CHECKING 2011 | A PERFECT STORM

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As the industry continues to emerge from the throes of the "great recession", it is faced with a rapidly changing world of consumer financial services.

In many ways, the convergence of impacting factors has resulted in a perfect storm. Not only have new and anticipated regulations forced the rethinking of the consumer checking business model, little changed since "Totally Free Checking" first came on the scene in the mid-eighties, but the explosion of new technologies rapidly transforming the payments landscape, combined with the growing influence of Gen X and Y and their financial services preferences and expectations, are revolutionizing the industry.

> **"Interchange regulation is going to have profound repercussions throughout the banking and payments industry, well beyond merely slashing banks' profits. Counter intuitively, the Durbin amendment is likely to usher in a new wave of innovation in U.S. retail banking and payments."**
> (Source: Gwenn Bézard, Research Director, Aite Group)

The retail checking business model has evolved over the years into one where portfolio profitability is supported largely by a combination of overdraft income and interchange fees. With the diminishment of these sources of revenue, the model must be reformulated. And with that comes the opportunity for innovation and a refocus on the core underpinnings of the business. Here are four key factors to consider in reshaping the checking model:

- Recognition that consumer financial needs and preferences vary widely across segments – and that success will be defined by the ability to deliver products and services that are relevant and of value to defined segments
- Ability to deliver a superior and integrated experience that crosses all delivery channels – with the understanding that the product or service can no longer be separated from where and how it's delivered
- Understanding of the importance of retaining long-term, profitable relationships, and strategically targeting new account holder acquisition
- Fundamental understanding of the dynamics of profitability at all levels – account/holder/household, segment, product, channel, etc.

THE NEW CHECKING ARCHITECTURE

As the industry awaits final rules on interchange fees, and anticipates additional regulation that will further challenge checking profitability, institutions are beginning to define and implement various strategies that address the potential impacts:

- Eliminating or modifying current free checking programs
- Restructuring their checking product line – with a focus on driving lower-cost electronic transactions, adding account value and strengthening relationships
- Continuing with free checking as a market differentiator – coupled with a focused acquisition strategy
- Taking a "wait and see" position – allowing for final regulations and rules to be announced, and industry leaders to execute their strategies

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Eliminate or Modify Free Checking

The free checking business model is the most impacted by reduced overdraft fees and expected interchange limits, and its elimination or modification is being seen as a rapidly emerging strategy. Typical account changes or new account types replacing free checking include requirements such as minimum balances, monthly direct deposit of a certain amount, estatements, check safekeeping and number of electronic (debit card, bill pay, ACH) transactions.

While this approach comes with the danger of account holder attrition, this risk will likely lessen as more financial institutions make similar changes to their product lineups. Grandfathering existing account holders into their current accounts will mitigate this risk, but will also reduce the fees that might otherwise be earned on converted accounts.

"Free Checking falls 11 percent at banks and credit unions. Moebs study shows financial institutions streamline checking accounts but raise fees."

(Source: Moebs Services, August 2010)

Restructure Checking Product Line

This strategy is quickly taking hold across the industry and offers most opportunity for fundamentally rethinking and overhauling consumer payments services. While the most complex strategy to execute, it enables a more holistic, integrated approach to the consumer transaction business. Here are some developments, trends and considerations:

- Simplified checking product offerings that provide clearer distinction of features, benefits, and requirements – making it easier for consumers to select the accounts that best meet their needs
- Products structured to reduce costs and provide account holders a choice in how they want to use their account and avoid fees – for instance, minimum balances, direct deposit, ACH payments, estatements and debit card usage
- Heightened focus on checking-based relationship accounts designed to incent and reward broader, cross-organizational relationships (including deposits, credit cards, loans/lines, mortgages and investments)
- Reexamination of all checking-related fee service policies and pricing to align with new checking product line strategy – incenting behaviors, bundling features and benefits and extending special advantages to targeted segments
- Increased momentum around an array of mobile services, including alerts, account access and transaction, bill pay and remote deposit capabilities – targeted to the channel preferences of the younger, tech-savvy consumer
- Increased interest in affinity packages and programs as a way of adding differentiated value, and as a new source of recurring fee income. Packages typically include such services as identity theft/fraud protection, shopping, dining and travel discounts, insurance options, etc.
- Reconsideration of reward programs, possibly eliminating/modifying debit rewards to focus on credit cards and/or relationships
- Introduction of prepaid, reloadable cards as an alternative to a low cost checking account, and a way to serve the un/underbanked market

"Strategies for replacing lost fee income include creating new fee-based products, improving operational efficiency, and aggressive marketing and cross-selling to deepen customer engagement."

(Source: BAI & Finacle™ Index of Bank Sentiment, January 2011)

Continue Offering Free Checking

Continuing to offer free checking may be an attractive strategy in markets where large competitors are eliminating free/lowcost accounts or adding new account requirements – particularly where account holders are "converted" to new accounts (vs. grandfathered in). Success of this approach will require supporting strategies and tactics, including:

- Maximizing account holder relationships, profitability and retention
- Effective branch and contact center sales
- Lowering cost of delivery through online, mobile and other electronic transactions
- Targeted new account holder acquisition

"Eighty-five percent of consumers surveyed say they do not expect to pay fees for a checking account."

(Source: BAI & Finacle™ Index of Bank Sentiment, January 2011)

Wait & See

While this strategy would perhaps mean foregoing some fee income, deferring checking product and pricing changes until the debit interchange rules are finalized in April and the Consumer Financial Protection Bureau (CFPB) is operational in July will enable better informed strategic decisions. It would also allow for new product lineups to be introduced and success of strategies monitored. This might be a more viable strategy for smaller institutions that have limited product expertise and resources, but will also require the ability to respond quickly to final rules and competitive actions.

Regardless of the strategy employed over the coming months, staff training and account holder communication will be vital in retaining and growing profitable relationships.

ACQUISITION & ONBOARDING

As financial institutions begin to restructure and reprice their checking product lines and eliminate free checking accounts, account holder attrition can be expected to increase. This will provide a unique acquisition opportunity for institutions that choose to continue with a free checking option – and those that have an alternatively competitive and compelling proposition. This will be especially so in markets where institutions are being acquired, branches are being closed, and where competitors are making big checking changes. These situations will offer a window of opportunity as consumers reconsider their choice of primary financial services provider and are more open to switching institutions.

Acquisition will also regain its position of strategic importance as the economy continues to strengthen and deposit retention and growth become increasingly important.

Acquiring the consumer checking account represents the initiation of a relationship. Fundamental to making this investment pay off in terms of relationship breadth and depth, profitability and duration is delivering a consistently high-value experience. Here are three key components to leveraging that critical new account holder opportunity:

- **First impressions count.** Perhaps most important is the effectiveness of the new account opening experience in the branch. As most consumers continue to open accounts with a new institution in person, having knowledgeable, well-trained employees on the front line is vital to engaging the new account holder and maximizing relationship building opportunities.
- **Make it simple and smart.** Another critical step in the acquisition/onboarding continuum is the "switch" process itself. Most institutions either have no formal process in place, or offer basic paper-based "kits" or online tools, leaving consumers on their own to work through the process. A facilitated, needs-based switch process that goes beyond simply changing direct deposit accounts can greatly expand the breadth and depth of that potentially valuable new relationship, including other deposit, credit and investments – right from the start.
- **Show you care.** To reinforce the new relationship, a disciplined onboarding process should include follow-up thank you calls, letters and emails, as well as targeted multi-channel communications over the first ninety days – followed by ongoing communication based on the relationship.

The payments world is undergoing a transformative change that will be game-changing for all. The road ahead will offer opportunities for financial institutions that understand the dynamics and move forward with a clear strategic focus.

MindBridge Marketing is a Minneapolis-based marketing company focused on the financial services industry.
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