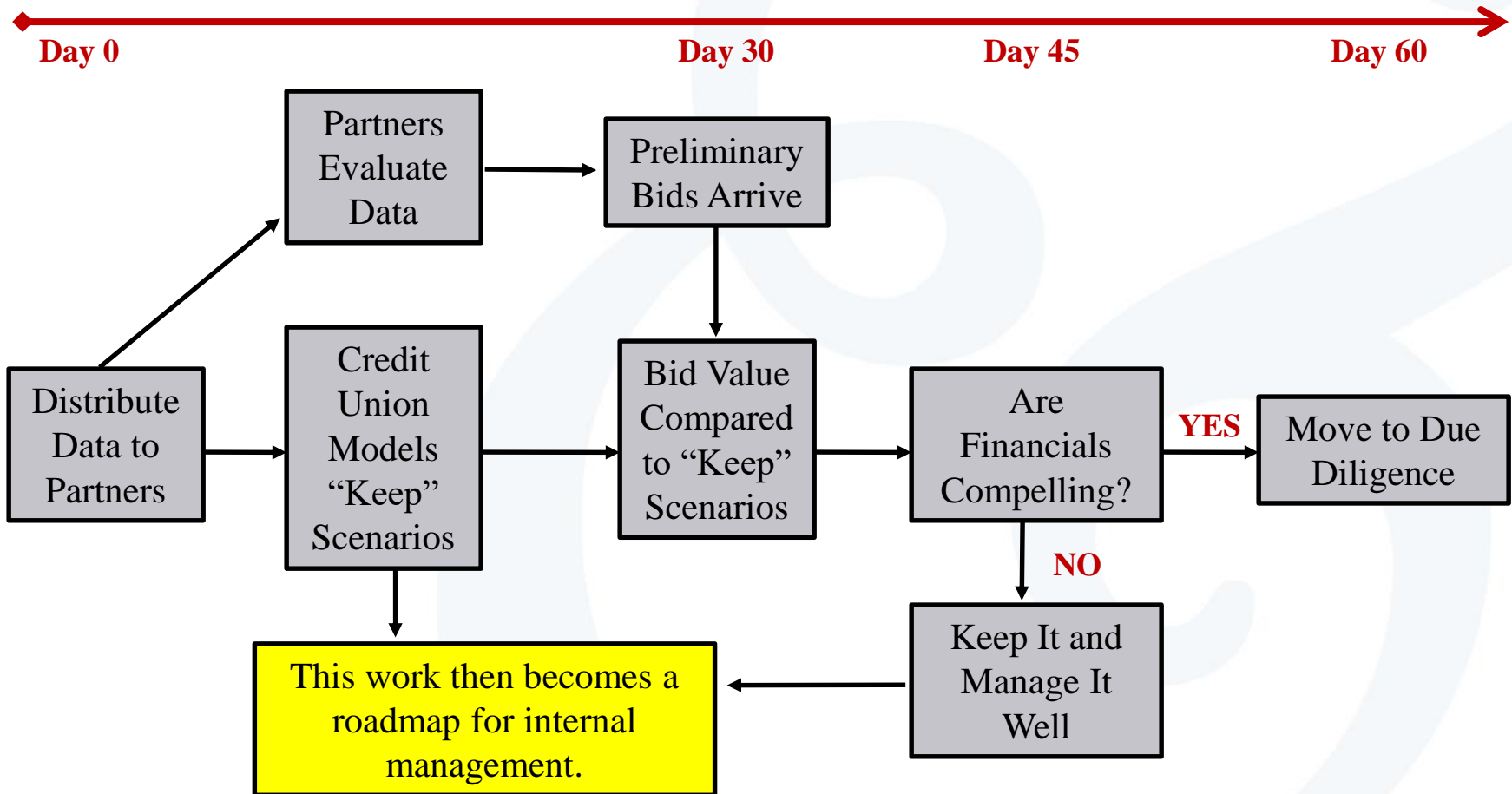
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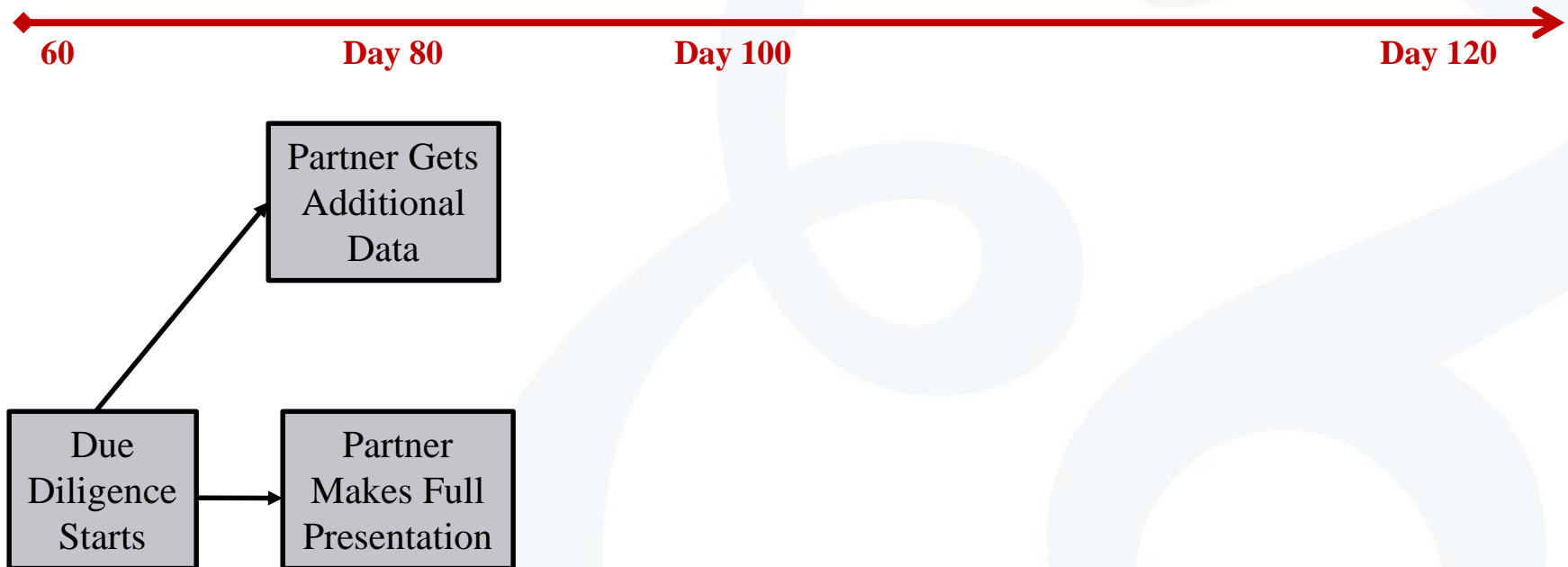
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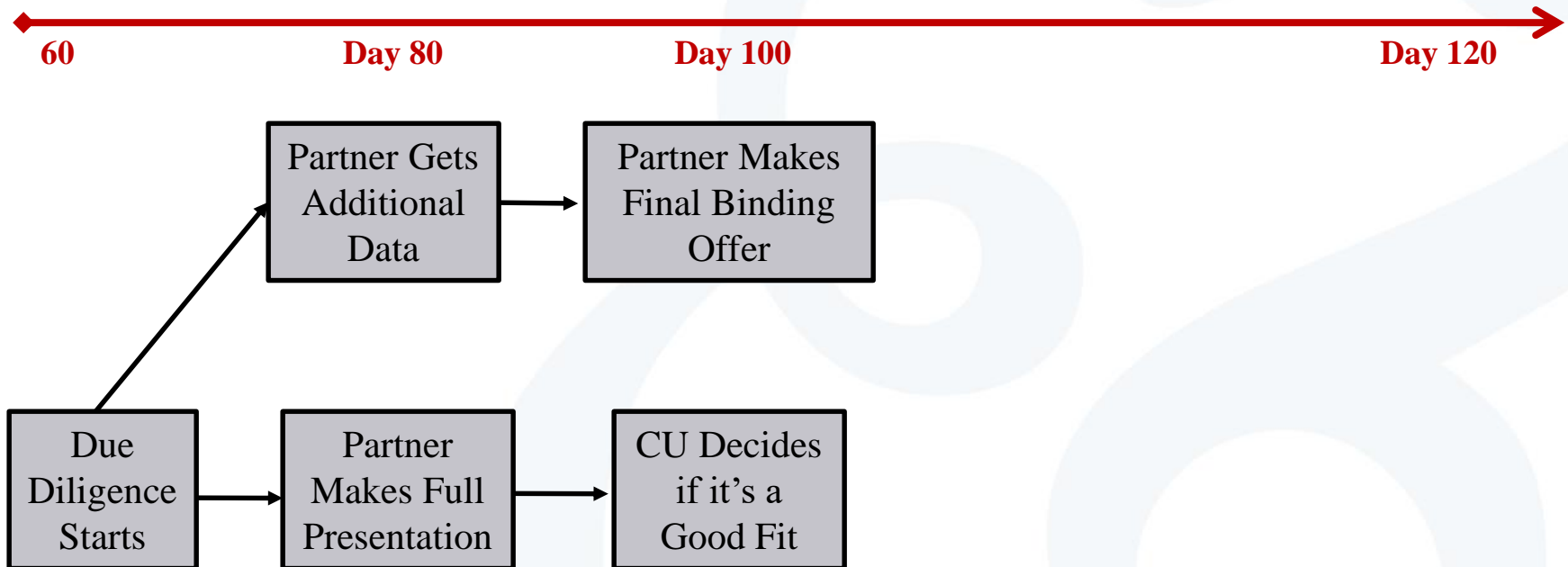
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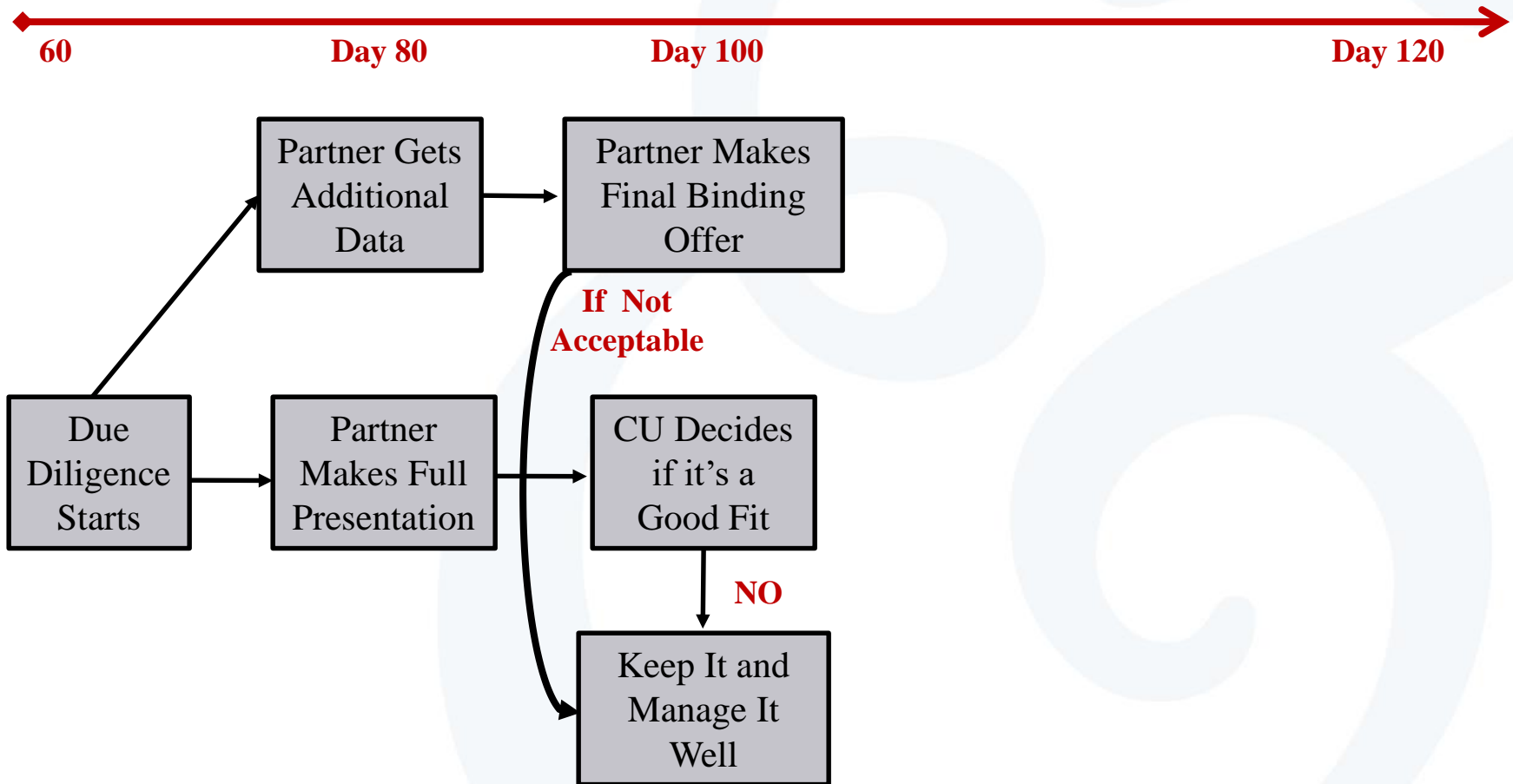
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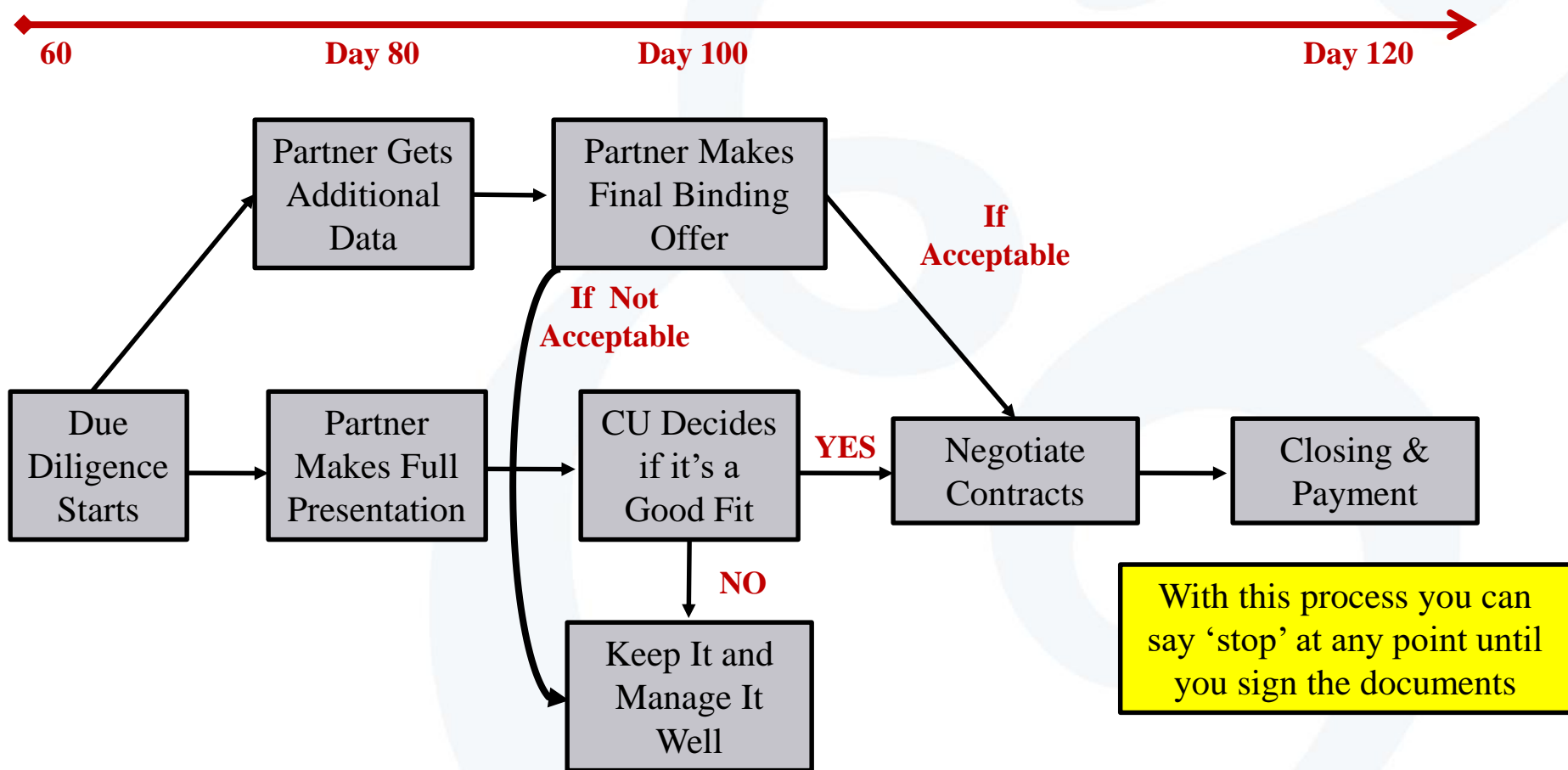
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Typical Evaluation Timeline



What Does An Offer Look Like

Components of the Financial Offer

Up-front Payment: Value of the portfolio + a premium

Ex) \$10 million portfolio at a 10% premium means you get \$11 million in cash, and \$1 million is booked as a one-time gain.

Ongoing Fees (for duration of partnership):

- Sharing in interest and/or interchange from the entire portfolio (purchased and new accounts)
- Fees for new account originations (often two categories)

Other Financial Impacts

- Reverse Loan Loss Allowance (maybe \$300,000 on a \$10MM portfolio)
- Reverse Reward Accrual liability (100MM points = \$500,000- \$700,000)
- Reinvest proceeds in other earning assets for annual, ongoing earnings
- Reduce RBC denominator (balances and unused lines)
- (minus) Potential exit costs to existing contracts (don't forget!)

The Legal Elements of The Relationship

1) Purchase & Sale Agreement

Governs the immediate transaction: Pricing, what accounts are included at the premium amount, what are purchased at a different price, what are not purchased, and what are purchased with recourse.

2) Agent/Joint Marketing Agreement

Defined the obligations of each party and term of the agreement (typically with autorenewals). Sets SLAs. Defines credit union rights if it wants to get back into credit card issuing later (very important!).

3) Interim Servicing Agreement (not always needed)

Defines obligations between the period of initial portfolio purchase and following portfolio conversion to new system.

All of these require careful review and should be part of the evaluation process before you decide if you want to proceed.

Making It A Successful Effort

- 1) Demonstrate you will be an engaged partner:
 - Looking to continue to promote cards
 - Ask a lot of questions about marketing support and partner efforts to promote the card; needs to be a good match!
 - Be open about what members want that you are having trouble providing

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- 2) Explain the strategic reasons you are exploring this option:
 - Do not focus on 'we want the \$' elements (if done right you don't need to)
 - Discuss member needs, growth plans and anything else that shows future account demand will be strong with competitive products
 - Works best if you want to bring the strengths of a partner to your card program and your members: competitive rewards, mobile tools, servicing skills, etc

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 - Works best if you want to bring the strengths of a partner to your card program and your members: competitive rewards, mobile tools, servicing skills, etc
- 3) Be forthright about any potential issues: it will all come out in due diligence.

More reasons why "Want a free offer?" is damaging.

The Absolute Worst Things To Do

- 1) Work with someone who brings only one option
 - Ask: “How many will see this opportunity?”
 - Ask: “How many different partners have you placed in the last two yrs”
 - A partner with no competition may not have the sharpest pencil.
- 2) Sign an agreement with an ‘exclusive period’ (e.g. 1 yr)
 - If they can’t bring a good opportunity immediately, why do they need this?
- 3) Work with a generalist
 - Card is specialized, that’s why it’s a (fun) challenge to manage
 - One size does not fit all; strategy & culture must match as much as the #s
 - Ask “How do you support me after the offer? Do you come to due diligence? What are the related contracts and what is in each? What does the transition look like? What problems have you helped solve? Will you review my current processor contract for exit costs?....”

The Absolute Best Things To Do

- 1) Make sure you also look at what your program could become with the right amount of commitment.
- 2) Make sure the management team has discussed why you are interested before you send data anywhere.
- 3) Define what success looks like before any partner is allowed to come in for discussions (the “Partner Scorecard” should be designed before discussions).
- 4) Receive multiple financial offers and review them before any on-site audience is granted.
- 5) Look at financial value last: strategy first, #s after.
- 6) Don't wait until there is trouble (often too late)
- 7) Assign a strong, senior ‘gatekeeper’ as only point of contact

THANK YOU

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Let me know if you'd like a copy of the presentation (CUs only please)

Feel free to reach out with any questions at any time