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How important is your virtual branch?

Branch accounting, it's the core of most FI's core general ledger setup. A new consumer opens an account at the Pine Street branch; they are automatically assigned to that branch on the G/L, regardless of the fact that they do the majority of their transactions at the Oak Street branch. Or worse, they open the account at the Pine Street office and then perform virtually all of their transactions ... online. The issue of how to account for all income and expense within a traditional G/L structure is a critical one that drives staffing and investment allocation. However, most FIs don't consider the virtual branch the same as a physical branch, certainly not from an accounting perspective. It is not set up as a separate branch on the G/L and therefore, the total profitability of customers/members that are banking virtually are not reflected on any Profit/Loss reporting. A physical branch P&L has all of the income and expense of the customers assigned to it, so you can easily see branch profitability. Without the same accounting treatment for the virtual branch, the CFO/CEO often only sees the expense associated with the virtual branch, skewing it to show the virtual branch as just a cost center instead of revealing a profitable branch in which investment is appropriate.

This makes the job of deciding to invest in new virtual branch technology difficult for most C-suite occupants. Most CEOs and other senior decision makers are not experienced in operations; they are generally lenders or investment experts. So when the conversation turns to advancements in mobile remote deposit capture, biometric security, or online account opening and these executives are quickly put out of their comfort zone. They would likely think of only 2 things: "Is this risky, something that might cause a public relations nightmare if compromised"? Secondly "How much income will this service generate to offset the cost"? Without getting a comfort level on both of these issues, critical virtual branch investment will go unfilled.

The challenge comes with the answers to these two questions. First, most IT and other similar technical staff are responsible for mitigating risk in their effort to identify exposure and lessen the effects of possible threats. While this is a great strategy, the risk may be perceived as greater than it really is. All the CEO hears is "risk", "fraud", "FFIEC", "compliance" and so on. This often freezes decision making by allowing perceived risk to outweigh actual risk. As with EVERYTHING we do as bankers, there is risk. It is our job to mitigate that risk and we have the tools to do exactly that. But the CEO must have a comfort level that the actual risk can be appropriately remediated by the tools deployed.

Assuming you have addressed the risk issue, then the CEO is looking for a Return on Investment (or ROI). This they know: when income exceeds expense, you have a profitable service. So they legitimately want to know if the new service, regardless of the elements of it, will be profitable. If all that is counted is the expense associated with a service, then it will NEVER be profitable. This makes it extremely difficult for a CEO to place the value of a new service in context to overall profitability of that "branch". The problem is how to count the associated revenue that is associated with a new service. Is it just fees that can be directly attributed to a specific online activity? What about fees that are generated due to the transaction initiating via online banking? The ability to assign specific income and expense events to a "branch" becomes the critical element to determine overall profitability. This brings us back to the original point about branch accounting and the G/L. Without a true virtual branch on the G/L, how will senior decision makers have the information necessary to make an informed decision with confidence?

What is needed is for banks to truly account for the virtual branch and get their core providers to change the way the general ledger is calculated. No problem, right? Stay tuned, I'll bring you part 2 of this discussion of the virtual branch in the next blog post.