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PAYMENTS

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Track Profit and Loss for a Healthy Credit Card Program

Growing a credit card program is easy in this environment; implementing a program scorecard allows for prudent and profitable growth.

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Credit cards have long been a high profit product for credit unions, which historically have been able to count on average Return on Assets of 3-6% on their card programs. A recent combination of economic forces and regulatory changes, however, has seriously impaired profitability. With 1-in-8 card portfolios losing money, all issuers need to know how their programs are performing; no credit union has the capital or earnings to support a money-losing card program.

To ensure a healthy credit card program, credit unions must have an understanding of current profitability levels and long-term pressures. A profit and loss report provides the clearest single picture of program performance and health and allows the issuer to better understand the impact of program changes. Not only does tracking P&L allow credit unions to offer the fairest, broadest, most valuable products to members, but it also provides comfort to regulators and Boards, who want to see that a risk-management discipline is in place.

STEP 1: PORTFOLIO BEHAVIOR

Item	Amount
Accounts	6,500
Active Accounts	5,000
Activation Rate	77%
Balances	$10,000,000
Credit Lines	$35,000,000
Utilization	28.6%
Purchase $	$24,000,000
Cash Advance $	$250,000
Average APR	13.1%
$ Delinquency	$150,000
Delinquency Rate	1.5%

How many members have your card (you pay fees for each one).

How many members are actually using your card? The rest have credit lines and can be risky but generate no revenue.

You want to make sure as many card holders as possible are actually using their cards.

Utilization rates (and how they change over time) can help you understand card holder needs and portfolio risk levels.

Card programs generate interchange revenue based on purchase volume. Tracking card holder spending and cash transactions provides insights into how they view your program and the revenues you can expect.

The average interest rate you are charging your members. It needs to balance providing fair value with generating appropriate revenues.

Changes in delinquency levels can be early indicators of underlying credit problems.

STEP 2: EARNINGS & RETURN MEASURES

Item	$	%
Yield	$1,050,000	10.5%
- Cost of Funds	(100,000)	(1.0%)
= **Margin**	**$950,000**	**9.5%**
- Gross Credit Losses	(420,000)	(4.2%)
+ Recoveries	20,000	0.2%
= **Net Credit Losses**	**(400,000)**	**(4.0%)**
+ Interchange	410,000	(4.1%)
- Rewards Expense	(170,000)	(1.7%)
= **Net Interchange**	**240,000**	**2.4%**
+ Fees	50,000	0.5%
- Expenses	(630,000)	(6.3%)
= **ROA**	**210,000**	**2.1%**

The CARD Act is causing many credit unions to reevaluate their funding cost methods.

Finance yield is a function of average APR and what portion of balances are actually paying interest. It can vary a lot by reward versus non-reward products.

Few are forecasting improvement in credit card credit losses this year. Track and forecast this carefully every month.

Credit loss levels have increased for almost everyone. Balancing product pricing and interest margin with credit risk requires regular monitoring.

Reward expense is directly tied to purchase volume, so think of it as a "contra-interchange" expense.

Interchange is the second largest revenue source for a card program. Legislative pressure may reduce the interchange rate; if it gets cut, all issuers need a plan to recapture these revenues and protect the bottom line.

The CARD Act has already eliminated some fee categories and coming changes could further impact late and other fees.

Expenses are often underestimated. Industry and credit union expense studies indicate using at least $125 per active account as an expense baseline. Expenses are more than simply third-party processor invoices. Missing expenses leads to mispricing the portfolio.

Credit card program returns have been reduced by half over the past three years. Too many are now losing money or soon could be. Few credit unions have room in their income statement or capital ratios to support a money losing product. The first step: Develop an accurate assessment of your program's true profitability.

Want to learn more?

612 Tim Kolk discusses the scorecards shown on these four pages in-depth in a CUtv exclusive: **Measuring and Managing Your Credit Card Program Profitability.**

Reward Card Versus Non-Reward Card

Different products have different profitability. The clearest example is a reward versus a non-reward card. Each can be profitable, but each appeals to different consumer segments and have different drivers of profitability (which is why it is typically best to have both products). An example of how reward versus non-reward card profitability differs shows reward cards have lower interest income (because of lower revolve rates) but higher interchange income. Reward cards typically attract higher spending consumers who tend toward the lower-risk end of the credit spectrum, leading to lower credit losses, but extra expense is incurred by providing the reward program.

This example compares the profitability of reward cards versus non-reward cards. All issuers with more than one product would be well served to measure the profitability of each card product separately. The more you know about how each product performs the better you will manage the portfolio. Ultimately, a carefully managed portfolio brings comfort to the overall institution and the best possible value to your members.

STEP 3: TAKE IT FURTHER

Item	Non Reward	Reward	Total
Yield	11.0%	10.0%	10.5%
- Cost of funds	(1.0%)	(1.0%)	(1.0%)
= Margin	**10.0%**	**9.0%**	**9.5%**
- Gross Credit Losses	(5.5%)	(2.9%)	(4.2%)
+ Recoveries	0.2%	0.2%	0.2%
= Net Credit Losses	**(5.3%)**	**(2.7%)**	**(4.0%)**
+ Interchange	2.6%	5.7%	4.1%
- Rewards Expense	0.0%	(3.4%)	(1.7%)
= Net Interchange	**3.0%**	**2.3%**	**2.4%**
+ Fees	0.7%	0.3%	0.5%
- Expenses	(4.9%)	(7.7%)	(6.3%)
= ROA	**3.0%**	**1.2%**	**2.1%**

Vintage Reporting

In concept, vintage reporting breaks a portfolio down into different segments based on the date the account was opened. This has become more important as credit unions find newer accounts behave quite differently from older, more established accounts. Although this has always been true, the differences have become more dramatic due to overall economic stresses and credit unions marketing to a broader community footprint than historic employer-based segments. What many find is newer vintages struggle (more than older vintages) to maintain a suitable bottom line.

Once the profitability of each vintage is understood it allows the issuer to more carefully analyze pricing plans, underwriting approaches risk-management tools, and other portfolio management elements. The large bank issuers are doing all of this and much more. If credit unions' techniques fall too far behind they risk losing their best cardholders to banks while retaining only the riskier segments of their portfolios.

VINTAGE REPORTING

Item	2009	2008	2007	. . .	<2004	Total
Yield	8.0%	10.5%	11.0%	. . .	10.0%	10.5%
- Cost of funds	(1.0%)	(1.0%)	(1.0%)	. . .	(1.0%)	(1.0%)
= Margin	**7.0%**	**9.5%**	**10.0%**	. . .	**9.0%**	**9.5%**
- Gross Credit Losses	(1.0%)	(6.0%)	(8.0%)	. . .	(2.5%)	(4.2%)
+ Recoveries	0.0%	0.1%	0.2%		0.3%	0.2%
= Net Credit Losses	**(1.8%)**	**(5.9%)**	**(7.8%)**	. . .	**(2.2%)**	**(4.0%)**
+ Interchange	3.8%	4.0%	4.2%	. . .	4.5%	4.1%
- Rewards Expense	(1.5%)	(1.6%)	(1.8%)	. . .	(1.9%)	(1.7%)
= Net Interchange	**2.3%**	**2.4%**	**2.4%**	. . .	**2.6%**	**2.4%**
+ Fees	0.3%	0.6%	0.7%	. . .	0.7%	0.5%
- Expenses	(6.9%)	(6.3%)	(6.1%)	. . .	(5.8%)	(6.3%)
= ROA	**1.9%**	**0.3%**	**(0.8%)**	. . .	**4.3%**	**2.1%**

Profitability Reporting Is Good For Your Members

It might be tempting to view profitability reporting as something that only the CFO and CEO need to care about, but reliable profitability measurement benefits the entire member base. It is the launching pad to fair product pricing decisions; it ensures that the institution knows where to best market its card products; and it provides critical information about what your members value in your credit card product. It's more than an exercise in measurement, profitability reporting provides information central to the mission of each credit union.