FREE CHECKING AND DEBIT OD FEES

by Steve Brown

Of all the accounts at a community bank, retail free checking usually drains the most value. While other accounts, such as student checking, usually are even less profitable, they are also smaller in volume and so lose the bank less money. Free checking on the other hand, on average, usually loses a bank $3 for every $100

on deposit. The main reason is that transactions are high and account balances are usually under $2k. Given this profile, it is hard to make money, no matter what additional fees the account generates. Add to this profile low interest rates and the fact that default debit card NSF charges are going away and the account becomes an even larger black hole.

Bank of America's announcement last month that they will stop charging debit card NSF fees has pushed community banks to rethink their strategy. As an aside, BofA found it too much of a drain on earnings to require an opt-in strategy and so chose to go with eliminating fees altogether to market it as a customer protection move. The ironic part is that it was BofA that initially marketed these fees as a way to give the consumer more options in case they overdrew their account.

NSF/OD fees usually make up about 30% of a community bank's fee revenue stream and account for more than 50% of the revenue generated from checking accounts. Deciding what your bank is going to do may be the most important decision you make this year. Making a good decision starts with deciding what your operational capabilities are and your overall philosophy.

Most community banks are flexible on their ability to have a customer opt-in or out and agree that allowing the customer to overdraft is a valuable feature for some accounts. If this is your bank's position, the next most important question to answer is how the payment hierarchy works in relationship to fees. While this is a whole separate topic, deciding whether you are going to clear items according to size (small to large or large to small), type (electronic or paper; ACH or online transfers, fees before items?) or timing is an important one. For banks that process in real time, clearing items in chronological order is usually the decision. For banks that process in a batch environment, most choose to clear lowest to highest items first to include type.

Next, most banks choose to segment their customers into heavy users of overdraft privileges and occasional users. From there, a marketing plan and methodology needs to be devised to best integrate the option for customers. Many banks choose to sell OD protection as "insurance" for accounts and present it through the internet, mailings and marketing collateral material. Banks start off by structuring the feature as an opt-in requirement for all new accounts. Here, staff education is critical, so line employees need to be comfortable with details. Next, accounts that OD their account 6x per year or more (these class usually makes up 75% of the income stream) are called and counseled. Maybe these accounts are counseled into a low cost, no-frills checking structure that does not allow an overdraft. On the other hand, maybe the bank designs an account with OD protection built-in with a higher monthly fee. Finally, maybe OD protection becomes a menu item that customers can choose, should their financial

situation warrant it.

Regardless of the path, community banks should count on fee income streams being 20% to 30% lower, due to OD fee restrictions. That said, this impact can be limited if banks handle this transition correctly. Community banks that have been running opt-in programs report an average benchmark of about 60% of their customers agreeing to keep debit OD protection. With the right structure, product alternatives, education and marketing effort; we are confident that banks can get this number well into the upper 80% level and thus get a chance to turn free checking once again profitable.

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BIG Metrics

BANK NEWS

Closed (57 YTD)

The FDIC closed the following banks on Fri: 1) Amcore Bank ($3.8B, IL) and sold it to Harris Bank, NA ($44B, IL). Harris gets 58 branches, all deposits (0.01% premium) and virtually all assets ($2B under loss share). 2) Sold both Broadway Bank ($1.2B, IL) and 3) New Century Bank ($486mm, IL) to MB Financial Bank, NA ($11B, IL). MB gets 7 branches, all deposits (0% premium) and basically all assets of both banks ($878mm and $429mm under loss share, respectively). 4) Citizens Bank&Trust ($77mm, IL) and sold to Republic Bank of Chicago ($1.3B, IL). Republic lands 1 branch, all deposits (0.00013% premium). The FDIC as receiver will retain most of the assets. 5) Lincoln Park Savings Bank ($200mm, IL) and sold it to Northbrook Bank and Trust ($899mm, IL). Northbrook gets 4 branches, all deposits (0.4% premium) and essentially all assets ($141.5mm under loss share). 6) Peotone Bank and Trust ($130mm, IL) and sold it to First Midwest Bank ($7.8B, IL). First gets 2 branches, all deposits (1.0% premium) and essentially all assets ($57.5mm under loss share). 7) Wheatland Bank ($437mm, IL) and sold it to Wheaton Bank & Trust ($447mm, IL). Wheaton gets 1 branch, all deposits (0.4% premium) and essentially all assets ($300.2mm under loss share). For more info regarding why these banks failed, see our related links section.

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