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Financial Services

POINT OF VIEW

MORTGAGE CROSS-SELL

THE ELUSIVE OPPORTUNITY

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Many banks are re-evaluating their commitment to residential mortgage lending in the face of the significant investments required to meet regulatory and customer expectations. These investments would have a higher return if mortgage could have a role in establishing and deepening customer relationships. Unfortunately, recent Oliver Wyman research indicates that mortgage is not effective as a relationship-deepening platform outside of a few niche areas.

MARSH & McLENNAN COMPANIES

If mortgage is to be a strategic relationship product, it should be easy to cross-sell into, or out-of, a mortgage. Therefore, we set out to test two deepening hypotheses:

- Hypothesis 1: A primary banking customer can be sold a mortgage more easily than a non-customer
- Hypothesis 2: A stand-alone mortgage customer can be sold other bank products, such as a checking account, to become the customer's primary bank[1]

However, Oliver Wyman's recent Survey of Consumer Finances supported neither hypothesis, except in niche cases.

THE OPPORTUNITY

There are a number of intuitive reasons to pursue mortgage as a relationship product:

OBTAINING A PURCHASE MORTGAGE IS A SIGNIFICANT LIFE EVENT FOR CUSTOMERS

Buying a home is a highly emotional and aspirational transaction that represents a key life event for customers. Serving this need with as few pain points as possible can make a lasting impression on the customer's relationship with the bank.

TOP 10 REASONS CITED FOR HOME OWNERSHIP ASPIRATION[2]	
1	Having a good place to raise children
2	Better physical safety for your family
3	More space for your family
4	Control over living space, e.g. renovations
5	Paying rent is not a good investment
6	Allows you to live in a nicer home
7	A good financial opportunity
8	Allows you to select a community that shares your values
9	A means to build wealth that can be passed on
10	More convenient location closer to work, family, and friends

LEVEL OF CUSTOMER INSIGHT IS UNPARALLELED

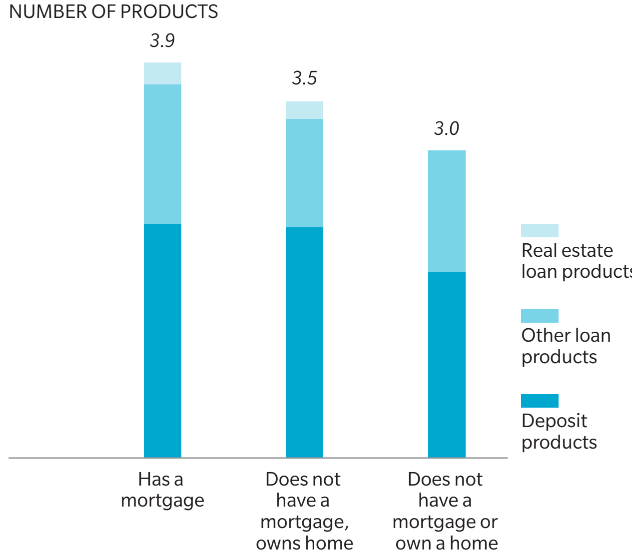
The mortgage application process reveals deep financial and demographic information on customers, which may be used to identify optimal cross-sell opportunities for other banking products.

MORTGAGE CUSTOMERS ARE DESIRABLE BANKING CUSTOMERS MORE BROADLY

Consumers who qualify for a mortgage tend to have higher incomes and are greater users of banking products overall, making relationships with them attractive.

EXHIBIT 1: MORTGAGE CUSTOMERS*

COUNT OF PRODUCTS HELD BY MORTGAGE STATUS (EXCL. MORTGAGE) AND AVERAGE INCOME BY DEMOGRAPHIC



	Has a mortgage	Does not have a mortgage, owns home	Does not have a mortgage or own a home
% with annual income greater than $75 K	*53%*	*32%*	*15%*

Source Oliver Wyman Survey of Consumer Finances (Q1/2012)

* "Other loan products" include auto, credit card, other installment, payday, and other loans. "Deposit products" include traditional checking, savings, online checking, online savings, money market deposit, and CDs. "Real estate loan products" consists of home equity loans/lines of credit.

1 A bank with a customer's traditional checking account.

2 Based on share of mortgage holders considering the reason to be major in buying a home. Other reasons include tax benefits associated with owning a home, good retirement investment, something to borrow against if needed, a symbol of success or achievement, and motivation to become a better citizen and engage in important civic activities.
Source: Fannie Mae National Housing Survey (Q4/2011).

CUSTOMERS WHO CONSOLIDATE THEIR MORTGAGE AND PRIMARY BANKING RELATIONSHIPS WITH ONE BANK TEND TO HAVE DEEPER RELATIONSHIPS WITH THAT BANK

Our research shows that customers who consolidated mortgage and primary checking also have a higher share of their other product holdings at their primary bank. It is important to recognize that while the mortgage product may have played a role in deepening the relationship, the stronger driver is likely these customers' general preference to consolidate products at a single institution, i.e. this cross-sell may have happened naturally even without much effort from the bank.

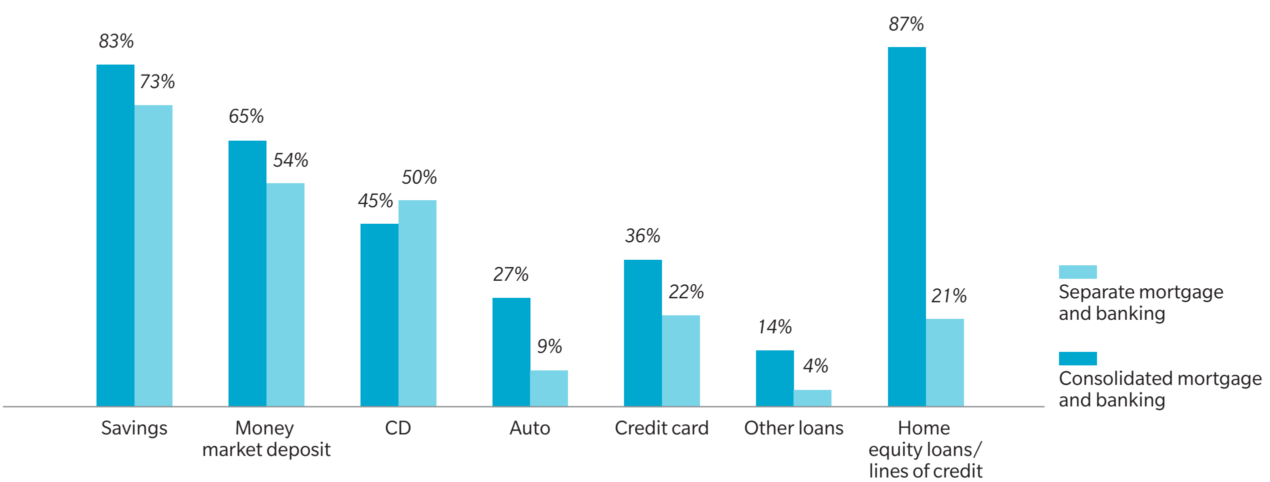
THE CHALLENGE

CONSOLIDATION IS THE EXCEPTION, NOT THE NORM

Customers who consolidate their mortgage and primary banking relationships with one bank are a minority. Most customers, even those who express a preference for consolidation, do not consolidate in practice.

EXHIBIT 2: HOW PRIMARY BANK SHARE OF NON-MORTGAGE PRODUCTS VARIES BY MORTGAGE CONSOLIDATION BEHAVIOR*

PRIMARY BANK'S SHARE OF OTHER PRODUCT HOLDINGS FOR CUSTOMERS

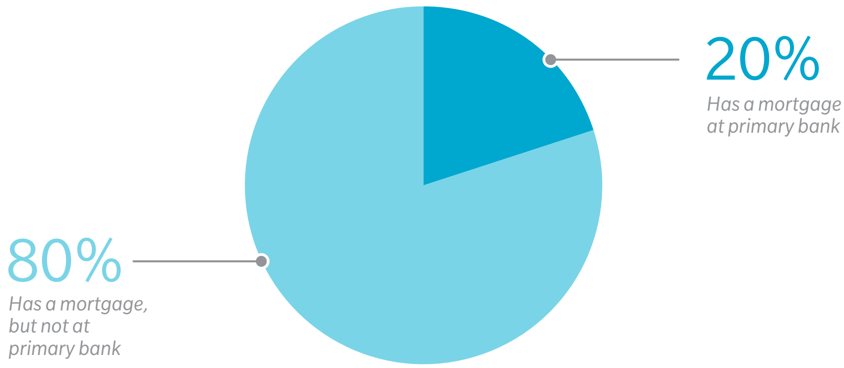


Source Oliver Wyman Survey of Consumer Finances (Q1/2012)

* Share of products based on count of products held

EXHIBIT 3: ONLY 20% OF CUSTOMERS OBTAIN THEIR MORTGAGE FROM PRIMARY CHECKING BANK

MORTGAGE CUSTOMER RESPONDENTS ONLY*



Source Oliver Wyman Survey of Consumer Finances (Q1/2012)

* Even for the 17% of customers who "strongly agreed" with the statement, "Ideally, I would keep all products at one financial institution", the percentage who actually consolidated mortgage and banking was only 27%

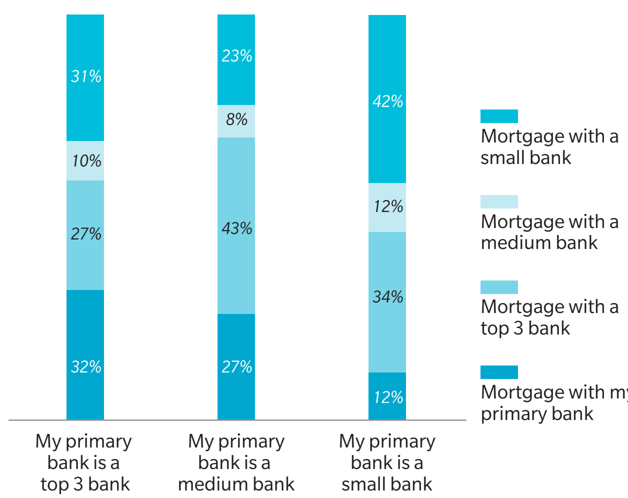
EVEN LARGE BANKS STRUGGLE TO PROMOTE CONSOLIDATION OF MORTGAGE AND BANKING RELATIONSHIPS

The mortgage market is highly concentrated, with the top three players accounting for nearly 40% of all originations.[3] Given their high market share in both mortgage and banking, these banks tend to have more customers who consolidate their primary checking and mortgage. However, even for them, consolidated relationships are a small share of all mortgage customers. Plenty of their banking customers get mortgages elsewhere, and plenty of their mortgage customers have their checking relationship elsewhere.

EXHIBIT 4: MORTGAGE MARKET SHARE AMONG PRIMARY CHECKING HOUSEHOLDS*

HOUSEHOLDS WITH A MORTGAGE AND A CHECKING ACCOUNT ONLY

SHARE OF CUSTOMERS



Source Oliver Wyman Survey of Consumer Finances (Q1/2012)

* Top 3 mortgage banks are Wells Fargo, Chase and Bank of America. Medium banks (next 5) include U.S. Bank, Citibank, SunTrust, BB&T and Fifth Third. Bucketing derived from rankings based on Inside Mortgage Finance: Top 100 Mortgage Lenders 6M2013

3 Inside Mortgage Finance: Top 100 Mortgage Lenders 6M (2013).

PRIMARY BANKS DO NOT APPEAR TO BE ADVANTAGED IN OFFERING MORTGAGES

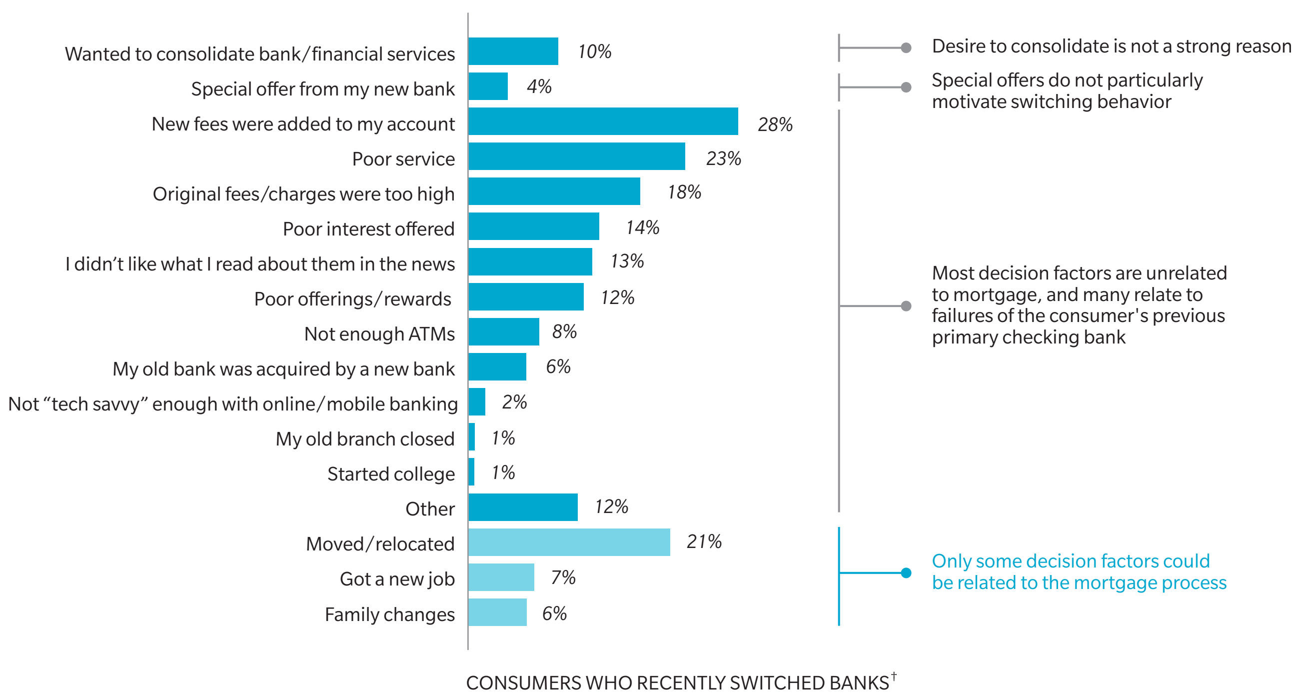
When selecting mortgage lenders to apply with, customers consider competitive pricing to be the most important factor. Among remaining factors, many are just as important as an existing relationship, including referral by a realtor or developer (for purchase mortgage customers), reputation for good customer service, or referral by a colleague, friend or family member. Convenience of branch locations, a potential advantage for primary banks, is among the lowest ranked factors, which also include strength of brand and quality of marketing materials. Once they receive quotes or pre-approvals, customers overwhelmingly consider pricing to be the key decision factor. None of this suggests a competitive advantage for most primary banks.

USING MORTGAGES TO ATTRACT PRIMARY BANKING RELATIONSHIPS MAY BE TOO LOFTY A GOAL

While lenders often sell mortgages to customers with a primary banking relationship elsewhere, cross-sell of primary banking to these customers is limited The Oliver Wyman Survey of Consumer Finances shows that deposit products are "sticky" financial products – customers rarely switch primary banks (in a given 18 month period, only 10-15% of customers switch). When they do switch, their stated reason is most frequently the incumbent bank's failure to deliver rather than a desire to consolidate financial services products elsewhere, or special offers from other banks.

EXHIBIT 5: REASONS FOR SWITCHING PRIMARY BANKS *

WHAT WERE THE MAIN REASONS YOU DECIDED TO CHANGE YOUR PRIMARY BANK?
BASED ON RESPONDENTS WHO SWITCHED PRIMARY BANK IN LAST 18 MONTHS (12% OF ALL RESPONDENTS)



Source Oliver Wyman Survey of Consumer Finances (Q1/2012)

* Respondents were asked to check all that apply

† Defined as consumers who switched their primary checking bank with within the last 18 months; Consumers are not counted as a 'switcher' if their new bank was acquired by their old bank and they did not actively switch banks

Our research also suggests that a fair share of customers find it difficult to justify consolidation of financial products with one provider, citing concerns around proximity of a new bank's branches, breadth of their services, pricing, and the effort required to switch.

Even if banks are able to address these concerns, it is not clear that many customers will care to consolidate their mortgage and primary banking relationships – some customers exhibited a level of indifference specific to mortgages, indicating that they held all financial products with one institution, save for their mortgage, and did not intend to change that.

EXHIBIT 6: REASONS WHY CUSTOMERS DO NOT CONSOLIDATE FINANCIAL SERVICES RELATIONSHIPS

EXPLANATION	ILLUSTRATIVE QUOTES
Value placed on brand and specialization	"I am loyal to my small hometown bank, but I wanted to go with a national bank for my mortgage."
Locational convenience	"I would like to consolidate everything to [mortgage provider], but they do not have a local branch where I live."
Price	"Service and fees associated with each product make me shop for best deal."
Breadth and quality of offerings	"No one financial institution suits all of my needs and preferences." "Each institution offers different advantages for their different products."
Hassle factor and lack of urgency	"It is a lot of work to move everything to a new bank." "I have not gotten around to it." "It is not important enough to go through the trouble of getting all at one institution."
Mortgage is a unique and separate product	"I presently have everything except my mortgage in one institution. I will not change that."

IMPLICATIONS

Cross-sell into and out-of a mortgage relationship are both attractive in theory, but uncommon and challenging in practice. Consequently, the strategic role for mortgages is most often:

- As a stand-alone business with attractive product-specific economics
- As an accommodative product sold to the minority of primary bank customers that prefer to consolidate their relationships

Due to the scale requirements and compliance burdens, pursuit of mortgage as a stand-alone business is likely to be feasible and attractive primarily to large banks and specialist lenders.

However, all banks should consider providing mortgages as an accommodative product to capitalize on the available, albeit limited, customer demand among consolidators. Outsourcing options can be considered to execute this strategy in a cost-effective manner.

While there are some clear limits to mortgage cross-sell potential, we see several opportunities to improve performance:

UPDATE BASIC MARKETING AND SALES APPROACHES

Ensure that all primary banking customers are aware of the bank's mortgage product offerings and that sales representatives can easily identify customer demand for a mortgage, i.e. leave no natural opportunity on the table. In addition, ensure that customers applying for mortgages are aware of the bank's primary banking and other products and encouraged to purchase them. In a recent mystery shopping exercise we observed that few banks consistently attempted these forms of low-effort cross-sell.[4]

4 See the Oliver Wyman "Point of View" "*Highlights from the 2013 Oliver Wyman Mystery Shopper: Customer Discovery and Relationship Selling*"

CONSIDER A SEGEMENTED APPROACH FOR HIGHER-EFFORT CROSS-SELL

The customer's reasons for applying for a mortgage and their relationship status with the bank can be useful in determining cross-sell potential.

Existing bank customers getting new mortgages from the bank should be a high priority for multi-product cross-sell efforts as they have demonstrated a willingness to consolidate, and the mortgage application will provide a detailed profile to help target cross-sell offers. Given their natural inclination to consolidate, these customers likely do not require high cost tactics or incentives, and banks should not overspend to get such sales. Additionally, banks may consider simplifying the mortgage application process for existing bank customers by pre-populating forms using information already available in bank systems. This is only a partial reduction of customer hassles, as the typical mortgage application requires significantly more information than what a bank may have on file, but banks may find this worthwhile if the required investment is low.

New customers getting new mortgages should be the next priority and banks should first attempt to cross-sell a primary checking account to gauge the customer's level of interest in consolidation. There are two types of new customers that may warrant use of tailored tactics to establish a checking relationship:

- Customers who are getting a mortgage due to a recent or pending life event may be more likely to switch their primary bank. For example, in the coming purchase mortgage market banks may see a higher percentage of applicants getting purchase mortgages due to a long distance move away from their current bank, generating the need to find a more convenient bank. For these customers, some higher cost attempts may be worthwhile (e.g. outreach by a branch manager, customized letter displaying conveniently located bank branches and ATMs near the purchase property, prepopulated checking account opening forms using information from mortgage application, etc.).
- Affluent customers, as identified by their needs for larger loans and information available in the mortgage application, may be worth pursuing through higher cost acquisition tactics (e.g. an in-person visit, concierge services for checking account setup) since the high potential return may justify the costs even taking into account expected success rate. Banks may also tailor mortgage terms and product features at the margin for large nonconventional loans, particularly if the loans are to be kept on balance sheet.

Refinance customers are likely to be the least attractive target for cross-sell (excluding other real estate credit) as they neither demonstrate a willingness to consolidate, nor signal a heightened need to switch banks. That said, checking customers may be good targets for mortgage refinance offers as their transaction data may be used to identify their current mortgage and how long they have had it, thereby assessing whether they would benefit from a rate reduction.

BE CAREFUL WITH RELATIONSHIP RATE DISCOUNTS

Unless they are used specifically to generate profitable multi-product relationships with affluent customers, the net result is likely to be a loss of profits. Instead, consider the use of lower-cost relationship enhancing benefits on primary accounts, such as ATM fee refunds, free checkbooks, or elevated service levels (e.g. dedicated service lines) for affluent customer segments.

CONCLUSION

Mortgage generally is not effective as a relationship deepening product, but there are still attractive pockets of opportunity for improved cross-sell. Banks should consider higher-effort cross-sell tactics focused on those niches where expected returns justify the costs, while avoiding generalized efforts that may be value-destroying.

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation.

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