THINKING ABOUT MORE FEE INCOME

by Steve Brown

The typical community bank usually has about 45% of their customers not paying any service charges. While the first conclusion is that these are all valuable customers, upon closer inspection, they are not. In fact, usually only about 15% of those customers that aren't paying service charges are materially profitable to the bank. The rest are free loaders. To be fair, these customers (both commercial and retail) aren't paying fees because probably no one has asked them. Either the bank gave them a "no fee" account option or a salesperson assumed that the customer was fee sensitive and put them in the account.

The facts are that most large banks have fee structures much higher than community banks. Remember, large banks control 80% of the market share in most markets, so it is hard to argue that community bank customers won't pay fees. Ironically, when we point that out to some community banks, we are told that a lower fee structure is a necessary position to maintain, in order to compete with large banks. This strikes us as odd, as isn't the value proposition at most community banks about superior service? If true, shouldn't customers be willing to pay more fees for superior service? If not, what does service count for?

The reality is that most community banks have just never gotten around to designing a product offering package and a fee structure that optimizes both profit and volume. Banks may want to consider taking another look at their fees, as given current rates many customers are more unprofitable than ever. In fact, if a small business client produces under $500k in sales annually and has less than 20 employees (this is about 20mm customers nationwide), the odds are that they are unprofitable for the community bank.

To make this group profitable, cross-selling helps, but there is only so much you can do without charging fees. Most banks need to institute a depository service charge on smaller customers that leave lower balances. But what if they don't pay it you ask? That is Ok, because if they don't like the service charges and leave, the bank makes money as each account is likely costing that bank a net average of $980 per year (according to our data). If the customer pays, so much the better, as the bank can now make these customers more profitable. In short, increasing fees on customers can be a win-win proposition.

Of course, with rates and margins low, many banks are taking another look at fees and asking themselves where they can increase them. In addition to depository fees, community banks are instituting fees for ID theft protection, paper statementing, credit bureau reporting, electronic notification services (like refinance notices), feeds to Quicken (or similar applications), extended check image archival, after hours service, bill presentment, reward programs and others. In addition, by providing these value added services, not only can income be increased, but retention and satisfaction as well.

Of course, the best way to increase fees is to combine several services in an "elite" package and charge say $15 per month for business and $6 for retail. Assuming an average community bank structure, that works out to be an extra $1mm for every 25k customers.

Banks intuitively know that customers will only be happy to pay fees if value is delivered. The key is to design account characteristics that support the service level and result in more satisfied customers and happier shareholders. This summer, launch a project to set aside some time to take a look at your fee structure to see where you can generate more revenue.

BANK NEWS

TAG Extension

The WSJ is reporting the FDIC will vote today to extend unlimited deposit insurance for business accounts for at least another 6 months. The program was set to expire Jun 30 and could be a positive for deposit pricing, as fewer banks will need to price aggressively to retain funding in the absence of this insurance.

Biz Confidence

Confidence among small businesses fell in Mar to the lowest level since 7/09. The Nat'l Federation of Business index dropped to 86.8 from 88.0 in Feb.

Equity Prices

As the DOW passes 11k, it is worthy to note that 3500 of the 4000 loss in value from 2008 has now returned. That is faster than we thought would occur and poses a few rhetorical questions: 1) Is this proof that capitalism works, 2) Are Gov't programs more important than previously believed to the economy, or 3) Are we living in a house of cards and the run up is temporary?

Troubled SFR Loans

: Lender Processing Services reports the total number of delinquent mortgage loans was 21.3% higher than the same period last year, reaching 10.2% overall. Meanwhile, the foreclosure rate reached 3.31%, a 51.1% YOY increase. The percentage of new problem loans remained at a 5Y high.

1Q Bank Earnings

As investors await 1Q bank earnings, some analysts at CreditSights are worried large banks may have to set aside an additional $30B for possible losses on home-equity loans. Large banks begin reporting earnings this week, so we won't have long to wait to find out.