



The Power of Plastic Card Relationships

Executive Summary

June 2007



Introduction

As credit unions consider their card strategy for the future, some are facing a tough decision of whether selling their card portfolio is the right decision for their credit union. CSCU, in partnership with Visa, CUNA and Raddon Financial Group, has compiled this Executive Summary as a resource for credit unions to help define the true value of cards in today's financial marketplace.

The numbers speak for themselves. There is a very a strong case for credit unions to remain in the credit card business. More importantly, as indicated in the first slide this document presents, credit unions should consider building their payment strategies around cards, not just offer them as a convenience product. Yet, many credit unions continue to sell their portfolios, despite compelling evidence that a card program helps promote member relationships and is the highest-yield loan or investment asset available to them. This document features data gathered by outside industry experts and graphically illustrates the power of credit unions' credit card relationships and their contribution to ROA. I've included detailed explanation about each slide in the notes section.

Over time, credit unions have cited different reasons for selling their portfolios. Before card fraud spiked in recent years, most said they couldn't compete with large bank issuers. Often, big banks had cherry-picked their best accounts with balance-transfer solicitations, and most credit unions hadn't fought back with their own solicitations and marketing efforts like upgrades to Platinum cards with rewards.

Now that data-security breaches at merchants and other entities have caused fraud to increase, I'm concerned that portfolio sales may accelerate. While fraud is indeed a serious issue, please remember that CSCU and our processing partner FIS have the same fraud-fighting tools in place that the big banks have to fight it, and that we continually work with industry experts to develop new ones.

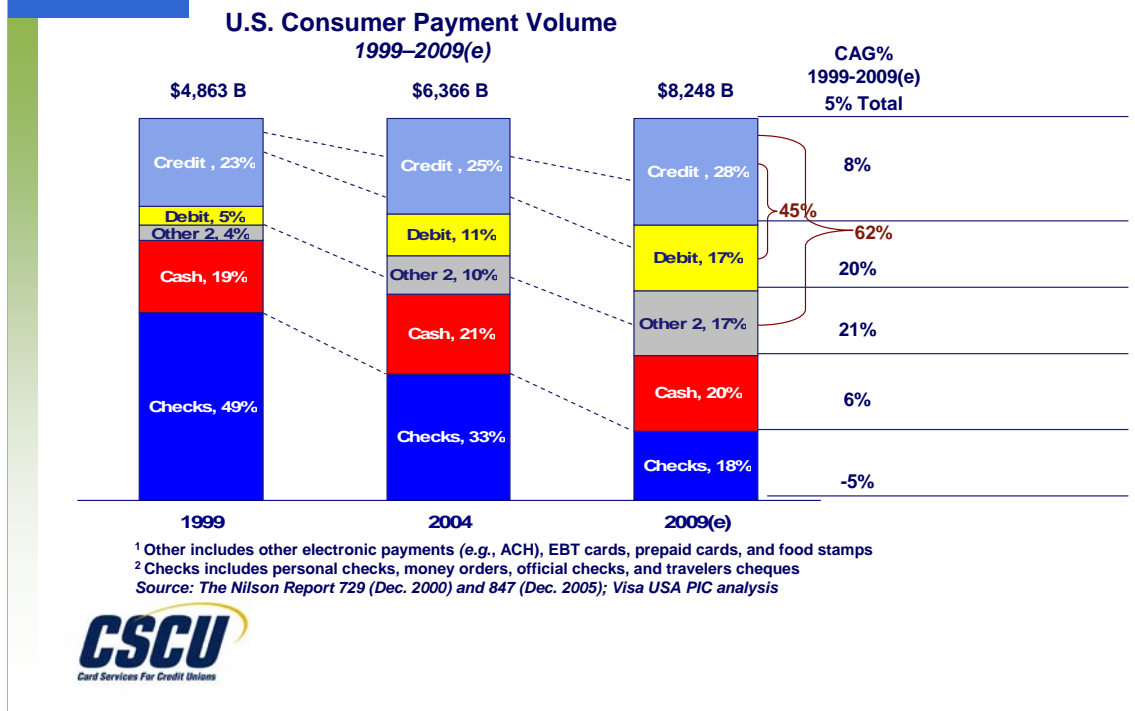
We at CSCU are here to help you build strategies around cards and other electronic-payment vehicles. Please feel free to contact us at 888-930-2728 with any questions you may have.

Sincerely,



Robert R. Hackney III
President, CSCU

Payment Segment Share & Growth: CU Relationship Opportunities



Building and positioning a Credit Union payment strategy to grow members, relationships, and revenues.

Based on data from Visa USA, this slide shows the dollar-volume share of various payment types: credit cards, debit cards, other electronic forms, cash, and checks. As you can see, by 2009 credit cards will be the largest payment segment accounting for 28 percent of all personal-consumption expenditures.

Following credit, debit cards will account for a projected 17 percent of payment volume meaning 45% of all transaction volume will be conducted on cards. It is important to keep in mind that credit and debit cards produce revenue to the credit union while building relationships.

Another 17% of volume will be conducted on other electronic forms such as e-banking/online bill payment and prepaid cards. That's 62% percent of payments made electronically.

While cash will hold its own as a share of consumer payments, checks will decline dramatically as electronic payment volumes skyrocket. This slide makes a strong case for building your payment strategies around electronic-payment products. They're more than convenience products—they're core strategic product offerings for serving and retaining members.

2005 Visa/MasterCard Issuer P&L/ROA

| Revenues: | \$'s (Bil.) | % Total | CU's |
|----------------------|--------------|-------------|-----------------|
| Finance Charge | \$71 | 65% | 71% |
| Interchange | 21 | 19 | 23 |
| Penalty Fees | 8 | 7 | 16 |
| Cash Advance Fees | 5 | 5 | |
| Annual/Other Fees | 4 | 4 | |
| Total | \$109 | 100% | 100% |
| Expenses: | | | |
| Cost of Funds | \$27 | 25% | |
| Ops./Mkt. | 27 | 25 | |
| Charge-Offs | 35 | 32 | |
| Fraud | 1 | 1 | |
| Pretax Profit | \$90 | 83% | |
| | \$19 | 17% | 3.1% ROA |



Source: Cards and Payments May 2006

The income statement for all Visa and MasterCard issuers.

Cards & Payments magazine compiled the data for this slide from all Visa and MasterCard credit card issuers creating this aggregated income statement. Several key points are revealed.

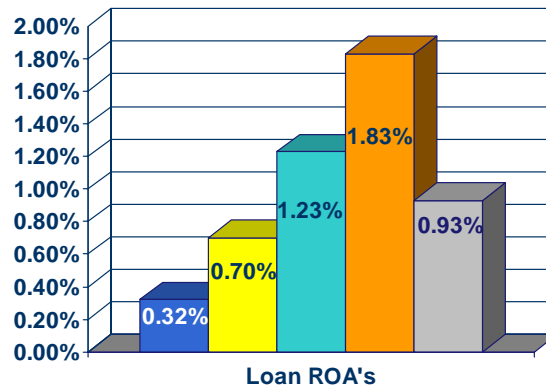
Green Box: Note the impressive 3.1 percent return on assets (ROA) and the 17 percent pre-tax margin. ***With this kind of margin and ROA, it is clear why Credit Unions should retain their portfolios and it is also clear why the big banks would like to buy them.***

Blue Box: Note the comparison between Credit Charge-Offs vs. Fraud. While we all know fraud has escalated dramatically over the last couple of years, it remains significantly less than credit losses. ***Based on this, which should a credit union be more concerned with?***

Red Box: When a Credit Union sells their portfolio to a big bank, they turn over the pricing decisions such as APR and fees. As you can see, 16% of the revenue of big bank portfolios comes from fees vs. only 6% from the aggregate of CSCU credit unions. The key consideration for a credit union is whether the pricing philosophies of the bank are consistent with the credit union.

ROA: Credit Cards vs. Other Loans

Credit Cards Are The Credit Union Industry's Highest Earning Asset



■ Auto ■ Mortgage ■ Equity Credit ■ Credit Card ■ Total



Source: Raddon Financial Group 2006; Callahan's

Credit Card ROA vs. Other Loan Asset ROAs

The data for this slide came from Raddon Financial Group and compares the aggregate ROA of its clients' credit card programs to the ROA of credit union loan assets. ***Credit cards have the highest ROA by far compared to autos, mortgage, and home equity loans and almost twice the total credit union ROA reported in Callahan & Associates.***

If a Credit Union sells their credit card portfolio, there are no other loan or investment options available to them that would yield the same ROA.

Note: Information from this slide will also be used in slide #10.

Visa CU Study of Credit Card Profitability

Return on Assets



| | 2006 CFI Study | | | 2006 Industry* |
|--------------------------------------|----------------|----------------|-----------------|-----------------|
| | Average | Low | High | |
| Revenue | | | | |
| Finance Charges | 9.50% | 7.91% | 10.62% | 12.24% |
| Interchange Fees (Gross) | 3.91% | 2.72% | 5.41% | 3.25% |
| Other Fees | 0.54% | 0.17% | 1.15% | 3.40% |
| Total Revenue | 13.95% | 11.17% | 15.99% | 18.89% |
| Expense | | | | |
| Net Credit Losses | 2.25% | 0.87% | 3.10% | 3.91% |
| Cost of Funds | 2.05% | 1.39% | 2.43% | 4.17% |
| Direct Expense | 4.13% | 2.71% | 6.33% | 3.52% |
| Other Expense** | 1.44% | 0.51% | 4.49% | 2.14% |
| Total Expense | 9.88% | 7.62% | 12.29% | 13.74% |
| Pre-Tax Net Income (ROA) | 4.07% | 2.30% | 5.55% | 5.15% |
| Net Income Per Active Account | \$93.81 | \$53.13 | \$118.30 | \$131.46 |

* Source: Visa Bankcard Outlook, Volume 11, September 2006

** Includes Net Fraud Losses, Rewards and Rebates, Interchange Fees Paid, Visa/Mastercard Association Service Fees and Corporate Overhead

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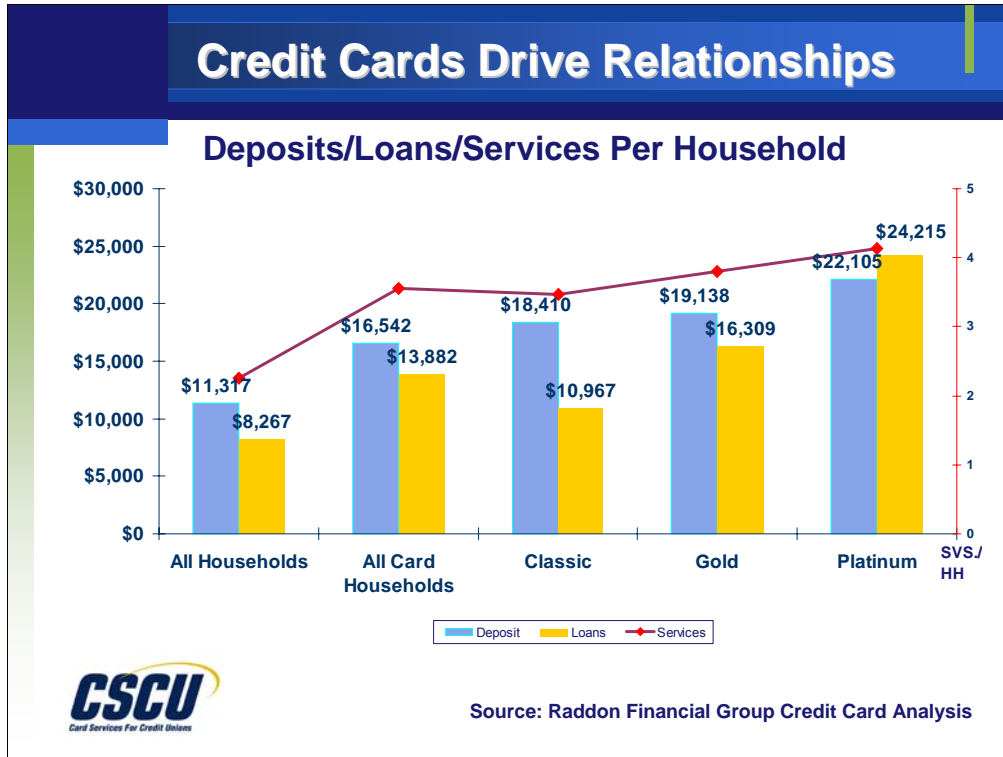
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Source: Visa USA

ROA of 9 Credit Unions that participated in the first ever Visa Credit Union Profitability study completed in 2006.

This slide shows the “bottom line” of Visa USA’s first-ever credit card profitability study for credit unions. Visa analyzed nine credit union’s portfolios in detail and fully captured all revenues and expenses. As you can see, the credit unions’ average ROA is 4.1 percent vs. an industry average of 5.1 percent. Since the industry includes big bank issuers, 4.1 percent is very respectable for these credit unions. It again illustrates that credit cards deliver the strongest ROA of any loan or investment product.



Making the case for: 1) having a credit card program and 2) moving as many cards to Platinum.

This slide, based on data from Raddon Financial Group, makes two cases. The first is that credit unions should have credit card portfolios. If you compare the two sets of bars on the left side of the slide, you'll see that member households with cards have much higher loan and deposit balances (46 percent and 68 percent higher) and more product relationships with credit unions than households without cards.

The slide also makes the case that credit unions should convert as many card accounts to Platinum as possible, since loan, deposit, and service-relationship levels are far higher than with Gold or Classic cards. In fact, CSCU members' Platinum cards generate 77 percent more revenue per account than Classic cards do, so converting to Platinum is an easy revenue-improvement strategy.

2006 Credit Portfolio Comparison

| | CU's ⁽¹⁾ | Industry ⁽²⁾ | Opportunities |
|-------------------------------|---------------------|-------------------------|---------------|
| Usage | 5.6 | 4.8 | |
| % Accts Billed (Active) | 60% | 52.5% | |
| % Accounts w/ Finance Charges | 65% | 56.8% | |
| Total Outstandings Increase | 9.2% | 5.6% | |
| Annual Sales Volume / Account | \$4,578 | \$4,509 | \$69 |
| Annual Cash Volume / Account | \$455 | \$924 | <\$469>* |
| Avg. Cash Disbursements | \$499 | \$1,042 | <\$543>* |
| Avg. Outstandings | \$2,461 | \$2,694 | <\$233>* |

*Opportunity to Grow Outstandings and Finance Charge is Through Balance Transfer



(1) CSCU Portfolio Data – 2006

(2) Visa Business Review – 2006

Contrary to what you may read in the press, credit union credit card portfolios actually outperform the industry in many metrics, but there are opportunities.

The above chart compares various metrics for the aggregate CSCU portfolio vs. industry averages and there is good news as well as opportunities for improvement.

As you can see, the Usage, Active Accounts %, Accounts with Finance Charges % (Revolvers), Growth in Outstandings, and Annual Sales Volume per Account metrics all indicate favorable results relative to the industry and are thus printed in **GREEN**.

The areas of opportunity in **RED** are all related to cash advance activity on credit cards primarily due to the billions of big bank solicitations for new accounts that also have a *balance transfer option, that is treated as a cash advance*.

Cash advances for balance transfer purposes are one of the fastest ways a Credit Union can increase balances, finance charge revenue and ROA.

2006 Classic vs. Platinum

| | Classic | Platinum | Difference |
|--|--------------|--------------|--------------|
| <i>Finance Charge Revenue Related Items:</i> | | | |
| % of Accts w/Finance Charge | 65% | 66% | 1% |
| Avg Credit Line | \$3,465 | \$8,507 | \$5,042 |
| Avg Outstanding | \$1,547 | \$3,439 | \$1,892 |
| Cash Advance Volume/Account | \$189 | \$638 | \$449 |
| Finance Charge Revenue | \$158 | \$292 | \$134 |
| <i>Interchange Revenue Related Items:</i> | | | |
| % Accts Billed (Active) | 57% | 65% | 8% |
| Usage | 4.6 | 6.7 | 2.1 |
| Annual Sales Volume/Account | \$3,460 | \$6,678 | \$3,218 |
| Interchange Revenue | \$52 | \$96 | \$44 |
| Fee Revenue | \$16 | \$12 | (\$4) |
| Total Revenue | \$226 | \$400 | \$174 |
| Gross Revenue Yield | 14.9% | 11.7% | (3.2%) |



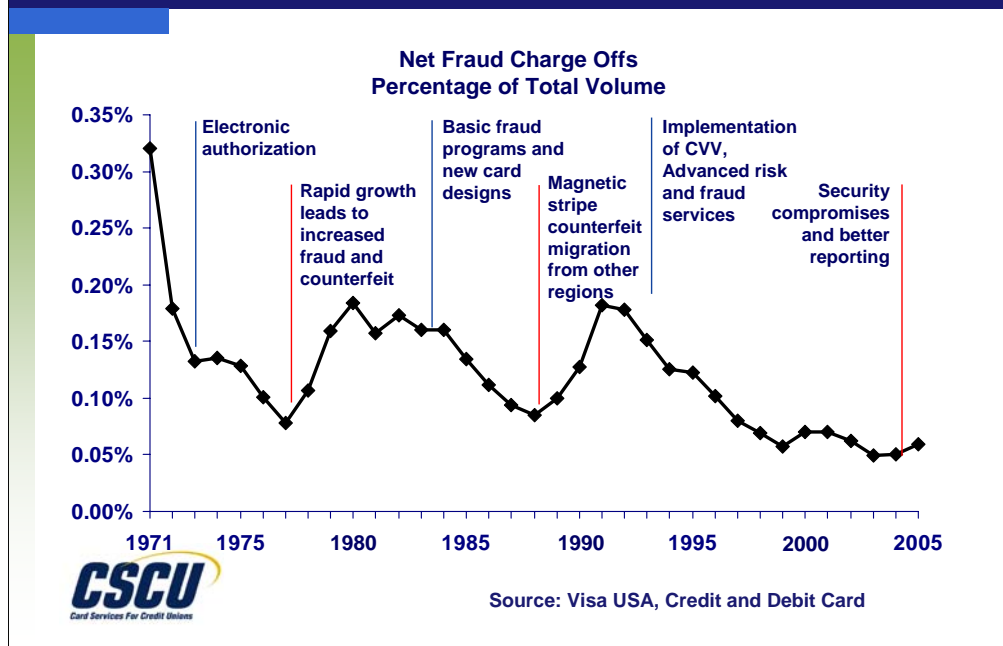
Converting Classic/Standard cards to Platinum cards is an excellent strategy to increase portfolio performance, revenue, and ROA.

The above chart compares the various metrics for the aggregate of the CSCU Platinum portfolios to Classic/Standard portfolios. As you can see, Platinum cards outperform Classic/Standard cards in every metric, all of which translates to a 77% higher revenue per active account.

One of the primary considerations a Credit Union must overcome is the willingness to offer its cardholders the appropriate credit limit to allow the transaction volume and balances to grow, thus driving both interchange and finance charge revenue.

An excellent way of promoting a new Platinum offering is to solicit all members, with and without the Credit Union's card, to do a balance transfer from other bankcards to the new Credit Union Platinum card. This technique will increase card penetration into the membership, increase balances, and will drive finance charge and interchange revenue as well as ROA.

Fraud Trends: Keep In Perspective



35 year fraud trend as a percent of total transaction volume expressed in basis points.

On this slide, data from Visa USA shows fraud trends in terms of basis points of card-sales volume. Fraud hit a historical low of four basis points several years ago, is now around six basis points, and is substantially lower than in the 1980s or early- to mid-1990s. Yet in those days, fraud didn't receive the attention it does now. While fraud is a serious concern that the industry is addressing, this slide suggests we should also keep it in historical perspective: There have been previous spikes and the industry has found ways to reduce fraud.

Industry Losses: Credit vs. Fraud

| | <u>Credit</u> | <u>Fraud</u> |
|--|---------------|--------------|
| Volume: | | |
| As a % of Total Volume | 1.86% | 0.069% |
| Per \$1,000,000 in Volume | \$18,600 | \$690 |
| Outstandings: | | |
| As a % of Total Outstandings | 4.43% | 0.163% |
| Per \$1,000,000 in Outstandings | \$44,300 | \$1,630 |
| Credit Losses 26 Times Greater Than Fraud Losses | | |



Credit Losses vs. Fraud Losses: Which is more costly to a credit card portfolio?

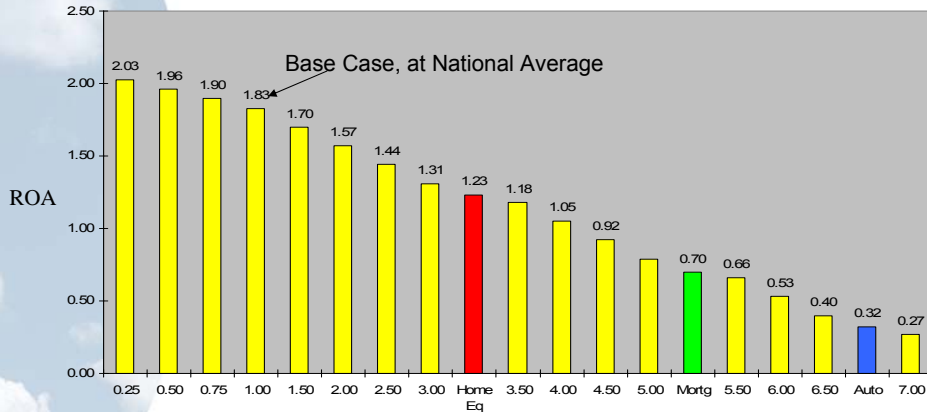
The recent spike in fraud, caused mostly by merchants and processors storing magnetic stripe data and subsequently incurring a data breach resulting in significant fraud, is one of the greatest concerns facing the industry today.

At the same time, fraud losses should also be kept in perspective, particularly with respect to credit losses.

As can be seen above, on an industry wide basis, ***credit losses are 26 times greater than fraud losses***. Said another way, for every \$1 in fraud losses, the industry incurs \$26 in credit losses.

ROA Varies by Fraud Loss

ROAs on Credit Card Portfolios at Different Fraud Loss Rates Compared to ROAs on Home Equity Loans (RED), Mortgages (Green), and Auto Loans (Blue)



Credit Card Fraud Loss as Proportion or Multiple of National Average

Estimates based on data from Raddon and Cuna Mutual Group



The ROA on credit cards vs. other loan opportunities assuming various fraud levels on credit card ROA.

Note: This slide utilizes the data presented in slide #3. Also, all yellow bars represent credit card ROA at various fraud levels.

The starting point is the fourth yellow bar from the left which shows credit card ROA at 1.83% (per slide 3) or “Base Case.” It further makes the assumption that inherent in the 1.83% ROA is the current industry level of fraud of 7 basis points which were indicated in slides 8 and 9. All of the remaining yellow bars reflect credit card ROA at various multiples of the base level fraud.

Note that if a credit union’s fraud experience on their credit card program was three times the base industry level, the ROA would be 1.31% and still higher than home equity loans of 1.23 % illustrated in the red bar.

If fraud was 5 times the base national average, the credit card ROA would be 0.8%, still higher than mortgage loans at .7% ROA indicated in the green bar.

Even at 6.5 times the base fraud average, credit card ROA of .4% is still higher than auto loan ROA of 0.32% indicated in the blue bar.

In summary, this slide illustrates that despite increasing amounts of fraud, credit cards still generate an ROA that will typically outperform other loan assets.

Closing Comments

- Credit/Debit Cards And Electronic Payments Are Fastest Growing Segments → CU Relationship Opportunities
- Credit Cards Highest ROA Opportunity vs. Other Loans
- Credit Unions Performing Well vs. Big Banks Except in “Cash” Related Transactions
- Card Upgrades to Platinum Provide Biggest/Quickest Revenue Growth Opportunity
- Credit Cards, Particularly Platinum, Generate Higher Loan/Deposit Balances And CU Relationships Per Household
- In Spite of Recent Fraud Spike, Still Historically Low. Even With Fraud Increase, Credit Cards Still Outperform Auto/Mortgage/Home Equity Loan ROA's





15950 Bay Vista Dr. #170 • Clearwater, Florida 33760
888-930-2728 • fax 727-536-0777 • www.cscu.net