First Data
beyond the transaction

A First Data White Paper

Seven Ways Financial Institutions Can Maximize Profitability

The convergence of the financial crisis, global recession and recently-enacted banking regulations has created nearly unprecedented economic turmoil for financial institutions in the United States. In the midst of these negative forces, many banks and credit unions have struggled to maintain revenue growth, profitability and customer satisfaction. With Federal Reserve Board's release of the final Durbin Amendment rules in June 2011, much of the lingering regulatory uncertainty was finally resolved, allowing financial institutions to begin implementing new strategic visions and broad operational changes that can ultimately improve their bottom lines.

First Data has identified several tactics that financial institutions are deploying to reduce costs, mitigate the effects of new regulations, and maximize overall profitability.

Promote PIN over Signature

As many consumers will still prefer to continue using debit instead of credit, financial institutions are noticing the cost advantages of influencing customer debit usage habits. Now that the Durbin Amendment has effectively resulted in parity between PIN debit and signature debit interchange rates, many institutions will find that it makes sense to promote PIN debit to customers over signature debit.* Historically, banks have favored signature debit because interchange rates were higher, making signature transactions more profitable than PIN transactions. Now that PIN and signature interchange rates will be equivalent, banks should alter their previous strategy of favoring signature over PIN. The average total cost to institutions for PIN transactions (including processing, routing, fraud, dispute resolution, etc.) is significantly less than for signature transactions, making PIN debit more favorable to banks in addition to reduced fraud losses. Consequently, they should consider deploying strategies to steer customers toward PIN rather than signature, including instituting incentives (like rewards) for PIN usage and disincentives (like fees) for signature usage.

Restructure DDA Offerings

The Durbin Amendment, which places a cap on debit interchange fees (among other things), fundamentally changes the economics of many institutions' checking account offerings. This comes after the recent enactment of changes to Reg E that limit the ability to charge overdraft fees. The combination of reductions in debit interchange and overdraft revenue means that ubiquitous free checking offerings are no longer viable. The result is that many institutions are undertaking initiatives to re-price their DDA offerings and to restructure the accounts according to the principle of "quid pro quo" consumer banking, whereby customers "earn" free checking through certain behaviors. For example, customers can avoid checking fees by maintaining minimum balances, opening other banking products (like credit cards and mortgages), agreeing to receive paperless statements, and/or using electronic bill payment services. While institutions may not recoup all of their lost DDA revenue, they will improve checking profitability and establish an account model with greater long-term sustainability.

*Parity between PIN debit and signature debit interchange rates exists only for Financial Institutions that are regulated under the Durbin Amendment.

Revisit Your Debit Strategy

With debit interchange fees reduced considerably by the Durbin Amendment, many financial institutions are facing debit transaction profit margins that are very slim or even negative. Accordingly, financial institutions may find it advisable to address these altered economics by rethinking current debit programs: redefining or scaling back debit rewards, review pricing strategies, limiting high-value debit purchases, and incorporating education and usage programs. These steps may enable institutions to restore the profitability of their debit offerings and the underlying DDA accounts. There exists considerable uncertainty about how consumers will react to such changes, however—so it is essential that financial institutions conduct careful competitive analysis and predictive modeling in advance of implementing such a strategy.

Upgrade Customer-Facing Technology

Today's consumers, especially members of Gen Y, are used to having technology integrated into most aspects of their work and personal lives—and banking is no exception. To respond to changing customer expectations, financial institutions have incorporated online and mobile technology into consumers' banking experiences. However, they must sustain investment in the latest technologies in order to continue meeting consumers' increasingly sophisticated technical demands. With the rapidly escalating adoption of smartphones, institutions must upgrade their mobile banking capabilities to make it safe and simple for customers to not only check their balances, but also transfer money between accounts, pay bills, receive and manage alerts, and remit funds with P2P payments. Additionally, the "mobile wallet" is an emerging trend that financial institutions should consider capitalizing on, especially given that the majority of respondents in a recent First Data study indicated they would most trust their financial institution to provide mobile wallet services.

Improve Fraud Prevention

Fraud represents a major cost to financial institutions—and one that threatens to escalate with the growing sophistication of financial criminals. Many banks and credit unions continue to manage fraud according to institutional silos, delegating this responsibility to individual business units and product types. Institutions should take steps to integrate fraud management into a centralized, cross-product function that enables the sharing of resources and data, and better coordination of tactical approaches—resulting in reduced fraud losses and a more consistent customer experience. Institutions should also make use of the latest detection technologies to reduce their fraud costs: neural networks and predictive software technologies represent just a couple of innovative solutions being used by institutions to cost-effectively detect and prevent fraud in real-time. Because fraudsters follow the path of least resistance, institutions that lag the rest of the industry in implementing advanced prevention and detection solutions make themselves especially vulnerable.

Deploy Analytics

Because of the major structural changes that financial institutions are making to their retail product offerings in order to restore or maintain profitability, customer analytics are more important than ever. Institutions must use analytics to segment customers in order to better understand revenue opportunities and re-pricing options. They must conduct analyses on revenue sources, consumer transaction behavior, and sensitivity to fees across their customer bases and within specific customer segments—and then use the resulting insights to design new pricing strategies and inform revenue replacement efforts. The savvy use of customer analytics is critical to evaluating customer profitability, predicting consumer behavior, optimizing relationship pricing, and developing cost-effective marketing tactics.

Evaluate Outsourcing Opportunities

Many institutions continue to devote their increasingly scarce internal resources to labor- and capital- intensive activities that could be performed less expensively and more efficiently by third party vendors. In the face of declining DDA profit margins, institutions should consider outsourcing functions that may currently be handled in-house, including processing, servicing, card production, and statements. Doing so enables institutions to take better advantage of economies of scale and technical innovations, as well as to re-allocate capital and personnel to revenue-generating activities. Persistently difficult economic conditions and challenging new regulatory pressures mean that financial institutions must achieve operational excellence by evaluating every individual business process and rigorously determining both the short-term and long-term cost-effectiveness of outsourcing that activity to a partner with greater scale and expertise.

