Facing Durbin:

Enhancing DDA Value with Check-Based Solutions

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I. Overview

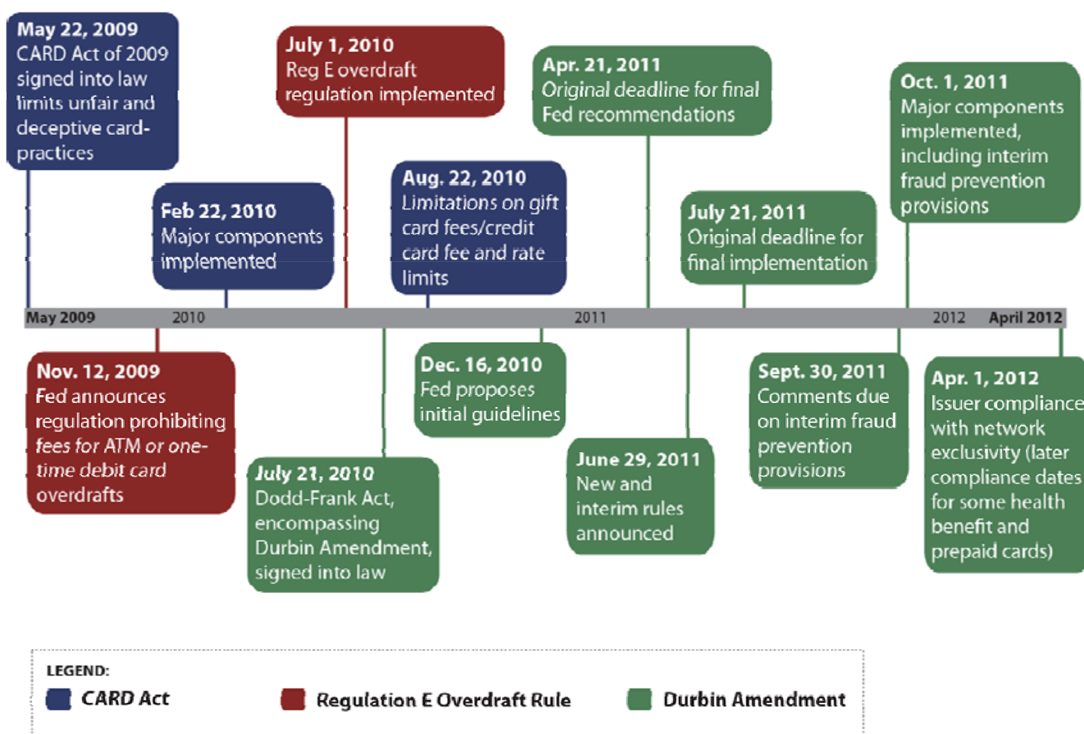
The economics surrounding the demand deposit account (DDA) are in flux. The federally mandated guidelines of the Durbin Amendment, the Credit Card Accountability, Responsibility, and Disclosure (CARD) Act, and updates to Regulation E (Reg E) have altered — and will continue to alter — the economics, value propositions, and incentives associated with DDAs, causing financial institutions (FIs) to reevaluate DDA products and positioning. As they do so, they should consider the role of checks in a comprehensive assessment of DDA profitability. Checks continue to be an important part of the payments value chain for both consumers and small businesses, and check use can also be indicative of primary banking relationships.

II. Regulatory Changes Redefine the Payments Landscape

Following recent rulings related to the Durbin Amendment and Reg E updates, FIs are becoming increasingly constrained in the manner in which they are able to generate revenue via interchange and fees. Traditional avenues of revenue associated with debit cards, credit cards, and other financial services have begun to experience dramatic contraction following recent regulatory intervention. Figure 1 shows a timeline for this recent regulation, indicating the pressure that new and existing regulations have placed on the revenue potential of the DDA.

In response, FIs are performing complete reviews of the DDA structure and associated fees to offset anticipated revenue losses. Institutions acknowledge that they must be cautious about implementing new fees that have a negative impact on client perceptions and customer retention. However, this is tempered by the notion that not all accounts are created equal. FIs are more likely to provide services at no charge, with bundled pricing, or at a reduced rate for their more valued clients. This approach is consistent with recent State of the Check research prepared by Javelin Strategy & Research that indicates that FIs are moving toward relationship pricing rather than "free" checking programs.[1]

Figure 1: Timeline of Legislation Affecting the DDA



[1] **State of the Check: FIs and Vendors Qualitative Report,** Javelin Strategy & Research, June 2011.
[2] Ibid.

The complete effect of these regulations has yet to be fully realized. However, each will contribute to decreases in FI revenues and spur further interest from FIs in identifying new sources of profitability. One FI summed up the response shared by many: "We want to be disciplined as an organization. There is no easy solution. That re-balancing and finding the equilibrium between customer and competitive landscape is not something that you do just overnight."[2]

The Durbin Amendment

In particular, the Durbin Amendment will have a tremendous impact on FI revenue stemming from debit interchange, changes to transaction routing and payments acceptance rules, and legislation enabling merchants to apply discounts to selected forms of payment and to set payment minimums. The new debit interchange cap, though more generous than originally anticipated, will substantially reduce FIs' DDA revenue stream. Javelin estimates that the interchange cap will reduce revenue at affected banks by a total of more than $6.6 billion per year.[3]

Clearly, Durbin will change DDA profitability in fundamental ways for which FIs have yet to fully account. Free services will be replaced by fee-based or relationship-based pricing, and limits to debit card rewards and transaction activity will also be implemented. According to research prepared by Javelin, 7 out of the 10 largest FIs have already announced plans to charge for checking accounts.[4] As an example of this trend, JPMorgan Chase has already indicated that it will stop issuing debit rewards cards, eliminate the option of debit card use as a means to earn free checking, and introduce higher monthly fees for accounts that carry low balances.[5] Bank of America has announced new account structures that require monthly fees, pending the results of trials being held in several states.[6] U.S. Bank has reported that it is considering eliminating free checking and debit card rewards and is even considering a debit card fee. Wells Fargo will be charging $3 per month in some states for the use of its debit card,[7] while USAA Bank will eliminate its debit card rewards program and maintain perks such as free checking and refunds of foreign ATM fees.[8] Even community banks, not directly subject to Durbin, are exploring similar steps: 72% say they will implement annual or monthly charges for use of a debit card, and 70% report they will have to charge for services that are now free.[9]

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[3] **The Durbin Amendment: Planning for $ix Billion in Change to Banks, Networks, Merchants and Consumers**, Javelin Strategy & Research, August 2011.
[4] Ibid.
[5] http://blogs.forbes.com/moneybuilder/2011/01/07/fed-looks-to-cap-debit-interchange-checking-institutions-cringe/?boxes=Homepagechannels, accessed Jan. 10, 2011.
[6] http://www.depositaccounts.com/blog/2011/06/bank-of-america-changing-checking-accounts-and-increasing-fees.html, accessed Jul. 6, 2011.
[7] http://www.credit.com/blog/2011/08/wells-fargo-will-charge-some-people-3-to-use-their-own-money, accessed Aug. 19, 2011.
[8] https://www.usaa.com/inet/ent_blogs/Blogs?action=blogpost&blogkey=newsroom&postkey=debit_card_rewards, accessed Jul. 7, 2011.
[9] http://www.icba.org/news/newsreleasedetail.cfm?ItemNumber=83508&sn.ItemNumber=1733, accessed Feb. 16, 2011.

Modifications to Regulation E

The latest changes to Reg E were implemented effective July 1, 2010, and prohibited FIs from charging fees for overdrafts on ATM or one-time debit card transactions unless a consumer opts in to overdraft coverage for those types of transactions. Javelin has estimated that the overdraft fee restrictions affected 62% of the banking industry's overdraft fee income.[10] Bank of America predicted it would lose $600 million annually to the new regulation, Chase estimated $500 million in annual losses, and Wells Fargo forecast that revenue from overdraft fees would fall $500 million.[11] In total, Javelin estimated the overall impact to the industry — for this regulation alone — at approximately $5.6 billion annually, excluding any new fees or services designed to offset those revenue losses.[12]

The CARD Act

Although the CARD Act has less direct impact on DDA profitability than does either the Durbin Amendment or the modifications to Reg E, the CARD Act has a continuing impact on FIs' revenues and is one more piece of recent legislation forcing FIs to reexamine their traditional delivery model for the DDA. The CARD Act is a comprehensive piece of credit card reform legislation developed with the intent of establishing fair and transparent credit card practices. It has forced realignment of many traditional practices, some of which were quite profitable to institutions.

[10] **Reg E and Overdrafts: How Financial Institutions Can Use Mobile to Increase Profits Post Reg E**, Javelin Strategy & Research, July 2010.
[11] Ibid.
[12] Ibid.

III. FIs Face Reassessment of DDA Profitability

Over the next year, significant changes to DDA structure are expected as FIs reconsider their product portfolios in light of regulatory requirements. FIs are looking at more strategic elements such as relationship management and customer segmentation to drive decision making. Through this evaluation process, some institutions have determined that checks may be more than just a payment vehicle; they can also be a sign of a primary account relationship — one that's worthy of attention.

In 2010, consumers wrote checks valued at an average of $440.09, while small business checks averaged $2,253.45. In addition, consumers wrote an average of 5.47 checks per month, and small businesses issued a much higher monthly average of 34.25 checks.[13] The *State of the Check* study by Javelin Strategy & Research shows that, among consumers, heavy check users (defined as those who have written more than 60 checks in the past 12 months) have an average checking account balance more than twice the average balance of those who do not use checks: $2,829 compared with $1,215.[14]

As new payment options have emerged and check-handling processes have been increasingly outsourced, few FIs have continued to dedicate resources to analyzing check-writing habits and behaviors. However, Javelin has found evidence that check behaviors are worth exploring in identifying high-value clients. Detailed analysis from one financial institution interviewed by Javelin is presented in the sidebar.

[13] Harland & Clarke internal study derived from client transactional data.
[14] **State of the Check: Consumers Quantitative Report**, Javelin Strategy & Research, August 2011.

Case Study — Identifying a Primary Relationship via the Checking Account

One FI compared the demographics of check writers and non-check writers in its customer base, discovering that check writing is a sign of a primary relationship strongly associated with the use of multiple products and with higher account balances. Check writers tend to have a higher number of products and services (an average of seven) than non-check writers (an average of five). And although the population of heavy check writers is smaller than the group of customers who do not write checks, it holds a higher percentage of products and services. Roughly 53% of check writers have a credit card product issued by the FI versus only 31% of non-check writers; 29% vs. 22%, respectively, have loans with the FI; and 19% vs. 11% use an overdraft line of credit. Additionally, check writers tend to have a longer relationship with the FI than do non-check writers: 15 versus 9 years, respectively. (Refer to Figures 2 and 3 for more details.) These findings have positive implications that warrant further investigation. If check writing is positively associated with a more valued relationship, can an FI promote a primary relationship by fostering check writing among account holders? If so, this approach will provide new direction for relationship marketing in product line emphasis and bundling of banking solutions.

Figure 2: Check Writers as Valued Customers

Ownership of Products/Services	Check Writers	Non-Check Writers
Overdraft line of credit	19%	11%
Money market securities	12%	5%
Credit card	53%	31%
Loans	29%	22%
Mortgage	10%	3%
Equity line	2%	1%
CDs	11%	6%
IRA	8%	3%
IRA CD	8%	3%

Figure 3: Check Writers Own More Financial Services

	Check Writers	Non-Check Writers
Age	**44 years**	**36 years**
Length of account	**15**	**9**
Checking product	**80% Everyday checking**	**81% Everyday checking**
# products/services	**7**	**5**

FIs have repeatedly indicated to Javelin that they are looking to establish a primary relationship with their banking clients. Yet most institutions admit that they have no clear data on checking account behaviors or correlation of check usage with ownership of other products. This is a missed opportunity. FIs should assess the extent to which their most valued clients are also their check-writing population. The *State of the Check* study shows that heavy check users typically portray a strong relationship with their primary banks, being more likely to have credit cards, store-branded credit cards, CDs, and the longest tenure for a primary checking account relationship. One FI mentioned a direct correlation between engagement in check writing and higher asset values, consistent with Javelin's consumer research that showed a significantly higher asset size, $240,454, among heavy check users than nonusers, $103,658, or low users (those who write between 1 and 13 checks a year for payments), $182,204.[15] A match between check engagement and strong account relationship opens up potential avenues for cross-selling and bundling products and services to promote account value and retention. Other areas to consider include the three described below.

Check usage and loyalty. Loyalty programs often overlook behaviors related to writing checks. A notable exception is the Banco Popular Premia Program, a relationship program that rewards the customer for the total value of the relationship, including the checking account and the use of various payment options, including checks.[16] Program data indicates that the checking account balance of Premia program participants climbed 50% during program participation, suggesting that DDA activity can be a focal point for rewards and can drive a more valuable client relationship.

Check orders as a revenue stream. Check use can also do more than indicate the presence of a primary relationship. It can be a source of revenue that is often overlooked. Check industry data indicates that a typical FI can generate $10,000 in fee income per branch, per year, with a healthy check program.[17] This income is advantageous in offsetting other expenses associated with the DDA to achieve product line profitability. FIs that are best in class in generating check revenue typically are able to actively integrate check sales with the new account desk, provide starter checks even to customers who have opened accounts online, and standardize selling procedures at the branch level. Some banks benefit by outsourcing more complicated check sales, such as for small business accounts, in which a standardized process can augment close rates and strengthen the customer-to-FI bond. Reordering must also be a streamlined process.

[15] **State of the Check: Consumers Quantitative Report**, Javelin Strategy & Research, August 2011.
[16] Legters, R. and Young, H., *Relationship Rewards — Beyond Credit and Debit*, Fidelity National Information Services Inc. and its subsidiaries, 2010.
[17] Harland & Clarke internal study derived from client transactional data.

Maintaining the primary DDA bond. Implementation of the Durbin Amendment will cause more banks to implement DDA-associated fees, and as they do, the time is right for banks to actively strengthen relationship bonds with the goal of being the primary — and possibly only — banking relationship. Today, about 30% of an average institution's customers are transacting business at other institutions as well.[18] But new fees may cause many consumers and small businesses to reduce their number of accounts. Efforts should be made to identify and focus on high-value relationships and to look for accounts that use check services. These linkages can provide the lever needed to retain business. Javelin's research finds that check users carry more than double the average DDA balance of nonusers, indicating the value of these account relationships.

[18] Giltner, Robert G., *Protecting DDA Profitability*, www.bai.org/bankingstrategies.payments/general/protecting-dda-profitability, Feb. 23, 2011.

VI. Conclusion

In response to recent regulatory oversight affecting the DDA, both banks and credit unions are reassessing DDA profitability. Projected revenue losses associated with the Durbin Amendment and Reg E compliance, and even the CARD Act, are of great concern. As FIs seek to offset losses and generate new fee income, an often overlooked aspect of the DDA is the check product. FIs should respond to the threat to DDA profitability with new product strategies that emphasize developing key identifiers of a primary relationship. One such identifier is check usage, which can be a sign of a more significant relationship. The data suggests check writing is an important engagement activity. Financial institutions are called on to mine their data to determine to what extent check writers are their most valuable clients and the extent to which promoting check usage can lead to reinforcement of a primary relationship. Although the DDA landscape is changing, institutions that adapt and focus on their most valued clients as well as key elements of their DDA product portfolio will retain DDA profitability in the near term.