STRATEGICALLY THINKING ABOUT CHECKING

by Steve Brown

Yesterday, we discussed the strategic advantage of knowing your bank and your customer so you can go after not every customer but those accounts that best fit your belief system and strategic objectives. Practical applications for this orientation abound and are nowhere more important than when it comes to handling free personal checking and business interest checking.

Free retail checking has been important for many banks for client acquisition. The problem is that this depository account has come at a steep cost, as the average bank produces an ROE on the account of about -38%, or about a hit of $1.5mm per year to the bottom line. The reason for the loss is that the cost on the accounts are usually too high and the balances too small to create any value. Now while there are many strategies to increase profitability on this account, such as lowering the cost structure, increasing balances or adding a service charge, the core question is what are you trying to accomplish? If your bank is all about a general retail focus then being able to handle entry level retail accounts makes sense. However, if your brand is all about service, high net worth clients or handling businesses then we point out an inconsistency in your strategic focus. Free checking customers, by their very nature, usually attracts accounts that average balances under $3,000 that only tend to use 1 or 2 products and are fee sensitive. As such, that customer segment is often not profitable. This issue is further exacerbated when a typical free checking customer is paired with a bank that is service-oriented, as cost levels are further increased when compared to an average delivery channel such as a branch at Bank of America.

On the opposite side of the coin is the question as to whether to roll out interest business checking after Reg Q changes in July. If your bank is still wrestling with the question, our question back to you is do you strategically want the customer that an interest business checking account tends to attract? Unlike free checking, interest business checking tends to attract a growing business account that has about $30k or more in balances. These accounts are not only profitable because of their balances, but also because they usually utilize 1.8 product/services more than an entry level, basic business checking customer. In other words, strategically, the interest on business checking customer would be inclined to thrive both in terms of satisfaction and in terms of bank profitability at a bank that is commercially-oriented with a strong service support infrastructure.

If the interest on business checking customer fits with your strategic alignment, then we might suggest a couple ideas. One is to be proactive and aggressive in marketing this account to customers that have larger balances and relationships with other banks. The goal is to grab a larger share of wallet by pulling balances away from the large banks, the brokerage firms and other short-term investment vehicles. Here, first mover advantage counts, as once other banks offer the product you may be left competing on rate or fees, a strategic position that you don't want to be in if you can avoid it.

After testing and modeling several designs, the structure we like the best is a hybrid account that has earning credits up to the point of usage and then pays hard interest on a 3-tiered basis with a rate of 10bp to 35bp. This rate can be enhanced if the account utilizes other products such as term loans or savings. Depending on the bank, a sweep may also want to be included with a peg balance of $100k or more (although we usually don't recommend it). Finally, unlike the free checking customer, the interest checking customer tends not to be fee sensitive and so a $15 to $30 monthly fee may also be appropriate.

Regardless, of what you end up doing, our point today is to consider the strategic ramifications of account offerings to help you in your decision over what to do with these two controversial depository accounts.

BANK NEWS

Patriot Act

The Senate voted overwhelmingly yesterday to extend expiring provisions of the Patriot Act for 4Y despite strong banking industry objections. We expect the Bill to be passed into law later this week.

Mortgage Negotiations

State Attorney Generals and regulators will meet with several large banks today in an effort to reach a foreclosure settlement. The big issue for today is the size of the penalty and whether collected monies go to interest accrual or principal reduction. As a backdrop, state attorney generals and federal agencies found the last offer of $5B from the main five banks "woefully inadequate."

OD Settlement

Bank of America won tentative approval of a $410 million settlement of lawsuits accusing it of charging excessive overdraft fees to roughly 1mm customers.

Payments

Mobile payments start-up Square introduced a new app that allows merchants to pull up registered users to verify identity with their picture and to automatically charge their credit card with just a name. The user opens a virtual wallet app and clicks the merchant to affect payment. Both the buyer and merchant then get an electronic receipt.