

Revenue Opportunities in 2010

2010 will continue to be a very difficult year for the banking industry. The recent State of The Union Address did nothing to ease concerns about the government's handling of the economic crisis. And the White House's budget proposal – calling for massive spending to spur economic growth, a \$1.6 trillion deficit in 2010, and rather meaningless incentives for small businesses to start hiring and spending again – won't do much for the banking industry.

Given the situation, banks must remain focused on expense control, customer retention, and continuing to work through problem loans. However, savvy management teams will also pay attention to revenue growth, taking advantage of opportunities and the unique competitive environment to build business. We expect to see aggressive action to steal share and build revenues on a number of fronts including:

1. Deposit retention and wallet penetration. Deposits grew at an average rate of 8% in the fourth quarter of 2009 versus the third quarter at large banks - a continued increase in deposit inflows into the banking system. Turning these new customers and new dollars into opportunities for revenue growth will be a challenge. Strong onboarding processes coupled with incentives for debit use are a must. In addition, banks need to break down

traditional barriers between their retail banking and investments businesses to make it far easier and more seamless to move money into higher yielding, higher return instruments as rates rise and the market continues to rebound. And, of course, growth in consumer and business lending would help.

good money to be made lending to others who have good credit histories but perhaps some circumstance that modeled them into a category for cutback or term changes recently. In addition, direct deposit advances, prepaid cards and other products will experience growth going forward.



2. Consumer loans to good (but not great) risk profiles. Demand for credit will be most robust where credit has been restricted in recent months – meaning small businesses in general and consumers who've experienced credit line reductions, changes in terms, and the like. Many consumers and small businesses - even those with good credit histories - are being alienated by their credit providers. Those borrowers with stellar credit will likely have more options going forward, but there's

3. Retirement planning and investment management.

This remains a huge opportunity. Witness Bank of America's announcement on January 25th that it will launch a \$20 million ad campaign targeting the retirement market ("help2retire"). The sheer size of the market makes it attractive (more than \$24 trillion in assets), and recent turmoil on Wall Street leaves the door open for banks to regain some of the business lost to investment firms over the last 20 years.

Other revenue generation opportunities are out there. Send me an email or give me a call to discuss! Mary Beth Sullivan, msullivan@capitalperform.com, 202-337-7872.

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Nine Steps to a Robust Credit Process

To retain existing customers and grow share, commercial lenders must ensure that their credit process is designed to achieve both efficiency and competitive differentiation. To accomplish this, banks should take the following steps to optimize their credit processes:

1. Analyze existing portfolios to identify opportunities to establish differentiated underwriting and approval processes that are consistent with the institution's definition of what constitutes a material loss.
2. Dissect volume reports on application approval, loan and line usage rates, and application fallout rates; and take remedial steps to address issues that are raised by

- the results.
3. Institute expedited underwriting treatment where appropriate.
4. To simplify the application process for the borrower and reduce time spent gathering information, review required documentation and eliminate documents that are not needed for underwriting or that are not required by competitors.
5. Appoint a gatekeeper to evaluate the completeness of loan packages, as well as to track the status of applications.
6. Align the bank's delivery channels to complement the differentiated credit process.

7. Remove and centralize any aspect of the loan officer's job that adds no value to the customer.
8. Reevaluate the adequacy of the technology platform.
9. Leverage the credit process to facilitate the bank's chosen value proposition to attain competitive advantage.

This last step will become even more important as loan demand rebounds. For more information, read Claude Hanley and John Barrickman's article, "Steps for Improving the Efficiency and Effectiveness of the Credit Process" in the March issue of *Commercial Lending Review*.

EPS Expectations

As we kick off 2010, CPG looks at earnings per share (EPS) estimates for two pools of institutions – large national banks and regional banks – to see the performance most analysts expect from each group over the next several years. We looked at institutions that will continue to report strong positive EPS as well as recovering institutions that are likely to swing from negative EPS to positive EPS in 2010.

Large Banks (\$20B+)

While large banks were largely discounted and written off during 2009, they are now returning to profitability and gaining strength. In 2010, analysts expect earnings growth at the top big banks to soar and then remain solid in the future.

Institution ¹	EPS Growth 2009-2010	EPS Long Term Growth ²
75th Percentile	95.0%	8.3%
Median	56.9%	7.0%
Top Performers (Continued Positive EPS Growth)		
Capital One Financial Corporation	185.1%	8.6%
Astoria Financial Corporation	106.7%	5.3%
U.S. Bancorp	66.0%	6.3%
M&T Bank Corporation	41.9%	6.0%
JPMorgan Chase & Co.	34.5%	8.0%
Recovering Institutions (Negative EPS to Positive EPS)		
Bank of America Corporation	379.3%	6.0%
Bank of New York Mellon Corporation	304.3%	11.0%
State Street Corporation	202.1%	10.5%

Regional Banks (\$5B-\$20B)

During 2009, the uncertainty surrounding the banking industry allowed regional banks to build strong capital positions as the focus of their larger counterparts was placed on simply surviving. Now analysts will look to regional banks to make use of their capital and translate their relative strength into strong earnings growth over the coming years.

Institution ¹	EPS Growth 2009-2010	EPS Long Term Growth ²
75th Percentile	105.0%	10.0%
Median	73.7%	8.1%
Top Performers (Continued Positive EPS Growth)		
Oriental Financial Group Inc.	261.0%	8.0%
City National Corporation	174.0%	6.0%
SVB Financial Group	162.1%	8.8%
East West Bancorp, Inc.	115.2%	10.0%
Old National Bancorp	107.1%	6.0%
Recovering Institutions (Negative EPS to Positive EPS)		
Susquehanna Bancshares, Inc.	420%	7%
First Commonwealth Financial Corp.	217%	5%
Wilmington Trust Corporation	194%	8%

Source: CPG analysis of data from SNL Financial, L.C. 2010.

Data is for all publicly traded banks and thrifts with total assets greater than \$5B for the period ended September 30, 2009.

1. Percentiles do not include those institutions that have not yet filed a year end earnings release for 2009. There were six institutions in the \$5B-\$20B group and no institutions in the >\$20B group that had not filed a report.
2. EPS Long Term Growth defined as the mean value of all current 3- 5-year growth rate estimates, expressed as an annual percentage.

The Myth Returning: Glass-Steagall Redux

As politicians attempt to capitalize on popular discontent with Wall Street, concerns about the dangers of mixing commercial banking and investment banking have resurfaced. Senators Maria Cantwell (D-WA) and John McCain (R-AZ) have introduced a bill that would essentially reinstate the Glass-Steagall Act. While the Obama administration claims to be against a full resurrection of the act, the President proposed the “Volcker Rule,” stating that “banks will no longer be allowed to own, invest, or sponsor hedge funds, private equity funds, or proprietary trading operations for their own profit, unrelated to serving their customers.” Both of these proposals rely on the premise that risky and corrupt practices of the investment bankers on Wall Street caused the Great Recession in the same way that they caused the Great Depression; and that reinforcing the separation of investment banking and commercial banking will go a long way to prevent a future financial crisis.

This premise is simply untrue. In his 1995 essay, “The Troublesome Myths of Banking: I”, Carter H. Golembe made clear that the villainous investment banking practices of commercial banks in the late 1920s and early 1930s were not only grossly overstated but were patently untrue and had little to do with the onset of the Great Depression. Similarly, the most recent financial crisis was not caused by risky proprietary trading or the losses of hedge funds operated by commercial banks, and the elimination of these vehicles would have done nothing to prevent the credit problems that sank so many financial institutions. Some have even gone further, suggesting that these operations, as well as the ability of large commercial banks to absorb companies such as Bear Stearns, helped the U.S. weather the crisis. The separation will do little to accomplish its stated goals of decreasing systemic risk and helping to prevent another financial meltdown. Instead, banks and policy makers should focus on improving risk management, internal controls, corporate governance, and supervisory oversight.



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