

Commentary

End of the Line for Monolines?

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By Rick Spittler

When U.S. consumers were busy piling up debt at levels unseen in world history, specialty lenders were at the top of their game. Each time rates fell by one notch, credit card balances and mortgage originations seemed to rise by 10 notches, and the monoline focus on marketing, products and efficiency made for an unbeatable formula.

That picture is changing as the consumer lending market cools. Growth is no longer automatic, and the name of the game has switched from products, the key strength in a pure-play monoline strategy, to relationships, the soft spot. To cope with this inversion, monoline players will have to build wider bridges to customers, either by broadening their brands and capabilities or merging with more diversified institutions.

Performance trends bring the issue into sharp focus. As reported by the Federal Reserve Board, revolving credit balances grew at an annualized rate of 2.3% during the first seven months of 2004, little improved from the 2.1% full-year rate in 2003 and down sharply from 11.4% in 2000 and 6.5% in 2001. For card companies, the options have dwindled — computer-driven pricing has run its course, rewards programs have become commonplace and affinity programs help with retention but not growth.

The situation is worse for mortgage specialists. According to projections released in August by the Mortgage Bankers Association, the dollar value of overall residential mortgage originations is expected to drop by \$1.2 trillion, or 32%, this year, followed by a 30% year-to-year decline in 2005. The culprit is mort-

gage refinancing, which is predicted to drop by \$1.1 trillion, or 57%, this year followed by a 59% year-to-year decline in 2005. Advanced pricing techniques still can help mortgage lenders substantially, but the larger question is whether monoline mortgage lenders can do a greater breadth of business with households.

Given these challenges, we expect more specialists to be re-combined with multiline retail banks. Why? Diversified retail banks can do a better job of blending products into relationship-based packages. This ability has fueled a resurgence at major institutions.

Consider a mid-year 2004 report from Bank of America Corp., Charlotte, N.C. Out of the total population of retail banking customers who hold more than one product from BofA, 36% have a card from Bank of America Card Services. Meanwhile, roughly four-fifths of customers with a direct deposit account have a BofA debit card. The company also reportedly is enjoying good success in cross-selling mortgage products.

Obviously, monolines would love to mirror this type of performance by cross-selling in the other direction, going from specialty products to general retail banking products. But they must find ways to extend their brands and capabilities to increase both the

number and the depth of customer relationships. They also must overcome the cross-sell hurdle when credit is the starting point — it is much easier to broaden a deposit relationship.

This task is made harder by the fact that remote channels become less effective as relationships become more complex. While monolines tend to operate through the mail, the telephone and the Internet, the lion's share of product bundles are sold through retail branches. Customers tend to prefer firsthand service on more complex transactions.

It appears that we are at the end of a long era of falling rates and sharply rising borrowing, and the great tide that lifted monolines to superstardom is beginning to recede. Meanwhile, multiline retail banks are beginning to overcome some of the packaging deficiencies that helped the monolines to flourish in the first place. Research shows many customers are recep-

tive to bundles of credit and deposit products, which banks are best positioned to provide. It all adds up to a tougher climate for monolines.

This does not mean, however, that generalist retail banks will get a free ride. The monoline reversal sends a strong message to the many retail financial institutions that still tend to operate as a collection of product units. Especially in a tight market, packaged offerings will be essential in improving customer retention and cross-sales. And those packages must be based on customer needs, not on internal production considerations for each of the constituent parts. At some level, any bank that operates as a "collection of monolines" is in for the same stress fated for the monolines themselves.

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