Trends in the Loan Participation Market

Presented By
Jeff Varner – Managing Director, LPC Services
Prescott Ford – Managing Director, Balance Sheet Management Services
Tony Muller – Senior Vice President, LPC Services
Loan participations strengthen the credit union industry by providing a useful way for credit unions to:

- Diversify Loan Portfolios
- Improve Earnings
- Generate Loan Growth
- Manage Balance Sheets
- Comply with Regulatory Requirements

Loan participations increase the availability of credit to small businesses and consumers.
A Federally Insured Credit Union (FICU) may purchase a participation interest in a loan from an eligible organization only when the purchaser is empowered to grant the loan and:

- The borrower is a member of one of the participants.
- The loan complies with regulations as if purchaser originated loan.
- The originator retains an interest in each loan.
- The loan complies with the written loan participation policy.
- There is a written loan participation agreement with originator.

Source: National Credit Union Administration
Definitions and Detail

- The rule applies to FICU’s purchase of loan participations where the borrower is not a member of that credit union.

- Loan participation means a loan where eligible organizations participate pursuant to a written agreement with the originating lender who must participate for the life of the loan.
  - Originating lender is the entity with which the borrower initially or originally contracts for the loan.
  - Eligible organizations include credit unions, credit union service organizations, or financial organizations.

- Borrower must be a member of a participating credit union.

- Complies with regulations (loans to one borrower and member business loan provisions) and internal policies.
The loan participation policy must establish:

- Concentration limits on the amount of loan participation that may be purchased by each loan type.
  - Stated in terms of net worth
- Concentration limits on loans to a single borrower or group of associated borrowers.
  - Not to exceed 15% of net worth
  - Waivers are permitted
- Originator concentration limits.
- Underwriting standards.

Source: National Credit Union Administration
The rule requires a single originator cap of $5 million OR 100% of net worth (whichever is larger).

FICUs are permitted to apply for a waiver from a single originator concentration limit.

It is important to note that purchases from a CUSO will not be combined with participation purchases originated by the CUSO’s owner credit union for purposes of the single originator limit.

Source: National Credit Union Administration
Risk Retention of Originator

The Federal Credit Union Act mandates that a Federal Credit Union originating lender must retain 10% of the outstanding balance.

- Throughout the loan’s life

Under the new rule, non-FCU originating lenders must retain at least 5% of the loan through its life

- In order for a FICU, FISCU, PISCU, CUSOs, or other financial organization to purchase a loan participation from an eligible organization, the loan participation agreement requires the originating lender to retain at least 5% of the outstanding balance through the life of the loan (absent state law requiring higher retention amount).
The loan participation policy must establish prudent underwriting standards for loan participations.

- Permits credit unions to participate in types of loans it does NOT originate.
- Establishes appropriate due diligence.
  - Can be done in house or through a qualified third party that is not affiliated with the loan.
  - May NOT rely on originating lender’s due diligence.
- Examiners will evaluate:
  - The Credit Union’s parameters for review.
  - How often the parameters are analyzed.
  - How well the Credit Union adheres to its own policies.
Loan Participation Agreement

• Be properly executed, acted upon by the Board, and retained.
• Delineate the roles, duties, and obligations of the originating lender, servicer, and participants.
• Identify each specific participated loan.
• Amount of loan retained by originating lender.
• Originators participation for the loan’s duration documented.
• Location and custodian of the original loan documents.
• Include disclosure requirements regarding ongoing fiscal condition of loan, borrower and servicer.
• Circumstances and conditions for replacing the servicer.
Loan Participations
Loan participation is the shared funding of a loan by two or more institutions.

- The originating institution grants a loan to its customers, and then participates out a portion of that loan (or pool of loans) to one or more institutions, known as participants. Federally chartered credit unions can participate out as much as 90% of the loan(s), and state chartered credit unions can participate out as much as 95%.

- The originator maintains servicing and through the retained portion of each loan is the only visible institution in the eyes of its members.
Loan participations offer both the buyer and the seller several benefits.
### Benefits of Loan Participations (cont’d)

<table>
<thead>
<tr>
<th>Originators</th>
<th>Participants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Additional source of balance sheet liquidity and/or better diversification through a reduced level of concentration in specific asset classes.</td>
<td>Ability to almost immediately secure attractive loans for your balance sheet.</td>
</tr>
<tr>
<td>Keep customer relationship and servicing</td>
<td>Ability to generate loan diversity in your loan schedule, meeting specific loan targets.</td>
</tr>
<tr>
<td>Adds leverage in specific loan niche with attractive current yields, providing for better market penetration and share, instead of rejecting loan applicants</td>
<td></td>
</tr>
</tbody>
</table>
### Loan Responsibilities

<table>
<thead>
<tr>
<th>Originator Responsibilities</th>
<th>Participant Responsibilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Must retain copies of loan documentation and worksheets</td>
<td>• Perform Due Diligence review of loan offerings</td>
</tr>
<tr>
<td>• Must maintain a 10% interest on each loan for federally</td>
<td>• Check loan policy, collection policy and actual</td>
</tr>
<tr>
<td>chartered credit unions, and 5% for state chartered</td>
<td>loan loss history</td>
</tr>
<tr>
<td>credit unions.</td>
<td>• Can participate in loans that they are able to</td>
</tr>
<tr>
<td>• Retain servicing in return for additional yield from</td>
<td>make under their loan policy underwriting</td>
</tr>
<tr>
<td>participant</td>
<td>standards</td>
</tr>
<tr>
<td>• Servicing includes: collection of payment, monthly</td>
<td></td>
</tr>
<tr>
<td>trial balance sheet creation, and forwarding, delinquency</td>
<td></td>
</tr>
<tr>
<td>or collection efforts</td>
<td></td>
</tr>
</tbody>
</table>
Types of Loans

- Auto
- Taxi Medallion
- Member Business
- Residential Real Estate
- Credit Card Portfolio
Residential Real Estate Market

The Mortgage Bankers Association said in late 2013 that it expects:

- 32 percent decline in mortgage originations
- 9 percent increase in purchase originations
- 57 percent decrease in refinance originations

The chart below illustrates how mortgage originations and refinancings crested in late 2012 and early 2013, respectively.

<table>
<thead>
<tr>
<th></th>
<th>Mortgage Originations: 1-4 Family: Total (Bil.$)</th>
<th>Mortgage Originations: 1-4 Family: Purchase (Bil.$)</th>
<th>Mortgage Originations: 1-4 Family: Refinance (Bil.$)</th>
<th>Refinance Share (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012 - Q1</td>
<td>436</td>
<td>139</td>
<td>297</td>
<td>68.1</td>
</tr>
<tr>
<td>2012 - Q2</td>
<td>461</td>
<td>154</td>
<td>307</td>
<td>66.6</td>
</tr>
<tr>
<td>2012 - Q3</td>
<td>550</td>
<td>151</td>
<td>399</td>
<td>72.6</td>
</tr>
<tr>
<td>2012 - Q4</td>
<td>597</td>
<td>144</td>
<td>453</td>
<td>75.9</td>
</tr>
<tr>
<td>2013 - Q1</td>
<td>524</td>
<td>136</td>
<td>388</td>
<td>74.0</td>
</tr>
<tr>
<td>2013 - Q2</td>
<td>537</td>
<td>183</td>
<td>354</td>
<td>66.0</td>
</tr>
<tr>
<td>2013 - Q3</td>
<td>401</td>
<td>195</td>
<td>206</td>
<td>51.3</td>
</tr>
<tr>
<td>2013 - Q4</td>
<td>293</td>
<td>138</td>
<td>155</td>
<td>52.9</td>
</tr>
</tbody>
</table>

Source: Mortgage Bankers Association

Currently, many credit unions have looked to replace loan activity with ARM/floating rate products or fixed-rate loans with less than 15 years maturity.
Residential Real Estate Trends

• Many credit unions are beginning to address their 30-year fixed rate portfolios and are requesting solutions to the recent market changes.

• Some credit unions have been participating out 30-year loans providing a 10- to 15-year buyback feature and pricing the participation to where 10 to 15 year mortgages are transacting.

• Many credit unions have been focusing on underwriting shorter fixed rate maturities (10 years and less) as well as originating more floating rate products.
One of our most successful programs lately involves helping credit unions with an over concentration of long-term, low coupon, fixed-rate mortgages.

Here is a brief explanation and illustration in how it works.

As you are aware, the National Credit Union Administration said in its supervisory focus for 2014 that interest rate risk is the “most significant risk that the credit union industry faces right now.”

Most credit unions are structuring their loan portfolios to protect themselves from an increase in rates, however many of them are still carrying a disproportionate number of 30-year fixed-rate residential mortgages – and that puts them at risk. They may want to consider participating these loans off of their balance sheet before rates shift to a higher range.

LPC has credit union customers that have an interest in selling (participating) blocks of their longer fixed-rate mortgages. For example, a 30 year residential mortgage pool with an average weighted coupon of 4.25% percent could be participated out for the next ten years at 3.25% percent. The seller would receive a 100bps servicing spread while executing the participation at $100. The buyer will control a one-time put back option at the maturity of 10 years. So essentially, the seller is removing 30 year exposure off the balance sheet for the next 10 years; while at the same time the buyer is purchasing a short-term pool of performing, agency underwritten collateral with a competitive 3.25% pass-through rate including its monthly cash flows.

The illustration below reflects a seasoned $40 Million pool of 360 WAM collateral with a 4.25% WAC. We are using a 10 CPR pre-payment model expectation. The projected outstanding principal balance is $10,776,054 after 10 years (put date).
### Residential Real Estate

<table>
<thead>
<tr>
<th>Gross Weighted Avg. Coupon:</th>
<th>4.250%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Participation Rate</td>
<td>3.250%</td>
</tr>
<tr>
<td>Original Weighted Avg Maturity:</td>
<td>360 Months</td>
</tr>
<tr>
<td>Current Weighted Avg Maturity:</td>
<td>332 Months</td>
</tr>
<tr>
<td>Weighted Avg Maturity Date:</td>
<td>11/15/2041</td>
</tr>
<tr>
<td>Interest Basis:</td>
<td>30/360</td>
</tr>
<tr>
<td>Delay Days:</td>
<td>15</td>
</tr>
<tr>
<td>Is there a Put Feature?</td>
<td>Yes</td>
</tr>
<tr>
<td># Months to Next Put:</td>
<td>120</td>
</tr>
<tr>
<td>Put Date</td>
<td>03/2024</td>
</tr>
<tr>
<td>DUS ?</td>
<td>No</td>
</tr>
<tr>
<td>Remaining Yield Maintenance Term</td>
<td>n/a</td>
</tr>
<tr>
<td>Interest Only?</td>
<td>No</td>
</tr>
<tr>
<td>Remaining IO WAM</td>
<td>n/a</td>
</tr>
<tr>
<td>Level Pay ?</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Net Servicing Income:</strong></td>
<td>$2,263,066</td>
</tr>
</tbody>
</table>

**LP Data**

<table>
<thead>
<tr>
<th>As of (or settlement) Date</th>
<th>03/28/2014</th>
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</thead>
<tbody>
<tr>
<td>Original Face</td>
<td>$40,000,000</td>
</tr>
<tr>
<td>Purchase Price</td>
<td>100.0000%</td>
</tr>
<tr>
<td>Factor</td>
<td>1.0000000000</td>
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<tr>
<td>Current Face</td>
<td>$40,000,000.00</td>
</tr>
<tr>
<td>Discount</td>
<td>$0.00</td>
</tr>
<tr>
<td>Accrued Interest at Settlement</td>
<td>$101,111.11</td>
</tr>
<tr>
<td># Days Accrued</td>
<td>28</td>
</tr>
<tr>
<td>Scheduled Monthly P&amp;I</td>
<td>$182,811.29</td>
</tr>
<tr>
<td>Effective Yield to Maturity</td>
<td>3.250%</td>
</tr>
<tr>
<td>Weighted Average Life:</td>
<td>5.64 Yrs</td>
</tr>
<tr>
<td>Modified Duration:</td>
<td>4.91</td>
</tr>
<tr>
<td>Forecast Balance at Put Date</td>
<td>$10,776,054</td>
</tr>
</tbody>
</table>
# Loan Participation Offer

<table>
<thead>
<tr>
<th>Offer: #1024</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Loan Type</th>
<th>RESIDENTIAL MORTGAGES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deal Structure</td>
<td>Participation</td>
</tr>
<tr>
<td>Institution Type</td>
<td>Credit Union</td>
</tr>
<tr>
<td>Pool Amount</td>
<td>$12,668,446.05</td>
</tr>
<tr>
<td>Number Of Loans</td>
<td>62</td>
</tr>
<tr>
<td>Participation Rate</td>
<td>2.70</td>
</tr>
<tr>
<td>Participation Amount</td>
<td>11,401,601.45</td>
</tr>
<tr>
<td>Region</td>
<td>PA; DE; NJ</td>
</tr>
<tr>
<td>LOIs</td>
<td>1</td>
</tr>
<tr>
<td>WAC</td>
<td>3.43%</td>
</tr>
<tr>
<td>WAM</td>
<td>331 Months</td>
</tr>
<tr>
<td>LPC Fee</td>
<td>37.5 bps</td>
</tr>
<tr>
<td>Close Date</td>
<td>2/26/2014</td>
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</table>

Notes: Put Option: 7 years
### Residential Mortgage Loans

<table>
<thead>
<tr>
<th>Loan Participation Offer #771</th>
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</thead>
<tbody>
<tr>
<td><strong>Type of Institution</strong></td>
</tr>
<tr>
<td><strong>Loan Type</strong></td>
</tr>
<tr>
<td><strong>Participation Amount</strong></td>
</tr>
<tr>
<td><strong>Participation Rate</strong></td>
</tr>
<tr>
<td><strong>WAC</strong></td>
</tr>
<tr>
<td><strong>Servicing Spread</strong></td>
</tr>
<tr>
<td><strong>WAM</strong></td>
</tr>
<tr>
<td><strong>WAFICO</strong></td>
</tr>
<tr>
<td><strong>WA LTV</strong></td>
</tr>
<tr>
<td><strong>Price</strong></td>
</tr>
<tr>
<td><strong>LPC FEE</strong></td>
</tr>
<tr>
<td><strong>Region</strong></td>
</tr>
<tr>
<td><strong>LOI</strong></td>
</tr>
</tbody>
</table>

**Notes**
- 8 year buyback on remaining balances
Thinking of Selling Your Direct/Indirect Loan Portfolio?

• Are you concerned about your financial institution’s low capital ratio?

• Are you considering shrinking your balance sheet in response to regulator concern?

• Are you at your limit on your auto loans with more demand than you can fund?
Auto Loan Overview

• The indirect auto market has expanded greatly over the last 12 months.

• Many credit unions are re-entering the market with new programs.

• Credit unions are selling indirect auto loans to generate a premium.

• It continues to be a seller’s market as many credit unions are looking to participate in auto portfolios.

• We have seen rapid growth in the participation market to levels that we have not seen since 2007.
By selling your direct/indirect auto loan portfolio, you can restructure your balance sheet

- Potentially booking a capital gain to offset dealer reserves.

If you have more loan demand than you can fund, you can sell off your existing auto loans and write new business

- Generate more revenue.
When selling an auto pool:

- Create an Excel spreadsheet for pricing.
- Receive indications on portfolio pricing.
- Execute letter of intent for auto pool.
- Provide underwriting guidelines.
- Provide loan files on selective random sample.
- Negotiate participation agreement.
- Close and fund the loans.
- Receive funding wire from buyer.
# Credit Union Auto Loan Participations/Sales with LPC

<table>
<thead>
<tr>
<th>Amount</th>
<th>Description</th>
<th>Date</th>
<th>Participation Price</th>
<th>Participation Rate</th>
<th>WAC</th>
<th>WAM</th>
<th>WAFICO</th>
<th>Min FICO</th>
<th>WAFICO</th>
<th>FICO</th>
</tr>
</thead>
<tbody>
<tr>
<td>$8,241,188.00 Loan Sale closed on 1/9/2014</td>
<td>Sale Price - 106.00</td>
<td>1/9/2014</td>
<td>106.00</td>
<td>12.44%</td>
<td>12.44</td>
<td>49</td>
<td></td>
<td>647</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$1,092,388.51 Participation closed on 12/27/2013</td>
<td>Participation Price - 106.50</td>
<td>12/27/2013</td>
<td>106.50</td>
<td>6.98%</td>
<td>7.98%</td>
<td>47</td>
<td>636</td>
<td>600</td>
<td>636</td>
<td></td>
</tr>
<tr>
<td>$2,014,703.80 – Participation closed on 6/28/2013</td>
<td>Participation Price - 104.40</td>
<td>6/28/2013</td>
<td>104.40</td>
<td>4.40%</td>
<td>4.90%</td>
<td>69</td>
<td>659</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$13,627,179 – 90/10 Participation closed on 6/16/13 (RV Pool)</td>
<td>Participation Price - 102.25</td>
<td>6/16/13</td>
<td>102.25</td>
<td>5.75%</td>
<td>6.75%</td>
<td>153</td>
<td>726</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$17,859,678 – Loan sale closed on 6/6/13</td>
<td>Sale Price – 102.50</td>
<td>6/6/13</td>
<td>102.50</td>
<td>4.45%</td>
<td>4.9%</td>
<td>64</td>
<td>714</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$2,872,451 – 90/10 Participation closed on 5/31/13</td>
<td>Participation Price – 103.50</td>
<td>5/31/13</td>
<td>103.50</td>
<td>4.66%</td>
<td>5.66%</td>
<td>47</td>
<td>660</td>
<td>720</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$7,722,480.88 – Loan sale closed on 4/29/13</td>
<td>Sale Price – 103.40</td>
<td>4/29/13</td>
<td>103.40</td>
<td>4.72%</td>
<td>5.73%</td>
<td>72</td>
<td>733</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$9,371,391 – Loan sale closed on 3/27/13</td>
<td>Sale Price - 102.70</td>
<td>3/27/13</td>
<td>102.70</td>
<td>5.73%</td>
<td>6.9%</td>
<td>519</td>
<td>728</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$10,545,166 – 90/10 Participation closed on 3/11/13</td>
<td>Participation Price - 103.25</td>
<td>3/11/13</td>
<td>103.25</td>
<td>4.30%</td>
<td>5.29%</td>
<td>72</td>
<td>681</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$5,307,344.60 – 90/10 Participation closed on 2/28/13</td>
<td>Participation Price - 103.25</td>
<td>2/28/13</td>
<td>103.25</td>
<td>4.30%</td>
<td>5.29%</td>
<td>72</td>
<td>687</td>
<td>715</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
What is a member business loan?

A member business loan is classified as any loan, line of credit, or letter of credit (including any unfunded commitments) where the borrower uses the earnings for the commercial, corporate, or agricultural purpose, or any other business investment property or venture.
Member Business Loan Trends

We have seen an increase in activity in the loan portfolios for member business loans as the economy continues to stabilize.

More credit unions have increased staff in the hopes of generating more net yield in their member business loan portfolios as rates started to rise.
How do you implement a member business loan program?

- The Board of Directors must adopt specific business loan policies and review them annually.

- The Board must utilize the services of an individual with two (2) plus years experience in the type of lending the institution is engaging in
  - For example, a credit union can use the services of a credit union service organization, an employee of another credit union, an independent contractor, or other third parties.

- The actual decision to grant a loan must reside with the credit union.
What must your member business loan policy address?

- Types of loans you will make, or participate in
- Geographic area
- 12 ¼% of MBL vs. Total Assets
- The maximum amount of your assets, in relation to net worth, that you will invest in the following:
  - Business loans
  - Given category or type or business loan
  - Anyone member or group of associated members
- The qualifications and experience of personnel involved in making and administering business loans
What must your member business loan policy address? (cont’d)

• A requirement to analyze and document the ability of the borrower to repay the loan

• Receipt and periodic updating of financial statements and other documentation, including tax returns.

• Sufficient documentation to support each request to extend credit, increase an existing loan or line of credit

• Interest rates and maturities of business loans
What must your member business loan policy address? (cont’d)

- The collateral requirements must include:
  - Loan-to-value ratio
  - Determination of value
  - Determination of ownership
  - Steps to secure various types of collateral
  - How often the credit union will reevaluate the value and marketability of collateral

- General loan procedures including loan monitoring, servicing, follow-up, and collection

- Identification of those individuals prohibited from receiving member business loans
What is a Taxi Medallion?

A Taxi Medallion loan is any loan in which a taxi medallion (predominantly from New York City) will serve as collateral, and/or a loan, the repayment of which is primarily from the cash flow of the taxi business income.
Taxi Medallion Values

New York City
- Individual Medallion is approximately $1,051,000.
- Mini-Fleet of medallions is 2-3 medallions owned by the same borrower approximately worth $3,153,000.
- There are currently over 13,300 medallions issued in NYC

Chicago
- Individual Medallion is approximately $350,000.00
- There are currently over 7,000 medallions issued in Chicago
Wheelchair Accessible Vehicles (WAV) Taxi Medallions

New York City launched an initiative to make half of all yellow taxicabs wheelchair accessible by the year 2020.

The city approved the additional auction of 2000 wheelchair assessable licenses to spur the initiative. The three auctions so far were for 100 (200 actual; lot of two) minifleets in November, 32 minifleets in March, and 168 individual licenses in February.

The average values were lower than the unrestricted licenses. The values are at $1,050,000 for the unrestricted vs. the average WAV price for an individual of $867k at the auction (minifleets are much higher; $2.6MM vs. $2.3MM for the unrestricted and WAV respectively).
Taxi Medallion Frequently Asked Questions

Who is eligible for these loans?
Any member of the credit union who is in good standing and has an acceptable credit history, is eligible to apply with the exceptions as required by NCUA Rule 723.21.

What is the security for these loans?
All member taxi medallion business loans are personally guaranteed by the member so all of his unencumbered assets including the vehicle if it’s in his name.

What are the repayment requirements?
Subject to specific operating requirements as determined by the borrower’s cash flow or other financial projections, payment will be made by periodic payments of principal and interest, or Interest only Loans.
Taxi Medallion Frequently Asked Questions (cont’d)

Are there maximum terms?
• The maximum term of any medallion loan will not exceed 30 years amortization
• Typically, maturities range from 3-5 year balloons.

What is the rate of these loans?
• Medallion loans are usually either a fixed rate or at a floating rate determined by the prime rate.
• LTV is generally 80 % or less.
Is there a written policy by the credit union on these loans?
Yes. The credit union has a written taxi medallion business loan policy that documents all of the lending policies and procedures, with respect to these loans. This document will be made available to any institution that is interested in a loan participation, after the LOI has been signed.

What has been the delinquency and default history of these loans?
This has been very low, primarily because these medallions are used to generate sufficient cash flow to cover debt service.
Credit Card Portfolios
For Target, the Breach Numbers Grow


Target revised the number of customers whose personal information was stolen in a widespread data breach during the holiday season, now reporting a range of 70 million to 110 million people. The theft is one of the largest ever of retail data, and the largest since the TJX breach in 2007.

Recent History of Retail Data Breaches

Neiman Marcus Confirms Data Breach

The Washington Post, Jan. 12, 2014

Michaels Retailer Investigates Data Breach

InformationWeek, Jan. 27, 2014
Data Breaches Are Not Going Away

- Adobe Software confirmed that its online store was penetrated in Oct. 2013. Potentially all of its customers’ personal information was compromised.

- According to the Identity Theft Resource Center, there were 600 publicly disclosed data breaches in 2013 – a trend that experts say is likely to continue.

- NAFCU Study: 13.9% of credit union cardholders affected by breaches in 2013.*

Data Breaches Are Not Going Away

• A confidential FBI report indicated that Target credit card information is being sold on the black market.*

• The report showed that in spite of increased security by issuers, law enforcement and retailers, the FBI expects that “point of purchase malware” crime will continue.*

• It was reported on Jan. 23 that unreported breaches had also occurred at other retail chains.* The retailer Michael’s reported a breach shortly thereafter.

* Source: "FBI Warns Retailers to Expect More Credit Card Breaches.” Reuters, Jan. 23, 2014
How Did This Happen?

• It has been reported that the type of “malware” used to hack Target is available online for $6,000.*

• These ongoing data breaches are at the retail level, and while the retail industry has experienced an increase in revenue due to a mandated reduction in debit card interchange there is a suspicion that the industry has not substantially reinvested this revenue in fraud deterrence or technology security.

• Due to outdated magnetic strip technology, many experts believe that the U.S. credit industry will continue to be low hanging fruit for cyber criminals worldwide.

*Source: "FBI Warns Retailers to Expect More Credit Card Breaches." Reuters, Jan. 23, 2014
Impact on Credit Card Issuers

• When a breach occurs, credit card issuers are faced with the costly decision of whether to reissue compromised cards.

• A Credit Union National Association survey showed that almost 14% of credit union debit and credit cards were compromised during the Target breach, with an estimated cost of $30.6 million. Substantial losses due to fraud could add to the total. As of Feb. 11, the average reported costs per affected card totaled $5.68 *

• The reissuance activity can also put a strain on resources.

*Source: Credit Union National Association, Target Data Breach Survey, Feb.12, 2014
Response to Credit Breach Incidents

- In many cases, credit card issuers are stuck with the bill.

- Several financial institutions have launched a class action suit against Target to recoup losses.

- The United States Senate has recently introduced a bipartisan bill, The Data Security Act of 2014 (S. 1927) which would mandate further protections for the personal data of consumers.
Is the EMV Card the Answer?

• The EMV-enabled card has an embedded microprocessor chip that encrypts transaction data differently for every purchase and is more secure than the magnetic strips used on most U.S. credit and debit cards.

• Joint venture between Europay, MasterCard and Visa that began in 2002 and was joined by American Express in 2009.

• Global standard for interoperation of “chip cards”.

• EMV cards are capable of working with Point of Sales (POS) terminals as well ATMs and can be used by both debit and credit cards.
EMV Card Alternative

- It is currently the industry standard for credit and debit cards technology in both Europe and Asia.
- In 2010, United Nations Federal Credit Union became the first U.S. financial institution to issue an EMV enabled credit card.
- In the United States, both debit and credit cards must incorporate EMV technology by October 1, 2015.
- The EMV cards cost significantly more than their magnetic strip counterparts, and ultimately POS terminals and ATMs will need to be reconfigured to support the new technology.
- In Europe, the merchant is liable for any fraudulent transaction that was processed by a terminal not EMV-enabled. This will be true in the United States after October 1, 2015.
Liabilities of Managing a Credit Card Program

- Increased cost of security.
- Increasing premiums for fraud bond protection.
- Margins are compressed in a rising rate environment, and credit card profitability subsequently decreases.
- Increasing cost of processing bills as third party processors now have significant capital expenditures and training expense in preparation for new EMV requirements.
- Cost of mandatory reissuance of EMV cards in 2015
What Is a Credit Card Partnership?

- A financial institution agrees to a partnership with a credit card-specialized institution to sell its credit portfolio in exchange for a premium, as well as ongoing revenue streams.
- The credit card stays branded in the institution’s name.
- The partner designs and finances a direct mail campaign to grow the business.
- 24/7/365 customer support is provided.
- Existing rewards points transition point-for-point into the new program.
- At closing, all costs, as well as credit and fraud risk, move to the partner.
- The institution could reenter the credit card space in an agreed upon timeframe.
15 Things You May Not Know About a Credit Card Partnership

- The credit card stays branded in the credit union’s name.
- Monthly statements carry the credit union brand.
- Members can check balances and make payments at credit union branches.
- Members can apply for cards, check balances and make payments on the credit union website.
- Member applications will not be turned down without consulting the credit union.
- The partner assumes all credit, compliance and fraud risks.
- The partner pays the credit union a share of the monthly gross interchange charges.
- The partner pays the credit union a bounty for new accounts opened.
- The partner trains credit union staff to sell the new credit card program.
- The partner offers cash incentives to employees who sell cards.
- The partner pays for a marketing campaign to grow the portfolio.
- A partnership program can make a program more competitive with larger credit card issuers.
- The partner offers a robust rewards program (cash back, travel, “name your own reward”)
- The partner provides 24/7/365 multi-lingual member service.
- The partnership contract is for five years. At the conclusion, a credit union can renew the partnership or restart a new in-house credit card program.
LPC Services

• For the past eight years LPC has helped hundreds of financial institutions nationwide explore the potential of a credit card portfolio partnership.
• LPC offers a complimentary valuation and analysis of an institution’s credit card portfolio.
• LPC has a network of potential partners who will review an institution’s portfolio for valuation.
• Since 2006, LPC has arranged 49 partnerships.
• There is no cost to have us evaluate an institution’s credit card portfolio.
For more information about loan participations and credit card partnerships, contact

Jeff Varner, Managing Director
Tony Muller, Senior Vice President
info@lpcservicesinc.com
866-441-9437

For more information about the Office of Regulatory Affairs at Balance Sheet Management Services, contact

Prescott Ford, CFA, Managing Director
regulatoryaffairs@bsms.com
800-645-5424
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www.lpcservicesinc.com

100 Motor Parkway, 2nd Floor | Hauppauge | NY | 11788
Toll Free: 866.441.9437 | Tel: 631.979.0097 | Fax: 631.622.0167