VELOCITY SOLUTIONS

COMMUNITY BANK RECOVERY SERIES

Part I — Top 5 Recovery Challenges for Community Banks Post-Crisis

Velocity Solutions LLC
www.myvelocity.com

We're beginning to emerge from a rare moment in history.

The COVID-19 crisis that impacted everybody around the world with no regard for age, wealth or education, is the stuff of Hollywood movies. A pandemic of this magnitude is something we thought we would only read about in old history books, and it will indelibly change the way American consumers think, behave and financially transact. Community banks will need to start planning now to stay a step ahead and respond accordingly.

There's no question that the overall U.S. economy has taken a crushing blow from COVID-19 in the unprecedented loss of jobs, strain on small businesses and a steep decline in consumer spending. This reduction in spending has had a major effect on the banking system through decreased debit card usage, negatively impacting interchange revenue. Less spending results in fewer account transactions that can cause an overdraft, thus impacting NSF/OD revenue. And although consumers are spending less money, they're also earning less money, while their household bills continue to come due. So, the need for consumers to obtain short-term liquidity simply to meet regular expenses has increased exponentially. Liquidity problems also plague small businesses throughout the country, who are struggling to survive, notwithstanding government efforts such as the Paycheck Protection Program.

Is your community bank prepared to tackle these unprecedented challenges? Fortunately, you can successfully recover from this turbulent downturn because these challenges present opportunities you can leverage with the right strategies. And the way your bank responds to this crisis has the potential to win—or lose—your customers' trust and loyalty for many years to come.

Velocity Solutions has been in business for 25 years and in that time our team has been immersed in the banking and regulatory landscapes. During the coronavirus quarantine, our team has been in regular contact with financial institutions across the country and has had in-depth conversations with everybody from the C-levels to the operations team to the front line. In Part I of Velocity Solutions' Bank Recovery Series, we've combined our professional experience to identify the top 5 recovery challenges your community bank will face on the heels of COVID-19. In the subsequent Parts II-VI of our Bank Recovery Series, we explore each challenge in detail and explain how other financial institutions are successfully responding to these challenges in their recovery strategies.

1. Debit Card and Deposit Activity Needs to be Revived

In a blow to our economy unlike anything we've seen before, spending has plummeted across all payment methods and has impacted nearly every category, except for necessities such as groceries. Most financial institutions are reporting a double-digit decline in payments revenue, and as much as 80% of that decline could come from a loss in interchange revenue as opposed to interest income, according to Mark Sievewright, founder and CEO of Sievewright & Associates. And with the financial insecurity caused by widespread loss of jobs, many consumers who made regular deposits prior to the crisis no longer have the income to do so.

Unfortunately, once we emerge from the pandemic, there is no guarantee that your customers' debit card spending or deposit activity will pick back up at its previous levels. Megabanks, digital-only institutions and other payment players are leveraging this unprecedented event to win over your customers. If your customers weren't fully onboarded and engaged

with your bank before the crisis, chances are they didn't view you as their primary financial institution and could likely end up as another attrition statistic.

A successfully onboarded account holder will generate more deposit activity, use more products and services with your institution, transact more heavily and stay with you longer. Research has proven that the level of engagement closely correlates with the profitability of checking accounts. But your account holders won't generate profitable activity until they're fully onboarded and committed to your bank as their primary financial institution. Savvy banking executives know that now is the time to reengage your customers and revive transactional activity. These executives know that initial account acquisition is only the first step in an effective account strategy and must be followed by onboarding, engagement and retention efforts for ultimate success.

For more information, see Part II of the Velocity Solutions Bank Recovery Series: *Revive and Reengage Customer Swiping & Deposit Activity*

2. The Need for Overdraft Protection Increases – So Does the Risk

Overdraft has always been a valuable service to consumers, even pre-crisis, and it will continue to provide value post-crisis for consumers who need to rely on this protection more than ever. As consumers across the country begin to recover financially, they'll need overdraft services as a line of defense for when their account doesn't quite cover purchases or regular household expenses. As a community bank, you have to strike a balance between supporting your customer's short-term liquidity needs while managing the increased risk to your institution.

And the most efficient, strategic way to strike the perfect balance is by using a truly managed overdraft program. If you are still offering only static, one-size-fits-all overdraft limits (like $500 for all accounts), then your program is essentially unmanaged. Even when the economy is strong, American consumers differ dramatically in their income levels, deposit behavior and transactional activity, and a superior, managed program can utilize all of these variables to determine a consumer's customized overdraft limit based on ability to repay. Managed overdraft programs assign limits calculated automatically based on a myriad of account holder data points, including specific deposit and overdraft activity. This data enables your institution to establish a risk profile for each account and assign individualized overdraft limits based on the account holder's ability to repay the overdraft, with the overdraft limit being updated in real time in response to changing conditions. Such a program can dramatically reduce charge-offs and overall risk to your bank, which is the type of protection that is critical to your bank's recovery.

For more information, see Part III of the Velocity Solutions Bank Recovery Series: *Why a Managed Overdraft Program Matters More Post-Crisis.*

3. Consumers Need Options for Short-Term Liquidity

More than 26 million Americans are jobless since the pandemic laid siege to the U.S. economy, and that number is growing every day. The last time unemployment was this high was in the early stages of the Great Depression nearly a century ago. Consumers across the country are struggling to meet their regular expenses such as mortgage/rent, utilities, insurance, groceries, etc. And it's clear that many households were unprepared for this swift financial blow: according to the Federal Reserve's 2019 report on Americans' economic well-being, 4 in 10 don't have enough cash savings to cover a $400 emergency expense and more than 60% said losing their job would mean they could not cover three months of expenses.

Even prior to the current pandemic and potentially looming economic crisis, consumers have been exiting the banking system in search of short-term liquidity, in many cases never to return. Each year approximately 12 million Americans take out payday loans resulting in nearly $46 billion in loan volume and a staggering $9 billion in fees. Of these, 7 in 10 borrowers use payday loans for regular living expenses. And there are currently almost 16 million unbanked adults in the US.

On March 26, 2020 the five primary federal financial regulators issued a joint statement encouraging banks to offer responsible small-dollar loans to consumers and small businesses in response to COVID-19. This statement follows years of previous comments from the same agencies encouraging better, more responsible options to high-priced payday loans. Further, they're encouraging alternative underwriting guidelines that better measure ability to repay than traditional credit checks, opening credit accessibility to consumers that might not otherwise qualify.

However, those seeking affordable short-term loans are only one type of consumers in need of short-term liquidity. Velocity Solutions has identified two distinct group of consumers in need of short-term liquidity. Those who prefer to seek high-priced short-term loans often do not have the ability to rely on overdraft protection because they can't obtain sufficient overdraft limits, or they simply failed to opt-in to overdraft. These consumers will benefit most from responsible, affordable small-dollar lending. Other consumers, such as those with irregular income streams like small business owners, might use overdraft protection regularly because incurring a periodic overdraft fee makes more financial sense to them.

In a time when American households are lacking liquidity in record numbers, is your bank prepared to serve both types of consumers? Can you provide affordable short-term loans to help your customers avoid payday loan traps? And do you have the capability of applying alternative data to your underwriting methodology? And for your customers who rely on overdraft, is your program adequately managed to assign individualized overdraft limits based on the account holder's ability to repay rather than a one-size-fits-all overdraft limit approach?

If you answered no to any of the above questions, we recommend that you refer to Part IV of the Velocity Solutions Bank Recovery Series: *Your Consumers: Smart Strategies for Providing Short-Term Liquidity*

4. Small Businesses Need Your Support More than Ever

A survey published by Main Street America in mid-April 2020 reported that 3.5 million small businesses will close permanently in the following two months, and 7.5 million over the next five months, if business disruption due to COVID-19 continues unabated. While the CARES Act provided some small-business relief through the Paycheck Protection Program, not all small businesses received funding, and the roll-out of the program was plagued with technical hiccups and questions about whether the businesses that needed the money most were the ones getting the limited funds.

Your bank staff is undoubtedly witness to your local businesses shutting down: your favorite restaurants, hair and nail salons, fitness centers, theaters, pubs, recreation centers and the list goes on. As their community bank, these businesses are looking to you to provide relief to help them stay afloat. And as mentioned above, even pre-crisis the five primary federal financial regulators were encouraging banks to offer responsible small-dollar loans to businesses as well as consumers.

But even prior to the pandemic, community financial institutions struggled to deliver small business loans quickly, conveniently and profitably, often finding themselves paralyzed in status quo methods of manual, inefficient loan processing. Processing just one loan manually can cost up to $5,000 and as many as 100 hours[1]. There's little chance to achieve loan profitability using outdated manual methods and substantial human resources.

If community banks lack the internal resources to profitably offer small business loans, fortunately there is the immediate option of partnering with a fintech. Vendors in this space can help banks streamline loan processing time, increase profits of even the smallest loan and vastly improve the loan experience for their business borrowers—conveniently and safely through the digital channel.

For more information, see Part V of the Velocity Solutions Bank Recovery Series: *Small Businesses: Provide Relief Through Efficient & Digital Loans*

5. Digital Operations are No Longer a "Nice to Have"

One indisputable fact this pandemic has taught us is that digital banking services are no longer just "nice-to-have" technologies. They are are more critical than ever before in this new normal. The benefits of digitizing bank operations are clear: speed and efficiency, increased margins, personalization, 24/7 access to banking features and many others. However, the need to avoid human contact inside bank branches due to a deadly global pandemic is likely the strongest catalyst to digitization that we will ever experience.

In a recent survey conducted by INV Fintech of more than 100 industry participants, 92% of respondents agreed that the pandemic will drive increasing demand for digital channels, potentially altering customer acquisition and servicing models going forward. As a result, 78% of respondents expect financial institutions will increase spend in innovation and digital transformation in the next couple of years. By fast-tracking their roadmaps

to digital operations, community banks have opportunities to emerge stronger from the crisis and be better able to address rapidly evolving customer needs.

The fastest road to digitization is through collaboration with a fintech partner. Many community bank leaders have viewed fintechs as threats in years past, with good reason. Fintech companies have become major players in the money transfer and payments space, and now they are beginning to cross over into retail banking. As consumers and businesses seek more and more fintech services, banks—at least those that want to outpace their competitors in meeting consumer demands in the new normal—must abandon the "us-versus-them" mentality. The answer is to tap into fintech's strengths, instead of wholesale dismissing these firms as too risky or progressive. And, there are fintechs like Velocity Solutions who exclusively serve financial institutions instead of competing with them. The reality is: your customers want the services fintechs make possible, and if your organization is not armed with the technology infrastructure to deliver them, then collaboration is a must.

For more information, see Part VI of the Velocity Solutions Bank Recovery Series: *Digitization is Here: Go Digital or Go Defunct*

References:

1. Raddon and PayNet, “Gimme Credit: Faster, Simpler, Safer Credit for Main Street America,” 2018.

Founded in 1995 and servicing the transaction accounts of over 30 million consumers and business owners, Velocity Solutions is the leading provider of revenue-driving solutions for community banks and credit unions. Our Velocity Intelligent Platform™ powers all of Velocity’s solutions, using machine-led intelligence that delivers powerful analytics and drives revenue, deposits and loans to our client financial institutions.

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