TIERING YOUR FEE STRUCTURE

by Steve Brown

In the march to fee income generation, one area that is slated to rise for banks in 2007 is fees from overdraft and NSF deposit account charges. In 2006, these fees were up an average of 2.8% and we project that this revenue stream will be up 4% in 2007, due to lower projected account balances and higher fees. Our preliminary analysis indicates that more than 20% of banks raised fees in 2006. On the large bank side, we have seen Washington Mutual and AmSouth increase fees in the last quarter. The average fee hovers around $23 per event for overdrafts and $21 for NSF. In 2007, we predict a convergence of fees, so that NSF and OD charges will be identical. From a risk and cost standpoint this makes sense, as the impact on both operational risk and credit are approximately the same. At the High Performance Bank Workshop, we will be talking about one tactic we advocate - tiering OD/NSF fees in order to better match customer profitability with usage. While this varies as to demographic, one fee structure that we often suggest (particularly for banks along the coast because of the demographics and competition) is a fee structure that starts at $19.75 for the first OD, goes to $32.25 for the next 5 and then jumps to $37.50. For starters, note that fractional pricing has been proven to increase revenue for banks, while impacting the customer very little. This fee structure optimizes the customer experience, while adequately compensating banks for the associated costs and risk. Finally, this tiered structure happens to be below the average for most major banks (that tend to have OD/NSF fees in the $35 range). This ramped tier structure has the advantage of a "forgiveness" level for first time users. Meanwhile, customers that repeatedly overdraft their account are proven to be less fee sensitive and create a larger operational risk for the bank (by a factor of 3x), so should be charged more. Banks should only move to a tiered structure if they waive fees less than 15% of the time, since waiving fees for preferred customers ends up accomplishing the same cost/risk/forgiveness matching tiering. In this competitive environment, how a bank sets and charges fees is important for ongoing profitability. With lower NIM and a flat yield curve, banks need to learn how to optimize both the customer experience and fee income generation, in order to boost earnings growth.

DO YOU HAVE ENOUGH ALM HELP?

As a reminder, BIG's consulting group provides an integrated and completely outsourced asset-liability management (ALM) solution. This service not only incorporates a full regulatory and board reporting package on interest rate risk, but more importantly, layers in professional on-site consulting. This combination helps subscribing banks better manage risk, boost return and achieve performance objectives. Face it - banks spend an inordinate amount of time and money meeting each month on ALM, only to leave executives wondering what they really accomplished. Numbers on a page serve no purpose unless they relay what is driving the risk and how it impacts return. Our package of services solves this issue by moving ALM beyond being a "regulatory check box" and into the realm of performance optimization. Give us a call to receive a proposal.

BANK NEWS

Acquisition

Conestoga Bancorp (newly formed, PA) will acquire PSB Bancorp ($562mm, PA) in a transaction valued at nearly $87.4mm or 1.64x book.

Countermeasures

Fed Chairman Bernanke said that he expects rising incomes to offset declines in the housing market. He further added that the increase in wages would likely have a small effect on labor costs and in turn on inflation.

Banking How You Like It

A recent ABA survey on customer preference for banking delivery methods found: 32% use branches; 26% online banking; 26% ATMs; 5% telephone and 5% by mail. Age also played a role with 47% of those over 55 preferring branch banking, but only 17% of those under 34.

Mortgage Concerns

According to the WSJ, WAMU disclosed that it had miscalculated some customer's DTI levels. The error resulted in favorable lending decisions that wouldn't have occurred, if the correct calculations had been made.

Land Cut

As the housing market continues to slow, some large homebuilders are cutting back on their land holdings, or renegotiating deals at lower levels. Recent industry information shows prices reductions of 10% to 20%.