CPG WIRE
BI-MONTHLY NEWSLETTER

CAPITAL PERFORMANCE GROUP

VOLUME 14/ISSUE 5
SEPT/OCT 2015

Enhancing Branch Goals with Insights from Market Analytics

Setting the appropriate goals at the branch level is one key to driving high performance in the retail branch franchise. Well conceived branch goals can lead to increased customer acquisition and cross-selling, increased penetration of key customer segments, improved customer service, and higher branch profitability and productivity. However, without the right market insights, setting the appropriate goals is difficult.

Goal setting at the branch level begins by establishing a minimum target for metrics across performance areas. Metrics may include those related to service, sales, financials, customer and deposit growth, and productivity and efficiency. Targets should be set for each metric based on management's expectations for the minimum performance. Using the minimum targets as a baseline, goals can then be calibrated based on the market attractiveness and characteristics of each geographic "trade area" in which a branch operates.

Determining market attractiveness of a branch trade area is both an art and a science. Market analysis may be performed to quantify the specific opportunities in each branch trade area. When done correctly, the market analysis should address key questions such as: how big is the market in terms of households, businesses,

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Core Deposit Growth

A review of industry performance data as of June 30, 2015, shows that the banking industry is very liquid. The median net loan to deposit ratio among all banks was 77.1%. The median growth rate of core deposits (total deposits excluding time) was 6.0% during the twelve month period ended June 30, 2015. Understandably, during the last few years, loan growth has been the primary focus of many community banks. In light of these considerations, it may seem counterintuitive to assert that growth in core deposits will remain an important financial characteristic of high-performing banks.

There are several reasons underpinning this view. It is well understood that the primary checking account is important for the subsequent sales of products and services. The use of online and other services significantly increases relationship profitability and is an important source of fee income. Deposit and payment solutions are also central to addressing some of the top financial concerns among consumers and small businesses such as saving for the future and managing cash flow. Banks with value propositions that clearly address those concerns will be in the best position to attract and retain profitable customer relationships.

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Fintech: Should You Build, Partner, or Acquire?

The financial technology revolution has affected a variety of industries and is transforming the way banks are doing business. Every day, we see new headlines that focus on the competitive challenge financial technology companies pose to banks. While financial technology, or "fintech", companies threaten to steal market share from banks, the fintech revolution also presents an important opportunity for banks. Some banks are leveraging fintech capabilities to make their branch networks more efficient, grow their customer base, and improve the digital banking user experience. Banks are building, partnering, and acquiring new fintech capabilities.

Strategy #1: Build. Many banks have developed financial technology tools internally to satisfy the self-serve preferences of younger customer segments and to create more profitable branch networks. For example, Wells Fargo ($1.7T; San Francisco, CA) has built several "mini branches" in Washington D.C. that are approximately half the size of the typical Wells Fargo branch and include advanced technology that features a multitude of self-service options. Within these mini branches are tablets as well as ATMs that present customers with a customized "favorites" section on the touch screen homepage that are determined based upon the customer's previous ATM transactions. Technological advances such as these enable banks to reduce branch size in terms of staffing levels and square footage, thereby reducing costs and increasing efficiency.

Strategy #2: Partner. Many small banks do not have the capital needed to develop technologies internally and have partnered with fintech companies to enhance product and service offerings. WSFS Financial Bank ($5.1B; Wilmington, DE) has formed a partnership with fintech company ZenBanx, which has created an app that allows customers to hold and exchange multiple currencies within a single account. The bank expects to open 37,500 new "ZenBanx" accounts in its first year of the partnership.

Strategy #3: Acquire. Banks have also exercised the option of acquiring fintech companies. In 2014, BBVA Compass ($88.5B; Houston, TX) acquired the fintech company Simple, which provides online banking services including money transfers and ATMs and offers deposits and online bill payment services. The fintech company focuses on the user experience of these services, which has helped the bank continue its mission of innovation within the financial services industry. BBVA has added 100,000 new US accounts as a result of the acquisition.

The intertwining of banks and fintech companies is inevitable in the financial service industry. Banks that understand this and act upon this opportunity will be far better off in the long term than those banks that are complacent and assume that banking will remain business-as-usual.

Enhancing Branch Goals (continued)

and/or key customer segments? How affluent is the market? What are the specific product opportunities? How big is the market in terms of deposits, loans, and investments? Is the market growing? This data can enable management to judge market attractiveness. Management may then assign higher goals to those branches with higher market attractiveness. Management can also utilize specific insights obtained from the analysis, such as product use and balance information, to set customized branch goals for specific performance metrics.

This analysis does not require the use of big data and can therefore be constructed and applied by banks of all sizes. Since market data typically does not change markedly in the short term, the analysis typically only needs to be updated annually.

Contact Kevin Halsey at 202-337-7873 or via email to discuss how CPG can help your retail banking franchise set better branch goals.

CPG BANKING INDUSTRY FINANCIAL PERFORMANCE UPDATE

Capital Performance Group analyzed the financial performance of the banking industry for three different asset tiers: Community Banks (total assets <$1B), Midsize Banks (total assets $1 to $10B), and Large Banks (total assets >$10B). Balance sheet data is as of June 30, 2015. Income statement data and growth figures are for the twelve months-ended June 30, 2015. The full report is available on our website.

CPG's next Industry Performance Update will be available mid November. Please contact us for pricing at 202-337-7870 or via email.

Core Deposit Growth (continued)

There are obvious asset liability management advantages to growing core deposits. The volatility of wholesale funding was clearly demonstrated during the financial crisis when secondary markets froze and asset values, particularly those tied to residential mortgages, dropped precipitously. This made it almost impossible for banks to borrow on reasonable terms. In contrast, core deposit levels increased during that time as investors sought the safety of FDIC-insured accounts.

The value of core deposit balances becomes even more compelling when viewed in relation to the cost of an alternative wholesale funding instrument. For example, commercial DDA balances have an average duration of between five and seven years. The current rate charged on a five-year Federal Home Loan Bank advance is 1.96%. By funding a five-year term with commercial DDA balances, a bank effectively adds 1.96% to the loan spread.

The likelihood that the Federal Reserve will begin to raise rates by the end of this year underscores another advantage to core funding. Rates paid on core deposits do not adjust as quickly as do those of wholesale funds. This will help to mute the impact on the net interest margin from an interest rate increase.

Banks that recognize the strategic importance of core deposits and take active steps to acquire, retain, and grow core deposit balances through well conceived sales goals, appropriate incentive plans, and product solutions that address concerns of customers will be the most successful.

Recent Regulatory Enforcement Actions Highlight Areas of Focus

Despite headlines surrounding large, residential mortgage-related settlements, CPG's analysis of recent enforcement actions shows that BSA & AML remain top focuses of the prudential bank regulators. Recent enforcement actions in this area have been levied against both large banks and community banks. For example:

- On August 3rd, Capital One, N.A., McLean, VA ($255.3B) entered into a consent order with the OCC related to BSA/AML compliance issues in a check cashing group that was previously part of its commercial banking business.
- On June 15th, the $96M-asset bank, Bank of Mingo in Williamson, WV, was fined $4.5M in penalties by the FDIC, FinCEN, and the DOJ for failing to implement an effective BSA/AML compliance program over an extended period of time.

Community banks that wish to minimize the risk of regulatory fines should focus on implementing an effective BSA & AML compliance program.

For its part, the Consumer Financial Protection Bureau has been targeting banks and non-banks. Its recent enforcement actions have centered on auto lending and credit card practices.

- On September 28th, Fifth Third Bank, Cincinnati, OH ($139.2B) was ordered to pay $18M in restitution fees for alleged auto lending discrimination against African-American and Hispanic borrowers. The Bureau also hit the bank with a $500,000 penalty over deceptive marketing of credit card add-on products and required the bank to pay $3M in relief to consumers.
- On July 22nd, Discover Bank, Greenwood, DE ($83.4B) was required to pay $18.5M in consumer refunds and penalties for overstating the minimum balance due on statements, denying customers information needed to obtain federal income tax benefits, and engaging in illegal debt collection practices.
- On July 21st, Citigroup, New York, NY ($1.8T) was ordered to pay $770M in customer relief and fines for illegal practices related to credit card add-on services and deceptive charges for expedited payments.
- On July 14th, Honda Motor Company reached a $24M settlement related to claims that Honda dealers offered higher interest rates on financing to certain borrowers based purely on race and ethnicity, rather than creditworthiness.

The enforcement actions against Fifth Third and Honda follow a similar CFPB enforcement action against Ally Bank in 2013. These actions are consistent with the Bureau's publicly stated priority of preventing discriminatory practices. Although these actions targeted large auto lenders, it is prudent to assume that enforcement will be applied to lenders of all sizes. Therefore, community banks that participate in auto lending, or are considering doing so, must carefully consider the significant compliance scrutiny to which the business will now be subjected.