

It's the Perfect Time for a Return to Relationship-Based Card Programs



Jerry D. Craft

For decades, regional and community banks have effectively given away a fundamental relationship-building tool from their lending arsenal – credit cards. Because of the expense, necessary management expertise, technology and regulatory burdens associated with running a credit card program, most banks have opted for agent card programs with large and monoline card issuers.

In the process, banks have ceded control over nearly all aspects of their customers' card accounts to the outside company, weakening customer relationships and mitigating long-term financial benefit. Banks' customers were often subjected to unfriendly rate and fee policies, and the cards became merely transactional – not relationship – tools. Frequently, the program provider became a competitor with its client banks.

Today, a perfect storm of economic, industry and regulatory shifts have combined to create an environment ideal for banks to bring the credit card business full circle, back to the way it was before agent bank programs domi-

nated. Owning and controlling their credit card business, community and regional banks can diversify their local market lending through balance sheet funding via low-cost, local deposits, while they strengthen their customers' overall banking relationship and reap additional benefits.

Recession-fueled unemployment, foreclosures and bankruptcies have resulted in record-setting delinquencies and losses for major card issuers. In 2009, the top three issuers' card programs lost more than \$10 billion. And they're saddled with billions more in nonperforming assets they'll probably be looking to shed.

It's estimated that up to one-third of the \$874 billion in U.S. banks' credit card assets are now considered non-core assets and will likely be available in the marketplace for sale to investors and financial institutions.

In addition, the Credit Card Accountability, Responsibility and Disclosure Act has fundamentally changed the credit card landscape, forcing issuers to comply with new provisions impacting interest rates, billing, disclosures and fees, among other areas. Large issuers have estimated their cumulative CARD Act compliance costs alone at well over \$1 billion.

More importantly, the CARD Act has, as one card executive said in a recent *American Banker* article, "...ended the era of a lot of fine-tuning and sophisticated repricing." In other words, the very business model mega-issuers have used to control and dominate the industry for decades is now effectively dead and buried.

The most significant result of these tectonic shifts in the card industry is a leveling of the playing field. Big banks are in retreat, leaving ample room for inroads by opportunistic banks, which have their own compelling reasons for taking back their card business.

Many community banks, especially, are in need of diversifying their loan portfolios to reduce dependence on real estate lending. Moreover, the recession and current interest-rate environment have put a premium on low-cost, core deposits and noninterest income. And regulators are placing renewed emphasis on both local deposit-taking and local lending.

In short, the timing could not be better for community and regional banks to re-introduce a relationship-based approach to their card business. And recent research on the benefits of relationship banking clearly demonstrates its value.

In a 2009 paper titled "Benefits of Relationship Banking: Evidence from Consumer Credit Markets," economists from the Chicago Fed, the OCC, the University of Nevada, Reno, and The University of Pennsylvania's Wharton School analyzed a data set of approximately 100,000 credit card accounts. The authors also had access to information about the other relationships the cardholders had with the issuing bank.

They found that, when compared to non-relationship card accounts, the relationship accounts demonstrated lower probabilities of attrition and default, along with higher utilization rates. Moreover, they found that these effects were more evident as relationship strength increased (measured by such factors as number of relationships, length of relationships, size of balances, and customer proximity to the branch).

It's not a leap of logic to predict that the very same dynamic is at work in reverse: That is, high-performance credit card accounts have a positive effect on other banking relationship accounts.

Now is the perfect time for a return to relationship-based card programs.

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