



BLF MARKETING

Urgent White Paper: **Deposit Products Must Be Updated Now!**

To: Clients, Associates and Friends of BLF Marketing
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I. **Overview**

There is extreme urgency to increase fee income while reducing expenses in the world of Community Financial Institutions. This urgency has been triggered by a series of at least five events in rapid succession that have crippled the financial services industry. These events – the latest of which will be the October 1 implementation of a federally mandated cap on debit card interchange rates – have seriously eroded the income and profitability of most Community Banks.

II. **The Culprits of the Downturn**

There are several events that have resulted in unprecedented financial peril for Community Banks. You are probably well aware of these events, but the following is a brief recap:

- A. **Real Estate Meltdown** — This massive meltdown – fueled mostly by a combination of inept federal policies and excessive greed within the private real estate financing sector – burst the real estate bubble in September 2008, which in turn, hung thousands of Community Banks with millions of dollars in loan write-offs. ***This meltdown has contributed to the failure of over 370 Community Banks.***
- B. **FDIC Insurance Coverage Escalation** — In reaction to the deep recession triggered by the real estate meltdown, the Fed attempted to shore up public confidence in a shaky banking system by increasing FDIC insurance coverage on deposit accounts from \$100,000 to \$250,000 per customer. Banks were required to immediately cough up an ***additional annual FDIC insurance premium of approximately \$125,000 per \$200 million in assets*** ... which is now a recurring annual expense.
- C. **NSF Fee Income Reductions** — “Reg E” was an ill-timed federal regulation that abruptly hacked away institutions’ net income earned from customer Overdraft Fees by an average of 20-40% ... which is about ***\$125,000-\$250,000 in vanished annual revenue for a typical \$200 million asset Bank that did not conduct an effective Reg E “Opt-In” campaign.***



- D. **Dodd-Frank Act with Durbin Amendment** — The fourth culprit was imposed on Financial Institutions, courtesy of federal lawmakers' misguided actions. Authored under the premise of "consumer protection," Dodd-Frank – along with the Durbin Amendment – will potentially inflict another serious wound to the income bloodstream of most Financial Institutions. There are broad differences of opinion about how this legislation will affect Community Banks ...from being a boon to being another bust. However, there is no substantive information from the electronic payment card industry supporting the notion that a multi-tier interchange system is feasible or that the so-called "small institution exemption" is operationally viable. We strongly suspect that this legislation will slash interchange fee earned on Debit Card transactions by up to 45% for Community Financial Institutions (this reduction assumes an average base interchange of approximately \$0.24 per transaction compared to the widely quoted pre-Durbin average interchange of around \$0.44). This means **more evaporation of bottom line income, by about \$120,000 per year for a typical \$200 million asset Community Bank.**
- E. **Fed's Vow to Keep Interest Rates Low into 2013** — With the persistence of economic uncertainty, the Federal Reserve recently made an unforeseen and unprecedented vow to keep interest rates low well into 2013, **which means banks may not be able to expand net interest margin until 2014.** Alternative investments for Community Banks such Treasury Bonds and other low-yielding instruments provide relatively safe (but razor-thin) returns. The prolonged low rate environment may be a "necessary evil" due to the United States' severe budget deficit problem and the need to prop up at least modest lending volume. However, low interest rates are not good for Community Institutions' profitability.

III. Key Negative Impacts

- A. **Slashed Revenues** — What is the cumulate affect of these five negative events on a typical Community Financial Institution?
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|---|--------------------------------|---|
| ■ | \$100 million in assets | Lost Revenue: \$250,000 or more per year |
| ■ | \$200 million in assets | Lost Revenue: \$500,000 or more per year |
| ■ | \$500 million in assets | Lost Revenue: \$1 million or more per year |
| ■ | \$1 billion in assets | Lost Revenue: \$2 million or more per year |
- B. **Low Profits** — Most institutions are coping with having lost one-fourth to one-third of annual bottom line profits since late 2008. What does this mean for many Community Banks?
- **Staff Cuts and Few Raises** = Lower Employee Performance and Morale
 - **Slashed Bonuses for Execs** = Less Inspired and Less Focused Leadership
 - **Reduced Dividends** = Nervous Shareholders and Board Members Who May Apply Pressure on Management for Greater Profits or Perhaps Sale of Institution
 - **Fewer Dollars to Reinvest** = Less Investment and Innovation in Technology, Facilities, Marketing and Attractive New Services



- C. **Intrusion and Distraction** — Most executive officers of Community Banks will tell you that since early 2009, they have spent the majority of their time dealing with regulatory issues and associated fallout ... and a disturbingly low amount of time actually running and marketing their institutions. Excessive regulatory intrusion has diverted much of management's focus away from innovation and overall service quality. The downsides are notable:
- **Managing from Defensive Position = Many Executives Forced to Be Reactive as Opposed to Proactive**
 - **Internal Communications and Leadership Suffers = Executives Lack Time and Energy to "Lead and/or Inspire the Troops"**
 - **Decision Gridlock = Many Good Plans and Improvements Have Been Put on Hold**
 - **Playing "Catch Up" = Some Management Teams May Make Decisions in Haste and Further Hamper their Institution's Competitiveness and/or Performance**
- IV. **For Community Banks ...**
- A. **What Is At Stake?**
By not taking action to defuse the impacts of lost revenue, some Community Banks could stagnate, wither and perhaps fail ... or become targets for bargain basement acquisitions by bigger Financial Institutions.
- B. **What Are The Key Opportunities?**
Every cloud has a silver lining ... and there are significant opportunities for a Community Bank to regain lost profits and effectively compete in this roller-coaster financial services environment:
- **Out-Maneuver the Big Banks** – Major national and super-regional banks have eliminated FREE Checking, and in its place have implemented high fee increases for Checking Accounts. These shifts leave room for Community Banks to provide superior value and perks at a lower fee structure than the big guys. Lost fee income can be regained – and even exceeded – with well designed Checking Accounts.
 - **Attract and/or Retain "Most-Profitable" Banking Customers** – Attentive "personal service" is a hallmark of successful Community Banks. Focusing smart marketing strategies on these crucial customers (and prospective customers) can drive significant additional product penetration, income and retention.
 - **Introduce Credit Card Options** – A Community Bank's branded Credit Card in the hands of credit-worthy high balance customers and businesses can evolve into a robust source of payment card interchange income (which is NOT adversely affected by the Durbin Amendment). These low-risk Credit Card customers can also be an important source of new loan business.
 - **Deepen Small Business Relationships** – Most Community Bank executives consider closely-held businesses to be among the most profitable of all customers. However, beyond lending services, many institutions do not have Business Banking product choices, packaging, perks and/or strategies that will lead to even deeper (and more



profitable) relationships with businesses ... and their respective owners/principals. Marketing an attractive suite of Business Banking services to highly targeted current and prospective customers can lead to new channels of fee income and profitability

V. **Acting With URGENCY To Update Deposit Products**

There will be no return to “business as usual” in order for Community Banks to achieve solid financial health and performance. Yes, cuts in overhead and other expenditures can shore up the bottom line temporarily. However, to be successful, Community Banks must develop and offer deposit products that are more customer-centric than the products of the past, with much keener profitability analysis, modeling and ongoing monitoring.

Premises of Product Design in Post-Durbin period:

A. **Personal Deposit Products**

- Deposit products must seamlessly plug into the customer’s lifestyle while fulfilling the customer’s financial and convenience expectations.
- “Free Checking,” which has proliferated over the past decade, will not be viable for long ... because Totally Free Checking will lose considerable amounts of money due to Fed changes to NSF and Debit Interchange Fees.
- Smart product design and services bundling should be designed to enhance the customer’s experience ... while leveraging the Bank’s technology investment (or outsourcing selected technology solutions).
- Products should have built-in flexibility, so when market conditions and/or prevailing interest rates change, the products continue to be relevant.
- Product design should be supported by a profit model that makes sense – and makes money – for the Bank, with periodic product-by-product trending and profit analysis to help keep product designs fine tuned for maximum performance.
- Perks, benefits and rewards are essential to build deeper wallet-share with key customer segments and establish stronger customer loyalty ... which leads to significantly greater profitability for the Bank.
- Deposit product design must quickly move away from tired old perks, cumbersome rewards programs, expensive fulfillment and outdated enrollment procedures.
- Customer loyalty IS NOT a thing of the past, as long as the Bank’s customers gain true value with their financial products (product design) ... coupled with an exceptional customer experience (human touch).
- Whenever practical, include “cross-service” incentives within product packages ... which will reward comprehensive deposit balances (Money Market Accounts, IRAs, CDs), attract higher loan balances and encourage the use of various other financial and electronic services.



B. Business Deposit Products

- Business Checking Accounts can constitute a significant percentage of ALL checking account balances, 25%-40% at most financial institutions ... and over 50% at some. Most Banks have considerable upside in attracting low-cost funds from Business customers.
- The Fed has loosened restrictions on Banks paying interest on Business Checking account balances, effective July 21, 2011. Most Community Banks have not yet determined how they will respond to challenges or opportunities presented by this change.
- When designing Business Checking Accounts, it is essential to correlate product features and/or interest rates with the numbers of items (checks, transactions and/or deposits) accumulated by businesses during typical account cycles.
- Many business owners resist (and even detest) the concept of Account Analysis (earned debits and credits within their checking account which can lead to unpredictable monthly fees). A well balanced lineup of Business Checking Accounts will mean less than 5% of businesses will be candidates for Account Analysis at most Community Banks.
- Smart product design, packaging and pricing can attract higher balance customers who desire e-services as “part of the deal” ... such as Cash Management, Card Services, Automated Payroll, Online Banking, Mobile Banking, etc.
- What if a Community Bank could drive Personal Banking customers to the cash registers of their good Business Banking clients? Smart deposit product design – and associated perks – should create win-win-win scenarios for retail customers, business clients AND the Bank.
- Special perks and attractive services bundling can be reserved for Business Owners and Principals ... and will build profitable total relationships that span personal and business products.

C. Overall Product Issues

- Standing still without smart, updated Deposit Products is not an option. To sit on the sidelines will mean losing even more profits and falling behind competitors.
- The Bank’s product design should incorporate fee-earning opportunities whenever possible ... but at the same time, provide fee-averse customers with packaging options that will be attractive while encouraging “profitable” customer behaviors.
- The Financial Institution’s costs for product perks and rewards must be reduced, with some reward costs shifted to participating merchants (a.k.a. merchant-funded rewards).
- Many customer perks, incentives and discounts should take advantage of emerging technologies that provide “instant gratification” ... which will lead to a much more satisfying customer experience.
- BLF Marketing continually strives to identify and bring “best practice” outside service providers to our clients when warranted ... or utilize the Bank’s existing service providers whenever practical and/or beneficial to the Bank.



VI. Solutions for Deposit Product Changes and Improvements

A. **Product Logic Process™ by BLF Marketing** — This product audit and revision process is completely objective based on BLF Marketing's 30+ years of award-winning experience in the Community Financial Services arena. As the name "Product Logic" implies, the Bank's deposit product evaluation and updates will follow a sensible yet forward-looking process that moves quickly ... and leads to changes that can be implemented in a period of weeks (not months). BLF's Product Logic Process™ has two components:

1. **Product Logic Snapshot™** — This cursory review of all existing Personal and Business deposit products will yield the following outcomes for the Financial Institution:
 - a. Organize current deposit products into a single Product Analysis Spreadsheet™ for ease in comparing and evaluating various pricing, features, and perks of every deposit account..
 - b. Identify "deficiencies" and "holes" in the Bank's existing product lineup.
 - c. Identify the Bank's various customer segments and recommend product types that will appeal to these important customer segments.
 - d. Summarize greatest strengths, weakness, opportunities and threats within current product lineup.
 - e. Timetable is 30-45 days.

Fee Range: \$2,500 - \$3,500

2. **Product Logic Comprehensive Audit™** — This in-depth process will yield the following outcomes for the Bank's entire Personal and Business Deposit Product lineup:
 - a. Updated product features and benefits will appeal to the Bank's most critical existing customer segments.
 - b. Features and benefits will also appeal to customers' product and convenience preferences based on analyzing the demographics and financial behaviors of key customer segments.
 - c. Streamline and simplify product choices.
 - d. Reflect the characteristics that customers desire within the Bank's unique market area(s).
 - e. Utilize the bank's available (and future planned) technologies.
 - f. Incorporate BLF Marketing's Profit Logic™ Profitability Analysis, Modeling and Trending into product designs, both old and new ... and consistently measure results moving forward.
 - g. Of greatest importance: Generate critical fee income and/or reduce cost for the bank.
 - h. Timetable is 90-120 days.

Fee Range: \$17,500 - \$25,000

PRICING NOTE: Based on an initial 1.0 - 1.5 hour no-fee consultation, BLF Marketing will prepare a detailed Proposal for Services and Budget Estimate for the Bank's consideration. If both Product Logic™ options are chosen by the Bank, 50% of the fee paid for the Product Logic Snapshot™ will be credited against the Product Logic Comprehensive Audit™.