Future Trends in Banking

NH & VT Bankers CEO Conference

Presented to:

NHBA
New Hampshire Bankers Association

VBA
Vermont Bankers Association, Inc.
"With Vermont's Banking Community, Vermont Prospers"

Presented by:

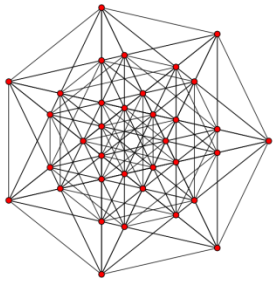
Loomis & Co., Inc.
and its wholly owned subsidiary,
NORTH
Capital & Advisory, Inc.
EAST

May 16, 2014

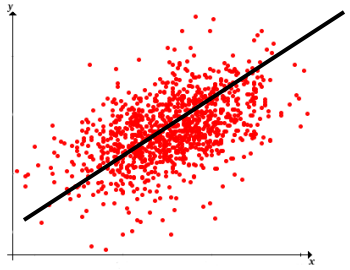
Background

To develop successful initiatives for the future, we need to understand the past and present.

- **Linear Programming Models**



- **Regression Analysis**



- **This won't help in a Black Swan Scenario though**

“

It’s tough to make predictions, especially about the future.

Yogi Berra

1996 Outlook for NH/VT Bankers

- Large banks start to develop computer systems and models to help them manage their best customers (18 years ago)

1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014

Demographic Waves of Wealth Management Opportunities

Population (millions)		National		
	Age	1990	2000	2010	Growth
	<25	90mm	91mm	90mm	0
Borrower Age Groups	25-34	44	37	38	-14%
	35-44	38	44	37	-2%
Saver/Investor Age Groups	45-54	26	37	43	69%
	55-64	21	24	35	65%
	65-74	18	18	21	14%
	>74	13	17	18	39%
	Total	250	268	282	13%

Source: U.S. Census Bureau data and NECA.

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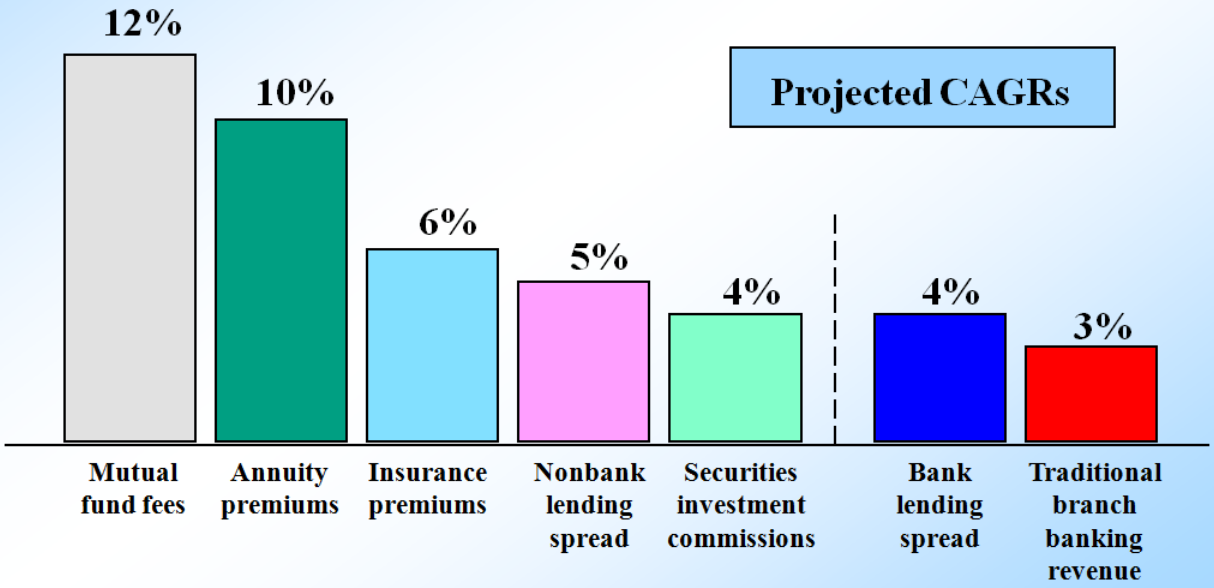
1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014

1996 Outlook for NH/VT Bankers

Branch Banking Revenue Growth Will Be Limited



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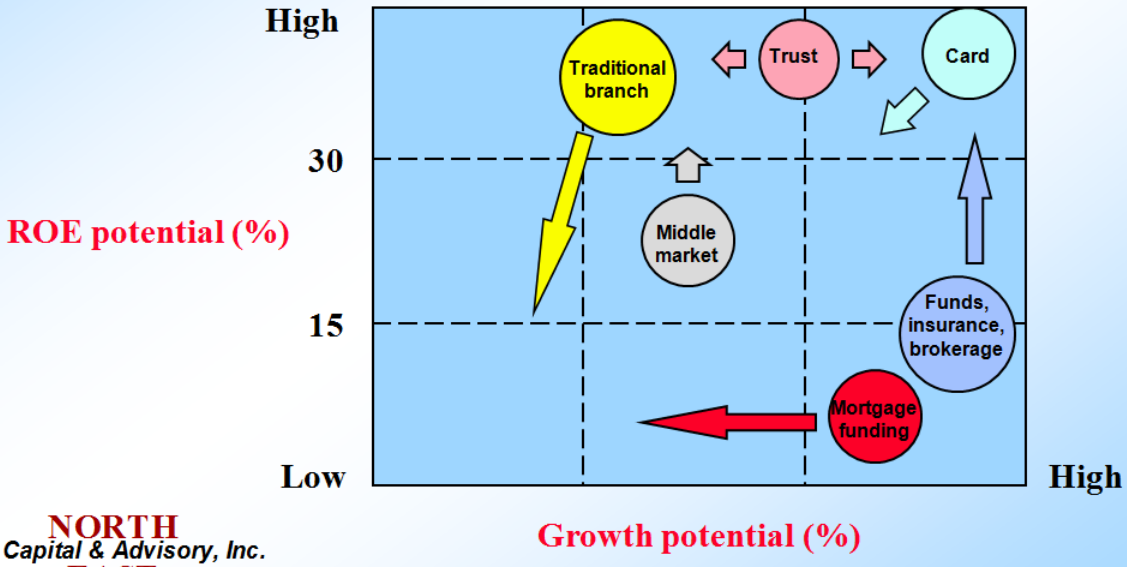
Source: BAI estimates

1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014

Real Opportunities

- **Units within traditional regional franchise banking are in flux**



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Best are:

Trust

Middle Market

Insurance, etc.

1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014

Strategies for Success

- **Banks are designing products to "nudge" customers to self-service delivery**

Account features	Wells Fargo "ATM-Checking"	B of A "Versatel Checking"	SeaFirst "FirstChoice"
Monthly service charge	$3.50-$6.00	$5.00	None
Minimum balance requirement	None	None	None
Unlimited check writing	Yes	Yes	Yes
ATM usage charge (proprietary/local)	None	None	None
Banker assistance charges (branch or telephone)	*$5.00 monthly charge for any in-branch teller assistance or "Excessive" telephone charges	*$4.00 monthly charge for any in-branch teller assistance	*$3.00 per "routine" branch teller or branch/telephone CSR assistance

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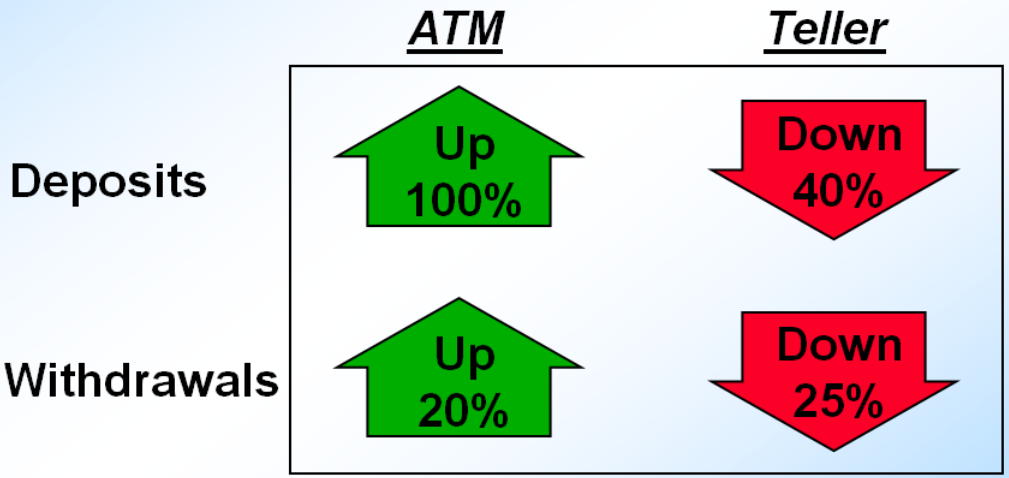
Source: NECA Analysis

Changing Customer Behavior

- The $3 charge heard around the world



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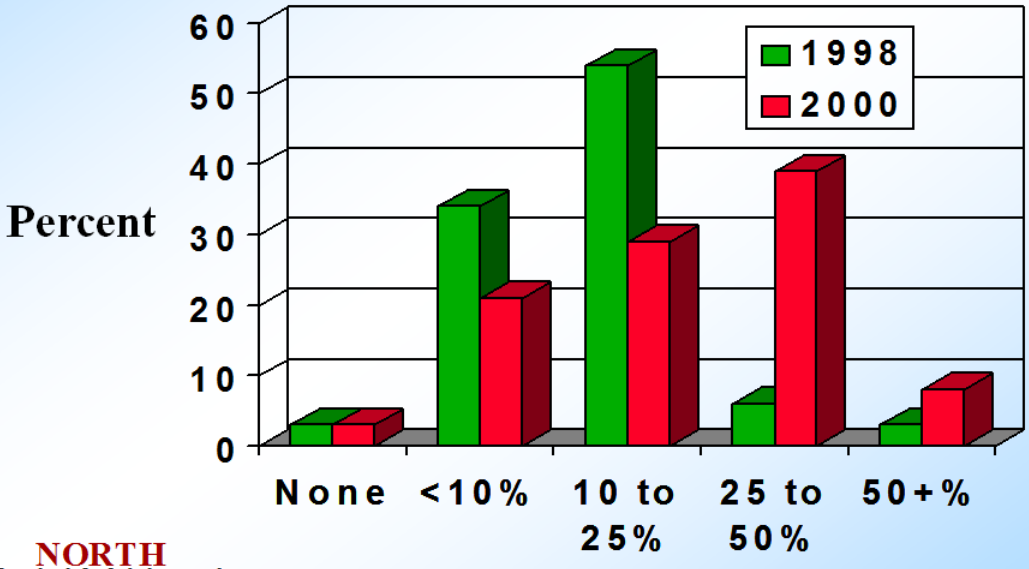
Smaller Branch Networks

Branch closings by 1998 and 2000.



Source: BAI survey

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1996 Outlook for NH/VT Bankers

5 Problems/5 Solutions

● 20% of customers subsidize everyone else	● Hold onto them; give them "freebies"
● Most high profit customers tied to branches	● Don't move too fast and dislocate them via branch closings
● Transaction hogs	● Move them to lower cost delivery mechanisms
● Overhead burden increase as customers migrate to self service channels	● Make these costs variable, not fixed
● Marginally unprofitable customers have high inertia	● Value/service trade-offs aren't monitored. Amount of service should be proportional to value received.

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1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014

Challenges Facing the Industry

- Margin compression
- Nonbank competitors
- Employee productivity (e.g. cut costs)
- Maintaining technological competitiveness
- Competition from mergers
- Regulatory compliance costs increasing
- Revenue growth

NECA's Warnings From The Past

- **Improve Non-Interest Income.**
- **Reduce Non-Interest Expenses.**
- **Beware of Smugness.**

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Some Suggestions

- **Fact: best customers (age 70+) are dying.**
- **Banks need to grab new customers, preferably 40-60 year olds, who are net savers of money.**
- **Who has a relationship product that is focused on this segment?**

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GROWING NON-INTEREST INCOME

1. Acquire Insurance Agencies:

	Insurance Fees as a % of Op. Rev.	
	1996	2001
Oneida Financial Corp. (MHC)	0.0%	30.5%
First Niagara Financial Group, Inc. (MHC)	0.0%	14.7%
Tompkins Trustco, Inc. *	0.0%	6.0%

** Has acquired 3 insurance agencies in the last year.*

2. Acquire Asset Management Firms:

	Trust/Advisory Fees as a % of Op. Rev.		
	1996	2001	CAGR
Boston Private Financial Holdings, Inc.	24.5%	42.4%	68.9%
Washington Trust Bancorp, Inc.	11.1%	16.3%	23.8%

3. Nuisance Fees Focus (No Waivers):

	Service Charges as a % of Op. Rev.		
	1996	2001	CAGR
Abington Bancorp, Inc.	16.7%	18.2%	19.3%
Connecticut Bank of Commerce	17.1%	12.4%	41.2%
Granite State Bankshares, Inc.	5.4%	7.4%	32.2%
Northway Financial, Inc.	4.7%	5.4%	10.1%

NEW HAMPSHIRE BANKERS ASSOCIATION

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REDUCING COSTS / IMPROVE EFFICIENCY

1. Acquire banks or branches and cut expenses:

	Efficiency Ratio	
	1996	2001
North Fork Bancorporation, Inc.	39.0%	30.6%
Roslyn Bancorp, Inc.	52.2%	32.3%

2. Internal Focus:

	Efficiency Ratio	
	1996	2001
New York Community Bancorp, Inc.	39.1%	33.4%
Brookline Bancorp, Inc. (MHC)	29.0%	36.7%
TrustCo Bank Corp NY *	39.5%	40.9%
Granite State Bankshares, Inc.	68.4%	55.7%

** Can set up and operate a de novo branch for $250,000 per year (total).*

NEW HAMPSHIRE BANKERS ASSOCIATION

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2006 Outlook for NYBA

NYBA

Options

➢ Do nothing	➡ The Waiting Game
➢ Create more risk	➡ Extend maturities Drop credit quality
➢ Make it up with volume	➡ Loan originations Wholesale borrowings
➢ Reduce reliance on interest rate risk	➡ Increase non-yield deposits or capital thru retained earnings Increase non-interest income (eg insurance, trust, asset management) Reduce non-interest expense Reduce wholesale leverage
➢ Merger & Acquisition	➡ Branch acquisitions Insurance, trust, asset management, etc. Whole bank deals

2

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Threats

- Limited profitability in NIM/ NIS.
  (Due to demographics and internet.)
- Most valuable customers are dying ⇨ Eventually
- Compliance costs out of control ⇨ Enron, etc.

Opportunities

- Mutual ⇨ Long-term focus
- Non-interest income ⇨ Time to develop.
- Acquisitions ⇨ 11 NH or VT deals since 2002.
- Big Banks ⇨ Focus on population centers.

2007 Outlook for NH/VT Bankers

Specific Forecast

- No vibrant rising tide, economically ⇨ 3-4% growth
- Spreads continue to narrow
- Small banks will sell or merge ⇨ Due to spreads & compliance costs
- Best management "team" wins ⇨ Think the Patriots
- Banks to become more advisory oriented, less "products" oriented ⇨ Capitalize on "TRUST"

Summary of the Past

Large banks develop computer systems to manage best customers
Demographic wave of wealth management opportunity
Branch banking CAGR revenues will be limited
Retail opportunities are trust, wealth management & middle market
Design products to "nudge" customers to self service
Expected branch closings
Operational solutions

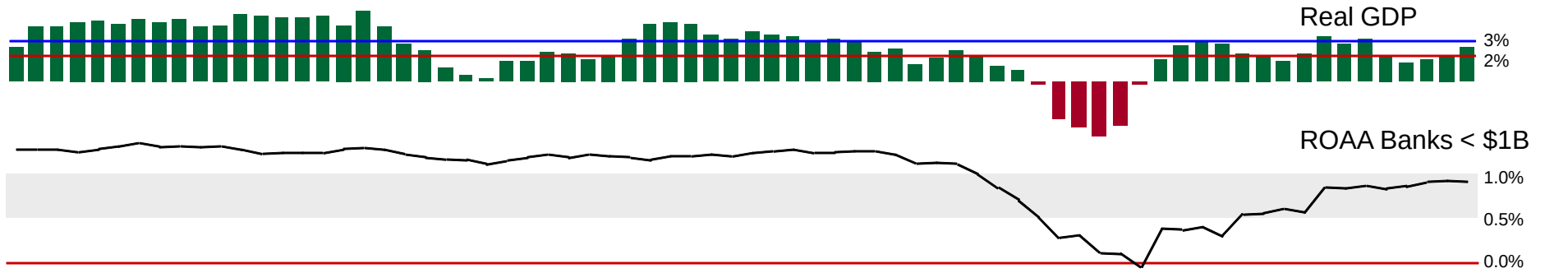
Challenges facing industry

Past warnings
Past suggestions

Growing non-interest income
Improving efficiency

Declining NIM options

Threats & opportunities
Specific forecast



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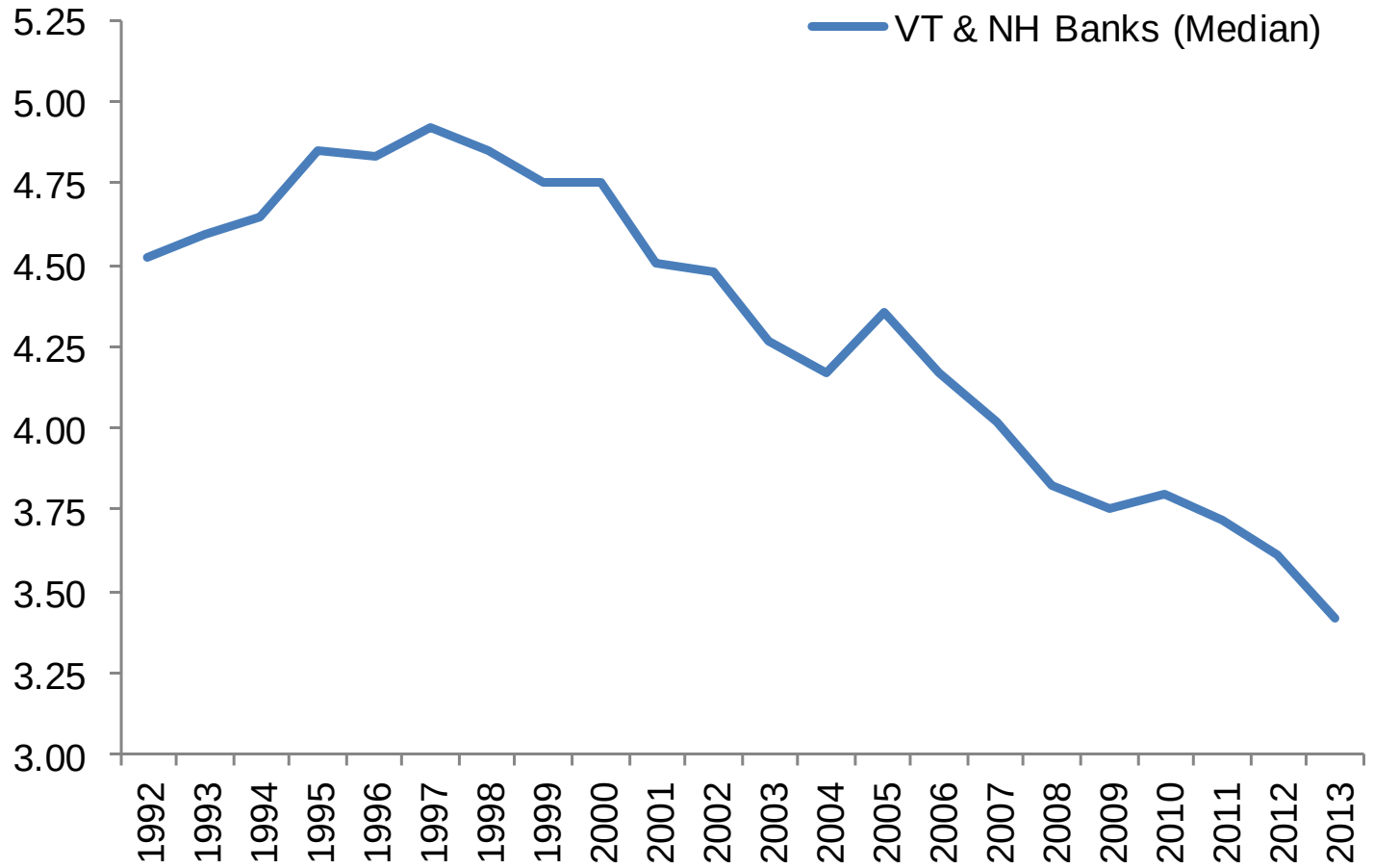
Present Conditions

NIM (%)

Down 100 bps since 1992!



Source: BankInsight

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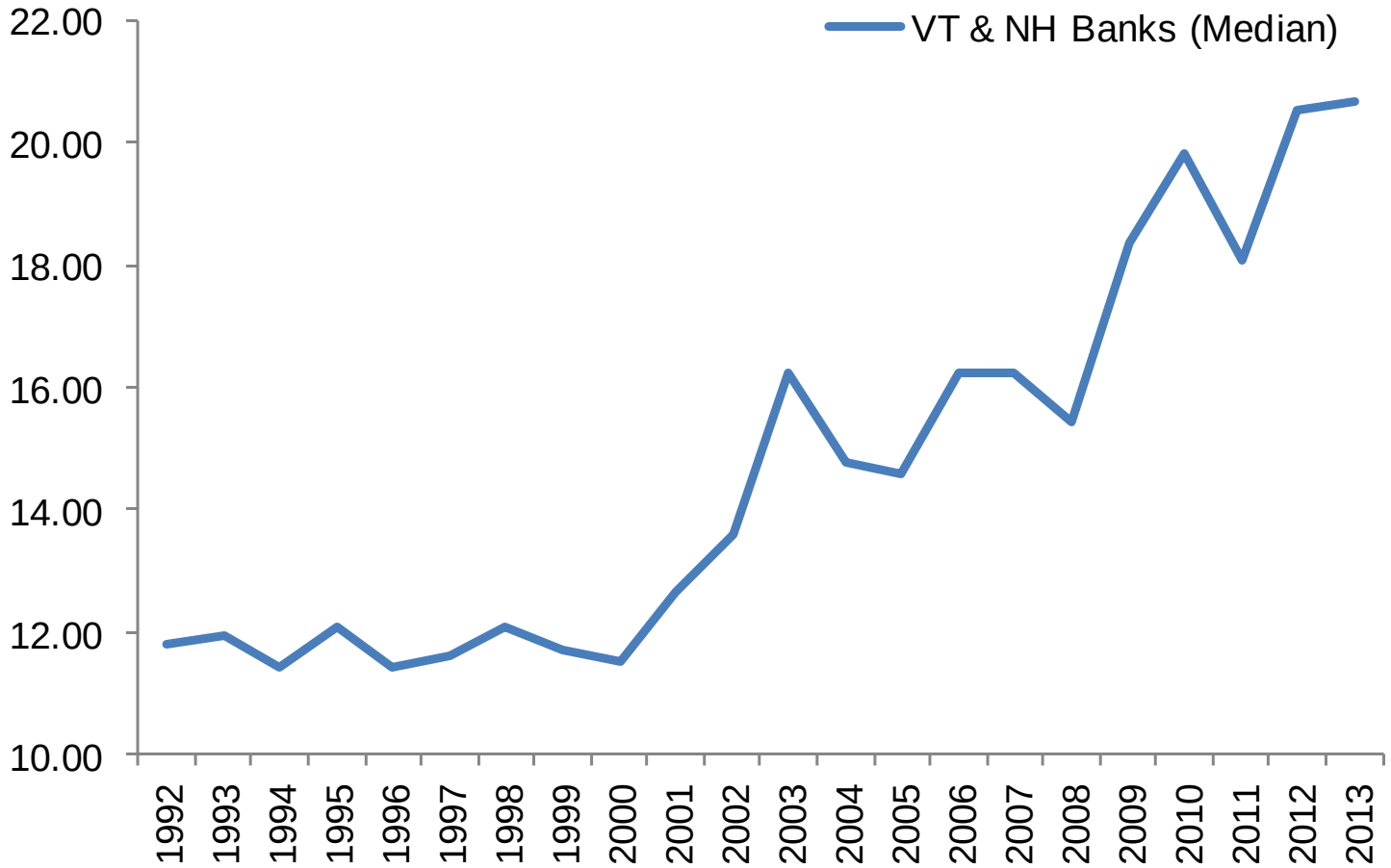
Present Conditions

Noninterest Income/ Total Revenue (%)
(Improving. Is it enough?)



Source: BankInsight

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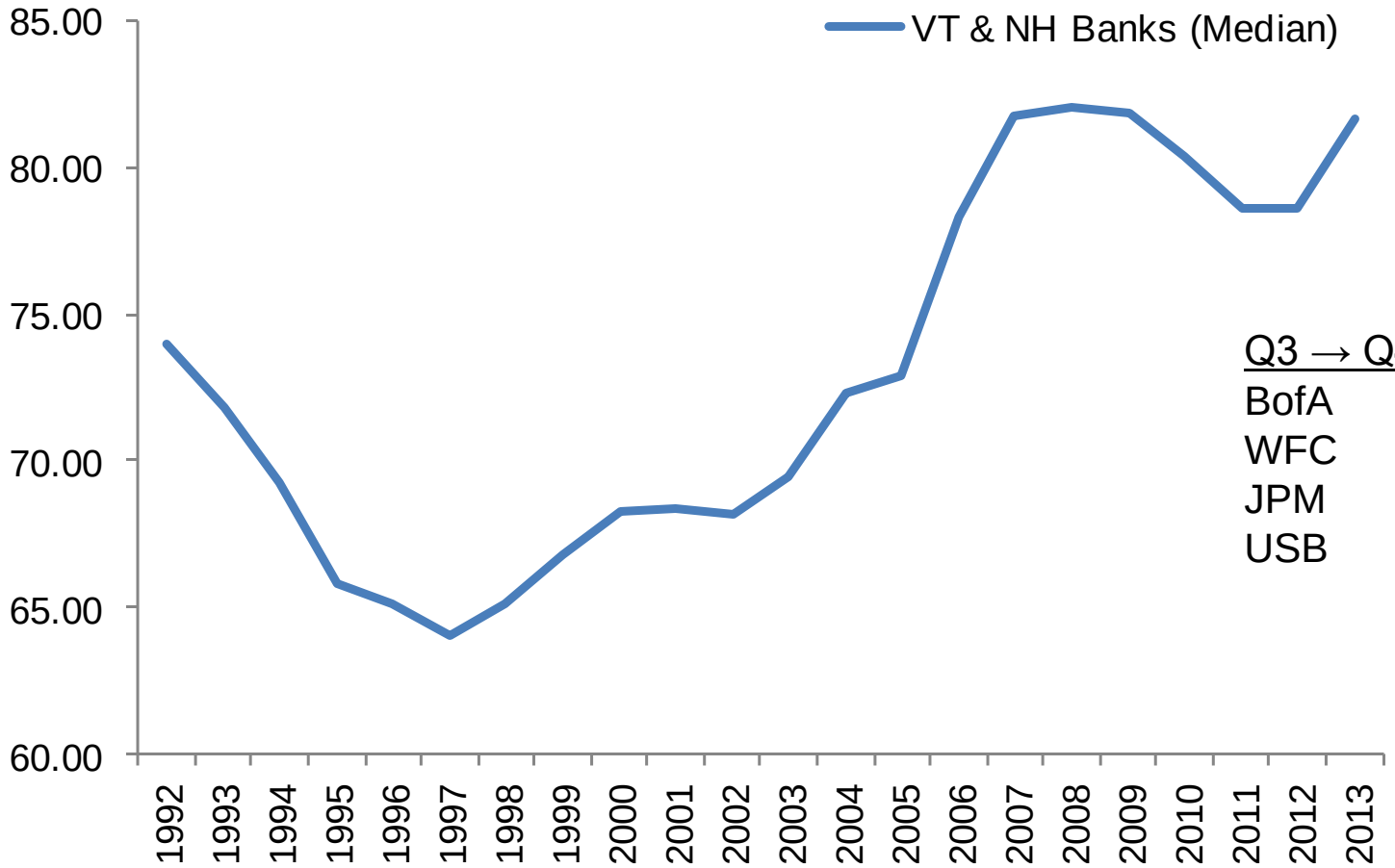
Present Conditions

Noninterest Expense/ Total Revenue (%)
(Going the wrong way, but large banks are the same)

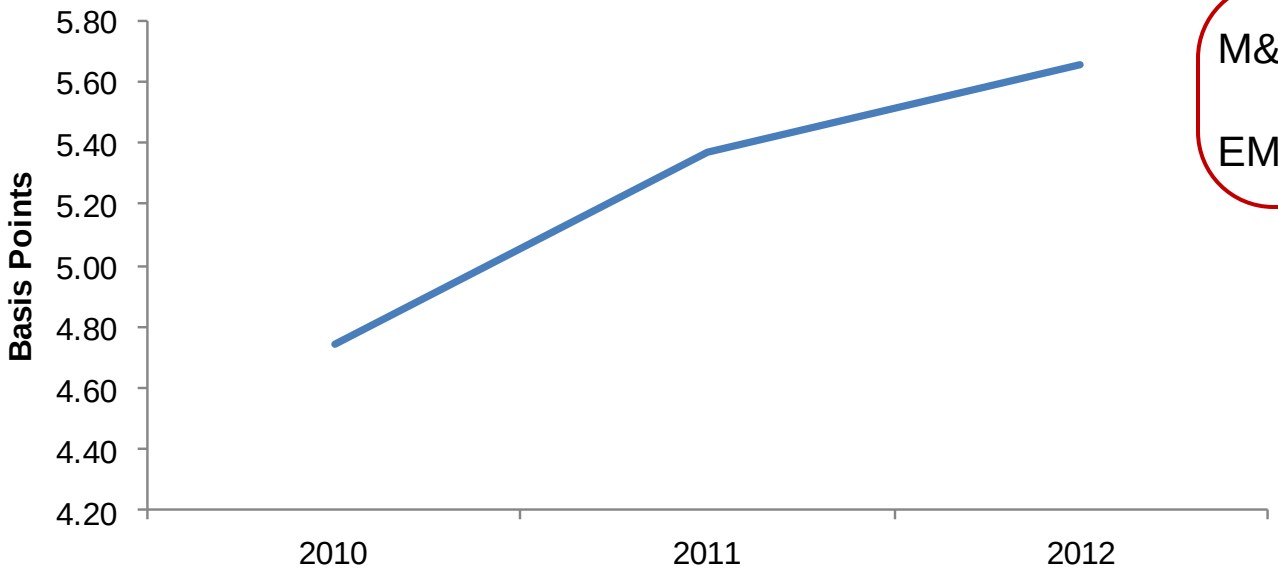


Q3 → Q4 Efficiency	
BofA	75 → 80%
WFC	59 → 59%
JPM	102 → 67%
USB	52 → 55%

Source: BankInsight

Direct Compliance Cost/ Avg Assets ≠ Others

(Our surveys)



M&T	$265	10% of Expenses
EMPK	2.3	14% of Revenues

$500 million assets = $290,000

2.5% noninterest expense = $12.5 million

4% gross yield = $20 million

1% noninterest income = $4.6 million

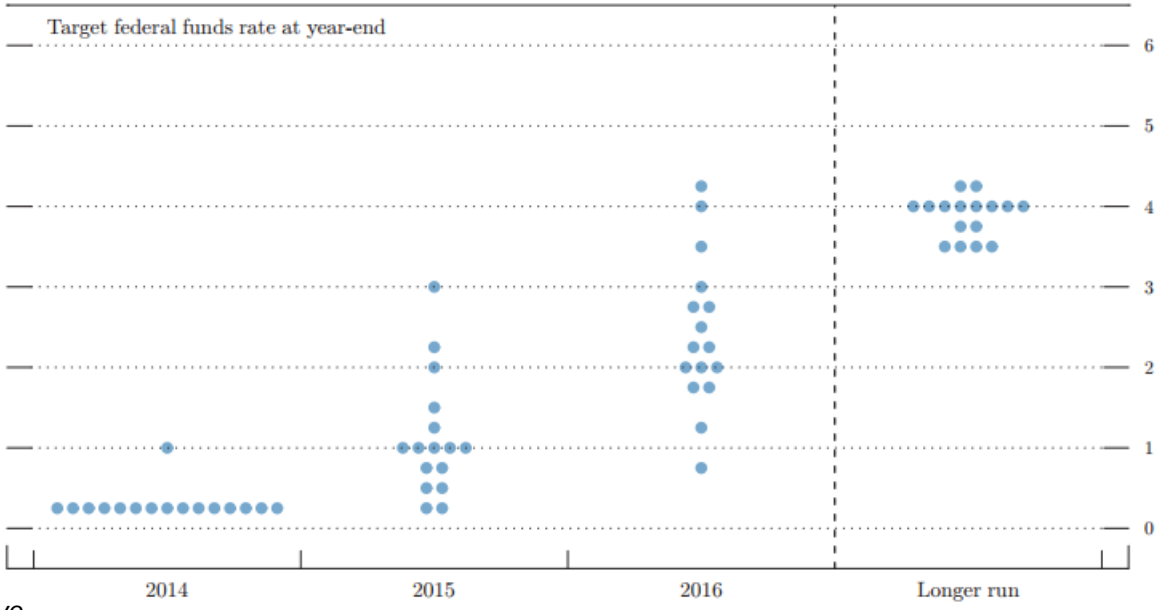
Our survey suggests 1.2% of revenue and 2.3% of expenses

Forecasted Rates

Long periods of low 2-10 year Treasury spreads

- 2005 – Current (Over 9 Years, & likely 12 years)
- 1994 – 2000 (7 Years)
- 1977 – 1982 (6 Years)
- 1958 - 1970 (13 Years)

Interest Rate Forecast of Federal Reserve FOMC Board Members as of March 2014



Source: Federal Reserve

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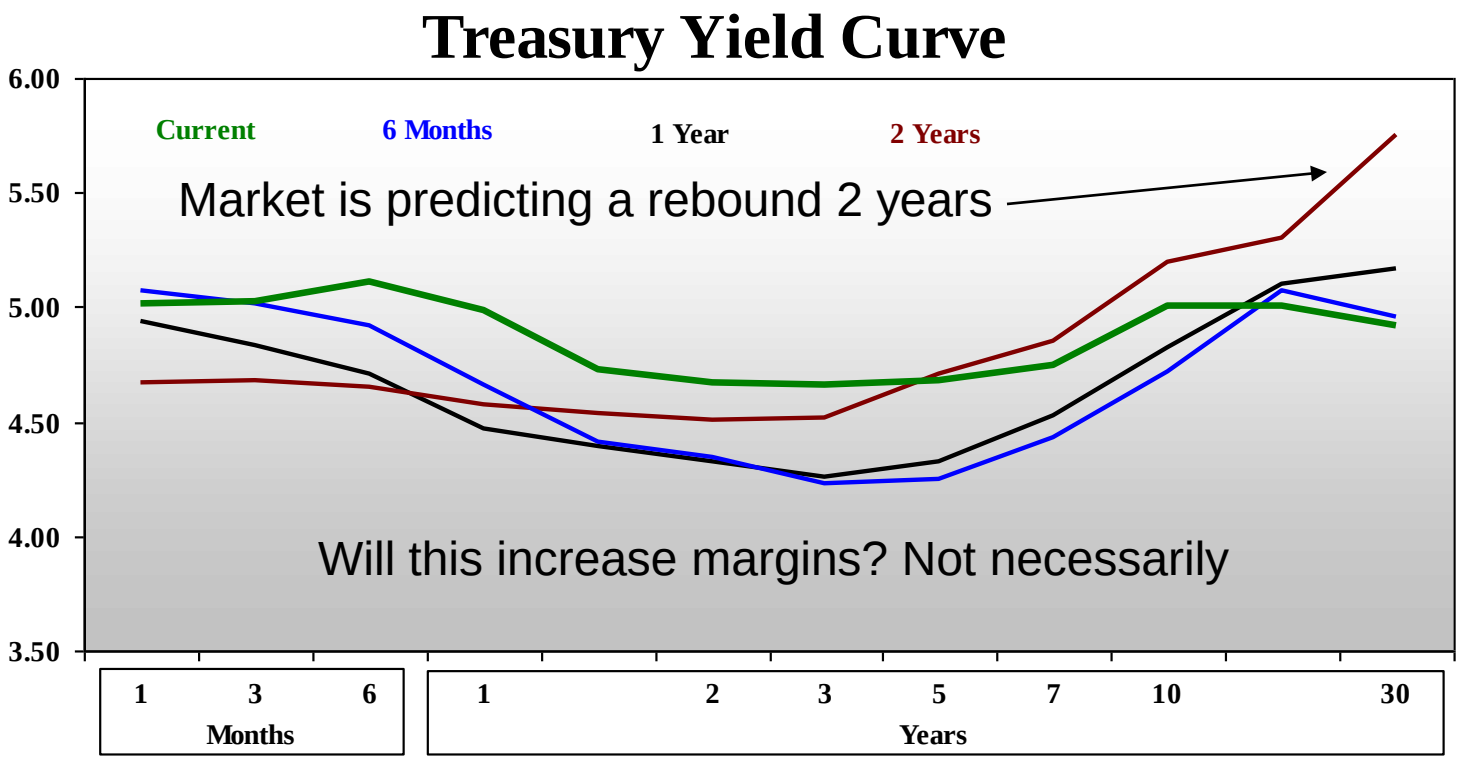
Forecasted Rates

In 2007, market anticipated 2 more years of flat rates.

Has been 7 years

So much for “market”!



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Age Trend and Income Trends

Population Profile	**2010 Census**	**2013 Current**	**2018 Projected**	**% Change 2010 - 2013**	**% Change 2013 - 2018**
Pupolation	19,378,102	19,728,279	20,233,649	1.8%	2.6%
Population Age 0 - 20	4,897,511	4,949,991	4,929,653	1.1%	-0.4%
Population Age 20 - 39	5,324,396	5,436,235	5,579,661	2.1%	2.6%
Population Age 40 - 64	6,538,252	6,612,287	6,557,262	1.1%	-0.8%
Population Age 65+	2,617,943	2,729,766	3,167,073	4.3%	16.0%
Median Age	38	38	39		
Household Income Profile	**2010 Census**	**2013 Current**	**2018 Projected**	**% Change 2010 - 2013**	**% Change 2013 - 2018**
Households	7,317,755	7,369,551	7,602,287	0.7%	3.2%
Households with income < $25K	1,686,523	1,681,328	1,400,372	-0.3%	-16.7%
Households with income $25K - $49K	1,569,917	1,560,574	1,381,146	-0.6%	-11.5%
Households with income $50K - $99K	2,135,594	2,175,402	2,587,467	1.9%	18.9%
Households with income $100K - $199K	1,442,533	1,465,327	1,681,494	1.6%	14.8%
Households with income $200K+	483,188	486,920	551,808	0.8%	13.3%
Median Household Income ($)	57,323	57,897	66,049	1.0%	14.1%

Source: BankInsight

Future Outlook

- **Thanks for hanging with me!**
- **Same themes apply** ⟹ **SURPRISE!!**
  i. Spreads will continue to shrink
  ii. Customer base aging supports wealth management initiatives
  iii. Efficiency rates under the gun, due largely to:
  iv. Compliance costs soaring
- **Great management can offset these themes, but excelling is increasingly hard**

If it was easy, everyone would want to be a banker!!

Specific Suggestions

OUTLOOK	WHAT TO DO	BEST OPTIONS
•Three more years of low rates	Nothing	
	Make it up in volume	Already being done
	Take interest rate risk	Not wise
	Increase credit risk	Not wise
	Gather more DDA deposits (30% of total deposits)	Major efforts
•Population Aging	Emphasis on wealth management, etc.	Smart revenue diversification
•Compliance costs soaring	Focus on efficiency	Maybe
	- Fewer branches	Maybe
	- Fewer employees	Yes
	- Productivity standards	Yes
•Branch closings/ consolidations increase	Community Banks – Maybe	Extreme caution!
	Large Banks – up to 40% of reductions	Great for community banks

Specific Suggestions (continued)

Size Matters

($000)	**2013**	**2014**		
Base Compliance Costs	100	250		
Capitalization	7.00%	7.00%		
Assets	100,000	100,000	200,000	250,000
ROA % (Before Compliance)	0.80	0.80	0.80	0.80
Net Income (Before Compliance)	800	800	1,600	2,000
Compliance Cost (After Tax)	60	150	150	150
Net Income (After Compliance)	740	650	1,450	1,850
Equity	7,000	7,000	14,000	17,500
ROE %	10.57	9.29	10.36	10.57

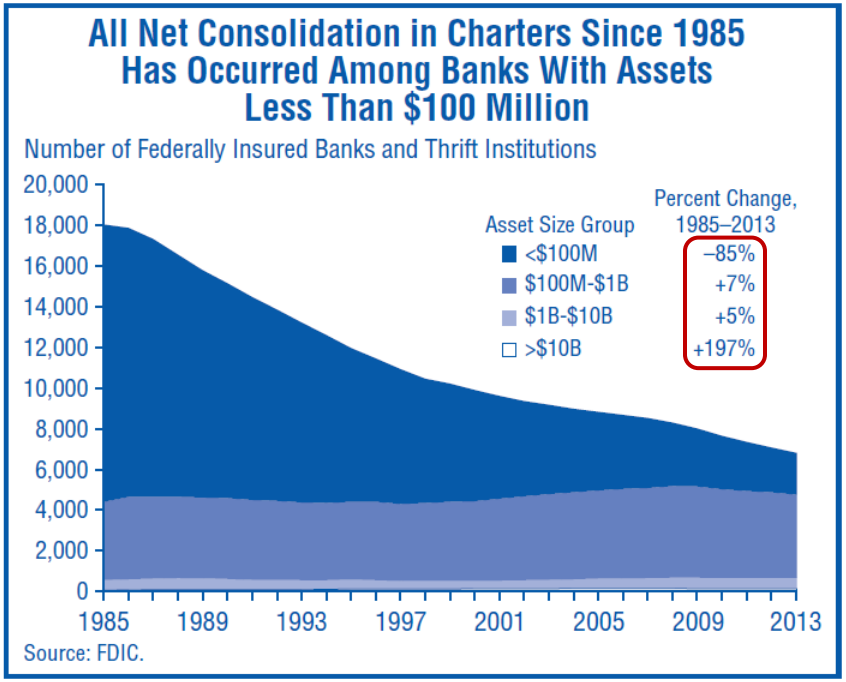
- To achieve the same results as a 0.80% $100 million in bank in 2013, in 2014, the Bank would need to be a 0.80% ROAA $250 million bank.

- What will base compliance costs be in 2020?

Size Matters

Evidence: 1) CORB, Nashua, and Randolph

2)



3) “Roughly two-thirds of mutuals surveyed by the American Bankers Association said they considered merger with another mutual. Forty percent gave it even odds that they would participate in a merger by 2019.” – Jackie Stewart, American Banker

Specific Suggestions (continued)

As Jim Collins suggests in “How the Mighty Fall”

- **Be disciplined, never give up your position of trust.**
- **Don’t be obsessed with growth, avoid competing on price.**
- **Avoid large bets if downside is intolerable.**
- **Do you have the right team in place? Management succession.**
    i. Responsibilities not jobs
    ii. Are they as passionate about the Bank as you?
    iii. Do they share credit and own failures?

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