



new england bankcard association

Unlocking the Power of



Board Members



Left to right: Joseph L. Wilson, Executive Vice President, United Bank, Inc.; Woody Nester, Executive Vice President (Retired), First National Bank; Terrance L. Beers, Executive Vice President & Chief Operating Officer, Rivergreen Bank; Stephen P. Shaffer, Senior Vice President, Community Bank of Parkersburg; Chairman James F. Dwinell, III, Chairman and Chief Executive Officer (Retired), Cambridge Trust Company; Barry Weed, President and Chief Executive Officer, National Grand Bank of Marblehead; Frank Sherron, President and Chief Operating Officer (Retired), NewBridge Bank; Robert S. Neese, Executive Vice President (Retired), Cape Cod Bank and Trust Company; and Richard K. Bennett, President and Chief Executive Officer, Marlborough Savings Bank.

Management Team



Left to right: Allen M. Bornheimer, Secretary and Legal Counsel; Theodore K. Keith, Jr., President and Chief Executive Officer; Emanuel R. Pansa, Senior Vice President and Chief Operating Officer; Stanley M. Linkous, Senior Vice President; Jean M. Zaccagnini, Senior Vice President; Paul W. Roberts, Senior Vice President and Chief Financial Officer

2007 NEBA Annual Report

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Dear NEBA Members:

In 2007, New England Bankcard Association worked to provide you, our community financial institution members, with the tools needed to successfully manage bankcard programs while improving your customer relationships and expanding product offerings. We are pleased to announce that your Association remains financially strong, with revenues increasing by 7.6% to \$13,285,721, a pre-tax income of \$1,439,302 and capital increasing from \$2,182,167 to \$3,032,471, primarily due to the redemption of MasterCard shares in 2007.

As we anticipate some negative impact from the economic downturn, our strong capital base will enable future reduction in risk to members and allow NEBA to increase its investment in products on behalf of our members – all while maintaining very competitive pricing.

Many other models in the industry require that financial institutions give up ownership of their customer relationship or use “plain vanilla” processing systems that don’t provide the functionality needed to meet the needs of individual customers. Our model puts the “custom” in customer to meet your organizational needs and those of your clients. In 2007, we began pilots of contactless card issuing, improved our technology infrastructure and began negotiations with vendors for improved reporting products. We can honestly say that NEBA offers the most flexible merchant processing arrangement in the industry, with the ability of members to use seven different processing platforms.

While NEBA’s offices are in New England, managed by Primax of Wakefield, Massachusetts (formerly known as T.K. Keith Company), our members are based throughout the United States as well as in Latin America. Living and working in a global economy, NEBA members have access to Primax’s multi-lingual contact center and our Latin American members have access to First Data processing platforms specific to their requirements.

One of NEBA’s primary values remains the ability for a community bank or credit union to own and manage their credit card and merchant acquiring programs while utilizing the power of First Data, a large and complex data processing company. NEBA brokers this powerful service for members and reduces their costs based on aggregated transaction volumes. NEBA provides the interface between your community bank and the mega-processor. Members also have access to advanced



Ted Keith



James Dwinell, III

analytics to reduce fraud and improve the efficiency of managing their credit card portfolios.

While we have received much positive feedback this year about our services and educational programs, we are always working to improve the membership model to make it even more attractive, accompanied with less risk. In 2008, NEBA will expand our member educational offerings to include monthly webinars featuring a variety of bank card topics, including loyalty programs, new tools to improve collections, and how to manage your credit card portfolio during an economic downturn.

Part of our commitment is to provide you with the confidence you need for your business to succeed in today’s changing competitive marketplace. Through updated service offerings, responding immediately to customer concerns and improving educational offerings about products and issues, NEBA empowers its owner-members to be their best.

Thank you for choosing to be a part of our community. New England Bankcard Association has met the payment system needs of community banks and credit unions for almost four decades, and we look forward to continuing to work with you, and for you, in the future.

A handwritten signature in black ink, appearing to read "TK Keith".

Theodore K. Keith, Jr. President and CEO

A handwritten signature in black ink, appearing to read "James F. Dwinell, III".

James F. Dwinell, III, Chairman

NEBA...

...Mission

To provide and enable our members to use the electronic payment and financial services of NEBA at a competitive price

NEBA will be a premier global provider of the best in payment system solutions at a competitive price and delivered with educational support and excellent service by management and staff known for quality, stability, credibility and accountability.

...Vision

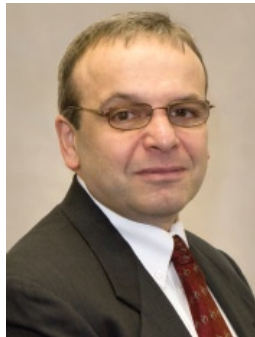
People, Places and Product Highlights from 2007

Starting off the year right, First National Bank signed an agreement in January to bring their credit card program back in-house through NEBA member Primax, after selling it several years ago.

In February, NEBA announced the development of a processing option for issuing members' Hispanic customer base that, when implemented, will modify all customer-facing materials and interfaces to be in Spanish.

In March, the credit card and merchant portfolios of the Barbados branch of Butterfield Bank were converted to NEBA, further extending the association's presence in the Latin America region.

In April, Emanuel "Manny" Pansa was named to the newly formed position of Chief Operating Officer, bringing additional depth to the management team. Manny comes to NEBA with more than 20 years of experience in the financial services industry.



Manny Pansa

Stephen Shaffer, Senior Vice President of Community Bank of Parkersburg, was elected to the NEBA Board of Directors in April as well.

Active negotiations commenced in May with First Data Corporation and TSYS for processing services for the period beginning January 2009.

NEBA held discussions in June with Discover to sponsor members for acquiring services under Discover's new business model.



In August, NEBA executed a service agreement for integrated debit card and ATM processing services for the First Data Northeast platform, expanding the debit card processing options for members.

A new web-based tracking system was installed in September to improve resolution of issues in NEBA's Client Services division.



In October, NEBA and Somerset Trust Company announced the launch of MasterCard PayPass contactless card issuance for Somerset Trust's MasterCard credit card program.

Also in October, NEBA member Butterfield Bank (Bermuda) announced the launch of their British Airways co-branded MasterCard program.



In December, NEBA completed the installation of the new Avaya phone system, providing expanded call center capabilities.

By year's end, 37 new credit card or merchant processing programs were signed with NEBA.



What Does NE

Lisa Bittner, AVP & Card Services Division Manager
Somerset Trust Company, Somerset, Pennsylvania



Helping support community banking while expanding our services nationally

As an independent community bank, Somerset Trust is under the leadership of the fifth generation of the family that founded our bank more than 100 years ago. It's important for us to maintain the traditional qualities of community banking, as well as enhance those qualities through technology. NEBA's support enables us to offer our own branded card services to our local customers, as well as offer quality services nationally. I recognize the fact that at Somerset Trust Company we represent a small region in western Pennsylvania which allows for limited organic growth. Working with NEBA for operational support, we are able to move into a national market, as well as develop niche products. We are now offering a Commercial Card Program to various institutions throughout the United States.

Keeping us competitive

NEBA allows us to move forward by assisting us with getting new programs up and running. Their team helps us build the project plan and complete the programming and testing with FDR in order to expedite moving the product to market. In this way, they enable Somerset Trust to stay competitive with regional and national banks. NEBA also helps us stay up-to-date with the latest developments on the FDR system; their guidance and support helps us

navigate the biggest credit card processor in the world.

NEBA continually expands the vendor options related to Merchant support allowing us to remain competitive in an industry that is consistently updating technology. For example, Somerset is able to offer MasterCard's contactless PayPass technology to both cardholders and merchants.

"NEBA's support enables us to offer our own branded card services to our local customers, as well as offer quality services nationally."

Maximizing capabilities and speaking the language of the community bank

Essentially we are a mid-size community bank, with approximately \$470 million in assets, 13 offices and over 200 employees. In the card services division, we only have four full-time employees representing multiple products, but NEBA helps us keep up with industry demand

and offer services 24/7 for fraud management, etc. NEBA helps us identify product lines to increase our profitability on the retail and commercial sides of our business. I believe there's a longer learning curve for bank employees to understand payment programs (vs. other parts of banking), but NEBA really helps community banks understand the payment industry because of their expertise in the banking industry and the regulatory environment. They also understand the restraints that community banks have to overcome in order to be competitive and streamlined.

BA Do For You?

Patty Schardein, Senior Vice President,
Towne Bank, Hampton Roads, Virginia

TOWNE BANK
A Tradition of Hometown Banking.



Real customer service

Since opening its doors nine years ago, Towne Bank has been a member of NEBA. We are the largest community bank in Virginia, with \$3 billion in assets.

It's gratifying for a community bank to feel that NEBA supports our customers with the same level of service they'd get if they walked into one of our branches.

While everyone claims to be all about customer service, NEBA genuinely believes in this and it is demonstrated in the extremely high level of customer service they provide. NEBA Member Representatives (MRAs) know their bank's portfolios. For example when I call with a question my MRA knows the number of card products we have and is familiar with our card programs. This makes it so much easier when I need help; I don't have to start from the beginning and explain the products and services we use. I have never had a problem that NEBA did not help me fix. They never fail to "step up to the plate." They typically resolve any issues within a day and keep me apprised of how the problem is being solved.

Training and access to the latest information

NEBA's training support is constant – whether through webinars or new product alerts. They are very much on the cutting edge within the confines of the platforms they

use, and keep their fingers on the pulse so we stay up-to-date on new products, services and compliance issues. Community banks do not have the time or skill to contract directly with platforms like Chase-Paymentech or TSYS Acquiring Solutions, but NEBA enables us to access those platforms, and negotiates the best pricing for us.

"NEBA's training support is constant - whether through webinars or new product alerts. They are very much on the cutting edge..."

NEBA understands my focus and concerns and breaks information down in a manner specific to my needs. Their support is more than industry-specific, there's a true understanding of each bank's needs, whether the bank's focus is e-commerce or more retail based, for example.

Giving us the tools we need

It's very important for a bank to ensure that cardholder information is safe, and NEBA gives us the tools and confidence to know that everything that should be done to protect our customers from fraud is being done. Banks today are overwhelmed with compliance and monitoring requirements, for example VISA security standards compliance. NEBA sifts through the information and passes it down so we can manage it. Not only does NEBA help with access to the best products and pricing, NEBA has also helped me learn how to better manage our portfolios. Not many associations or vendors take the time to really know their clients the way NEBA does. They've also really helped us learn how to price effectively.

I. Report of Independent Auditors

New England Bankcard Association Inc.
Financial Statements
Years Ended December 31, 2007 and 2006

I. Report of Independent Auditors

Audited Financial Statements

II. Balance Sheets

III. Statements of Income

IV. Statements of Changes in Capital

V. Statements of Cash Flows

VI. Notes to Financial Statements

Board of Directors and Members
New England Bankcard Association Inc.

We have audited the accompanying balance sheets of New England Bankcard Association Inc. as of December 31, 2007 and 2006, and the related statements of income, changes in capital, and cash flows for the years then ended. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Association's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of New England Bankcard Association Inc. at December 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

Boston, Massachusetts
March 21, 2008,
except for Note 8, as to which the date is
March 28, 2008

II. Balance Sheets

| | December 31 | |
|---|--------------------|---------------------|
| | 2007 | 2006 |
| Assets | | |
| Cash and cash equivalents | \$2,481,437 | \$ 1,432,590 |
| Settlements receivable | 2,309,337 | 7,643,283 |
| Member receivables | 1,231,655 | 1,070,229 |
| Other receivables | 242,341 | 235,349 |
| Prepaid contract incentives | 31,708 | 70,775 |
| Deferred tax asset | 113,155 | 40,212 |
| Other | 502,758 | 302,109 |
| Total assets | <u>\$6,912,391</u> | <u>\$10,794,547</u> |
| Liabilities and capital | | |
| Liabilities: | | |
| Settlements payable | \$2,563,353 | \$ 7,684,184 |
| Accounts payable to processing agents | 721,851 | 724,449 |
| Other accounts payable and accrued expenses | 594,716 | 203,747 |
| Total liabilities | <u>3,879,920</u> | <u>8,612,380</u> |
| Capital: | | |
| Member contributions | 807,821 | 807,821 |
| Accumulated earnings | 2,224,650 | 1,374,346 |
| Total capital | <u>3,032,471</u> | <u>2,182,167</u> |
| Total liabilities and capital | <u>\$6,912,391</u> | <u>\$10,794,547</u> |

See accompanying notes

III. Statements of Income

| | Year Ended December 31 | |
|---|------------------------|-------------------|
| | 2007 | 2006 |
| Revenues: | | |
| Processing fees, rebates, and assessments | \$12,028,317 | \$11,757,910 |
| Plastics sales | 387,483 | 279,467 |
| Termination fees | 869,921 | 301,595 |
| | <u>13,285,721</u> | <u>12,338,972</u> |
| Expenses: | | |
| Settlement and processing fees | 9,677,252 | 9,474,154 |
| Cost of plastics sold | 354,753 | 255,257 |
| Other client services | 897,756 | 855,000 |
| Management fees | 1,377,171 | 981,085 |
| General and administrative | 684,185 | 584,353 |
| Sales and marketing expenses | 274,421 | 273,899 |
| Professional fees | 97,704 | 68,891 |
| Insurance | 50,854 | 50,721 |
| Other | 734,931 | 210,894 |
| | <u>14,149,027</u> | <u>12,754,254</u> |
| Loss from operations | (863,306) | (415,282) |
| Other income: | | |
| Gain on redemption of MasterCard shares | 2,217,841 | 358,132 |
| Interest | 76,525 | 76,020 |
| Dividends | 8,242 | 1,799 |
| | <u>2,302,608</u> | <u>435,951</u> |
| Income before income taxes | 1,439,302 | 20,669 |
| Income tax expense | 588,998 | 17,601 |
| Net income | <u>\$ 850,304</u> | <u>\$ 3,068</u> |

IV. Statements of Changes in Capital

| | Member Contributions | Accumulated Earnings |
|--------------------------------|-------------------------|-------------------------|
| Balance at December 31, 2005 | \$ 793,321 | \$ 1,371,278 |
| Contributions from new members | 14,500 | — |
| Net income | — | 3,068 |
| | <u>807,821</u> | <u>1,374,346</u> |
| Balance at December 31, 2006 | 807,821 | 1,374,346 |
| Contributions from new members | — | — |
| Net income | — | 850,304 |
| Balance at December 31, 2007 | <u>\$ 807,821</u> | <u>\$ 2,224,650</u> |

See accompanying notes.

V. Statements of Cash Flows

| | Year Ended December 31 | |
|--|------------------------|--------------------|
| | 2007 | 2006 |
| Operating activities | | |
| Net income | \$ 850,304 | \$ 3,068 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Amortization | 29,339 | 4,564 |
| Deferred income taxes | (72,943) | 20,100 |
| Changes in operating assets and liabilities: | | |
| - Settlements receivable | 5,333,946 | (1,892,933) |
| - Member receivables | (161,426) | 266,773 |
| - Other receivables | (6,992) | (60,517) |
| - Prepaid contract incentives | 39,067 | 43,969 |
| - Other assets | (193,059) | (189,761) |
| - Settlements payable | (5,120,831) | 1,857,130 |
| - Accounts payable to processing agents | (2,598) | (45,311) |
| - Other accounts payable and accrued expenses | 390,969 | (176,915) |
| Net cash provided by (used in) operating activities | 1,085,776 | (169,833) |
| Investing activity | | |
| Purchase of software | (36,929) | (61,552) |
| Net cash used in investing activity | (36,929) | (61,552) |
| Financing activity | | |
| Contributions from new members | - | 14,500 |
| Net cash provided by financing activity | - | 14,500 |
| Net increase (decrease) in cash and cash equivalents | 1,048,847 | (216,885) |
| Cash and cash equivalents at beginning of year | 1,432,590 | 1,649,475 |
| Cash and cash equivalents at end of year | <u>\$2,481,437</u> | <u>\$1,432,590</u> |
| Supplemental disclosures of cash flow information | | |
| Cash paid during the year for income taxes | <u>\$ 895,000</u> | <u>\$ 190,000</u> |

See accompanying notes.

VI. Notes To Financial Statements

1. Accounting Policies

Organization and Nature of Business

New England Bankcard Association Inc. (the Association) is a nonstock Delaware membership corporation operating a multimember credit and debit card plan for the mutual benefit of its financial institution members. Revenues are earned through assessments to bank members and others at rates established by the Board of Directors (the Board), and through rebates from First Data Resources, Inc. (FDRI), a processor of credit and debit card transactions, paid to the Association at contractual rates. The Association has no employees. The Board has contracted with T. K. Keith Company, Inc. (TKKC) to manage the Association and serve as liaison between the members and FDRI. See Note 7 for further details.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, and all highly liquid investments with initial maturities of three months or less when purchased.

Investments in MasterCard Incorporated and Visa Inc.

The Association holds Class B shares in MasterCard Incorporated (MasterCard) and Class USA shares in Visa Inc. (Visa). Due to restrictions placed upon the transfer of the shares, the investments do not fall within the scope of Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. The investments are carried at original cost, which is \$0, as the Association received the shares from MasterCard and Visa at no cost.

Settlements Receivable and Payable

Settlements receivable and settlements payable represent amounts due from and due to FDRI and the Association's member banks in connection with the daily credit card settlement process. The amount of loss the Association would incur if parties to these contracts failed to perform would be limited to the forfeiting party's net settlement position. In 1992, the Board approved an amendment to the operating rules to authorize the Association to require collateral to be furnished from any member whose merchant program has been, or is being, sold or otherwise terminated, or from any other member deemed to present a collection risk to the Association. The amount of collateral is determined based upon management's estimate of potential exposure consider-

ing chargeback activity and costs paid by the Association on the member's behalf that may not be reimbursed. Collateral is obtained through a charge to the member's reserve account. At December 31, 2007 and 2006, the Association did not require any collateral balances.

Association Membership

Member contributions are determined by a formula applied to the prospective member's total assets, with a minimum of \$2,500. Such amounts are credited to capital. Upon termination of membership in the Association, members may be assessed certain costs, and the contribution is only refundable by approval of the Board. At December 31, 2007 and 2006, the Association's capital included \$589,599 and \$541,827, respectively, of forfeited membership initiation fees. In addition to this forfeiture, if adequate notice is not given to the Association prior to termination of membership, the Association assesses termination fees to the member in accordance with rates specified in the membership agreement.

The current membership agreements were renewed on November 1, 2003, and will continue through 2008. As an incentive for the members to renew their contracts, the Association paid incentives totaling \$321,106 based on the members' processing fees paid to FDRI for the year ended December 31, 2001. The Association's policy is to capitalize all incentive payments exceeding \$5,000, and expense the payments ratably over the contractual life of the new agreements. The incentive payments are refundable if membership is terminated prior to December 31, 2008. The Association's expense related to these incentives was \$18,404 and \$30,796 for the years ended December 31, 2007 and 2006, respectively, net of refunded incentives.

Software

Purchased software, with an unamortized balance of \$64,579 and \$56,988 as of December 31, 2007 and 2006, respectively, is recorded at cost, and is amortized on a straight-line basis over three years.

Revenue Recognition

The Association records processing fee revenue in the month that the fees are incurred by the members under the Association's contract with FDRI and are payable to FDRI. Rebates earned on the FDRI processing fees are recorded in the month the fees are incurred. The Association assesses monthly fees to its members based upon the volume of the member's cardholder purchase and merchant sales activity as reported by FDRI in the month the activity occurs. Revenue from plastics sales is recorded when the credit card plastics are shipped from the vendors to FDRI.

Two of the Association's members accounted for greater than 10% of total revenues. One member represented

VI. Notes To Financial Statements

approximately 18% of total revenues in 2007 and 15% in 2006, and the other member represented approximately 17% of total revenues in 2007 and 13% in 2006. At December 31, 2007, a total of approximately \$91,000 was due to the Association from these two members.

Income Taxes

The Association accounts for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*, which requires an asset and liability approach to financial accounting and reporting for income taxes.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year's presentation.

Recently Issued Accounting Pronouncement

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes*. FIN 48 provides guidance for the financial statement recognition, measurement, and disclosure of uncertain tax positions recognized in an enterprise's financial statements. FIN 48 is required to be adopted by nonpublic enterprises in annual periods beginning after December 15, 2007. The Association does not expect the adoption of FIN 48 to have a material impact on its financial condition or results of operations.

2. Processing Agreement

Credit and debit card transactions are processed for the Association by FDRI under a five-year agreement which expires on December 31, 2008. After the original term, the agreement shall automatically renew for an additional two years, unless either party gives written notice six months prior to the termination date of the original term. The agreement guarantees FDRI minimum annual fees of \$2,500,000.

In connection with the renewal of the agreement in 2003, the Association received several incentives from FDRI. Upon signing the agreement, the Association received a bonus payment of \$315,000. Costs of \$25,017 associated with the renewal were deducted from the bonus, with the remaining \$289,983 to be recognized as income over the period of the agreement ending December 31, 2008. The Association recorded income in connection with this signing bonus of \$56,126 for the years ended December 31, 2007 and 2006. As of December 31, 2007, the remaining amount to be amortized was \$56,126. The signing bonus was required to be reported as taxable income in 2003, which resulted in a deferred tax asset, the balance of which was \$20,112 and \$40,212 at December 31, 2007 and 2006, respectively.

In addition to the signing bonus, the Association is eligible to receive certain other credits against costs associated

with the implementation of new products and related processing fees and computer programming services as needed. The maximum value of these additional incentives is approximately \$350,000. No revenue has been recognized related to these additional incentives for the years ended December 31, 2007 and 2006.

3. Investments in MasterCard Incorporated and Visa Inc.

In May 2006, MasterCard completed an initial public offering. As part of the offering, MasterCard issued Class A shares to the public and to The MasterCard Foundation, and Class B shares to its existing shareholders (i.e., the institutions that were issuing members of MasterCard), including the Association. The Class B shares are restricted for four years. Commencing on the fourth anniversary of the offering, Class B shares may be converted to Class A shares, subject to certain rights of first refusal by the other holders of Class B shares. In June 2006, MasterCard used all but \$650 million of the net offering proceeds to redeem a portion of the Class B shares, from the existing shareholders, that was equal to the aggregate number of shares of Class A common stock issued to investors, and to The MasterCard Foundation, in the initial public offering.

In May 2006, the Association received 48,747 Class B shares of MasterCard at no cost as a result of the initial public offering. In June 2006, the Association received \$358,132 upon redemption of 28,761 Class B shares, which has been reflected in the statement of income as a gain on redemption of MasterCard shares. At December 31, 2006, the remaining 19,986 of Class B shares were subject to the restrictions discussed above, and thus carried at original cost, which is \$0.

In 2007, MasterCard shareholders approved an amendment to the MasterCard Certificate of Incorporation that provided for an accelerated conversion of Class B shares into Class A shares. The MasterCard Board of Directors approved a conversion window for the period from August 4, 2007 to October 5, 2007, during which time owners of Class B shares may voluntarily elect to convert and sell a portion of their shares. During the conversion period, the Association elected to convert and sell 17,000 shares of Class B shares. The Association recognized a gain of \$2,217,841 from the sale which is reflected in "other income" in the statement of income. At December 31, 2007, the remaining 2,986 of Class B shares were subject to the restrictions discussed above, and thus carried at original cost, which is \$0.

Dividends of \$8,242 and \$1,799 were received in 2007 and 2006, respectively, and are included in "other income" in the statement of income.

VI. Notes To Financial Statements

3. Investments in MasterCard Incorporated and Visa Inc. (continued)

In October, 2007 Visa completed a restructuring from a membership organization to a stock corporation. As a result, the Association received 36,284 shares of Class USA Visa common stock. Class USA Visa shares are subject to restrictions as to transfer, and thus are carried at original cost, which is \$0.

4. Revolving Credit Agreement and Letter of Credit

The Association has a secured revolving credit agreement for \$2,500,000, which expires April 30, 2008. The interest rate on loans under this agreement is the prime rate. The lending bank holds a security interest in net settlements and assessments receivable, deposits, and other property in the Association's possession. At December 31, 2007 and 2006, the Association had no borrowings outstanding under this revolving credit agreement.

The Association has a secured standby letter of credit agreement in the amount of \$1,000,000 in favor of MasterCard, as beneficiary. This standby letter of credit is payable on demand, and the interest rate on loans under this agreement is the prime rate. The lending bank holds a security interest in net settlements and assessments receivable, deposits, and other property in the Association's possession. At December 31, 2007 and 2006, the Association had no borrowings outstanding under this letter of credit agreement.

5. Contingencies

In accordance with SFAS No. 5, *Accounting for Contingencies*, the Association records a liability for litigation when it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated. As a member of Visa, the Association has indemnification obligations to Visa with respect to final judgments and settlements of litigation against Visa as described below. The Association accounts for its indemnification obligations to Visa in accordance with the provisions of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees*.

In November 2004, American Express (Amex) filed an antitrust lawsuit against MasterCard and Visa and several member banks alleging, among other things, that the defendants jointly and severally implemented and enforced illegal exclusionary agreements that prevented member banks from issuing American Express cards. The complaint requested civil monetary damages. On November 7, 2007, Visa and Amex announced that the lawsuit had been settled. The Association's

share of damages as a Visa member has been accrued by the Association, in accordance with SFAS No. 5, for approximately \$176,000 as of December 31, 2007.

Discover Financial Services (Discover) has filed a similar lawsuit against Visa. Because the resolution of that lawsuit is now both probable and the amount of the loss is reasonably estimable in Visa's opinion, Visa has reported a litigation reserve of \$650 million under SFAS No. 5. This is an accounting estimate, and not a settlement of the case. In connection with the Discover litigation pending against Visa, the Association has recorded an indemnification related liability, in accordance with FIN 45, of \$55,000 for estimated possible damages, reflecting the Association's share of potential damages as a Visa member.

The combined liability related to these two contingencies as of December 31, 2007 was approximately \$231,000, and is reflected in the Association's balance sheet as of that date. The corresponding expense is included in "other expense" in the statement of income for the year ended December 31, 2007. The reserve is not deductible for income tax purposes until such time as the claim is paid. Accordingly, the Association recorded a deferred tax asset of \$93,043, which is included in the deferred tax asset on the balance sheet at December 31, 2007.

Due to the complex nature of the litigation pending against Visa and the inherent difficulty of predicting the outcome of pending litigation, the Association cannot determine the maximum potential amount of its share of potential damages as a Visa member. Based upon communications received from Visa, it is possible the Association may not have to pay out any funds related to the settlement of these claims. However, as of December 31, 2007, any funds from Visa to settle these claims cannot be assured, thus the Association is required to reflect the potential loss related to these contingencies in its balance sheet.

6. Income Taxes

Significant components of income tax expense were as follows:

| | Year Ended December 31 | |
|--------------------------|------------------------|-----------------|
| | 2007 | 2006 |
| Current: | | |
| Federal | \$505,094 | \$(4,057) |
| State | 156,847 | 1,558 |
| | <u>661,941</u> | <u>(2,499)</u> |
| Deferred: | | |
| Federal | (56,093) | 15,000 |
| State | (16,850) | 5,100 |
| | <u>(72,943)</u> | <u>20,100</u> |
| Total income tax expense | <u>\$588,998</u> | <u>\$17,601</u> |

VI. Notes To Financial Statements

The reconciliation of income tax expense attributable to operations computed at the U.S. federal statutory tax rates to the income tax expense is as follows:

| | December 31 | |
|---|------------------|-----------------|
| | 2007 | 2006 |
| Tax at U.S. statutory rate (34%) | \$489,362 | \$ 7,027 |
| Effect of graduated income tax rate | – | (3,927) |
| State income tax, net of federal benefit | 90,244 | 4,985 |
| Other, primarily meals and entertainment expenses | 9,392 | 9,516 |
| | <u>\$588,998</u> | <u>\$17,601</u> |

At December 31, 2007, the deferred tax asset balance was comprised of two components: the accrual for contingencies related to the Visa litigation (\$93,043) and the deferred signing bonus from FDRI (\$20,112). At December 31, 2006, the entire deferred tax asset balance related to the deferred signing bonus from FDRI.

7. Related-Party Transactions

The Association and TKKC are parties to several agreements which govern many areas of the Association-TKKC relationship. TKKC is a corporation owned by a Director, the President, and three Senior Vice Presidents of the Association.

TKKC provides management services to the Association, under a contract which extends through December 31, 2008, for which the Association paid a predetermined monthly expense of \$58,170 through April 23, 2007, and \$68,170 beginning April 24, 2007 upon hiring additional management personnel, and \$55,400 in 2006. In addition, management bonuses of \$135,831 and \$136,285 were paid to TKKC in 2007 and 2006, respectively. Also, the Association paid an additional management fee of \$460,800 and \$180,000 in 2007 and 2006, respectively, to TKKC in recognition of costs being incurred by TKKC for project services and upgrades to technology for the benefit of the Association.

In the early 1990s, TKKC began to perform client services previously provided by FDRI. FDRI began paying a rebate to the Association as compensation for the services previously provided by FDRI. Prior to 2006, NEBA had shared the FDRI rebate with TKKC, but in 2006, the arrangement was changed such that a flat monthly fee was paid to TKKC in lieu of a portion of the FDRI rebate. The monthly fee for client services was \$74,813 and \$71,250 in 2007 and 2006, respectively.

These amounts are reflected as “other client services” in the statements of income.

The Association also paid TKKC \$367,620 and \$319,200 for salary-related expenses incurred by TKKC on behalf of the Association for expenses such as business development, training, and industry compliance personnel not covered under the management contract during 2007 and 2006, respectively.

In addition, the Association reimburses TKKC for certain costs associated with office space and other services. During 2007 and 2006, the Association paid TKKC \$35,441 and \$35,308, respectively, for insurance and \$146,280 and \$138,000, respectively, for rent.

In exchange for services that TKKC provides to the Association related to the recruiting of new members and servicing of existing members, the Association has agreed to pay TKKC a portion of fees paid by the Association’s member banks. The Association pays TKKC 50% of all new member contributions, 67% of the net income realized from the sale of card plastics, and 45% of all termination fees assessed to members leaving the Association before the expiration of their membership term.

Payments to TKKC under these arrangements for the year ended December 31 were as follows:

| | 2007 | 2006 |
|------------------|---------|----------|
| New member fees | \$ – | \$ 7,250 |
| Plastics sales | 65,461 | 48,427 |
| Termination fees | 391,465 | 135,718 |

The Association had a net receivable of \$50,462 and \$22,557 due from TKKC at December 31, 2007 and 2006, respectively, for certain processing fees and costs incurred by the Association on behalf of TKKC.

Certain members of the Board are also officers or employees of the Association’s member banks. TKKC provides additional services to certain of the Association’s member banks.

8. Events Subsequent to the Balance Sheet Date

Visa completed its planned Initial Public Offering (IPO) in March 2008. On March 28, 2008, the Association recorded a pre-tax cash gain of approximately \$563,000 on the redemption of approximately 39% of its equity interest in Visa pursuant to Visa’s planned use of the IPO proceeds. In addition, Visa also established a litigation reserve using a portion of the IPO proceeds. Accordingly, the Association has reversed approximately \$173,000 of the \$231,000 reserve established as of December 31, 2007 for indemnification liabilities related to the Visa litigation.



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