

**The Evolution of Banking &
How to Position for it**

Quarterly Pertinent Issues Report

September 2008

The Banking industry is always evolving. . . .

The historical perspective of banking by decade . . .

1970s – finance companies

1980s – money market mutual funds

1990s – asset management

2000s – internet deposit gatherers

2010s – Virtual Banks? Digital Dollars?

What is the banking vision for the future?

The future of banking . . .

1. Decline of brick and mortar branches
2. Increase in mobile banking
3. Human branches
4. Advisory, not transactional
5. Digital dollars, less hard currency
6. Barbell banking industry
7. Return of portfolio lending to banks
8. Revised organizational structure
9. “All in One” loan accounts
10. Changing demographics in United States
11. Lack of leadership in banking

1. Decline of brick and mortar branches . . .

- Cost to build branches has increased significantly – time to profitability extended
- Lack of A+ locations
- Roadblocks like government interference and building restrictions
- Large retail franchise have already experienced the decline in brick and mortar locations: Blockbuster and now Starbucks

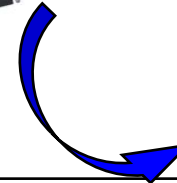
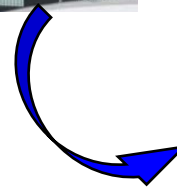
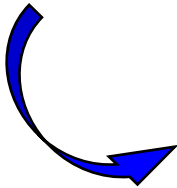
Category	2000		2007		HH Growth	% Growth
	# U.S. HH	% HH	# U.S. HH	% HH		
ATM/Debit Cardholders	68,983,986	65.4%	92,746,172	81.6%	23,762,186	34.4%
Direct Deposit	43,985,202	41.7%	59,796,019	52.6%	15,810,817	35.9%
Direct Deposit - Social Security	26,053,585	24.7%	33,544,241	29.5%	7,490,656	28.8%
Electronic Banking (excl ATM)	63,499,021	60.2%	93,562,708	82.3%	30,063,687	47.3%
Home Banking Services	47,993,446	45.5%	85,687,466	75.4%	37,694,020	78.5%
Telephone Banking Service	42,930,401	40.7%	52,763,511	46.4%	9,833,110	22.9%
Own a PC	52,634,570	49.9%	99,930,571	87.9%	47,296,001	89.9%
Internet Banking	11,180,891	10.6%	66,771,363	58.7%	55,590,472	497.2%
Use Brokerage Services	19,513,819	18.5%	18,662,905	16.4%	(850,914)	-4.4%
Use Trust Services	2,426,042	2.3%	3,366,281	3.0%	940,239	38.8%

2. Increase in mobile banking . . .

- Beginning to enter the market through large banks
- Growth has occurred
- Possible security issues



3. Human branches . . .



- Incremental Balance Sheet and Income Statement Analysis
- Benchmarks
- Training and expertise

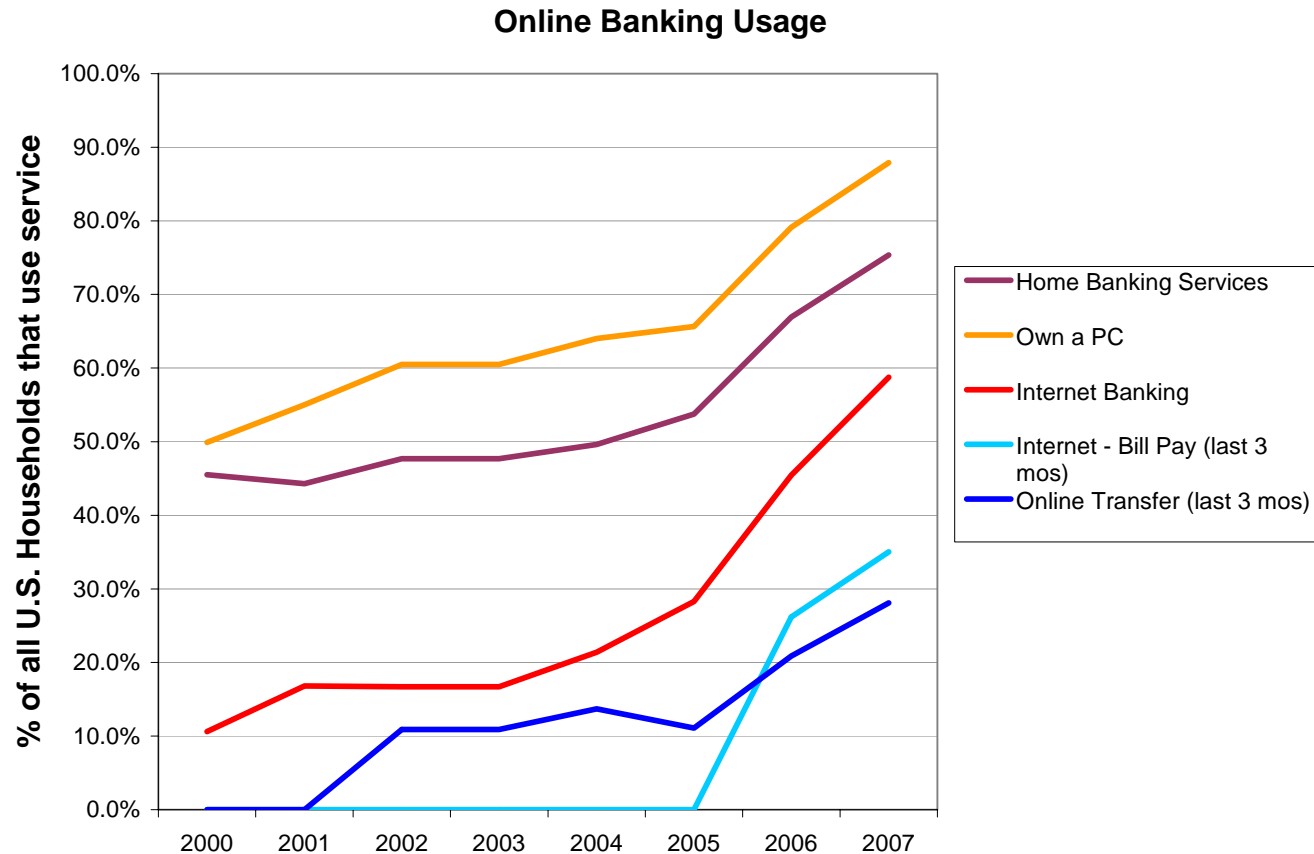
4. Advisory and Service, not transactional . . .

- Fall in teller transactions and checks
- Rise in electronic transactions
- Rise in AUM
- Better educated and trained personnel going forward



5. Digital dollars, less hard currency . . .

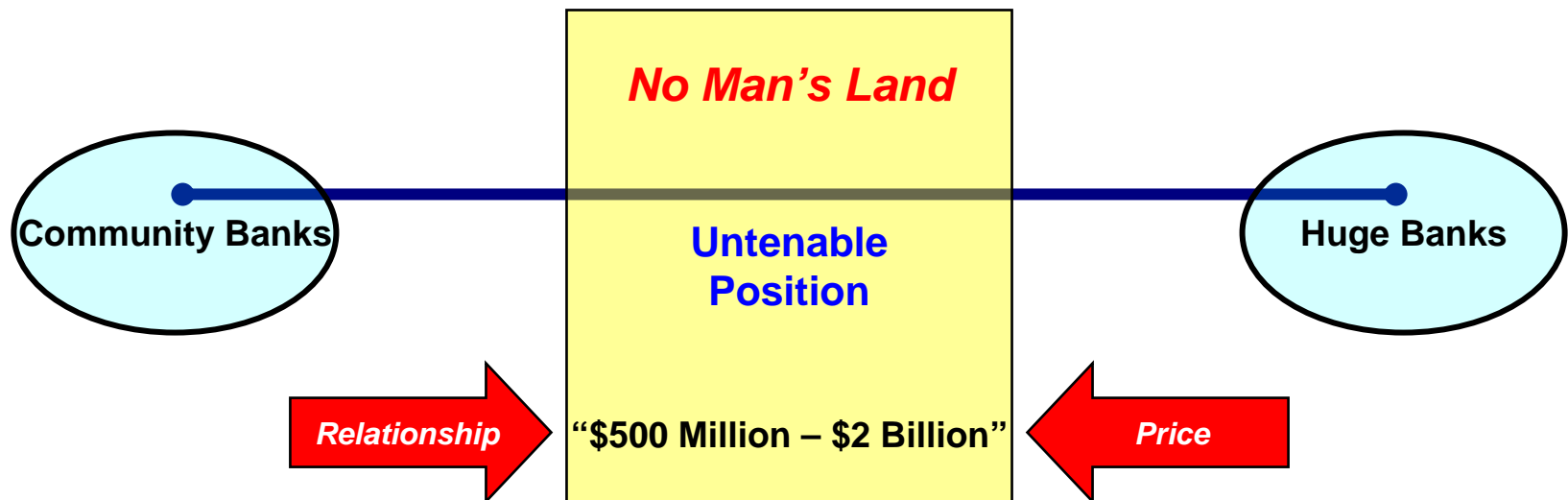
- Elimination of fed processing centers, changing cost per transaction
- Direct payments (ACH, Fed wire, etc)
- Use of debit and credit cards



Over the same time period the number of checks processed declined from 50 billion to 19 billion.

6. Barbell banking industry . . .

- The largest banks continue to gain in market share
 - 10.0% of total national deposits was recently waived for Bank of America
- Bank's go through a transition phase between \$500 MM and \$2.0 B. Banks do not want to be in "No Man's Land."



- Banks either need to acquire assets quickly to reach \$2.0 B in total assets or rebrand the organization into smaller community bank focuses

The total number of institutions has declined, small banks have a much smaller share of the pie, and the largest banks continue to increase market share . . .

3/31/2008 FDIC Insured Institution Data				
Asset Range	# of Institutions	% of Institutions	Aggregate Assets ('000)	Percentage of Total Industry Assets
over \$10 billion	285	3.28%	\$10,418,975,104	77.8%
\$1-\$10 billion	552	6.36%	\$1,454,659,059	10.9%
\$100 mil - \$10 billion	4,486	51.67%	\$1,337,117,808	10.0%
under \$100 million	3,359	38.69%	\$178,158,842	1.3%
Totals	8,682	100.00%	\$13,388,910,813	100.0%

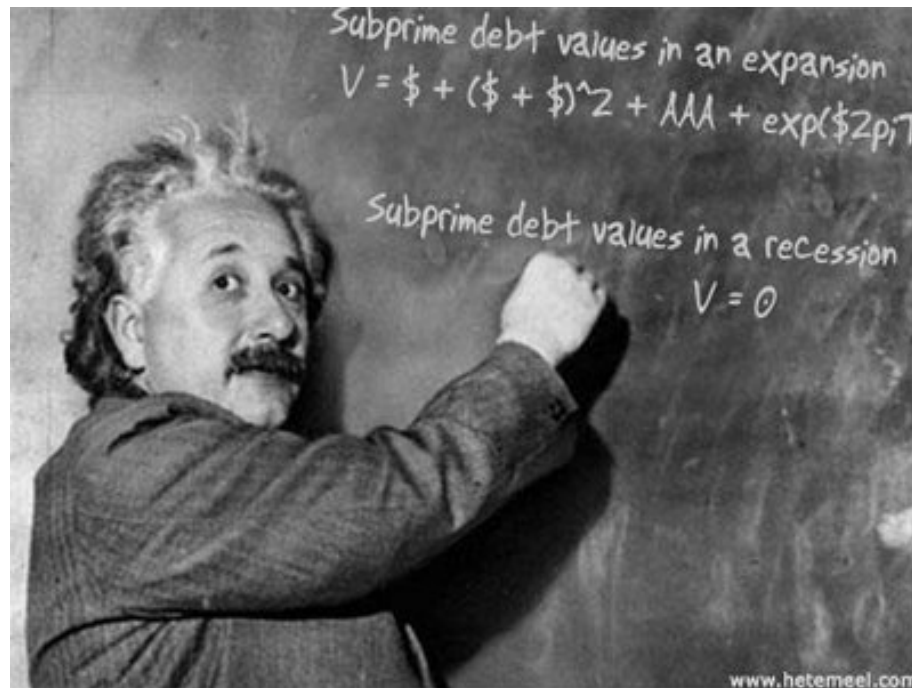
12/31/2005 FDIC Insured Institution Data				
Asset Range	# of Institutions	% of Institutions	Aggregate Assets ('000)	Percentage of Total Industry Assets
over \$10 billion	118	1.33%	\$8,036,719,357	73.8%
\$1-\$10 billion	516	5.83%	\$1,406,999,174	12.9%
\$100 mil - \$10 billion	4,346	49.13%	\$1,249,460,075	11.5%
under \$100 million	3,866	43.70%	\$200,788,360	1.8%
Totals	8,846	100.00%	\$10,893,966,966	100.0%

A strategy for midsized banks to combat the **No Man's Land** circumstance is JV (joint venture) Branching . . .

- The branch is jointly “owned” by the Sponsor Bank and by local individuals.
- The local “ownership” need not take the form of a direct equity interest in a separate jointly owned entity. Instead it could take the form of: incentive based compensation, equity in the Sponsor Bank, phantom stock, etc.
- Local branch identity.
- Local investors/partners have a vested interest in branch success.
- Similar to Human Branches in that both will:
 - Have a Incremental Balance Sheet and Income Statement Analysis
 - Rely on a sales force with compensation/ consideration exchanged for performance.

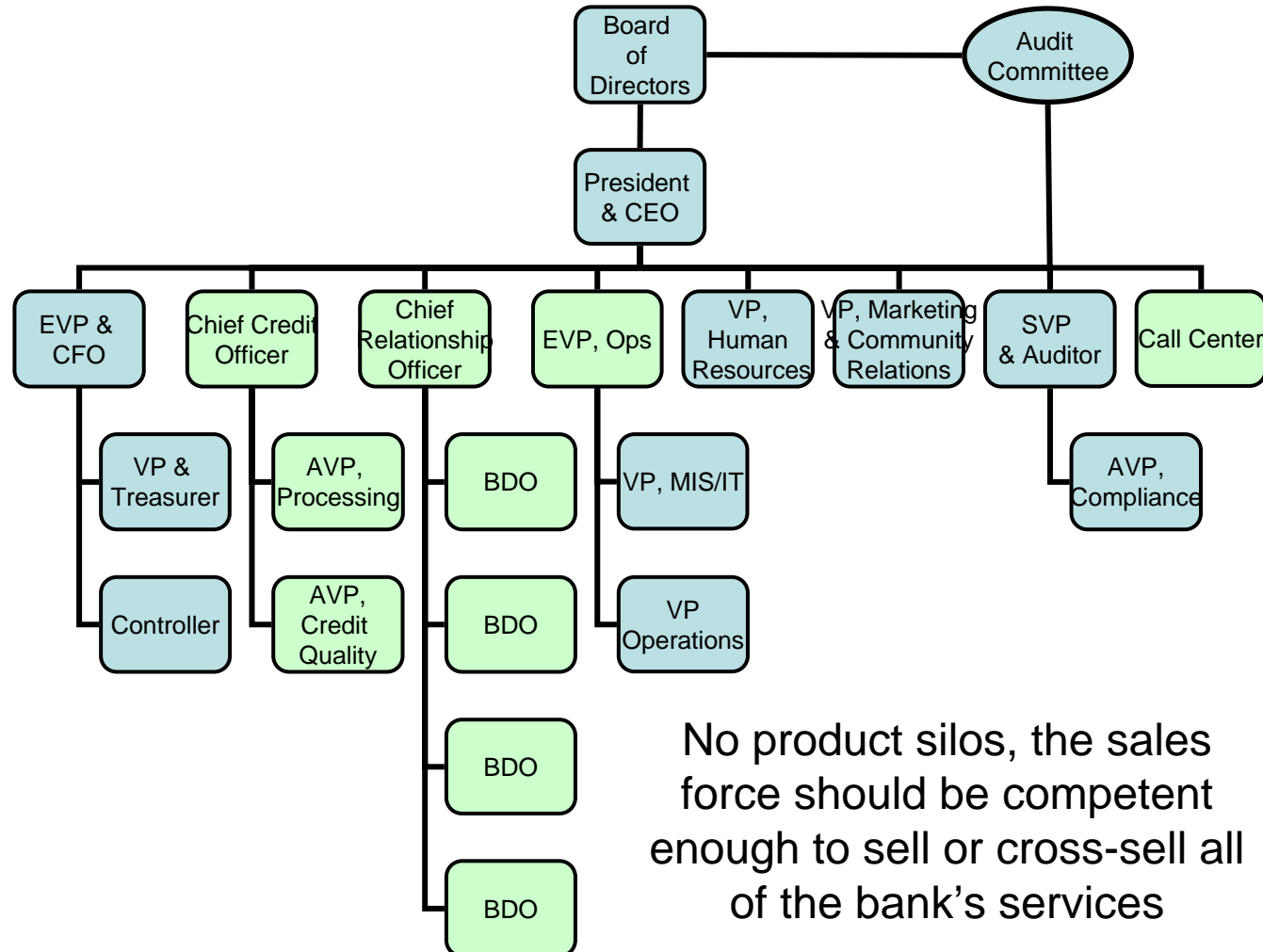
7. Return of portfolio lending to banks . . .

- Residential 1-4 opportunity
- Mortgage bankers and brokers either out of business or regulated
- Collapse of secondary markets
- Evacuation of sector by large players



8. Revised organizational structure . . .

- Business developers not lenders and branch managers
- Credit specialists for underwriting and processing
- Electronic back office
- The shift of the organizational structure is towards a business development and credit administration structure versus the separation of lending divisions.



9. “All in One” loan accounts . . .

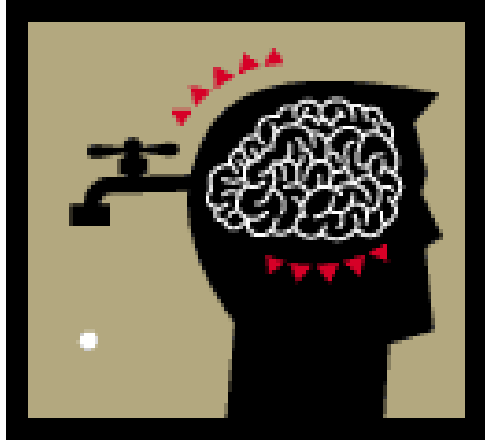
- One mortgage, multiple notes (fixed and variable rate options, revolving line of credit, ability to shift between options)
- Borrower Capacity = RE equity + fixed Assets + stocks + bonds + ?

10. Changing demographics in United States . . .

- Aging boomer population
- Changing racial profile of the U.S. population
- Continued immigration growth
- Changing marriage patterns
- Changing geographic shift in total population and sub groups
- Declining tenancy time and more frequent moving / relocation

Population or percent and race or Hispanic origin	2000	2010	2020	2030	2040	2050
POPULATION						
TOTAL	282,125	308,936	335,805	363,584	391,946	419,854
White alone	228,548	244,995	260,629	275,731	289,690	302,626
Black alone	35,818	40,454	45,365	50,442	55,876	61,361
Asian Alone	10,684	14,241	17,988	22,580	27,992	33,430
All other races 1/	7,075	9,246	11,822	14,831	18,388	22,437
Hispanic (of any race)	35,622	47,756	59,756	73,055	87,585	102,560
White alone, not Hispanic	195,729	201,112	205,936	209,176	210,331	210,283
PERCENT OF TOTAL POPULATION						
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0
White alone	81.0	79.3	77.6	75.8	73.9	72.1
Black alone	12.7	13.1	13.5	13.9	14.3	14.6
Asian Alone	3.8	4.6	5.4	6.2	7.1	8.0
All other races 1/	2.5	3.0	3.5	4.1	4.7	5.3
Hispanic (of any race)	12.6	15.5	17.8	20.1	22.3	24.4
White alone, not Hispanic	69.4	65.1	61.3	57.5	53.7	50.1

11. Lack of leadership in banking . . .

- Retirement and turnover will cause shortage of executives
 - Need to do management succession now
 - Need to train now
 - Need to lock up key players now
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- The baby boomer “brain drain.” There are many Bank CEOs that are nearing retirement and will soon be out of the industry.
 - Median CEO age is 57, and over one-third are 60 or older for Mid-Atlantic and Northeast banks and thrifts less than \$5 billion in assets ⁽¹⁾
 - Voluntary retirement for bank CEOs and other executive officer-level employees is at 4.0%, compared to just 2.6% of all other employees. ⁽²⁾

1. SNL Datasource: SEC/Public reported data for 258 Mid-Atlantic and Northeast banks and thrifts with assets less than \$5B at 6/30/07
 2. The Crowe 2007 Financial Institution Compensation Survey Report- Crowe Chizek and Company LLC

FinPro believes that a good vision for banks would include . . .

- Providing full array of financial services to our select customers through personal visits, internet, telephone, and remote electronic devices.
- In the near future, the traditional branching model will be obsolete, similar to Blockbusters Video.
- Money will exchange hands in digital units – a virtual monetary system
- Therefore, advice/service will matter more than convenience.

So what does a bank do to prepare for this new world?

- To prepare for the future, FinPro is recommending changes to the traditional branching model:
 - ✓ Hub facilities
 - ✓ Spoke delivery
- Hire sales oriented people now and train them to become financial advisors not order takers.