SUCCESSFUL CROSS SELLING

by Steve Brown

We have long touted the benefits of cross-selling different products to your customers. It's a mathematical no- brainer that the deeper the customer relationship, the more profitable it is for your bank. Right? Well maybe not always.

Take for example Mrs. Persnickety, a long-time customer of the bank. She spends a lot of time in the lobby talking with the tellers and customer service reps. She has trouble with her finances and relies upon your staff to help, but nonetheless frequently overdraws her account. She always demands overdraft fees are waived since she is such a good customer. She also has some CD accounts, but whenever they roll over, she requires an above market rate, because she is such a good customer. She has twelve savings accounts with $250 in each one for her twelve grandchildren. It is easy to understand that this customer relationship is not profitable for the bank, so more must be done to make this relationship profitable. Every bank has to assess its relationships individually and reputational risk may make changes nearly impossible in a small market, so extra care may be needed.

While our example demonstrates the negative impact of this customer on the bank's earnings, usually the level of profitability of a multi-product customer relationship is far less clear. For instance, consider the customer with multiple products in your bank. Customer facing teams in the bank know about these accounts, but the approach to discounting services in one area has been haphazard and assumes there is profit in another. This can lead not only to infighting depending on how people are paid, but also to inconsistent results. How do you price a commercial loan for a customer with a trust account generating $1,000 of fiduciary fee income every month and a business checking account with large balances? Now consider that customer is being targeted by a large bank such as Wells Fargo or JPMorgan and things get really interesting and complex.

We don't normally toot our own horn, but think it important you know PCBB was a pioneer in building one of the first risk- adjusted loan pricing models for community banks. We rolled it out prior to the credit crisis and back then the model projected the level of risk associated with CRE loans and especially construction loans was probably far greater than banks were anticipating. Using an expected loss methodology leveraging concepts of probability of default (what is the likelihood of a given loan having a problem) and loss given default (what amount would be collected if the loan actually defaulted), plus borrower cash flow as measured by the debt service coverage ratio (DSCR), this model has helped many banks better assess the risk/reward trade-off in lending relationships.

Once you know how an individual loan is expected to perform over its life and on a risk adjusted basis, the next step is to understand the combined profitability of the entire customer relationship. It may seem simple when you start such a process, but nothing is ever quite as simple as you might imagine.

Take the example of the customer with a fiduciary account that generates monthly fees. If your bank is like most, trust fees reside on a different accounting system that may or may not talk to your bank's core. This requires a more robust approach, which is one reason we combined the concepts of our risk adjusted loan pricing model to create our relationship profitability model.

Loan underwriting based on risk assessment is great, but when market conditions are like they are right now, you are likely to be in competition with at least a few banks to retain key customers. As such, you may need to lower the loan rate to remain in contention. Having a clear understanding of the value of all products the customer has with your bank gives the flexibility needed to win the business & stay profitable over the long-term.

If you are good at cross-selling but aren't quite sure how to apply it to your pricing, give us a call and we would be happy to help you better measure success.

BANK NEWS

Bank ROE

S&P reports financial companies in the S&P 500 index returned a 7.9% ROE last year.

Mobile Wallets

A study by Vantiv finds just 10% of consumers are interested in using mobile wallets, as the rest worry about security or lack overall awareness.

Changing Customers

Banks should note research by Vantiv finds 46% of consumers now research products online prior to making any purchase. In addition, 67% expect mobile payments will be common in 5Ys, 44% are aware of mobile wallets (up 12% YOY), 50% of those want a bank or credit union to provide the wallet and only 19% believe smartphones provide a secure technology for payments.

Lawsuit

The FDIC is suing a law firm in FL related to the failure of Orion Bank. The FDIC indicates the firm should have seen red flags related to $82mm in illegal loans to an individual associated with the bank that used a portion of the proceeds to buy stock in the bank.

Threat

The Financial Stability Oversight Council has tagged REITs as an increased threat to the financial system, as assets now exceed $400B. More regulation is expected to surface in coming months as a result.

Strange

The Credit Union Times is reporting Huntington and JPMorgan Chase sent letters to at least 30 credit unions in W. VA and OH terminating their correspondent account relationships. A CU in FL also reports getting a similar letter from Bank of America. The letters reportedly cite regulatory requirements, changes in strategy, BSA and money laundering risks as primary reasons for the terminations.