
New Rules Are Certain to Impact Features and Costs of Bank Checking Accounts

Many bank customers have enjoyed free or very low cost transaction account services from their bank. Providing over 300 million transaction accounts comes at a considerable expense for banks. ***In fact, the cost of opening an account runs between \$150 and \$200¹ and the yearly cost of maintaining an account runs between \$250 and \$300.²*** These expenses reflect not just the obvious costs of providing monthly statements and ATM, online, and teller access; they also include the expense of processing transactions, fraud prevention and fraud losses, complying with a myriad of regulations, ensuring privacy and data protection, new payment system technology and software to improve the customer experience, and staffing call centers, among others. Sherief Meleis, managing director of Novantas, estimates that about half of checking accounts are unprofitable in a “good year,” and that the coming regulatory and business environment changes could hike that percentage to 75 percent.³ Other research suggests the number of unprofitable and breakeven accounts is much higher – around 90 percent.⁴

It is a simple fact that for any business to remain viable, revenue has to exceed costs. Banks are able to provide transaction accounts for free or at very low cost because of the revenue received from lending out the deposits, interchange income on debit card transactions, overdraft protection programs, other activity-based fees, and the sale of other services. ***New rules created by Congress and bank regulators will severely reduce expected income from interchange fees and threaten other sources of revenue.*** This will force every bank to rethink the features of transaction accounts they offer and how they will cover the significant costs of providing these valuable services. As a direct result of Congressional and regulatory actions, in many cases, free checking will be a thing of the past.

Checking Accounts Are Costly to Provide

Bank customers have grown accustomed to an efficient, reliable, and accurate system for making their day-to-day purchases and payments from their bank accounts. They benefit from 24/7 access to their protected money from the comfort of home and across the world. While banks currently provide these services for free or at low cost, there are significant costs of providing transaction account services, including:

- ***Processing Costs:*** The processing and infrastructure costs associated with 28 billion check transactions, 30 billion debit card transactions, and 17 billion ACH transactions each year are significant.⁵ In spite of the movement away from paper checks, the costs of clearing checks – and the infrastructure required – still remain. Moreover, the rapid growth of all customers’ payment transactions means continued growth in costs to efficiently manage the many systems.
- ***Technology Costs:*** There are significant technology costs involved to make transactions as efficient as possible. Banks are constantly investing in new technology to improve their services and respond to customer demands for electronic payments, including imaging software, remote deposit capture systems, and online and mobile-phone access. ***New electronic services provide new customer conveniences, but they do not replace existing services.*** For example, ATMs were once thought to be a replacement for tellers, but the reality was that customers wanted multiple ways to access their accounts. Thus, we have ATMs ***and*** tellers now. New systems and software applications are costly to develop, test, and implement, and require considerable resources every year for maintenance and upgrades.

¹ Robert C. Giltner, Velocity Solutions, Inc., Wilmington NC, BAI Retail Banking Solutions Live, May 19, 2010. Giltner estimates that it typically takes a year or so to break even on new accounts.

² Estimate by Celent, a unit of Marsh & McLennan Cos, May 2010, as reported in the Wall Street Journal, June 17, 2010, “The End is Near For Free Checking.”

³ “Banking Strategies: Retail Delivery Insights Special Edition,” March 11, 2009, BAI

⁴ Rich Weissman, president and CEO of DMA (a database management firm) said that their research showed that “in one typical institutions, just 20% of the 64,000 accounts were considered profitable, while another 10% were breakeven and the rest unprofitable.” *Retail Banking Insights*, BAI, June 17, 2009.

⁵ Estimates based on: The 2007 Federal Reserve Payments Study, December 10, 2007.

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- **Costs of Providing Convenient Access:** Customers want convenient access to their money through many different channels. Thus, banks bear the costs of brick-and-mortar branches, tellers, call centers, ATM deployment and maintenance, (including security required to replenish cash on a regular basis), debit card systems, and online and mobile-phone banking.
 - **Staff Costs:** The cost of bank personnel – including salaries, benefits, social security, etc. – are major expenses in every aspect of providing transaction accounts, from the front-line personnel to all the back-room operations and sophisticated systems that are involved with ensuring uninterrupted security and privacy, online and phone access, timely and accurate statement preparation, and delivery and the handling of millions of customer inquiries at readily available call centers.
 - **Legal and Compliance Costs:** Banks must comply with close to a thousand pages of regulations related to checking accounts. These regulations cover advertisements, account opening requirements, statement disclosures, treatment of consumer complaints and claims, permissible transaction practices, fraud prevention, and privacy and data protection to name a few. **And the list increases each year.** Compliance involves not simply understanding and interpreting the rules, but implementing and testing them (which involves many people and program changes), training employees, auditing compliance, and proving compliance to examiners. Given the nature of complex laws, rules, and regulations, significant legal costs are associated with every **new** compliance obligation, every **existing** one, and every **change** in an existing one.
 - **Fraud Costs:** Banks use sophisticated and complex systems and intensive employee training to fight against criminals looking to open accounts to use for fraudulent purposes, access accounts through counterfeit and altered checks, counterfeit debit cards, and access online accounts. These systems, which include, for example, neural networks to detect unusual account activity, are expensive and subject to constant upgrades and modifications to respond to fraudsters' ever-changing techniques. Banks must also pay for the fraud losses because, generally, consumers are not liable for the loss. In 2008 (the most recent data available), the industry suffered **over \$1 billion in check fraud** losses and, through capital investments in fraud prevention systems, **avoided another \$11 billion in losses. Debit card losses reached an estimated \$788 million** in 2008, rising significantly at smaller banks. Besides investments in software and technology, yearly deposit account fraud-related operating expenses ranged from \$1 million to \$10 million for a large bank, \$50,000 to \$250,000 for a mid-sized bank, and \$10,000 to \$50,000 for a small bank.⁶
 - **Capital Costs and FDIC Insurance:** Banks are exposed to losses on transaction accounts and, as a result, must allocate capital to cover this risk. In addition, the banking industry pays billions of dollars every year to the FDIC for deposit insurance to protect depositors.

Congressional Action is Limiting Sources of Revenue That Support Low-Cost Checking

Banks have been able to provide free or low-cost checking services because of revenue derived from lending, interchange income on debit card transactions, overdraft and other activity-related fees, and selling multiple products and services to depositors.

- **It Takes Many Low-Balance, High-Overhead Accounts to Fund Loans:** Managing large numbers of low-balance accounts is not only expensive, but it takes many small accounts to fund a typical small business loan. For example, consider a \$50,000 small business loan. Funding it with one \$50,000 deposit account is obviously less costly than funding it with 100 deposit accounts with \$500 each. Thus, including the **overhead and capital costs** of servicing a large number of small accounts, it is clear that funding loans from larger accounts provides a better return to help offset the cost of providing the account services. In an example of one institution, DMA (a database management firm) found that unprofitable checking accounts held less than \$2,500 in balances and constituted 70 percent of the bank's 16,000 accounts.

⁶ ABA Deposit Account Fraud Survey Report, American Bankers Association, 2009.

This is why many banks had, at one time, provided free checking only if a minimum balance was maintained. Moreover, accounts with large volumes of transactions (particularly paper checks) are also more costly to administer. This is also why many banks had, at one time, charged for payments that exceeded a certain number each month.

- ***Debit Card Interchange Had Become a Stable Source of Revenue Offsetting Some of the Account Costs:*** As debit cards became more widely used, the interchange income helped to offset some – but certainly not all – of the cost of providing checking accounts services, thus enabling many banks to reduce or eliminate the monthly charges or cost-per-transaction fees. Debit card and online banking customers benefited from having lower costs and a convenient and safe method to make payments electronically. Unfortunately, Congress is currently enacting legislation that will severely limit interchange revenue. While Congress will protect retail businesses from paying these costs, ***the costs still remain*** and will be now be borne by banks and their customers.

Moreover, products such as payroll cards and prepaid cards funded through direct deposit – that are popular among low- and moderate-income consumers and those who have had trouble managing full-service checking accounts – will be threatened without the income derived from interchange. Interchange incomes has also helped support other important community development services. This is particularly true for minority depository institutions that typically have higher than usual operating costs due to high customer turnover and a large number of low-balance accounts. These banks use interchange income to offset costs associated with offering affordable banking products and neighborhood programs such as financial literacy.

Other regulatory changes will also have an impact. For example, regulatory changes in pricing of overdrafts and other activity-related fees will change the economics of offering free and low-cost transaction accounts, which will once again require a re-examination of the features and prices of services that banks can provide. New capital requirements will affect the allocation required to cover the risk of transaction accounts, adding to the cost of providing accounts.

- ***Multiple-Service Relationships Help Offset Costs of Deposit Accounts:*** Banks, like any business, want their customers to buy more than one service or product that they provide. Having multiple relationships with customers means that there is more revenue that helps offset the cost of providing transaction and other deposit accounts. Research suggests that it takes several account relationships to make up for the cost of providing the transaction account.⁷ With restrictions in other revenue-generating areas, the focus on multiple relationship banking will become even more important and influence the pricing of transaction accounts.

Conclusion

Transaction accounts are expensive to provide. Banks have been able to offset the costs and offer free or very low cost transaction accounts because of other revenue – particularly revenue from interchange fees and lending. As Congress and the bank regulators add restrictions that severely reduce interchange and other sources of income, as well as new regulatory costs, banks will have no choice but to reexamine the features and pricing of these types of accounts. No business can be viable unless its revenues exceed its costs. Congressional action is driving these services back to the days when monthly fees, direct deposit requirements, and restrictions on the number of transaction were the norm.

⁷ Rich Weissman of DMA, said: “For example, 10.3% of one bank's 28,000 relationships last year were customers with only a retail savings account, averaging a loss of \$99 each for the year. Those with retail checking and savings accounts – about 3.7% of all relationships – averaged a loss of \$57. Yet those relationships with retail checking and a certificate of deposit yielded a profit of \$496 each.” *Retail Banking Insights*, BAI, June 17, 2009.