HARLAND CLARKE

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

Background

Recent regulatory changes, combined with ongoing economic factors, are taking a toll on financial institutions' income statements. Noninterest income has decreased due to the impact of Regulation E on overdraft income, and a further reduction of noninterest income is expected due to the looming effect of the Durbin Amendment on interchange income. In fact, 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.

Since early 2010, financial institutions have had the benefit of declining loan loss reserves, which has contributed to attractive earnings (see chart). However, loan loss reserves are now heading back to prerecession levels, and historical data suggest they may be normalized by early 2012 if consumer credit delinquencies continue to decline and commercial delinquencies decline or remain steady. Therefore, financial institutions must identify additional sources of revenue — or ways to reduce expenses — in order to meet Wall Street's expectations.

Opportunity

Financial institutions face an intensifying battle to grow net income as some traditional sources of revenue wane, making a multipronged approach that includes solutions for both growing income and decreasing expenses necessary for success. Part 1 of this *Strategy Update* series discussed ways to grow noninterest income. Part 2 featured recommendations for growing interest income. And this *Strategy Update* focuses on ways to decrease expenses.

The opportunity for financial institutions to decrease expenses is currently gaining strength due to the need for sustainable earnings growth. Many institutions will achieve expense reductions by acquiring failed institutions. However, expenses can also be reduced by exploring ways to increase operational efficiency.

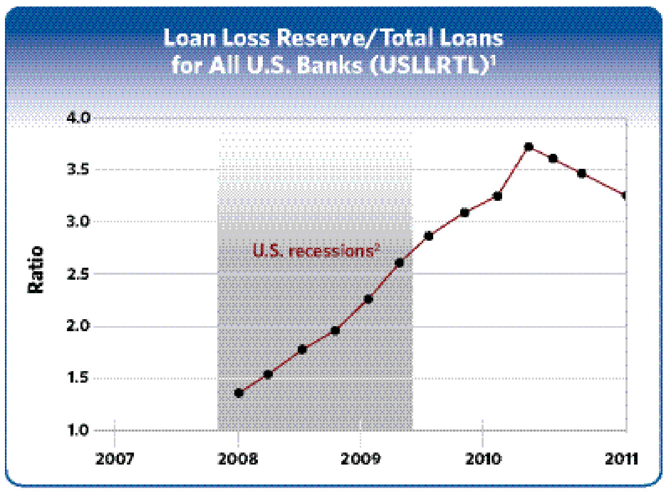

Chart Source: Federal Reserve Economic Data
[1]Federal Financial Institutions Examination Council
[2]2011 research.stlouisfed.org

Recommendations

The following solutions are key to reducing expenses in a volatile market:

- **Review the current checking account program**
  - Financial institutions should review and analyze the use of discretionary check printing fee waivers. In working with a number of clients to review this process, we have found that some institutions have been able to reduce waivers by 35 percent. After conducting an initial process review, it is important for financial institutions to educate employees in order to curtail the use of such waivers and realize ongoing expense savings. In addition, regular reviews and semiannual reporting can help ensure ongoing compliance.
  - Institutions should also review and analyze the waiver of monthly service or overdraft fees. A centralized assessment of these waivers provides insight into any opportunities for correction. Again, once the review is complete, employee education will be a key component of realizing ongoing expense efficiency.
  - A portfolio review often reveals opportunities for cost savings in terms of identifying low-balance and inactive accounts. Accounts with low engagement can be contacted for re-engagement, or for account closure to reduce the associated monthly servicing costs.

- **Optimize electronic channels**
    - o Marketing program expenses can be reduced by expanding efforts to obtain account holder email addresses and leveraging multichannel communications. Employee education is critical here as well, particularly in terms of the value of data capture at account opening. Employees should also become skilled at capturing email addresses from existing account holders, which can help increase cross-sell campaign results and provide financial institutions with the option to communicate with account holders through lower-cost operational channels.
    - o Educating account holders about the use of electronic channels can help increase usage. Such channel usage includes account statements received via email or accessed through online banking, online bill payment, ATMs and remote deposit capture. The more account holders utilize these electronic channels, the more financial institutions can achieve savings in the cost of service.
- **Engage in marketing planning**
    - o Financial institutions can reduce costs with larger print quantities by coordinating efforts across product lines and jointly printing materials. We have worked with a few clients that have yielded more than 15 percent savings in print expenses by taking advantage of this opportunity.
    - o Cost savings can also be achieved by reviewing mail package configurations and developing a limited number of "standard" packages. Expenses are reduced by preprinting color elements and purchasing selected paper in larger quantities.

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 multipronged. Through the deployment of multiple complementary strategies, expense reduction can help provide greater long-term stability.

For more information about how your financial institution can improve its income statement by reducing expenses, contact your Harland Clarke account executive or visit harlandclarke.com/contactus.

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