Solutions for Generating Income Despite Regulatory Headwinds: Part 2 of 3

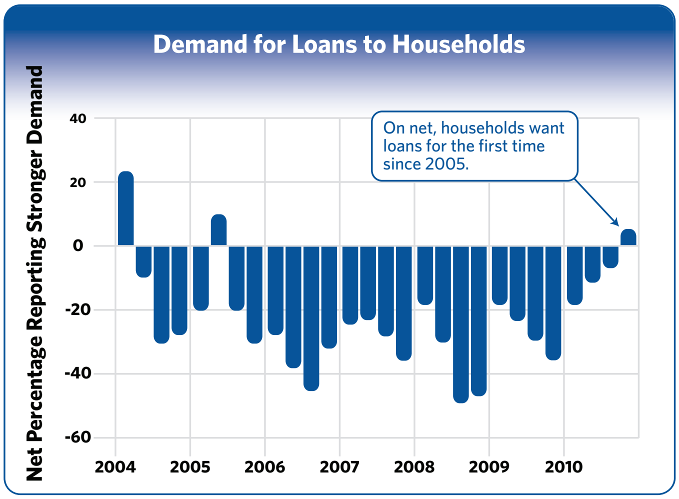
Background

Regulatory changes and economic factors have taken a toll on financial institutions' income statements. Non-interest income is suffering from the significant revenue impact of Regulation E on overdraft income and the looming effect of the Durbin Amendment on interchange income. According to an October 2010 webinar report from the Independent Community Bankers of America, more than 80 percent of financial institutions expect Regulation E to impact their overdraft revenue by 5 to 20 percent.

In addition, interest income has decreased during the past three years due to the recent recession and its lingering effects. Financial institutions have been faced with reduced market demand for loans, which has made it difficult to grow their margins, as well as lower federal funds rates.

Opportunity

With some traditional sources of revenue waning, the battle for financial institutions to grow net income is intensifying — and a multi-pronged approach that includes solutions for both growing income and decreasing expenses is necessary for success. Part 1 of this *Strategy Update* series discussed ways to grow non-interest income. This *Strategy Update* focuses on how your financial institution can grow interest income. Part 3 will address ways to decrease expenses.



Source: Federal Reserve Board

The opportunity for financial institutions to increase interest income is currently gaining strength. According to the *January 2011 Senior Loan Officer Opinion Survey on Bank Lending Practices* issued by the Federal Reserve Board, during Q4 2010 — for the first time since 2005 — the percentage of loan officers reporting stronger demand is positive (see chart). In addition, some economists believe the reduction in total U.S. household debt during 2010 for the second straight year sets the stage for improved consumer spending in 2011. The return of household loan demand makes now an opportune time to fill the income gap through the execution of several proven loan-balance-generation techniques.

Recommendations

The following solutions are key to maximizing interest income in a volatile market:

- **Launch new or expanded account holder onboarding and engagement programs within credit or deposit portfolios.** Today, new credit account holders typically receive an initial supply of access tools, such as checks, in a package that is operational in nature. This approach focuses the account holders on doing something "operational" themselves, such as putting the access tools in a "safe" place like a special drawer or safe deposit box for future use. To engage account holders, it is imperative to keep the access tools out of the drawer and, instead, keep them where they will be seen and used. This can be achieved by sending additional access tools that will serve as a reminder and will be used by account holders. Some of our clients have experienced significant success by altering their welcome processes to include two touchpoints within the first 45 days. Recently a client institution expanded its program with an additional touchpoint — a process change that has achieved an ongoing 1.2 percent increase in balances and is expected to contribute an incremental $1.7 million in annual revenue.

In terms of deposits, increasing numbers of new deposit account holders are receiving welcome and 30-day communications from their institutions that are focused on engagement services. In today's market, many consumers are focusing on financial responsibility, which provides the opportunity to discuss automatic savings as part of financial planning. This type of savings program not only increases account holder engagement, but also provides for additional low-cost deposit funding.

- **Utilize targeted loan acquisition and cross-sell programs.** In the current interest rate environment, pockets of opportunity remain for loan refinancing. This is primarily the case with mortgage loans, but auto loan refinancing is possible to obtain as well. In working with our financial institution clients, we have achieved the greatest success when contacting current account holders and communicating the product offer in a pre-approved format. Much of the program success is based on the fact that the account holder already owns a loan, rather than an institution sending a loan program offer in anticipation of a borrowing need. Our research shows these programs can deliver response rates between 0.45 and 0.60 percent for account holders, and from 0.08 to 0.25 percent for prospects.

- **Send ongoing credit utilization communications.** While many institutions pulled back from regular credit utilization communications during the recession, now is the time to get back into the routine. The best place to begin to grow loan balances is with account holders who have already been approved. Regular communications through statements, as well as direct mail with access checks, will serve to grow outstanding balances. In working with clients on such communications, we have experienced response rates in the range of 3 to 7 percent. By sending solicitations to this existing account holder base, segmentation based on available credit and payment history can aid in the mitigation of risk. The key to optimization is regular communication.

Although a few significant regulatory changes have the potential to dramatically reduce net income for financial institutions, the best plans to replace that income are multi-pronged. Through the deployment of multiple complementary strategies, the replacement revenue can provide greater long-term stability.

For more information about how segmented account disclosures and acquisition strategies can help grow interest income by attracting and retaining the right account holders for your institution, contact your Harland Clarke account executive or visit harlandclarke.com/contactus.

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