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Top Performing Banks: Core Deposit Funding

This is the first in a series of articles that spotlights the strategies that contribute to superior financial results. The series is based on CPG's recent analysis of Top-Performing banks, defined as institutions that ranked in the top quartile in return on average equity within their respective asset tier group.

CPG analyzed the performance of Midsize Banks, defined as institutions with total consolidated assets of between $1 billion and $10 billion. We compared the performance of all Midsize Banks to Top-Performing Midsize Banks, as well as those institutions that ranked in the top quartile in terms of the percentage that core deposits comprise of total deposits. The latter group is referred to as High Core-Funded Top Performers. As shown in the table below, High Core-Funded Top Performers had a slightly higher return on average equity than the Top Performers overall. Notably, the median cost of funds for High Core-Funded Top Performers was half of that of the other groups. These banks were better positioned to cost effectively fund loan growth, and their median ratio of net loans to total deposits was substantially lower than either the Top Performers or all Midsize Banks.

	Core Deposits[1]/ Deposits (%)	ROAE (%)	Core Deposit Growth (%)	Net Loans & Leases/Total Deposits (%)	Costs of Funds (%)	Net Interest Margin (%)	Yield on Earning Assets (%)
All Midsize Banks[2] ($1B-$10B)	76.85	8.37	10.30	87.17	0.42	3.46	3.86
Midsize Bank Top Performers[3]	77.13	12.18	11.44	85.36	0.40	3.66	4.07
High Core-Funded Top Performers[4]	88.76	12.48	9.43	72.76	0.21	3.55	3.81

Source: CPG analysis of data from SNL Financial, LC, 2016.
1. Core deposits are defined as total deposites less total time deposits and foreign deposits.
2. Midsize Banks are defined as of top consolidated bank holding companies & banks with consolidated assets of between $1 billion and $10 billion as of September 30, 2015. Excluded are nondepository trust companies, industrial banks, banks owned by nonbank companies, and institutions with gross loans to total assets of less than 10%, deposits to liabilities of less than 10%, or credit card loan composition of over 70%.
3. Midsize Bank Top Performers are defined as those institutions in the asset tier that rank in the top quartile in terms of ROAE (tax-adjusted for S-corps) for the twelve months-ended September 30, 2015.
4. High Core-Funded Top Performers are those institutions in the Midsize Bank Top Performers group that rank in the top quartile in terms of core deposits to total deposits.

Cambridge Bancorp ($1.7B; Cambridge, MA) was among the institutions that placed within the High Core-Funded Top Performers group. The company is perhaps best known for its wealth management business; however, in a recent investor presentation the company cited continued growth in the core deposit base as one of its six areas of strategic focus. Last year, the bank grew core deposits by 10.5%. Its twelve branch network is situated in very attractive, affluent markets in Massachusetts, and the bank has invested in digital platforms to stay abreast of changing customer expectations and to improve the customer experience.

Continued on back

Management Priorities for Achieving High Performance

Management Priorities	The To-Do List
FOCUS: Focus is the most important element of strategic planning.	◆ A vision for the company 3 to 5 years out ◆ A set of long-term financial and strategic performance goals ◆ A strategic plan that is vetted annually
ADAPTABILTY: Successful companies analyze environmental trends, anticipate significant changes and adapt.	◆ External environmental scans ◆ Quarterly strategic plan progress assessments ◆ Contingency plans
CLARITY: A company's decisions, investments, and programs must make sense to analysts, investors and, importantly, to its employees.	◆ Budgeting and investment processes ◆ Employee communications ◆ Investor communications
ALIGNMENT: Alignment reflects the degree to which elements of the company's operating environment are consistent with and supportive of established objectives.	◆ Structured implementation process (e.g. Project Management Office) ◆ Organizational scorecards and incentive plans ◆ Customer surveys ◆ Employee engagement surveys

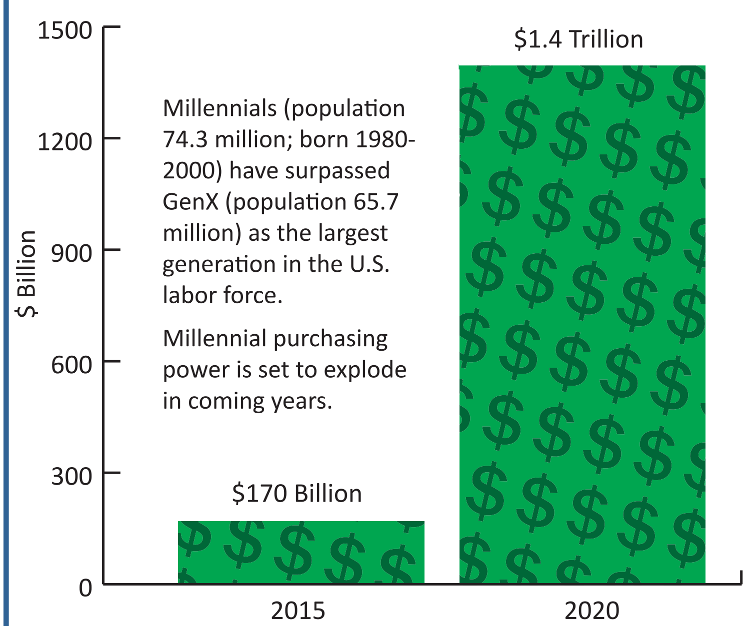
Top Performing Banks: Core Deposit Funding (continued)

WSFS Financial Corporation ($5.6B; Wilmington, DE) also placed among the High Core-Funded Top Performers group. Innovative products are helping the bank to grow. It has a new set of products for its fast-growing and profitable Wealth and Cash Connect Divisions. The bank recently partnered with ZenBanx to offer a deposit account that allows for person-to-person payments and currency exchanges while also leveraging social networking platforms. WSFS has expanded its presence in southeastern Pennsylvania through acquisitions. It has simultaneously capitalized on customer dislocations arising from the acquisition of other community banks by large out-of-market banks.

Core deposits will remain highly valuable. Already we see evidence of this borne out in the fact that acquirers are paying more for core deposits. According to SNL Financial, the median deposit premium paid on branch transactions in 2015 increased to 3% compared to less than 2.5% in each of the previous three years. While the pace of future interest rate hikes and loan growth remain uncertain, it is certain that those banks with a high percentage of core deposit funding will be better positioned to attain Top Performing status.

Millennials on the Verge of Becoming an Economic Powerhouse

Millennial Purchasing Power



Source: Moosylvania 2015 Millennial Ranking Report

Announcements

Mark Gibson joins CPG as a Senior Consulting Associate

Mark joins CPG after spending 20 years in Chief Marketing Officer roles at several top 100 banks.

Lauren Rosenberg joins CPG as a Business Analyst

CPG is happy to announce that Lauren Rosenberg has joined our team. Lauren is a recent graduate of the George Washington University where she majored in economics.

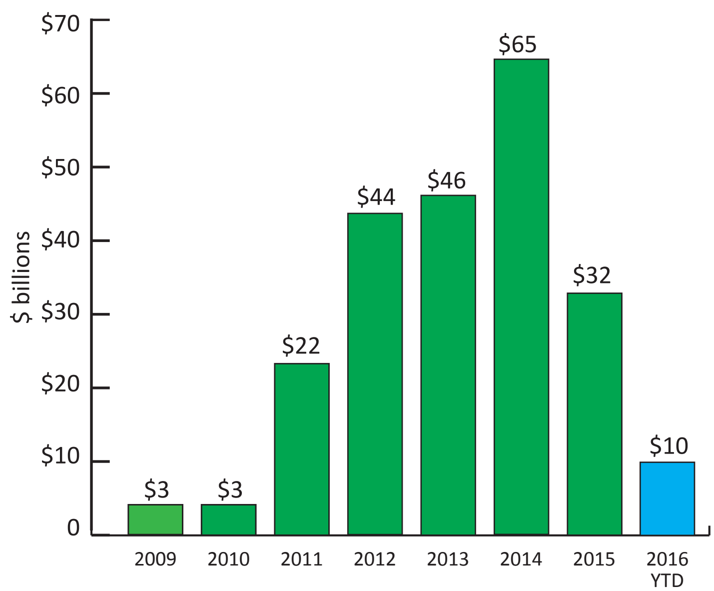
Upcoming Speaking Engagements

- **Creating Relevancy in the Age of the Millennials**, Pennsylvania Bankers Women in Banking Conference, March 7, 2016.
- **Utilizing Branch Network Insights to Generate Better Branch Goals, Marketing Strategies, and Sales**, Pennsylvania Bankers Branch Transformation Conference, March 30, 2016.
- **Retail Strategic Planning: Assessing 2020 Distribution Strategies**, NYBA 2016 Small Business & Retail Banking Conference, April 4, 2016.
- **Strategic & Long Term Capital Planning**, Missouri Bankers 2016 Bank Finance & Accounting Conference, April 14, 2016.
- **Leadership Lessons from Top Performing Banks**, Pennsylvania Bankers Annual Convention, May 12th, 2016.
- **The C Suite Marketing Plan**, The Financial Brand Forum, May 16-18, 2016.

Trends in Regulatory Fines & Penalties

One might assume that the beginning of a new year would be a slow time for regulatory fines, penalties and settlements. After all, the first few weeks of 2016 were relatively quiet. As earnings season began, however, it became clear that the lull was only temporary.

Total Fines, Penalties, & Settlements for the 18 Largest U.S. & E.U. Banks[1], from January 2009 to January 2016



Source: BCG analysis for the years 2009 to 2014. CPG analysis for the year 2015 and YTD 2016.

1. Peer group of the 18 largest U.S. & E.U. banks includes the following 6 U.S. banks: Bank of America, JPMorgan Chase, Citigroup, Morgan Stanley, Wells Fargo, and Goldman Sachs, and the following 12 E.U. banks: BNP Paribas, Credit Suisse, Deutsche Bank, UBS, HSBC, Barclays, The Royal Bank of Scotland, Rabobank, Lloyds Bank, Standard Chartered, ING, and Banco Santander. Data only includes fines, penalties, and settlements of $50 million or greater.

Our large bank group – the 18 largest institutions headquartered in the U.S. and the E.U. – announced a total of roughly $10 billion in penalties in January. Goldman Sachs led the way after reaching an agreement in principle with the Residential Mortgage-Backed Securities Working Group related to claims concerning the bank's securitization, underwriting, and sale of RMBS in the years leading up to the financial crisis. Between a civil money penalty and consumer relief, the agreement will cost Goldman a little over $5.0 billion. JPMorgan Chase and RBS also reported significant settlements related to allegations involving past activities in the RMBS market, costing $2.4 billion and $2.2 billion, respectively.

One month into the new year, it is too early to make any predictions about the level that fines, penalties, and settlements will reach by December 31st. It seems a safe bet that the resolution of issues related to the financial crisis will continue to impact large bank earnings.