

Checking Rewards: On The Ropes?

By Gary D. Stein, April 2011

Implementation of the Durbin Amendment will hamper debit-based rewards. In the future, these programs will continue to exist – only with a stronger focus on enhancing customer loyalty rather than simply bolstering revenue.

Rewards checking products and programs are intended to create “win-win” relationships among banks and their customers: Customers earn points or something of value by exhibiting behaviors that generate profit to the institution. Many programs focus on debit card use, but in recent years a number of banks have broadened and enhanced their programs beyond signature-debit usage. These expanded programs make it worthwhile for the customer to engage in all kinds of financial transactions—including debit PIN, and in some cases even check and teller transactions.

While the rationale behind the original approach continues to make sense for a lot of organizations, a number of developments are driving retail bankers to rethink their programs. Most notably, the proposed implementation of the Durbin Amendment will significantly reduce debit interchange and comes on the heels of Reg E and its impact on overdraft income. As a result, some banks have already decided that they can no longer afford their existing reward programs.

JPMorganChase, for example, in February stopped issuing debit rewards cards. The bank is ceasing programs designed to encourage debit card use and will eventually begin to phase out its present debit-card reward programs altogether. Undoubtedly, a points program fully predicated on debit card fees would be hard to justify in an environment in which interchange rates have been slashed by over 80 percent.

Rewards programs will adapt

The checking rewards concept is not totally dead, however. At the time of this writing, the final Durbin Amendment guidance and its impacts—and specifically, whether smaller banks will effectively get the benefit of the proposed rate exemption—are very much in question. Major stakeholders continue to analyze options, and TCF Bank’s lawsuit against the Federal Reserve (over debit card interchange fees) is looming. Furthermore, banking industry lobbyists are going head to head with those from the retail industry, and while Dick Durbin is currently sticking by his bill, Barney Frank, among other powerful lawmakers, is raising significant questions about the amendment’s implications.

In addition, history suggests that bankers hawking rewards will not uniformly retreat, but rather, adapt. When Australian regulators in 2003 instituted substantial interchange limits, issuers reacted by retaining their rewards programs and instituting participation fees. What’s more, merchant

funded programs and other innovations are providing banks with new options for rebuilding “win-win” situations and transforming debit-based checking rewards programs.

Perhaps most significantly, though, many existing checking rewards programs were implemented to drive customer loyalty in addition to fee generation. As such, the fates of these programs will be determined by more than just Durbin-related outcomes.

For example, the Southern Community Bank and Trust’s (assets: \$1.6 billion), Winston Salem, N.C. offer a rewards program called UChoose Rewards, the intent of which is to help retain the bank’s most profitable customers and complement the bank’s Maximum Earnings Banking checking product.

Participants earn points for both signature and PIN debit transactions, and while Senior Vice President Jeff McDowell is keeping a keen eye on Durbin developments, he expects no change in strategy.

This is largely because McDowell and his team assumed only moderate contribution from debit card fees. Instead, UChoose payback is expected to come in the form of increased customer retention, balance growth and, to a lesser degree, new customer acquisition. The program’s business case is further helped by the fact that the expense stream is delayed until customers accrue and spend their points.

Bankers like McDowell are wise to recognize the value associated with improving customer retention. The cost of acquiring a new customer is frequently quoted to be six to seven times that of retaining an existing one. Furthermore, consider that a bank with \$1 billion in retail deposits that achieves a 1 percent increase in customer retention would otherwise need to acquire 4,000 new relationships with an average balance of \$2,500 to realize the same overall level of balance growth.

Well-crafted loyalty programs typically break even within 12 months of launch and achieve targeted returns on investment by year 2 or 3. McDowell set similar milestones for UChoose and says the program is on track to accomplish its year-one goals, Durbin or no Durbin. Southern Community and its vendor, Fiserv, are monitoring results regularly and have already seen a jump in debit card penetration percentages from the mid-60s to the low 70s. The team is also tracking account open/close ratios and will soon start measuring retention and

balance trends of program users versus nonusers.

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Enroll in Online Banking today in three easy steps:

- 1 Go to firstnational.com/quickstarts and click "Enroll in Online Banking"
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Shown here are a print ad, statement stuffer and direct-mail piece used by First National Bank of Omaha (assets: \$9.1 billion) to promote the bank's merchant-based MyDeals program. MyDeals customers are presented with a series of targeted, online coupons that reflect each individual's prior purchase behavior. Customers click to register for coupons that interest them and then visit the merchants to make qualifying purchases using their First National debit card. Rebates are credited to customer accounts at the end of each statement cycle.

Refining traditional debit-points programs

While Southern Community intends to stick with a traditional debit points program, other institutions have refined the concept. Union First Market Bank (assets: \$3.8 billion), Richmond, Va., rolled out its aptly named Loyalty Banking program in the fall of 2009 and soon after enhanced the program to address a couple of objectives. In early 2010, Union Bankshares completed its acquisition of First Market Bank, a Richmond-based franchise with deep ties to the Ukrops Supermarket chain. Union Marketing Director Olen Thomas wanted to be sure to retain First Market customer who had grown accustomed to First Market's MarketShare program, which enabled participants to redeem debit points for free groceries and other rewards.

In addition, Thomas wanted a benefit that would not be rate sensitive to offer its best customers. The Union team thus expanded its existing Loyalty Banking credit card rewards program to include debit transactions, a move that Thomas says has helped to drive cross-sales by allowing customers to combine points generated with either card. Union's Loyalty Banking also helps to generate core deposits, as customers earn 1 point for every \$100 maintained in the checking account and another point for every \$200 held in savings, money market, IRAs and CDs.

Merchant-funded rewards

Rolland Johannsen of First National Bank of Omaha (assets: \$9.1 billion), Omaha, Neb., says he had always

Merchant-funded programs and other innovations are providing banks with new options for rebuilding “win-win” situations.

Union First Market Bank (assets: \$3.8 billion), Richmond, Va., expanded its existing Loyalty Bank program in 2009 after acquiring First Market Bank, which had a program called MarketShare, which enabled participants to redeem debit points for free groceries and other rewards. The expanded Loyalty Banking program includes debit transactions, which drives cross-sales by allowing customers to combine points generated by either card. Shown here are a print ad and a brochure explaining the program.

Loyalty Banking® Rewards
 Earn Reward Points On:
 Checking & Savings
 Debit Card Use
 Credit Card Use
 Money Market Balance
 CDs & IRAs

Is it so wrong to love a bank?
 When was the last time your bank made you happy? If you can't remember, maybe you should look into Loyalty Banking at Union. Who wouldn't love a bank that pays you back just for being loyal?

With Union's Loyalty Banking, you earn points based on the balance in your Loyalty Checking and savings including money market, CDs and IRAs. Plus you'll really add up the points with Union debit and credit card purchases. Then you can redeem your points for gift cards, merchandise and travel. Visit one of our branches to find out how easy it is to fall in love with Loyalty Banking.

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You will find that most people like to be rewarded for their efforts. At Union, we think you should be too. With Loyalty Banking, being rewarded comes with the territory.

Union's Loyalty Banking customers can use their debit card to earn points and redeem them for gift cards, merchandise and great hotel rewards. The more you use your debit card, the more points you earn. As an added benefit, if you also have a Union VISA® credit card, you can combine your debit and credit card points to reach your reward goals, faster.

Find out how easy it is to become a Loyalty Banking customer by visiting one of our branch offices for more details. Don't let your rewards pass you by.

Union is here to help you resolve financial issues and take advantage of opportunities. We're prepared to address a wide range of financial service needs — in ways that we know will please you.

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Loyalty Checking

Our Loyalty Checking account has great benefits:

- \$500 minimum to open
- Non-interest bearing account
- \$300 minimum daily balance
- \$5 monthly fee if balance drops below \$500
- \$2 monthly fee for Easy Image checks (optional)
- 1% off installment loans with automatic debit
- Earn points based on average monthly balance in the Loyalty Checking account
- Earn 1 point for every \$2 spent when you sign for debit card purchases
- Earn 1 point for every \$4 spent when you use your PIN (Personal Identification Number)
- Earn 1 point for every \$200 in average monthly balance on Statement Savings, Money Market Account, Certificate of Deposit and Individual Retirement Accounts

To redeem your points:

- Log On to www.union.com to review your reward point balance and redeem current gift card items
- Redeem your points for gift cards, hotel, cruise, train, bus, car and travel
- Combine your checking account, debit card, and credit card points for more points, faster

eschewed point programs because he could never make the business case work. With 40 percent market share in its hometown of Omaha, Neb., and an already deeply cross-sold customer base, First National saw little upside to traditional rewards programs.

In contrast, Johannsen said the decision to launch the bank's new merchant-based MyDeals program was an easy one. The program is completely merchant funded and even pays the bank a small percentage of the transaction revenue. Best of all, according to Johannsen, the MyDeals program enables participants to save money on their debit purchases, a strong and empathetic consumer benefit in the present economy.

First National teamed with Cardlytics to develop the MyDeals program. MyDeals customers are presented with a series of targeted, online coupons that reflect each individual's prior purchase behavior. Customers click to register for coupons that interest them and then visit the merchants to make qualifying purchases using their First National debit card. Rebates are credited to customer accounts at the end of each statement cycle.

Sovereign Bank (assets: \$73.8 billion), Boston, which is part of the Spain-based Santander Group, also offers merchant-funded rebate rewards, but with a few twists that Sovereign Card Division Managing Director Eduardo Tobon believes are critical to ensuring marketplace separation and high customer adoption. For one, Sovereign's Cash Rewards

program requires no registration for coupons, though customers are presented with targeted merchant offers. In addition, customers earn rebates from both online and brick-and-mortar retailers.

Most significantly though, Sovereign iPhone users can download a GPS-based app that identifies nearby participating merchants when they are out shopping. Sovereign's is the first banking app of its kind offered through Apple's online store, and Tobon says the company will soon expand the program to other smart phone operating systems. Preliminary results indicate that customer reaction to the app has been "fantastic" and is even helping Sovereign to attract some new customers.

Tobon hopes the program gives customers the confidence to use their Sovereign debit card more and to increase debit card loyalty. While debit card loyalty should ultimately translate into greater customer loyalty, the primary focus on debit card loyalty reflects the fact that Tobon and his team sit within Sovereign's Card Division versus within retail banking or marketing, as is the case with the managers of each of the other programs profiled above. Importantly, Tobon works closely with his retail bank counter parts, and Sovereign views Cash Rewards as an instrumental facilitator of the bank's "Get More with 4" initiative, which focuses on cross-selling services to new checking customers as a means to increase retention and customer profitability.

While Sovereign has no immediate plans to expand the Cash Rewards program to other forms of payment, the bank specifically designed the Cash Rewards platform to be flexible and continues to investigate program enhancements that will further differentiate Sovereign from its key competitors.

Simplicity of participation

While all of the profiled programs vary in structure, they each exhibit a number of best practices. For one, the requirements and reward offers are all very straightforward, making the programs easy for customers—and sales staff—to grasp. Many of the banks said that simplicity of participation was one of the factors—if not *the* most important factor—used to decide between program vendors. Sovereign's Tobon says his bank is continually focused on reducing program complexity and believes that providing customers with better enrollment, participation and redemption experiences creates significant competitive advantage.

In addition, all of the programs feature transparent participation-reward trade-offs. While transparency cannot provide competitive advantage, poorly communicated program terms and reporting of customer status will inhibit enrollment and program participation. Most banks today provide online demonstrations that include snapshots of screens customers use to monitor their purchase activity and rewards accumulation.

While all of the featured programs' mechanics are rather simple, none of the banks profiled emphasize instant

gratification, which can be a competitive differentiator. For example, First National's MyDeals and Sovereign's Cash Rewards programs both payout purchase rebates at the end of the statement cycle versus providing more timely or even instant discounts. Instant discount programs carry their own caveats—they are harder to sunset and can imply to some that regular pricing is too high; however, customers receive immediate benefits and reinforcement for their actions.

As a rule of thumb, a bank's best customers in a points program should earn enough points to redeem for a reward in about 3 to 6 months, and customers whose behavior the program is designed to influence may take up to 9 months. These time frames are shortening. Fifth Third Bank (assets: \$112 billion), Cincinnati, recently refined its rewards program to include more lower-point level awards, such as packages designed for evenings out versus vacations. In addition, points can be used quickly to pay down debt or add to savings. Points program administrators will want to watch competitors' redemption time lines closely: According to Maritz Loyalty Marketing, individuals earning more than \$125,000 annually are quite willing to drop one points program for another that they feel is better.

For this reason, banks should ensure rewards offered are highly regarded, as customers will inherently equate the quality of rewards with the quality of the bank brand. First National's Johannsen said that the inclusion of credible merchant providers with a notable presence in the bank's footprint was a must-have. Johannsen also emphasized that the operational accuracy and effectiveness of a program will impact brand perception. The last thing a bank looking to increase customer loyalty wants to do is introduce their best customers to a program that does not work. Along these lines, First National conducted a small market pilot to gauge their vendor program and identify and resolve any kinks before introducing the program to their entire customer base. Similarly, Southern Community ultimately selected a rewards solution offered by their core system provider, Fiserv, because integration would be substantially easier due to the vendor's already extensive familiarity with the bank.

A distinctive loyalty program, though, requires more than quality rewards and dependability. Consider that, according to a 2009 Colloquy.com study, the average U.S. household is a member of over 14 loyalty programs (all industries), but only actively participates in about six of them. Thus, while a defensive minded, me-too program may help stem the flow of attrition, much of the desired stickiness is lost when market competitors are promoting similar programs.

This is one reason why merchant-funded programs were already emerging as an alternative to the increasingly ubiquitous points-based programs well before the Durbin Amendment was proposed. Ironically, if the Federal Reserve's interchange guidelines are implemented as proposed, debit card points programs may once again become a marketplace distinction. Banks like Southern Community that focus on luring customers from super-regional and na-

tional competitors hope this is the case and that more large banks follow JPMorganChase's lead.

The shape of the future

The best programs, however, feature innovative differentiators, such as the Sovereign merchant-finder app. Another interesting innovation, while for credit card only, is Citibank's upcoming 2G card. The point-of-purchase option allows customers to determine, at the cashier, whether to pay with credit or redeem rewards by virtue of two small buttons embedded into the card.

Interestingly, few, if any, bank loyalty programs include "aspirational" rewards that provide recognition and exclusive (usually nonmonetary) benefits for customers that reach key thresholds. Airline miles programs frequently offer silver, gold, and other elite award tiers, but Neiman Marcus' longstanding InCircle program is widely considered the bellwether example. Neiman Marcus customers that spend an accumulated total of at least \$3,000 per year receive invites to special sales events, parties, and community events, among other rewards. Aspirational programs typically incorporate service-oriented benefits: Banks might offer dedicated customer service phone lines and special Web landing pages within online banking for qualifying customers. Most importantly, while most existing bank programs encourage customers to behave profitably (e.g., use their debit card and even maintain desired balance levels), aspirational rewards help to drive *attitudinal loyalty*, which can be even more critical to retention, and better at generating customer-referrals.

Going forward, expect the popularity of fee-focused programs to diminish, but expect bank loyalty reward programs to persevere, and at the best banks, evolve. The final terms (and outcome) of the Durbin Amendment implementation will ultimately influence what a number of banks do; however, competition for customer relationships and new payment and technology innovations will likely cause equal if not more significant impacts to checking rewards programs.

Gary Stein is a partner with Capital Performance Group, LLC, Washington, D.C., a management consulting firm providing advisory, planning, analytic, and project management services exclusively to the financial services industry (www.capitalperform.com). Gary manages the company's Distribution Planning practice and specializes in developing and implementing business performance improvement strategies and initiatives. E-mail: gstein@capitalperform.com.