CPG wire

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It's that time again, when we dust off our crystal ball to prognosticate about the future and take a look at 2016

2016 Year in Review

Stagecoach Robbery

In September, Wells Fargo admitted to having illegally opened unauthorized consumer accounts. The result has been severe criticism on Capitol Hill as well as public scorn. Saturday Night Live aired a sketch of a Wells Fargo banker forcing bank accounts onto individuals. Politicians are discussing bonus clawbacks. The industry is also receiving more regulatory scrutiny. The OCC sent formal letters in October to large and regional banks asking for information about sales practices and incentive-based compensation.

Trumpet Call

With Donald Trump's surprise presidential victory and the Republican Party's control of the House and Senate, banks are expecting a roll back of regulation that was implemented following the financial crisis. The president-elect's transition team has promised to dismantle the Dodd-Frank Act as they believe this regulation is a primary reason for slow economic growth. Though a full repeal of the regulation is not likely, it is expected regulatory relief will be had through the modification or elimination of provisions and will benefit banks of all sizes. With a decrease in regulatory burden, industry analysts and investors forecast banks to experience significant income gains, as shown by the KBW Bank Index's 13% increase the week following the presidential election, greatly outpacing the overall market.

A Fantasy Come True?

In October, the CFPB was declared "unconstitutional" by a Washington D.C. circuit court citing the inability for other government arms to review or dispute the regulator's judgments and actions. The courts have ordered that CFPB powers be curbed and that it face oversight by the White House. As expected, the CFPB has appealed this ruling, claiming the decision "compromises its mandate to function as an independent agency." If the ruling stands, leadership change within the regulator is expected as president-elect Donald Trump could fire Director Richard Cordray at will instead of "for cause."

If You Can't Beat 'Em

In December, the OCC announced special purpose federal charters will be granted to fintech companies that originate loans, take deposits, or pay checks. Such a charter would enable online lenders to fund themselves through FDIC-insured deposits and thereby avoid reliance on volatile secondary market funding. Fintech investors responded positively to the news with P2P lending leader LendingClub's stock jumping over 7% following the announce-

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Predictions for 2017

CPG and industry friends gazed into a crystal ball to predict that the following events will occur in 2017:

1. **Increasing healthcare costs and the magnitude of student loan debt will continue to be a drag on the economy.** New economic weakness will appear in multifamily housing and the automobile industry. ~ John Barrickman, New Horizons Financial Group

2. Financial services institutions will experience increasing credit problems in their income property portfolios. There will be sharp increases in the number of maturing loans which must be restructured in 2017 and 2018. **Rising interest rates will adversely impact debt service coverage ratios and result in higher capitalization rates reducing the value of income properties.** ~ Christine Corso, New Horizons Financial Group

3. Despite Republican control of the White House and majorities in both the House and Senate, Congress will **fail to make significant modifications to any of the major provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.** ~ Claude Hanley, Capital Performance Group

4. With the announcement by the **OCC that fintech companies can apply for national bank charters, expect to see many try to go that route in 2017 - especially online lenders.** A special purpose banking charter would enable online lenders to fund themselves through FDIC-insured deposits and thereby avoid reliance on the volatility of secondary market funding. It will also give them access to preemption from state laws. It's important to note that to garner deposit powers, the FDIC must approve the charter as well and it has not been as enthusiastic as the OCC. So it may be awhile before a charter is given to a fintech company focused on lending; however, we think it is inevitable that one will be granted. But those companies should be careful to study history. A national bank charter doesn't mean that the online lending operating model is necessarily viable long-term. Remember monoline credit card companies (First USA, Providian, etc.)? They were able to become category killers with the special charter, but they ultimately went the way of the dodo. Risk management and asset diversification are even more important than funding costs in banking. ~ Mary Beth Sullivan, Capital Performance Group

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2016 Year in Review (continued)

ment. However, the FDIC, which has not been as avid a supporter of the fintech industry, must approve the charter as well.

The Wait is Over

In June, the FASB issued the long-awaited final version of the Current Expected Credit Loss Standard for ALLL (CECL) accounting standard, which the ABA described as the most significant change to bank accounting ever. The new standard will alter how banks estimate loan losses using an "expected loss" notion where a life-of-loan loss expectation is recorded at origination. This will require banks to forecast multiple years into the future and take into account economic indicators such as interest rates and unemployment.

Getting Content Marketing Right

Embedding a product or service into editorial content is more important now than ever before. Millennials have become suspect of traditional advertising, but even baby boomers are more receptive to editorial content than ads. Content marketing can be a powerful tool to encourage customers to interact with your product. Content marketing consists of providing information that customers need or are passionate about so that, in turn, they pay attention to your product or service.

It's easier than ever to place content in a venue of choice. Venues come in the form of earned (i.e., search engine optimization), owned (i.e., the bank's web site) and paid (placement adjacent to relevant content). Most of us think of words when we think "content." But on Instagram, one of the most popular social media sites, the editorial content is the photos that users post. Brands like Free People have amassed nearly 3 million followers because of their quality content. They post beautiful photos that their primary demographic, young women, are drawn to. They also demonstrate their products in photos and through links to their blog and visitors can buy the product.

As bank marketers plan for next year, they should think creatively about how to provide content that their target customer will find interesting. Media agencies can help to place the content in relevant places. Good things will happen to your bank's brand, and revenue will grow when marketing efforts are aligned with the needs and interests of customers.

Balance Sheet Well-Positioned for Rate Increase

The Federal Reserve increased the fed funds target to between 0.50% and 0.75% and indicated three additional rate increases in 2017 amid signs of improving economic conditions. Below are mid-sized banks that appear well-positioned to benefit from rising rates.

Mid-Size Banks[1] with Highest One-Year Asset Gap[2]

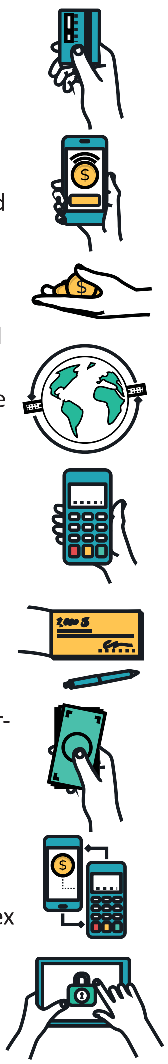
Institution	City, St	Total Assets ($000)	One-Year Asset Gap[2] (%)
1. Capital City Bank Group, Inc.	Tallahassee, FL	2,738,840	61.6%
2. TriState Capital Holdings, Inc.	Pittsburgh, PA	3,715,518	58.7%
3. Merchants Bancorp (Indiana)	Carmel, IN	3,077,086	57.0%
4. Bank of Utah	Ogden, UT	1,064,062	55.1%
5. New York Private Bank & Trust Corp.	New York , NY	6,707,163	54.8%
Median Among Mid-Size Banks		**1,918,507**	**7.9%**

Sources and footnotes: see www.capitalperform.com/wire-newsletter/december-2016-wire

2017 Predictions (continued)

5. **Mobile/cashless payments will continue to grow at high, double-digit rates in 2017, but even faster than predicted.** As Millennials and Gen Xers continue to earn more and use cash less (payment habits are rapidly changing), and banks continue to promote Mobile Wallet capabilities, we'll see even grandma making mobile purchases from her phone next year!
~ Mary Ellen Georgas, Capital Performance Group

Payments Disruption: You Ain't Seen Nothing Yet



Excerpted from the American Banker, November 9, 2016.

Since the 1990s, most banks have heavily invested in new payments technology, distribution services and capabilities for consumer and commercial markets. In fundamental ways, these new capabilities have altered how, where and when customers do business with their banks in addition to influencing cost structures and profitability models.

However, a whole host of industries have been altered dramatically by the entrance of technology-based category disruptors that have changed the competitive landscape and left once-powerful companies to either wither or die. Retail, media, news, entertainment and transportation are just a few industries that have experienced painful (for some) transformations. The question remains, "Is the banking industry next?" We believe the answer is "yes!"

The risks — which do not solely rest on ever-accelerating tech advancements — are far greater than they were 20 years ago. The primary threats lie in banks' unwillingness or inability to change: fundamental operating processes, rigid core systems that limit flexibility and innovation, high legacy costs and investments in outdated distribution channels. Banks are also struggling to understand a new and powerful demographic group that questions the very relevancy of banks.

Only adding to these reasons is an increasingly complex bank regulatory environment that does not seem to apply to new entrants — at least not yet. Addressing these threats effectively will require banks to make significant changes to long-held policies and practices, major capital investments in new technology platforms, transformation of payment and distribution channels and networks, and appropriate responses to a seismic generational shift in consumer attitudes, behaviors and expectations.

Payments have always been the banking industry's primary and most fundamental competitive advantage. Threats to the industry's control over this critical capability were visible 20 years ago, but they are even more apparent and real today. In an environment in which choices are many and resources are limited, a comprehensive, clear and focused payments strategy is required to drive investment decisions, create market differentiation and maintain the relevancy of banks.

Happy Holidays and Best Wishes for Success in 2017!