Consumer Finance Monitor (Season 3, Episode 19): Strategic and Other Considerations for Credit Card Offerings by Medium and Small Financial Institutions

Speakers: Chris Willis, Glen Trudel, and Robert Curry

Chris Willis:

Welcome to the Consumer Finance Monitor Podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. I'm your host, Chris Willis, and I'm the Vice-Chair of Ballard Spahr's Consumer Financial Services Group. And I'll be moderating today's program.

Chris Willis:

For those of you who want even more information, don't forget about our blog, consumerfinancemonitor.com. We've hosted the blog since 2011, so there's a lot of relevant industry content there. We also regularly host webinars on subjects of interest to those of us in the industry. So to subscribe to our blog or to get on the list for our webinars, just visit us at ballardspahr.com. And if you like our podcast, let us know.

Chris Willis:

Leave us a review on Apple Podcast, Google Play or wherever you get your podcasts. Now, the subject of today's program is strategic and other considerations for small and medium sized financial institutions with respect to their credit card offerings. And I'm joined by two speakers today. First, we've got my partner, Glen Trudel from our Wilmington office, who's been on the podcast before, so his voice will be familiar to you.

Chris Willis:

But we also have a very special guest today. I'd like to welcome Bob Curry to the podcast. Bob was the initial founder of, and is now the managing partner and chief business officer of Bassett Capital Group. He's widely considered to be one of the top credit card industry experts in the area of portfolio acquisitions and conversions between financial institutions.

Chris Willis:

And in fact, he's been involved in over $50 billion of portfolio acquisitions involving hundreds of credit card programs. So, we're really lucky to have Bob on our show today. Bob, welcome to the podcast.

Bob Curry:

Thanks for having me, Chris. And thank you, Glen.

Chris Willis:

So, to kick off our discussion, let's say that I'm a small or medium sized bank or credit union, and I currently don't offer a credit card program, or maybe I have my own standalone portfolio. Why should I be looking at reviewing my position at this time? What's going on in the market to inform my thinking about what I do in the future with respect to my credit card offerings?

Bob Curry:

Well Chris, that's a great question, and the dynamics of the credit card industry continuously change. And as we sit here today in these unfortunate times, there's still a business to run and there's still credit cards to be used. So, just a quick history, I think would be appropriate before I go into the question itself. We have seen mass consolidation in the industry between 1995 and 2006 with the allonge and the FMBOs and the First USA's.

Bob Curry:

The model lines that were partnering with credit unions and financial institutions. And that took a turn around the mid 2000s when Bank of America bought MBNA. And many of the partners that had long-term relationship with MBNA decided that they were of size and capability to issue their own credit card programs. And that included Wachovia, SunTrust, PNC, Huntington, Regents Bank, etc. Some of the larger regional banks and issuers that are in America today.

Bob Curry:

And since that time, there's been very little activity within the industry, both on the partnering side and also on banks that are looking to get back into the business. But over the span of the last seven or eight years, regional banks have grown in size through acquisition, through organic growth, and they are now taking a look at what their options are in terms of either partnering with an organization like an ALON, like an FMBO, that partner with the banks credit unions to be able to issue the cards on their behalf.

Bob Curry:

But some of the banks that are of scale are looking ... They are looking at options to get back into the business. And so, we are starting to see quite a bit of activity in the market.

Glen Trudel:

Yeah, no, that's certainly true. And some of the other reasons why a bank, for example, that may not have a portfolio might be looking to get into it is because with a changing credit environment, banks ... Banks make money two ways, right? Through interest or through fees.

Glen Trudel:

And banks may be interested in generating more fee income, which as we discuss options, they'll see as pretty maximized from an agent-bank relationship. Or they might want to increase customer loyalty to their brand and see a credit card as a very easy way of achieving that additional stickiness, if you will, with the customer to the bank for ...

Glen Trudel:

Or the bank may be coming to the end of a co-brand or affinity relationship where they are issuer and that's where they have their portfolio, and may not either be able to retain the portfolio or may not wish to, assuming that they have the right to retain the portfolio after the end of the affinity or co-brand program, because they anticipate significant runoff and either don't wish to expend the resources, or maybe don't have the resources to try to retain it and to try to fend off the significant runoff, which is what typically happens in those sorts of relationships.

Glen Trudel:

And in another, maybe just in response to the fallout from COVID-19 and its effects on the economy where they anticipate additional stress to the credit exposure of their existing portfolio, and may not wish to support that, or may wish to avoid some of that, or the bank may be looking to increase its capital position by offloading credit lines or that sort of thing.

Glen Trudel:

Or finally, it may be that as they're looking at their portfolio and at the resources required and seeing that, "We may be entering some choppy waters going forward," perhaps they're deciding that they may not be able to adequately or economically manage their current infrastructure or the resources that would be needed for additional growth.

Glen Trudel:

Either for additional growth or to handle the material up swinging credit collection workout issues that they may fear that they're going to experience down the road.

Bob Curry:

Oh, absolutely. And it's so many headwinds today that are facing the smaller and mid-size issuers, besides the COVID-19, the situation that we're in right now. But the regulatory and the compliance of having a credit card program has been more difficult than it was in past years. There's also a brand new market out there that's developed over the last 10 years with marketplace lenders. And their objective is to issue unsecured loans for debt consolidation.

Bob Curry:

And where are they going? They're going over directly to the balances of small regional credit card issuers and eroding their balances and cannibalizing their balances. And that would be the best balances that they have, the earning balances on their credit cards. The other thing that we have right around the corner is CECL. And the CECL requirements are going to require issuers of all shapes and sizes to look at what the reserve requirements are for their future credit losses.

Bob Curry:

And in a higher risk environment that we're now approaching, that's going to have a greater impact on capital, on reserve requirements and on profitability. So, this there's a lot of compounding headwinds that are facing some of the small and medium issuers. And we're really starting to see a trend in issuers, generally with portfolios of under a hundred million looking at what their options are. Right?

Bob Curry:

Like, "Do I risk what I'm doing right now, or do I continue to issue a bank or credit union issued credit card for my customers and members, and create higher value and a higher yielding product?" So, there's a lot of looking for a strategic direction at all sides is the issuers today.

Chris Willis:

Thanks, Bob. So, let's consider the example of a bank or a credit union that doesn't have an existing credit card product and is looking to start being a credit card issuer, because of the various benefits or strategic considerations that you and Glen were just talking about. It seems like it could be kind of a daunting task to just become a credit card issuer. What are the principle options that a bank or credit union can consider to get into offering this sort of product?

Bob Curry:

Okay, great question, Chris. And there's really three options that an issuer can look at today. One is a great partnering option, but we could call agent banking or agent relationship. And that's a pure partnership relationship where all the activities of managing the credit card program, the underwriting, the servicing, the marketing, the products are owned by the issuing bank under the partner bank brand. Right.

Bob Curry:

So, that's the most traditional and that's what roughly 2,500 to 3,000 banks are doing. And the banks and credit unions are doing today. And you get risk-free income with decent products that they can offer to their customers and their members. The

second is, would be selfish. Clearly, that's the most complicated. Includes the having to have the right pricing and credit strategy, the right products, the right management and being able to take on the risk.

Bob Curry:

And to go from either a partnership or non-issuing to self-issuance, it's a daunting process. It could take up to 18 months to do. We're working with a client right now that's a fairly large financial institution. It's a bank in the Northeast that is ... They're starting their own credit card business from scratch. They exited a partnership a few years ago, so it was a true credit card program and it certainly is a daunting exercise to them.

Bob Curry:

But I think they'll get through it, and they'll get through it in the best way possible. But they are the size of the bank that would mean having their own credit card program and offer that to their customers under their own control. There's also a third option that exists in the market.

Bob Curry:

And I would say this would be for banks and credit unions that have portfolios that are in an excess of about a hundred million, only because anything less than that probably doesn't make any sense. And it's called participation. And what that is, that's sort of a hybrid relationship that you have with an issuing partner whereby all the activities exist in an agent banking relationship.

Bob Curry:

The underwriting, the servicing, the marketing, the products and everything, but they're sharing in the economics of the program. So generally, the way it works is that 45% of the assets will be with the partner bank, 55% of the assets will be with the issuing bank. And there would be joint control, full visibility into the P&L, the partner bank would be able to use their capital to capitalize the assets they have on the books, and they can also use their funding or their deposits and liquidity to fund the assets that they have in their book.

Bob Curry:

So, that's a very attractive option for several issuers that are looking to enjoy some of the economics of having a credit card business, but not all the compliance and regulatory oversight and management that's required to self-issuance. And so, we're looking at that throughout the several issuers, and there's several issuers out there that are currently employing that particular strategy.

Glen Trudel:

Yeah, those are right. Those are all really good options. With respect to the agent bank arrangement, they ... When a bank is looking to get into that arrangement, they'll have another partner as the issuing bank, and it's marketed principally as under the agent bank's marks. However, there needs to be clarity as to the customers who the lender actually is.

Glen Trudel:

And so, that's where in the advertising, you'll see a disclosure to the effect that the cards are issued by issuing bank. And the card agreement will be between the customer and issuing bank. So, they are the creditor in that circumstance. And you try to have that clarity, although it's a bit of a balancing act between wanting the ... Your agent bank wanting to get the benefit of having its name and emblazoned on the credit card, but not actually being the creditor.

Glen Trudel:

Those arrangements are basically are usually done on a single agreement. And in that agreement, it needs to be clear on the respective rights and responsibilities of the parties, and especially control related issues, rights and economic and other responsibilities. Because often, these programs may have some sort of promotional or a rewards program, and there needs to be a lot of clarity with respect to those programs.

Glen Trudel:

That might be part of it in terms of who owns the liability for the points, who's responsible for its management and servicing, and that sort of thing. So, there's still a fair amount of to consider. And to the extent that the agent banks are ... If it's a regular bank, for example, their vendor management guidelines, and while ... And there's a good argument to be made, that even in these circumstances, there are service provider relationships.

Glen Trudel:

So, those sorts of regulations should be looked at and considered in terms of figuring out what the agent bank agreement needs to provide, in terms of controls and audit and that sort of thing. Because even though the agent bank isn't actually the creditor, their regulators are still going to want to see how they're controlling or how they are getting visibility into what's happening, because ultimately it is being marketed under their mark.

Glen Trudel:

Bob was also, of course, correct when we talk about self-issuance. It does take a considerable amount of time and there's an awful lot to consider. From a contractual standpoint alone, you're looking at everything from a network issuer agreement with whether it's Visa, MasterCard, Amex, Discover, what have you, and which may also include incentive agreements.

Glen Trudel:

There may be an account servicing agreement if the bank is not going to be servicing the accounts in-house, which most likely for a bank coming into this, they would not be doing it in-house. They would most likely be getting a third party service or one of the big services or some of the others in the marketplace. So, that's a detailed agreement. Rewards program agreements, with vendors and suppliers.

Glen Trudel:

If there is indeed, there'd be a reward program as part of this card offering in terms of the vendor who might be administering that program, or if the bank's going to be doing it-in house, there are still agreements to be had with the various rewards premium providers. And all of those would be seen as service providers. And so, it would be subject to a vendor management regulation, as well as the usual concern over being clear on all of the issues and the rights and responsibilities, SLAs, and that sort of thing.

Glen Trudel:

Contract is one piece of it. You need still ... The bank still, if they're getting into credit card lending and they haven't been doing it before, are going to need to build a compliance infrastructure specific to the card product. Now admittedly, if they're doing other sorts of consumer open-end loans or even installment loans, they may have some basis that they can ...

Glen Trudel:

They won't have to completely reinvent the wheel, but each policy and procedure is going to have to be created with the idea - if we're talking about credit card, we're talking about consumer credit card here, or even if it's small business credit card - in mind and tailor fit to fit that new product.

Glen Trudel:

So, everything from the application, the card agreement, the periodic statement disclosures and the forms, underwriting, customer fulfillment, customer set, collections, all of these have regulatory requirements. Some are over to specific to credit card, of course, which need to be observed both at the federal and often state levels.

Glen Trudel:

In all of this, policy and procedures have to be created, have to be vetted, approved, and actually implemented for all aspects of offering the product. And all of this process has to be documented. And again, as I mentioned before, vendor management policies and procedures against specific for the credit card will need to be created, and there will have to be a robust vendor risk management structure and auditing structure put together.

Glen Trudel:

The regulators, particularly for a new entering into the card digital space, is going to want to see all of this, is going to want to know exactly what you did and how you did it. And so, those are certainly going to be made to considerations in putting into the sub-issuing of it. And as well, even when for those accounts which ended up going to charge off ...

Glen Trudel:

And if you're looking to sell those off of your balance sheet, then there are debt sales agreements and there's a whole process for selecting the buyer or the debt buyer, and for putting that agreement, getting that negotiated and put together. Maybe admittedly a little bit down the road from the actual issuance, but nevertheless, something that's got to be on every bank's to-do list that's seeking to get into the space.

Glen Trudel:

And now with respect to the participation model, compliance risk is still ... Will still be on the issuer. But now a greater concern, now that there's a sharing of the economic risk, then it becomes even more so, more incumbent on the bank looking to get into this, to be exercising appropriate controls and oversight over what the issuing bank is doing. At least the principle issue bank, I guess I should say.

Glen Trudel:

And all of the things that I've just been talking about incumbent to a self-issuance kind of situation, need to be that same ... Those same steps have had to be considered and that process has to be considered. But keeping in mind the relative role of the participation holder in connection, in this sort of a sort of hybrid method of getting into the card issuing business or benefiting, at least from card issuance.

Chris Willis:

So gentlemen, we've talked about the options for a small or mid-sized financial institution to jump into the credit card business. Let's consider the other situation where we have a financial institution that's already grown a self-issued card portfolio. What should a financial institution in that situation be considering regarding how to operate going forward in what seems to be an increasingly competitive credit card?

Bob Curry:

Well, this is Bob. I'll take that. I would say that with banks and credit unions that have existing businesses right now, and then some of them have stood the test of time, right? So, early on in the podcast we talked about how the industry has changed over the many years. But many credit unions and smaller banks have kept their credit card portfolios.

Bob Curry:

I'll be at this mall, but they deem them as strategic that they happen to benefit their customers or their members. And it's a high yielding product, that they can't replace the earnings from those products. But when you look at what's happening today in the market and what we discussed earlier, it does make sense to look at what your options are. Right.

Bob Curry:

Do you need this? Should you be stepping up for a subscale portfolio? What are the risks? And what are the potential opportunities of going into a partnering relationship? Relieving yourself of risk, focusing on other strategic initiatives in your organization. And in many cases, when you sell the portfolio to your partner, you can enjoy a pretty good premium that can ... As a go-to investment in other products that you have, or just released earnings if that's what you want to do.

Bob Curry:

So, we are still starting to see a much bigger trend, going into 2020 with financial institutions and looking at partnership know options. So, I would say it's pretty much of a size thing. Right? So, smaller institutions are looking at partnership options. Larger financial institutions that have some scale, they're looking at the options of self-issuance, which when I listened to you go through all the complexities of self-issuance, it's pretty daunting. And it is.

Bob Curry:

And any of the steps that you have to go through to issue your first card, if you miss any of them or miscalculate them, or you're not in compliance with part of that, it can really cause the problem for the organization before you even get started.

Glen Trudel:

Yeah. Those are all certainly true and good considerations. Part of that is ... One thing the bank may ask themselves is really how well do they know their customers? Many of these banks that have these relatively moderate-sized portfolios or medium-sized portfolios have had them for some time and have been through perhaps a financial crisis, or have been through up and down periods, and so may have a good fix on what their customer base is like and how it's apt to react.

Glen Trudel:

That could be very valuable in deciding whether in economic downturn and what sort of effect it's going to have in terms of credit loss rates and things like that. So, that's certainly a factor to be considered, and trying to decide what to do. So, I'm going to continue to self-issue in the face of that, or perhaps take another option from monetization.

Glen Trudel:

Now, if they do decide to either try to spread the risk, maybe through a participation sale, or maybe a receivable sale as a way of picking up some additional capital or what have you, that could be looked at and typically there's some sort of an RFP process which would be done. And depending on the results, that can inform a decision as to whether that may be one way of getting some more immediate economic benefit from the portfolio at the cost of future flows.

Glen Trudel:

In thinking of that, or perhaps selling the portfolio as a whole, you begin to think one consideration as well is if you're going to go that way, then you need to prepare for that. And one of the things you'd be thinking about is what's been promised to the customer base at this point? Is that going ... If the portfolio were, for example, to be sold, how would that change and what's been promised to the customer and when?

Glen Trudel:

It could be that in order to avoid, you'd have claims too, what have you. You may be constrained from selling a portfolio as quickly as you would like. And then, other things. Depending on size, if you're talking a smaller or medium-sized portfolio,

issues like Hart-Scott-Rodino filings may not be as much of a consideration. But in the event that it were become a consideration, that timing has to factor as well.

Glen Trudel:

So it's not a matter of saying, "Well, I'm just going to sell the portfolio right now, monetize it in some fashion. And that, will happen in time to avoid the deleterious effect of a downturn." These things can take time. Sometimes a lot of time. And that can factor into as well, as your decision as to whether you might be better off continuing with self-interest, managing your accounts and more carefully from an underwriting standpoint and a collection standpoint in the light, versus going out and trying to monetize bringing in another partner and either ... And perhaps risk damaging or maybe losing some customer relationships.

Chris Willis:

Gentlemen, thank you both very much for sharing your expertise and insight on these issues today. And Bob, special thanks to you for being a special guest on our podcast today. We really appreciate you joining us and sharing your very considerable expertise and background in this area. And thank you to our listeners for tuning in to today's podcast episode.

Chris Willis:

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