Affinity Card Program

Find the opportunity for you!

Overview

After all but disappearing in the early 2000s, affinity credit card programs are back on the scene, this time with improved card features and more advantageous pricing and interchange rates. But does that mean that an affinity card program would be right for your credit union?

This Advisors Plus Decision Guide summarizes the comprehensive analysis process necessary to answer that question for any given affinity partnership that might be proposed to your credit union. What information does your management need to gather? What issues need to be addressed by both parties to the proposed partnership? How should the potential marketing and financial opportunities be assessed and quantified? Finally, how can possible program risks be identified and addressed?

Whether your credit union finds itself responding to an outside RFP, exploring a strategic growth opportunity that your management has brainstormed, or is researching a member request, this guide will provide your management with the background, questions, and decision framework necessary to help you “know before you grow” in evaluating a potential affinity card partnership.

Affinity credit cards were wildly popular from the late 1970s through the early 2000s, but fell out of favor with consumers as reward cards and co-branded cards came on the scene. Now, thanks to more advantageous card features, pricing structures, and interchange terms, today’s new and improved affinity cards are making a strong comeback in the marketplace.

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If your credit union is considering launching an affinity card program, it can be difficult and challenging to analyze all of the moving parts involved in the decision. How do you pick the right partner? How do you negotiate the best terms? How do you quantify the opportunities and risks? In short, would adding an affinity card program represent an exciting marketing growth opportunity for your credit union —or might it instead create headaches by gobbling up resources without adequate payback?

Your Guide for Informed Decision Making

Advisors Plus has created this Decision Guide to give your credit union the analytical framework and support your management needs to conduct comprehensive due diligence and avoid costly mistakes.

We've created a checklist to help you gather the relevant background information you will need, ask insightful, probing questions, and develop pro forma financials.

Whether your credit union is responding to an affinity card RFP or initiating its own investigation into possible avenues for strategic growth, following this Decision Guide will help your management maximize the fit and upside potential of an affinity card partnership while minimizing its risks and future pain points. As your credit union works through the process, remember that the deep Advisors Plus credit card expertise that created this Decision Guide is only a phone call or e-mail away whenever you need additional insight, analysis, or a fresh point of view to supplement your internal discussions.

Welcome to the Affinity Card Renaissance

Credit card programs are growing again after a long period of economic and regulatory uncertainty marked by the Great Recession, the CARD Act, unprecedented delinquencies and losses, massive data breaches, and the ongoing dispute between issuers and merchants over responsibility for the implementation of EMV anti-fraud protection.

As those issues resolve, our Advisors Plus credit card consultants foresee a brighter outlook ahead, marked by strong credit card earnings resulting from climbing net interest margins, fueled in turn by low charge-offs and low cost of funds. Those factors have led to the questions our Advisors Plus credit card team hears most

frequently these days: "How do we grow our credit card portfolio?" and "How can we unlock the cross-selling potential of our cardmember base?"

Credit unions' desire for growth has led to renewed interest in the potential of affinity card partnerships. In many ways, such partnerships make intuitive sense for credit unions to explore since by definition, credit unions think in terms of marketing to membership groups with common bonds.

A Brief History of Affinity Card Programs

Affinity credit card programs originated in the late 1970s when Maryland Bank, NA (which later became MBNA, then FIA, and is now part of Bank of America) popularized them by focusing on the university alumni market.

Although alumni associations are the best-known affinity partners, there are a host of others, including charities, clubs (such as professional groups and sports organizations), and causes (whether political, environmental or faith-based), as well as more local and individualized groups such as community-based programs. In essence, any collection of individuals who can be identified and marketed to as a group can potentially form the basis for an affinity program.

In the early days of affinity cards, their novelty was so great—and member group loyalty so high— that simply carrying a card that advertised an affinity group's name and logo was reward enough for a cardholder. The programs were a strong win for issuers as well because the cards could be marketed very efficiently to an affinity group's members using a combination of targeted telemarketing and direct mail. Response rates were high, while usage and loss rates were far superior to those of bank-branded cards.

What's more, there was fee-based income to be earned as well. Issuing banks would compensate affinity groups for the right to use their trademarks on a "per new account" or "renewal of account basis" in addition to rebating a portion of the revenue based on sales and/or finance charges and typically providing a minimum compensation guarantee as well.

Yet just as quickly as affinity cards were initially embraced, demand for them fell virtually overnight due to the introduction of co-branded and generic reward cards. Ironically, the card industry had only itself to blame. It had done such an effective job of educating consumers to expect something in return for using their credit cards that cards which didn't provide monetary rewards quickly lost their appeal. As issuing banks found themselves struggling to pay cardmember rewards and affinity group compensation out of rapidly shrinking revenues, affinity cards went from top-of-wallet to bottom-of-the-pile.

How Are Today's Affinity Partnerships Different?

Today's affinity cards are most definitely not your parents' college alumni association offerings. The strong resurgence of affinity programs has been fueled by two primary market changes:

1. Affinity groups themselves have revised their expectations regarding fee income and are now willing to accept far lower compensation than in the past.
2. Mastercard and Visa have enhanced their interchange structures to allow for offering reward cards such as the World/ Signature and small business products on a profitable basis.

Today's Affinity Partnerships Are Complicated

The overriding lesson to be learned from affinity card programs in both their previous and current incarnations should be this: Entering into a successful and rewarding affinity partnership is far, far more complicated than simply partnering

with a group and slapping its name and logo onto your plastic. Because your partnership will contractually last a minimum of four years—and quite possibly longer—it is vital that your credit union conduct careful, thoughtful, and thorough due diligence before making a commitment.

To do that, your credit union must balance optimism about a partnership's growth potential with a long- term, clear-eyed approach to analyzing and quantifying the impact that a given affinity partnership will have on its resources, strategic objectives, staff, and current members. That means focusing on fit and synergy rather than novelty or the perceived cachet of a given affinity partner.

Is This Partnership Right for You?

Before you enter into the deep-dive analysis phase of your due diligence, start by asking some big picture questions such as these:

- Do we, or would we, enjoy working with this partner?

- Do our values, goals and concepts of member service seem to align with theirs?
- Does this potential partner show respect for our time, opinions and decision process?

Avoid the Wrong Partnership

If your answers to the questions above signal a lack of enthusiasm for any reason, it is possible that an affinity partnership might be right for your credit union but that this particular partner is not. That's when it becomes vital to remember that the wrong partnership can have such negative consequences that deciding to say no to an opportunity can often be far more valuable in the long run than saying yes. For that reason, as your credit union begins its analysis process, avoid being swayed by factors that will probably prove to be irrelevant "red herrings" but pay careful attention to those that genuinely seem to raise red flags.

Examples of "red herring" factors to ignore include:

- Which potential partner approached whom or which member suggested what affinity group
- Acting out of fear that this will be the one and only partnership opportunity that will ever present itself to your credit union

Examples of red flags to pay careful attention to include:

- Unclear or unshared expectations for success
- Rushed, unrealistic, or pressured decision timetables, e.g., "We want to be able to announce this deal in time for our annual meeting."
- Unequal investments of senior management attention at any point(s) in the process. Successful affinity partnerships simply must have equal buy-in from both CEOs.
- Unequal commitments to transparent information sharing and no-stone-unturned due diligence. If your potential affinity partner doesn't display complete candor or the answers you receive appear either incomplete or too good to be true, this is an enormous cause for concern if not an outright deal breaker.

Articulate the "Why" of Your Partnership

The starting point for your analysis—and the touchstone to which you must return at regular intervals during the due diligence process— is to address in strategic terms WHY your credit union thinks it will benefit from this partnership.

- Why is this partnership something your credit union should consider?
- Is such a partnership consistent with your credit union's five-year strategic plan?
- Are you envisioning the affinity partnership as a new product area or a one-off opportunity?
- Do you envision the credit card partnership as a single stand-alone product or the beginning of a robust

member relationship that could lead to cross-sales of products such as debit, checking, auto loans, and/or mortgages?

Evaluate Your Partnership's Synergy—or Lack Thereof

Obviously, not all potential partners are created equal in terms of fit, so early on it's important to assess potential partners for potential synergies—or lack thereof.

- What is the group and what do they stand for? Does its positioning align with that of your credit union on social, political, and/or economic issues?
- Does your potential affinity partner strike you on a general level as being a good fit or natural extension of your credit union member base?
- Is the make-up of the affinity group consistent with interest in a financial product or products?
- Does your credit union have an emotional commitment to the group and vice versa?
- Conversely, does the potential pairing give you pause for some historical, logistical, philosophical, or brand alignment reason?
- Does your potential partner seem too large or too small to be a good fit?
- Does the timeframe of a partnership contract (minimum of four years) seem consistent with the "staying power" of the affinity group?
- To what degree does your potential partner's field of membership (FOM) overlap with that of your credit union, versus representing an expansion?

Get a Handle on Your Partner's Demographics

As field of membership and geographic considerations imply, it is imperative once the preliminary "whos" and "whys" of your potential partnership pass muster to begin analyzing the scope of the potential market that the partnership represents. The best way to begin is by collecting as much demographic information as possible:

- How many members does your potential partner have?
- What does the overall level of engagement seem to be among the affinity group's members?

For example, is membership free and if not, how much are dues? (It's worth noting that Advisors Plus has noticed a strong anecdotal correlation over the years between the level of financial commitment required to join a group and the level of loyalty and involvement displayed by its members.)

- Geographically, is the membership of your potential affinity partner concentrated in your market area or is it dispersed?
- What information does the group know about its members (e.g., name, address, SSN, phone and e-mail contact information)?
- Are they willing to share this information?
- What is the group's privacy policy and how well does it dovetail with that of your credit union?

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Define Success

Armed with the demographic information your credit union has collected and the indications of scope and potential that it provides, it's time for your credit union to decide how it would define success for the affinity partnership. Making that determination is important for more than existential reasons because to be successful, your partnership metrics must be defined and measurable. That doesn't mean that they have to be one-size-fits-all, however. Valid measures include any or all of the criteria below:

- Size of the program
- Financial performance q Community give-back
- Employee engagement
- Some other well-defined measure

Come to Terms with Possible Deal Breakers

For reasons similar to the process of defining success above, now is the time in the analysis process when there is adequate information for the rubber to meet the road in acknowledging and deciding about potential deal breakers that have surfaced. Because credit unions will define success differently, it stands to reason that they will also have differing points of view about what constitutes an intractable problem, but some potential deal breakers include:

- First and foremost, will the affinity group be open to joining your credit union as a requirement of carrying the card?
- How will the membership fee be handled?
- If the potential affinity partner's membership is geographically dispersed from that of your credit union, do you have the existing channel capacity in online and/or mobile to seamlessly enroll and provide quality member service to the new members who join as part of the affinity partnership?
- Will the members of your potential affinity partner be open to carrying a branded credit card?
- Have any additional red flags been raised regarding your chosen group's receptiveness, management dynamics, working style and/or potential for growth in the course of your working together thus far?

"Measure Twice, Cut Once" when Crafting Your Deal

If your credit union has gotten this far in the due diligence process, there is great cause for encouragement but signing on the dotted line is still premature. While the sort of details that this section will elaborate may not be large enough to derail a potential affinity partnership, overlooking any one of them could lead to a partnership that might sadly come to be viewed as "death by a thousand cuts."

One thing to make clear is that up until now, we have viewed the larger size of an affinity group strictly as an asset—the bigger the group, the more substantial the program opportunity. However, the time has come for your credit union to recognize that the larger the affinity group membership, the more labor-intensive and expensive the program's ongoing management and maintenance will be.

In broad-brush terms, here are some program details that will require upfront delineation of responsibility and ongoing tracking:

1. Marketing, Products & Pricing

- Given the demographics of the affinity group's members, what products will you offer?
- How will the affinity card offerings fit into the product suite currently offered by your credit union? For example, most affinity programs lead with a World/Signature product to capture the increased interchange and thereby expand the revenue pie.
- How will the affinity product(s) be priced?
- Will your credit union plan to run specialized marketing campaigns (e.g., 0% intro offers, intro reward offers) and/or a customized reward program (e.g., a bonus reward category for group oriented purchases) for the affinity card product?

2. Program Ownership & Division of Labor:

- Who will be the program's owner—the buck-stops-here manager who will have the authority to coordinate all the credit union departments, drive marketing, develop and oversee the budget and interact with representatives from the affinity group?
- What dedicated program staffing is required or recommended?
- Who will pay for what?
- Is the marketing budget required a number your credit union wants to commit to year after year?

3. Cardmember Communication

- Who will handle ongoing account management and cardmember communications, particularly if there is the added expense of group branding those communications?
- Who will craft and disseminate marketing messages?
- Who will coordinate financial updates? (Operationally, communication suppression may be required if product limitations are required in the affinity agreement.)

4. Affinity Group Compensation

Affinity groups enter into partnerships like these in order to provide additional benefits to their members. They provide access to their members and the right to use their trademarks in exchange for compensation. A compensation agreement must be hammered out that typically will:

- Compensate the affinity group for new accounts generated.
- Create some sort of activity-based compensation (e.g., percent of sales, finance charges and/or annual fees if any).
- Include an annual level of guaranteed minimum compensation to the group.

5. Financial Projections & Tracking

- Who will create the pro forma financials that will provide a best estimate of how the partnership will perform and allow for a final go/no-go decision on the partnership business opportunity?
- Assuming the partnership is agreed to, who will schedule and handle announcements and minutes for the regular meetings that will be required? This will be where your credit union will be able to assess how the affinity card partnership is performing versus your original financial projections and your original definition of success.
- Who will handle specific financial reporting tasks, including the generation and communication of monthly profit and loss statements?

6. Legal & Reporting

- To facilitate financial and legal reporting, the accounts associated with the affinity program should be established in their own reporting units on your credit union processing system.
- Segregating the accounts will allow for quick access to the performance metrics and back-end reporting/tracking needed to create monthly financial statements.
- As you measure actual versus projected performance over the course of the partnership, your credit union may well identify areas of the agreement that need to be modified. Make sure that your affinity agreement will allow you to modify account terms and program structure as needed.

Communication Is the Key to Success

Whether your credit union ultimately decides to enter into an affinity partnership or concludes based on its analysis that such a partnership would not be beneficial, open communication is vital every step of the way. Any relationship works best when both parties understand what they're entering into, what their responsibilities will be and what the expectations will be for success. With the help of this Decision Guide and the ongoing support of Advisors Plus, we think your credit union will be well-equipped to identify an affinity partner that will bring you synergy, growth and value-added throughout the life of your partnership.

Advisors Plus

Founded in 2004, PSCU's Advisors Plus offers consulting services for credit unions to help fuel growth and achieve financial and business goals. From project analysis to implementation and management, Advisors Plus offers an end-to-end portfolio of consulting services including business strategy, business and affinity cards, credit and debit cards, contact center optimization, risk and collections analysis, branch sales training, marketing services, and B2C campaign execution. Whether your credit union is looking to expand its offerings, build a legacy of community involvement, create the strongest possible capital footing—or all of the above—Advisors Plus consultants bring the strategic vision, deep industry expertise, and proprietary data analytics needed to help credit unions better serve their members and their communities. For more information, visit advisorsplus.com.