

# Credit Unions Return to Credit Cards for Better Service and Profitability



Richard Cordray, the newly appointed director of the Consumer Financial Protection Bureau, wants consumers to receive fair treatment with credit cards and other financial products. Hey, so do credit unions. That's why many of them are getting back into the credit card issuance game for increased revenue and, above all, offer consumers a better choice.

To provide a little history on this topic, credit card expert Tim Kolk of TRK Advisors says about 430 credit unions sold their portfolios between 2000 and 2010. Maybe 50-70 of those institutions no longer exist—with most having merged into other credit unions. This number leaves about 370 that had sold and are still around as operating credit unions.

At year-end 2010, about 25 credit unions had actually started new programs that had previously sold (spread across several prior years, some as early as 2005). In 2011, Kolk estimates another 10–15 started new programs, as well. “Three credit unions did so by purchasing back their old portfolios,” he says. “The rest are starting from scratch.”

At the time of publishing, Kolk believes around 40 credit unions have already restarted their programs that had previously sold—about 10% of the original 430. And there are certainly other credit unions that have decided to reenter in the next few years as their current agent agreements expire as well as even more starting to ponder a return to credit card issuing. There is no doubt that more could be restarting their programs this year and in the near future—which many experts have said is an opportune time.

“It's a good time to get back in on the ground floor because of the cautiously optimistic comments being made by economists,” says Caroline Lane, Senior Vice President, Business Development & Marketing at CO-OP Financial Services. “There are signs that things are sparking back to life and when consumer confidence returns, consumers use their credit cards. So now is a good time because consumers aren't receiving a flood of competing card offers yet.”

Since credit unions were formed to serve people of modest means, Lane adds, now is the perfect time to

demonstrate that vision and help those consumers who might not be well-served by big banks. With all of the changes in the secondary market for portfolios, there will be stepped-up credit card marketing efforts to consumers, so credit unions want to ensure they are protecting their relationships with their members by making them an attractive offer on a credit card product to continue enhancing their value.

Another reason to get back in, Lane explains: “In the last two years negative publicity regarding unfair fees and practices from large bank issuers have appeared in every news channel. Consumers want to trust their financial services provider, and credit unions, with their founding philosophy of ‘people helping people,’ are being touted as the place to turn for fair pricing and honest disclosure. Now is a good time to take advantage of the heightened awareness by aggressively promoting credit card products.”

## Risks Getting Back In

On a note of caution, Kolk says credit unions need to have clear expectations if they’re returning to the credit card business. Benchmarking against what others have done in the past is a good place to start. For instance, on average credit unions that start reissuing cards seem to penetrate about 2% of their members in their first year of the new program, and growth seems to continue at that pace fairly consistently for the next several years. But he cited several credit unions he has met who had plans to penetrate 5% or even 10% of their member base in the first year or two. While possible, Kolk cautions that may not be realistic without incredible focus and marketing commitments.

“Although, it’s a very profitable product, it’s also a very risky product—especially in the beginning because new accounts are riskier than established ones. You don’t know what you’re getting in the beginning,” he explains. “Established programs are less risky because the cardholders are stable, whereas, with new accounts, the charge-offs will be above average in the beginning.”

Kolk adds that it’s not a business to get into if you want to earn a quick buck. It usually takes three or four years to fully earn back what you put into the program to get it restarted. “It can be a great decision to get back in

but don’t expect to have a quick turnaround to profit here,” he says. “Credit unions need to have a rigorous business plan to succeed, with realistic expectations about the time, energy and costs required to invest to build that long term value.”

Kolk has seen a few credit unions get back in without any real business plan and a simple desire to find more loan balances with good yields. While there is nothing wrong with that motivation they sometimes find that the bottom line doesn’t follow so easily. And some have had downright disastrous results, citing specific examples of credit unions that had charge-off rates of more than 6% by the third year of their new programs.

“This remains a tough economy for prudent lending, particularly unsecured credit. The economy doesn’t care if you make a mistake,” Kolk states. “Credit unions need to have a well developed and reviewed plan and staff their card management with data-driven professionals. Only then will they be able to track performance to plan and correct course early on when issues arise.”

CO-OP’s Lane agrees, adding that credit cards are essentially unsecured loans. “It’s the first loan people walk away from when they get into financial trouble,” she says. “This is where credit unions need to be sure their credit standards are up to par—and review them regularly to avoid any issues.”

The credit landscape is entirely different in the post-recession era. To maintain their standards, credit unions now must look at a longer span of time of a particular member’s credit history to see if they can be a viable, risk-free borrower—which creates a whole new issue: the pool of available cardholders being much smaller today because of the economy.

Adding insult to injury, Lane says that many cardholders today are carrying less debt than pre-recession days—which puts another dent in a credit union’s income stream. “People are much more cautious now about carrying debt or just having ‘balance rollers’ on their cards,” she explains. “Credit unions can’t depend on that income anymore; they’ll have to depend on transactions and get creative in managing their risk.”

Lane uses herself as an example of her changing credit spending habits: “I used to use my credit card to pay for a vacation and take two or three months to pay it off. I wouldn’t think twice about it,” she says. “Now, I’m much more vigilant on how I use it.”

It is important for credit unions to be realistic and fully understanding about the start up costs, the marketing costs and ongoing costs of a credit card portfolio, and to plan appropriately. Most credit-worthy consumers already carry several credit cards and the reduced average response rate to card solicitations, along with the need to influence change in spending behaviors to make the credit union’s credit card the card of choice, take considerable planning and management.

## State of the Credit Card Industry

Painting a rosier picture: The state of the credit card industry, according to Jennifer Kerry, Vice President of Credit Card Services at CO-OP Financial Services, is both a mature and a dynamic market—as the proliferation and convenience of credit card use is always changing. As the world continues to move toward the use of digital means of payment, the credit card market has been nimble and has developed and spun off a plethora of product and service variations to keep up with the consumer purchasing habits and needs.

Jeremy Pinard, CLO, Community Financial Credit Union, believes the credit card industry has a great outlook right now and credit unions need to get on board to offer a great product, gain market share and take care of their members, whereas, banks see credit card portfolios as a pure profit line item. “I believe we can look at it as a great service to our members,” Pinard says. “While we have to ensure our credit card portfolio performs, we don’t have to make the margins banks do. Take care of your members and they will take care of you.”

## Why Credit Unions Should Issue Credit Cards and/or Get Back in the Game

Lane states that credit card portfolios were going for a premium five or six years ago. Credit unions may have made the decision to sell their credit card portfolios to reduce their risk exposure and for a one time lift to their balance sheet. [Most credit unions thought they would be able to retain the relationship with their card members through an “agent” relationship, but soon found that in most cases if they sold their portfolio to a bank, or the entity they sold to, actually sold to a bank.] Subsequently, they did not have much control at all.

“Many credit unions today are taking a full swing in the opposite direction, getting back into issuing their own credit cards, knowing that they can provide more fair product pricing, credit union-centric product structures, and better member service,” she explains. “The credit card is practically a mandatory product offering that consumers expect from their financial institution.”

When a credit union issues the card, it has the ability to offer the personal and customized services that are expected from a credit union. Not to mention credit card portfolios are a profitable product line to the credit union as well as a valuable member service.

A well-managed credit card portfolio is profitable in more ways than just the bottom line. Not only are credit cards a very popular consumer product, but credit cards are “sticky”, meaning cardholders tend to hang on to their favorite credit card, whether or not circumstances lead them to move other financial services relationships. Keeping this relationship alive and active throughout lifecycle changes provides opportunities for cross-sell and keeps the credit union top of mind for new product/service offerings.

“Credit cards are the perfect vehicle for loyalty-building with programs like rewards that tie earning points to card usage,” CO-OP’s Kerry says. “Credit union-specific offers and messages keep the product fresh and communicating to credit card members is relatively easy, as the account is transaction-based and requires monthly “statementing.”

Even though there are plenty of relationship reasons to issue credit cards, the credit card product line is also profitable—something credit unions are looking for to remain viable.

“We wanted the ability to offer our members a card that was owned, operated and controlled by the credit union,” says Community Financial’s Pinard, whose credit union was out of the credit card issuing business for six years. “Credit cards, along with debit cards, are just another way to gain ‘wallet share.’ When members open their wallets I want them to use only our cards.”

Community Financial’s re-launch has been very successful. The credit union conducted very little marketing in 2011 but has managed to add more than 400 cards and \$500,000 in balances (\$2.7 million in limits). The big push for marketing and growth will come in 2012, as the credit union wanted to work out any issues or problems that could arise with being a beta.

## Credit Unions Credit Cards a Helping Resource

Another reason for credit unions to re-enter or beef up issuing credit cards is to enhance their position as a helping resource for their members who have been adversely affected by the economy. Credit unions can further increase their value by helping this member population restore their financial status.

“The economic downturn hit those traditionally credit-worthy individuals right in the credit score,” Kerry states. “While ‘doing everything right’ by working, paying bills and believing in the American dream of owning their own homes, everything changed.”

The priority of bill paying has changed for some. Well-meaning people have found themselves in a position where they may not be able to pay their mortgage, but need a credit card to help them get back on their feet and will prioritize making that payment.

“Credit unions are just the institutions to help those individuals,” Kerry adds. “Historically, fostering personal relationships with their consumer members, credit unions are more willing to give people a chance

and to work with them to help them restore their financial stability.”

A “Credit Builder” type of credit card product is not foreign to credit unions and the willingness to expend the extra effort to build a product that helps people, along with continuation of fair practices, will make credit unions advantageous in today’s market.

Those who have made necessary changes in their bill-paying habits aren’t the only ones who will benefit from getting their credit card from a credit union. While banks found themselves in a less profitable position over the last few years and took it out on the consumers through a series of penalty fee increases, credit line decreases and in some cases closing of accounts, even those unaffected resent the greediness that has been exposed and are looking for alternatives—a.k.a., credit unions and their multitude of credit card products.

## Credit Card Products

According to Kolk, there are three priorities in designing credit card products that will have the expected impact for credit unions:

1. Use risk-based pricing to price risk-to-rate while at the same time ensuring that the rates are competitive with equivalents offered by the large bank issuers (which is different than making sure you always offer the lowest rate anywhere in town).
2. Demonstrating and communicating that their fee structure is fair and representative of their credit union philosophy (not as aggressive as the bank next door, and show it).
3. Delivering a decent reward program with a combination of cash back, gift cards, travel and other items to those members who want it. Reward programs are a critical tool, but too often credit unions focus on them as only an expense to be reduced. But today about 80% of offers have rewards and consumers expect a value of one penny per point earned; sometimes credit union programs have trouble showing that value. Marketing can suffer as a result.

“Even when all these elements are in place and everyone can feel good about the card program, credit unions need to remember that just because they have a fair program doesn’t mean their members will notice or care,” he says. “Very specific and analytically driven marketing campaigns, with detailed segmentation and messaging, need to make sure the members’ attention is captured and they are given a tangible reason to switch their card provider—because all interested credit worthy members already have a credit card, so you have to displace someone else’s.”

In regards to profitability, Kolk suggests that credit unions have a real advantage over banks and that leads to competitive and marketing advantages. “Banks are the ones trying to maximize profitability,” he states, “credit unions try to reach an acceptable level of profitability. That difference can create a lot of room to provide more appealing products.”

He suggests designing a card program with a reasonable Return on Assets (ROA) of maybe 2-4%. Once that goal is achieved, focus on giving the highest possible value to the cardholders (lowest reasonable rate, reward bonuses, etc.) instead of trying to bring even more to the bottom line.

Pinard echoes Kolk’s profitability comment: “I believe members see credit cards as a way for banks to generate huge fee and interest income,” he says. “We believe our members deserve a simple and fair card when it comes to that.”

Simple is right: Community Financial has one rate for cash advance, purchase or balance transfers. It doesn’t charge any annual fees, huge late fees or over the limit fees. “It’s simple,” Pinard says. “Here is your interest rate and when you use the card this is what you will pay us.”

Being fair to members when issuing credit cards is noble, but credit unions need to have some semblance of profitability—and even Kolk’s 2-4% ROA target is not always an easy task because of the highly competitive environment. To ensure credit union profitability targets are achieved, whether maximizing or shooting for something a little lower, requires specialized credit card program reporting is in place and forecasting

tools are operating in close to real-time. To review the card program once a year during budget season is a recipe for disaster (and probably means there is no one watching and responsible for the program on a daily basis).

## Designing for Specific Membership Segments

In designing a credit card product for specific membership segments, Kolk says to first determine what different members see as the function of the credit card product—Marketing 101: research and know your audience. “Those who see it as a source of credit are going to respond very differently than those who view it is a transactional convenience,” he says. “Those groups see this as two different products, actually, and effective marketing messages and the valued product features are very different between them.”

Kolk adds within those very broad categories there are many other ways to go about segmenting the member base, for example:

- Long-term and established members are different than newer members,
- Community-based members are different than SEG-based members,
- Those whose credit scores are increasing over time are different than the reverse,
- Those who already have a card but don’t use it now are different from those who never had an interest in the card.

One can go on and on, he says, and proper segmentation has to be responsive to the specific situation, history and goals of each credit union. Credit unions need to think about their overall member contact and messaging strategy and then put the credit card within the broader brand message and segmentation plan. Too often a card is marketed as “something else we have” not as part of the entire relationship or credit union message—and that’s a real missed opportunity.



## Structuring Credit Cards to Meet Varying Member Needs

As for structuring credit card products to meet the varying needs of members, Kolk says he's seen issuers try to convince members to use cards in ways they haven't before, such as using a credit card instead of a debit card. "Those efforts rarely pay off," he says, "as consumers pick the products that best suit their needs and world view—and an issuer is always better off providing what a member wants instead of convincing them they want something else instead."

So, for those that use the card to borrow it means offer credit-related value (fair overall rates, rate promotions, consolidation campaigns, no fee transfers, etc.). For those who value the transactional convenience and protections, meanwhile, most of the value comes from ease of use, reward value, variety (not just cash back, not just travel and merchandise), and promotions to reward keeping that card active in the wallet—which is the ultimate goal, a "credit union's nirvana," as Lane puts it.

There are a other interesting ideas out there being used by smaller issuers, Kolk adds, with credit unions limited only by their creativity and appetite for interesting (and challenging) projects. For example, one of his clients has created a local merchant reward program for in-market sporting goods stores. "Those kinds of things are great," he says. "But in general too few credit unions have mastered the basic blocking and tackling, and sometimes getting distracted by the fancy stuff. The first step is to get a process established where regular segmentation and marketing happen based on clearly demonstrated product value. I often get asked what is the 'silver bullet' to sell credit cards. Truth is, the silver bullet is operational excellence, relentless focus and day-to-day work to sell and manage the program."

Since Community Financial started issuing credit cards again back in April 2011, it has structured its cards in the following ways:

1. Its reward card offers points per dollar spent (similar to others), but the credit union increases those points based on a member's relationship rewards score.

Relationship rewards score is an internal number that increases along with the products and balances the member has with the credit union. Relationship rewards score levels are: Platinum, gold and community.

2. The credit union rewards its most loyal members.
3. Platinum earns 2 points for every dollar spent. Gold earns 1.5 per dollar spent. Community earns 1 point per dollar spent.
4. Community Financial credit cards are attached to the members' membership. They can use credit card at ATM and OD (overdraft). They have access to their checking funds through ATM.
5. It is a universal card—only carrying and use the credit card.

Pinard adds that Community Financial has only had one card delinquent for 30 days since it has returned to issuing credit cards last year.

## Managing Portfolios to Manage and Grow Assets

According to Brian Scott, The Members Group Vice President of Sales, credit card loans should be at least 10% of total loans. To drive members to sign up for credit cards to achieve this mark, credit unions should hire a person who is focused on managing the metrics around the program.

"The number one thing any credit union can do to gain cardholders is provide incentives for front line staff to cross-sell credit cards during every member interaction," Scott says. "A simple \$5 incentive to staff for each credit card application and \$20 if the member transfers a balance can be a powerful growth tool. Every member opening an account should receive a credit card as a benefit of membership."

CO-OP's Lane mirrors Scott, saying that step one is having a solid program and step two is driving members to sign up for that program. Credit unions can do this by offering incentives for them to use their credit cards: "X number of times they use it, they get a reward."

## Instant Issuance Increases Usage

One of the most powerful activation tools for credit unions issuing or reissuing credit cards, Brian Scott adds, is instant issuance—which drives up profitability via transactions. “If a member can walk out of a branch with credit card that is ready to be used,” he explains, “the likelihood that the card gets used goes up dramatically.”

Many studies cite the first 45 days as the most critical in determining if members will use a card as their primary credit payment vehicle. Credit unions with instant issuance boast 48% more transactions in the first 45 days, 13% more activated accounts (70% as compared to 85%) and four transactions in the first 10 days as compared with .2 on average when compared to those without instant issuance.

Ongoing usage of the card is most often determined by two criteria: rewards and rate. “Again, rewards programs are powerful drivers of ongoing usage,” Scott says. “If a card member redeems points at least three times, the likelihood of keeping that member as a loyal cardholder goes up dramatically. Rewards programs have the power to create affinity.”

## Grow Profitability and Manage Risk

In many credit unions the first measure of the success in a credit card program is delinquency and charge-offs—rather than overall loan yield. Credit cards are and have historically been the highest yielding asset in most credit unions’ portfolios. The higher rates typical with credit as compared to other loan products (example: 2.99% or 3.99% auto loans compared to 8%–12% credit cards) give the flexibility to offer cards to a greater percentage of members.

According to Scott, some of the most successful credit unions work hard to find ways to say, “Yes,” to members for a card rather than find reasons to say, “No.” Those credit unions take the view that they are in business to serve that person. If the credit union will not approve the credit card, the bank down the street likely will—and certainly not treat the member as well as the credit union. The most successful credit

unions manage the risk associated with credit cards, price their product appropriately and manage the risk associated with their program by using metrics to track trends in their program.

Another key to effective card program management, Scott mentions, is in effectively managing the expenses associated with the program. Regularly purge closed and inactive accounts, manage credit lines effectively by increasing lines for quality cardholders and reducing lines for cardholders not utilizing their lines. Active credit accounts should be at least 65% of total accounts and accounts carrying a balance should be at least 60%. Finally, credit utilization should be less than 40% since most cardholder spending starts to slow down when approaching this threshold.

Many credit unions can easily achieve \$75 in net income per account per year and at least a 4% net yield on the program.

## Grow and Retain Usage

First is segmentation of the portfolio for targeted marketing efforts. Knowing which members are likely to take advantage of specific promotions and only giving promotions to those that are specifically qualified. Many credit unions give blanket promotions that cost more and often result in lower success. For example, knowing that a cardholder routinely makes purchases in home improvement stores, makes the cardholder a good candidate for a reward point promotion on Lowes and Home Depot transactions and likely not on Bed, Bath and Beyond promotions.

To summarize, today is a perfect time to get back in the credit card issuance game to increase income and add another valued product offering—which, in turn, makes credit unions that offer credit cards more inviting and ultimately more valuable. The market is ripe with its slow return and consumer confidence is slowly on the rise once again, as well. Both create a perfect recipe for increased spending, which boost the revenues for offering credit unions nationwide. All this is good news for the industry. But at the same time, credit unions must do their due diligence to avoid any major charge-off issue during this delicate time of recovery. Credit unions must maintain their conservative nature, yet,

enhance their creativity for risk. It's quite the balancing act. But with a rigorous plan for issuance and sensible profitability, credit unions can be well positioned not only to achieve but exceed Richard Cordray's goal of providing fair treatment with credit cards and other financial products. Again, this achievement provides members with a valued service that does nothing but boost a credit union's image and its bottom line.

"I believe we have a unique opportunity to offer a great service to our members and make money," Community Financial's Pinard says. "If a credit union does not have their own credit card portfolio, they should be looking to add one ASAP. The time is now. Don't let it pass you by."

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