DIRECTORS / SENIOR MANAGEMENT

The Loyalty Factor

Translating relationships into noninterest income

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Last year challenged our industry in ways previously unknown. We began 2020 expecting our biggest challenge to be continued growth of deposits at reasonable rates. Today we are faced with: a prolonged low-rate environment with continued margin compression; keeping branches open and serving our communities; and an increasing number of customer transactions moving to the digital arena.

Much has been written regarding the validity of the branch in the current environment. Has community banking been changed forever based on consumers' digital behaviors? Possibly. Is some of this for the best? Definitely. Does the branch still have value? Absolutely!

Community banking is about community support. It's about being present and accessible. Unless your strategic plan is to shutter your branches and vacate your communities, keep reading.

Margin compression is real, so what can you do? You can offset a portion of it by shifting your deposit mix toward low- or noninterest-bearing deposits. Adding long-term, low-rate deposit relationships should be the foundation of any strategy, and community bank data shows your branches are the key to shifting your deposit mix.

While new core relationships are strategic in managing and maintaining your margins, they are also key drivers of additional noninterest-income (NII) – a critical component in the shorter term. Financial institutions must increase their NII to offset some of the challenges on the interest income/margin side.

To accomplish growing those new relationships you must:

1. Bring more new customer relationships into your organization;
2. Serve all of your customers better than any other financial institution has previously;
3. Create customer loyalty by increasing relational intensity over time.

The Loyalty Factor

Bringing in more relationships should be data-driven, and the data shows the checking account and branches are key. Looking at data from more than 100 community-based financial institutions and over 2.5 million households/businesses illustrates this point. The vast majority, 72%, of consumer and business rela-

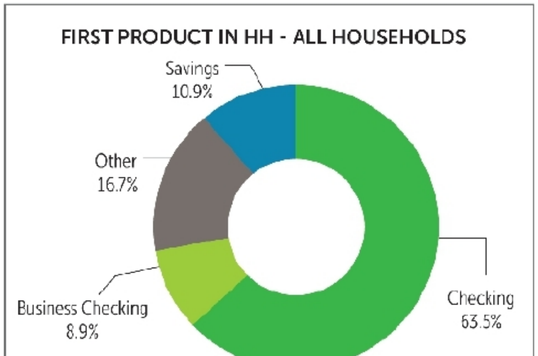

Chart: First product in household at community financial institutions tionships at community financial institutions begin with checking accounts.

In other words, the checking account provides the best opportunity to create customer loyalty. It is the gateway to primary financial institution (PFI) status, allowing your bank first right of refusal on other products and services 68% of the time. In addition, customers who have their checking accounts with your bank outpace other customers in using products and services, generating additional NII.

Even during the pandemic, and with limited access to community-based financial institution branch networks, client data shows over 90% of new PFI relationships have come through branch channels (in-person, appointments, drive-thru, telephone). The value of your branches cannot be ignored.

The more customer loyalty you build, the more interest income and NII your customers generate. With consumer and business customers averaging almost six products and services with their primary financial institutions, the math works. Most importantly, the more loyal customers you have, the better your bank will perform now and in the future.

Segmenting data from several million customers based on their tenure with their community financial institutions shows that loyal customers, over their lifetime, generate dramatically more NII. Additionally, annual NII contribution peaks once customers have been with their PFIs for a few years.

Further analysis of the data explains why the checking account revenue stream does not continue to grow. It is driven by customer age demographics. In general, more mature customers tend to drive more checking deposits than checking NII.

Creating Loyalty

In order to create loyalty, it is imperative your organization be positioned to capture new customers when they are ready to switch. The data shows that up to 12% of current retail and business customers are consistently switching financial institutions. A recent study published by The Financial Brand indicated this number could be as high as 22% post-COVID-19, driven by the failure of some banks to adequately serve customers during the pandemic.

Years household has been with institution	Annual NII per household	Lifetime NII per household
<1 year	$166	$81
1-3 years	$206	$480
3-7 years	$233	$1,362
7+ years	$218	$4,241

How do you position your organization for growth?

1. **Checking product.** You need to get your checking product right. Confusing product offerings does not create value and will not develop customer loyalty.
2. **Processes.** It is imperative you remove barriers. Account opening polices and customer identification program practices often inhibit growth rather than encourage it. Read the policies for yourself.
3. **Promotion.** Community financial institutions have an audience that needs to be maximized and then optimized within a defined footprint. If your bank isn't using targeted, data-driven print and digital marketing to grow PFI customers, you are missing growth opportunities.
4. **People.** Your team members must be equipped with the skills and the product knowledge to develop true relationships with customers, because customer loyalty is created through customer connections.

The Bottom Line

- To create loyalty, you first have to attract new customers.
- The checking account is the key to the PFI relationship.
- Once you have customers, you can move them up the loyalty ladder with checking products, processes, promotion and people.
- The longer customers stay, the more they will contribute.
- You can take steps to accelerate growth.
- Because customers are not all the same, you must understand their lifecycle journeys.

As with any strategy, there is no silver bullet. Rather, your bank should be looking for a long-term, loyalty payoff. **HB**