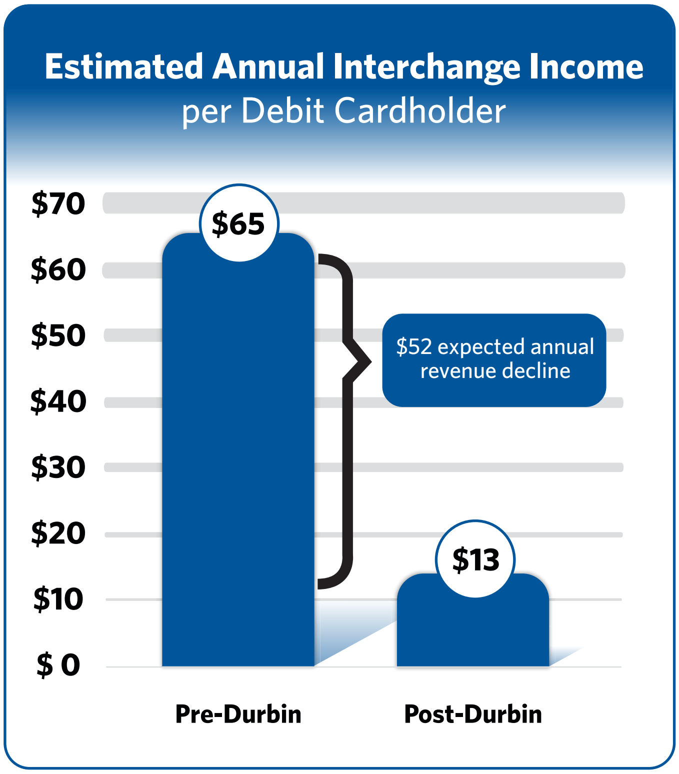
Solutions for Generating Income Despite Regulatory Headwinds: Part 1 of 3

Background

Given the significant revenue impacts of Regulation E on overdraft income and the looming impacts of the Durbin Amendment on interchange income, non-interest income is suffering. According to an October 2010 webinar report from the Independent Community Bankers of America, more than 80 percent of financial institutions expect Regulation E to impact their overdraft revenue by 5 to 20 percent. And a recent Raddon report indicates financial institutions can expect an annual revenue decline of $52 per debit cardholder in estimated annual interchange income as a result of the Durbin Amendment.

Opportunity

Amid the drive to grow net income and the waning of some traditional revenue sources, a multi-pronged approach can help your financial institution successfully shore up its income statement. This Strategy Update focuses on deploying complementary initiatives to assist with growing non-interest income by segmenting product line-up change communications, targeting household acquisition and providing ongoing Reg E opt-in support. Parts 2 and 3 of this series will examine ways financial institutions can increase interest income and reduce expenses, respectively, in a marketplace characterized by increased regulatory oversight.



Source: Raddon Financial Group report, *The Debit Card Debacle*, January 4, 2011

Recommendations

We recommend focusing on the following multi-solution approach to grow non-interest income:

- **Segment product line-up change communications:*** In today's environment, the best offense is based on a strong defense. Due to the recession of the past three years, account holders have been less likely to change providers, translating into significantly reduced attrition rates. Now, with many providers implementing checking product changes, attrition rates are expected to skyrocket. Therefore, it is critical to provide change disclosure communications that are geared toward retention rather than business-as-usual and that include the following actions:

  - **Segment the portfolio early.** Segmentation of the portfolio should view different variables, including household profitability (not just at the account level), current account behavior (number of transactions, channel usage, balances, etc.) and degree of account holder change required to avoid fees. This process allows for providing unique and relevant messaging to distinct groups of account holders.

  - **Develop a detailed communication matrix.** Institutions should review the required communication touchpoints by product line and segment to ensure that the account holders whose current account behavior meets new product thresholds receive communications clearly indicating that there will be no changes, or minimal changes, to their relationship. If their account remains free, they should be told so. The focus here is migrating toward account holder centricity as compared with the more typical disclosure communication approach to product realignment.

- **Provide options.** Typically, disclosure communications fail to offer account holders logical product alternatives. Financial institutions should break the mold, take the time to review current account behavior and develop logical options to include in communications.

- **Engage in targeted household acquisition:***

  - **Identify your most profitable current account holders.** Given that 50 percent of typical account holders are unprofitable, it is vital to identify the 20 percent of account holders who deliver 90 percent of the revenue. By identifying this population, marketplace look-a-likes can be targeted for acquisition efforts. Additionally, the profiles of these most profitable account holders should be analyzed to identify the products that are most attractive to them.

  - **Quantify your markets.** Evaluate where consumers reside in relationship to the existing branch footprint in order to create branch market areas. These will be used to guide the prospect list process. Our experience in working with clients on acquisition programs has shown that as much as 35 percent of mail is wasted by using a radius rather than a branch market area approach. The latter hones in on smaller carrier route segmentations and takes into account the impact of physical barriers, such as highways and rivers, that consumers do not find convenient to cross in the process of conducting personal business.

  - **Create marketing pieces that resonate with prospects.** Both the offers and the creative marketing materials sent to prospective account holders are important elements of a campaign's success. Unlike the free checking solicitations of the past, consumers are more interested in finding financial institutions they can trust. Therefore, offers should be realistic, with the number of hurdles required to qualify for an account kept to a minimum. In our work with financial institutions, we have found that programs with clear and easy-to-understand disclosures and offers that represent real value outperform cash or giveaway offers that are too good to be true.

- **Provide ongoing Reg E opt-in support:**

  - **Utilize initial contact or welcome communications.** While some of our financial institution clients are achieving opt-in rates of more than 60 percent at account opening, others are experiencing only a seven percent opt-in rate. Given the broad range of effectiveness of obtaining opt-ins at new account opening, additional touchpoints should be leveraged to maximize this revenue stream. Opt-in communications can be placed in existing welcome communications, or they can be added as inserts in a debit card mailing or within the initial check order. They also require careful wording to avoid confusion for account holders who opted in at account opening.

  - **Make use of event-driven communications.** Each time an account holder transaction is denied at the point of sale, your financial institution has an opportunity to communicate with that account holder about the option to opt in for protection. Such communications should clearly depict the benefits of opting in, as well as alternative solutions provided by your financial institution to prevent other potentially embarrassing moments for the consumer.

With analyst predictions of the slowest period of bank growth since the Great Depression, it is important to review all opportunities to increase revenue. Although there is no silver bullet, there are many initiatives that, when combined, can make significant revenue contributions.

For more information about how Harland Clarke can help you grow revenue by increasing non-interest income, contact your account executive or visit harlandclarke.com/contactus.

*For additional information, refer to the Harland Clarke Strategy Update, "Preserving Revenue While Changing the Product Line-up," Volume 2, Issue 6, December 2010.

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