

Home Equity Retention Strategies

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In today's highly competitive Home Equity Lending environment the ability to both attract and retain customers is critical. With interest rates rising and a flattening or inverted yield curve, the demand for home equity lending is growing at a slower pace. Many lenders have found borrowers migrating from variable-rate home equity line of credit products to fixed rate home equity loans. The attractiveness of relatively low first mortgage rates has also led to cash-out refinance mortgages where the home equity loan amount is rolled into the first mortgage. Additionally, the economics around the popularity of the 80-10-10 or convenient line of credit product have also changed – lowering overall home equity volume. The net result is that the year-over-year home equity line of credit (HELOC) growth rate is flattening and outstandings are dropping (as shown in Figure 1) demonstrating the critical nature of developing strategies for retaining profitable customers¹.

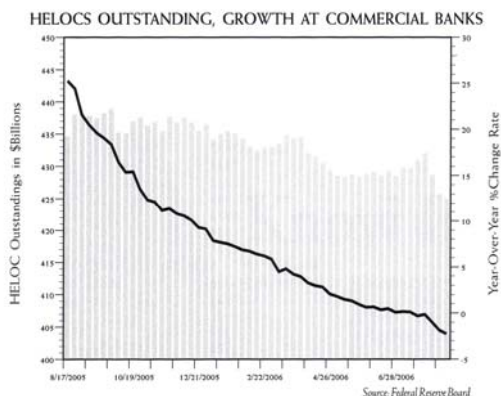


Figure 1

¹ "Market Monitor," Home Equity News, 11 September 2006.

Retention Strategies

Many lenders have experienced an increase in the home equity portfolio runoff. The costs associated with the generation of new business including origination, underwriting, vendor fees, documentation and booking are significantly higher than retaining existing customers. Per the 2005 Consumer Bankers Association - Home Equity Lending Study, origination-related costs represented 76% of the total costs associated with equity products. Consequently, the ability to effectively retain profitable customers is critical.

In addition to closed accounts, many lenders are finding that customers are paying down outstanding balances on variable interest rate lines of credit. This has a negative impact on the bank's overall profitability. In an effort to curb this run-off, many lenders are applying more efforts toward retention with an increased focus on driving success through cross-sell strategies.

BenchMark has identified three strategies that banks are successfully deploying to address retention concerns: cross-sell, dedicated retention teams, and reward programs. Each of these strategies is discussed in more detail as it relates to home equity retention.

Data Analysis and Interpretation

Successful home equity retention generally requires a dedicated focus to analyzing the existing home equity customer portfolio, and identifying possible signals of attrition. Instead of waiting until customers close their account and then reacting, a successful strategy is to identify the

reasons customers may leave and proactively address those reasons.

While many banks have internal capabilities for data analysis, others partner with vendors for this service. One industry vendor who offers a Home Equity Retention: Alert and Trigger Program provided a case study where “fifty percent of contacts resulted in a successful, client-defined outcome”² which included increasing the credit line, modification, HELOC draw, or lead transfer or follow-up. This success rate was possible by targeting the appropriate audience through data analysis and interpretation.

Cross-Sell

In today’s lending environment, cross-sell has become a way of life for most consumer lenders. Moving from a silo-product mentality to how to best help the customer with a variety of needs has resulted in a proliferation of cross-sell initiatives. While cross-sell efforts appear widespread, many bankers and lenders are not effectively executing. The result is a wide range of cross-sell success ratios among lenders as shown in Figure 2.³

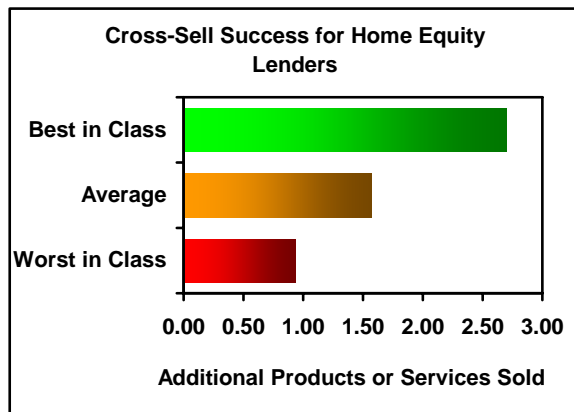


Figure 2

A wide variety of industry research demonstrates that customers with multiple products are less likely to attrite. According to a recent presentation at the Consumer Bankers Association Home Equity Conference, attrition rates are three

times higher for single relationship customers versus multiple relationship customers.⁴

Reward Programs / New Product Offerings

Many banks have recently begun developing retention strategies. They are actively tracking home equity run-off and many are beginning to track recapture activity within their respective portfolios. A growing number of lenders are using computer modeling tools to identify customers who are likely to pay off their credit lines. Through their retention strategies they are proactively contacting those customers they wish to retain.

Some examples of recent developments in retention strategies BenchMark has seen at clients, or may have been mentioned in the press are provided below:

- A program that reduces the rate on home-equity loans and lines of credit for customers who also have a bank checking account.
- A home equity line of credit with the ability to “lock” a portion of the line with a fixed term and fixed rate is an excellent strategy for retention. In the 2006 Consumer Bankers Association Home Equity Study over 50% of lenders already had this functionality and the adoption rate is nearly 100% among the largest lenders. This is now a must-have feature for consumer lenders and especially important during a rising rate environment.
- Some banks increase the credit limit for customers who have fully utilized the available balance on an existing home equity line of credit. The credit line amount is usually increased based on rising property values, so the underlying fundamental LTV is maintained.
- U.S. Bancorp rolled out its "EquiLine Rate Reward" program earlier this year, which reduces the borrower’s rate the

² “Case Study >> Home Equity Retention: Alert & Trigger Program.” [FiServ Lending Solutions](#) March 2006.

³ Bowler, Jeremy. Telephone Interview. 17 May 2006.

⁴ Dakay, A. & Rupp, D. “Improving Performance Retention: Providing One Face to the Customer.” Consumer Bankers Association Home Equity Conference, Orlando. September 2006.

longer they maintain their credit line. Within the program, a borrower's credit line interest rate drops by ¼% every six months until it reaches prime minus 1 percent.⁵

- Rate modifications may be appropriate to retain customers where a competitor offers a lower rate. In some cases, existing customers may have interest rates higher than a bank's current offering for that same product due to recent price compression.
- Following the trend of affinity and reward credit cards, some banks are now giving customers reward points based on the outstanding balance or account activity on a home-equity line of credit or home equity loan. Bonus reward points may be provided when customers open a new account. The reward points can be redeemed for gift cards, travel, or various merchandise.
- Many lenders mail activation checks to customers. These are used to activate lines with a zero balance, as well as to encourage continued borrowing from customers with a balance.

While many of these are “pilot” programs, the focus that is being provided to home equity retention is clear. Those who execute successfully will be rewarded accordingly.

Dedicated Retention Teams

A recent Consumer Bankers Association (CBA) study indicated 47% of the participants have dedicated home equity retention specialists, up from 12 percent in 2005. The retention specialist typically performs a number of functions including analytics, marketing and fulfillment. Many also perform outbound calls to customers that have been targeted for retention. The remaining 53% of participants indicated they manage home equity retention through relationship management generalists.⁶

⁵ Simon, Ruth. “Lenders Giving Hard Sell for Home-Equity Loans.” *The Wall Street Journal* 7 May 2006.

⁶ “Home Equity Customer Run-Off and Retention.” Consumer Bankers Association ASaP Research. March 2006.

The benefit of reaching out to the customer directly is that many borrowers do not realize the options that may be available - such as locking into a fixed interest rate for a portion of the credit line. By selectively reaching out to borrowers, banks can help avoid attrition. However, it is too costly to contact every customer. The outbound calls generally leverage predictive modeling to know which customers are most likely to attrite and consequently focusing energy on that specific segment.

Some banks are changing process flows to combat portfolio run-off by eliminating the automated pay-off request feature and requiring borrowers to talk with a live agent to obtain pay-off information. There are examples of some limited success with this process, but it may be too little too late if the borrower has already committed to a cash-out refinance or otherwise locked-in to paying fees associated with taking out a new loan.

Customer Satisfaction Dilemma

Recent analysis by Rockbridge Associates contends that while customer satisfaction has a strong correlation to retention and loyalty, there are other factors beyond satisfaction that drive retention.⁷ This new twist on customer retention contends that some customers will not leave even if they are dissatisfied. Others will move even when they are completely satisfied.

In the model pictured in Figure 3, “safe” borrowers are satisfied but typically wouldn't leave even if they were unsatisfied. The “high risk” borrowers are unsatisfied and more likely to leave than other customers. This is not referencing credit risk, but rather risk the customer will attrite. It is difficult to put much energy towards retaining this group, since even if they were satisfied, they would likely leave.

“Unhappy but static” borrowers are not likely to leave, but an increase in their level of satisfaction could move them to become “safe” borrowers. “Happy but mobile” borrowers are likely to leave for a better offer. For this defined segment, the

⁷ Colby, Charles. “A New Paradigm for Understanding Customer Retention.” *Rockbridge Associates* 3 July 2006.

“stickiness” of the relationship is very important in creating the barrier(s) to leaving the bank.

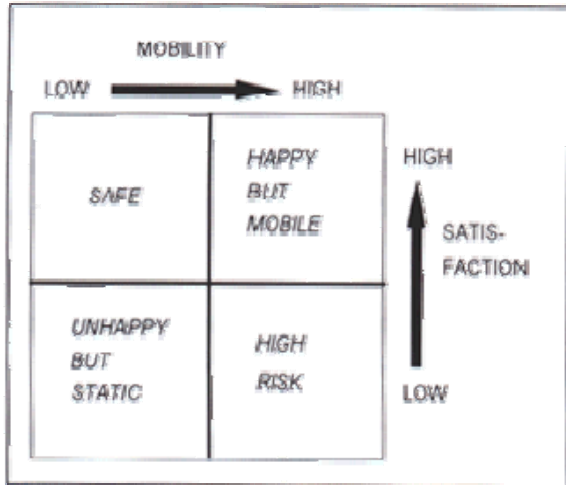


Figure 3

While this is just one model example, it highlights the importance that firms conduct data analysis to understand how their portfolio is performing from a retention perspective and identifying high-risk customers so they can intervene as appropriate.

Key Steps to Success

As a result, every firm must follow some key best practice steps to ensure a solid retention program. Those steps with a summary description are provided below:

1. Measure baseline retention level and track and measure going forward

While this is difficult, it is critical in being able to validate improvement. A baseline will be necessary to track future results to determine what is working well.

2. Conduct data modeling

Data analysis is needed to identify the customers most likely to attrite based on past portfolio performance. High-risk accounts that can be converted to loyal customers should receive the highest level of attention. This enables proactive targeting.

3. Identify why customers are leaving and determine where to take action

The US Census Bureau, in its 2004 American Community Survey, reports nearly 10% of owner-occupied households have moved within the last 12 months. For customers that are not moving, some may be consolidating their home equity outstandings with a cash-out first mortgage refinance. Still others may be moving to a competitor. Determine why customers are leaving and what action (if any) can be taken to retain the account.

4. View the customer relationship based on overall value to the organization

Instead of a product silo mentality, it is important to understand the entire customer relationship and how losing or saving the home equity account can impact other existing business within the organization.

5. Create culture and incentive plans that recognize the value of each retained account

Too often, employees are focused on the next new sale versus retaining existing customers. By creating a balanced incentive plan, companies can help drive the right behavior and demonstrate a focus on customer advocacy. Understanding and meeting the customer’s needs helps the bank win long-term business and retain loyal customers.

Conclusion

In summary, the majority of retail banks are clearly focused on their home equity portfolios and are developing new strategies to retain customers. The challenge is putting the people and technology together in such a way to drive success. Several best practices have been shared along with strategies that are in place and working at other firms. However, it is important to note that one size does not fit all. Each organization should carefully evaluate their specific situation and then take the appropriate action.

As you consider your retention plan for the next 12 months some important questions to ask may be:

- Who is the champion within my organization for home equity retention?
- Is my retention champion empowered to make a difference and drive change?
- What is my baseline of retention performance, and how do I measure success?

- Is the organization aligned to support retention efforts?
- What changes are needed in my retention strategy?
- Am I fully utilizing the branch channel to promote retention?
- What is the dollar impact of a 5% change (up or down) in my attrition level?
- What is the origination cost of one new home equity account versus the expense to save one existing account?

As you think about these important questions, remember that a comprehensive retention strategy must be adaptable and continually refined based on actual company results. Focus on how to economically retain your book of business. Where appropriate, seek outside help to make sure you have efficient business processes that will drive success for your organization.

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