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What a Retail Bank Is Really Worth

Excerpted from BAI Banking Strategies "Best of the Month", July 20, 2015. Full article.

At a time when traditional business unit accounting unfairly discounts the value of deposits, and thus of the retail franchise itself, banks need to rethink their evaluation of institutional profitability.

For most banks, the retail franchise is the most valuable part of their companies. Ask any M&A professional. Yet, because of the way many banks do business unit accounting, it is often the least profitable, especially over the last few years when the accounting value of deposits has declined precipitously.

This presents a difficult issue for managers. No area of banking is changing faster, or needs to change faster, than retail. Customer delivery channel behavior is evolving quickly, new entrants are using their access to the payment system to attract your customers, regulatory requirements are imposing new burdens on your people and systems and legacy costs are difficult to eliminate. In order to keep pace, significant investment is required in facilities, systems and people. So, how do you obtain the needed funding when resources are scarce and other business units can, and do, make more compelling financial arguments for a bigger piece of the pie?

To read the entire article, visit www.bai.org/bankingstrategies/home.aspx (free subscription required) or contact Rolland Johannsen to discuss at 646-303-3312 or rjohannsen@capitalperform.com.

U.S. Banks Increase Holdings of U.S. Treasuries by $176 Billion

Source: The Federal Reserve, 2015.

U.S. commercial banks have increased their holdings of U.S. Treasuries over the past few years. Since December 2013, holdings of U.S. Treasuries have increased by $176.1 billion. On June 30, 2015, U.S. Banks held $660.4 billion of U.S. Treasuries, representing 4.31 percent of their total assets. This increase has occurred at the same time that concerns have arisen about increased volatility in the U.S. Treasury bond market. Regulators and government officials worry that the market's volatility will pose a new risk to banks and decrease the attractiveness of U.S. Treasuries. Analysts worry that a rising rate environment will negatively impact banks with large bond portfolios.

Defining Your Innovation Agenda

We are in the midst of remarkable change. Technology-fueled innovation is changing virtually every aspect of our lives – including how we conduct our financial lives.

Winning in the Digital Age

In the media, there are loud voices proclaiming that traditional banking is poised for serious disruption, and that digital banks will win the day. We've heard this proselytizing before. More than twenty years ago, Bill Gates proclaimed that "Banking is essential. Banks are not." And yet, banks remain highly relevant in today's world, and traditional banks aren't going away. The rapid proliferation of financial technology applications is upon us, but we believe traditional banks will ultimately gobble up the best disruptors and their technologies, thereby morphing into better companies with more relevant value propositions in the digital age.

Still, the world is changing fast, and it is imperative to have an innovation agenda. This agenda should include innovations to improve your value propositions to your clients as well as those designed to improve your business processes to drive higher levels of efficiency and productivity. While most bankers see this need, sorting through the vast array of alternative innovations is daunting. Every bank needs to make it the responsibility of individuals to set the innovation agenda, and progress on this agenda needs to be a regular feature of executive management discussions. Without a proactive approach, your bank may get left behind as innovation continues to change lives – and the banking business – in profound ways.

Where should you go to look for innovative solutions for your bank? One place to start is KPMG's annual "The 50 Best Fintech Innovators Report". The most recent of these was published in December 2014 and you can find it here: http://fintechinnovators.com/. Contact Mary Beth Sullivan at 202-337-7872 or msullivan@capitalperform.com to discuss how to define your innovation agenda.

Commercial Banking Executives Need Better Performance Metrics

In recent years, many banks have made significant investments in the commercial business to drive growth and to deepen customer relationships. These investments have come in the form of hiring relationship managers, adding treasury management products and staff, and installing new technologies. At the same time, interest spreads on commercial loans have declined and capital and liquidity requirements have increased which have put pressure on profitability. Executives want to ensure that their investments are generating growth, profit, deeper relationships, and that the resources are productive.

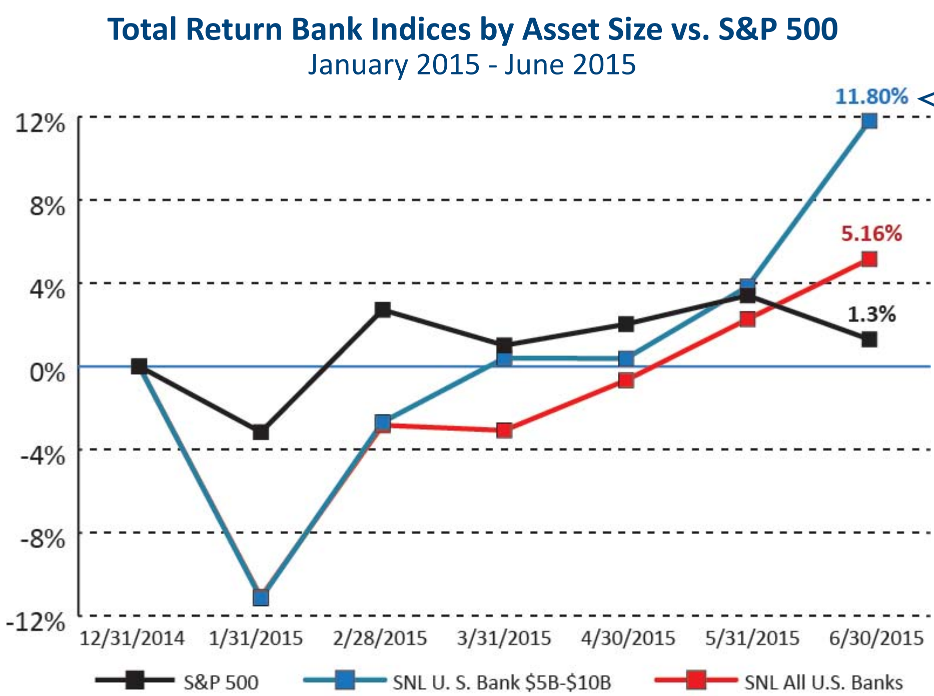
Yet the analytics that executives currently must rely upon to assess performance are often inadequate. While executives typically can measure progress against their bank's past performance or across markets, they lack metrics to assess performance gaps or identify improvement opportunities relative to an industry norm or an objective performance standard. There are industry metrics that address very specific elements of the business such as loan pricing, but they provide insights into only a narrow part of the business. Other sources of performance metrics gather and present data in a manner that make comparisons among banks problematic. The end result is that executives have to juggle multiple sources and in the end often must rely more on intuition than hard data when they make strategic decisions.

The dearth of reliable industry benchmarks means that executives are forced to make strategic and day-to-day business decisions partly in the dark. For example, expanding treasury management services and sales has been a strategic focus for many banks; however, it is difficult to definitively state what constitutes best-in-class performance of treasury management sales within a comparable customer segment.

Comparative benchmarks would help commercial executives to objectively evaluate performance in fundamental areas such as growth in primary relationships, cross-selling, and the productivity of relationship managers. Reliable, comparative benchmarks have been developed and are widely used in consumer banking. Commercial bankers should undertake a similar effort. Some people argue that the commercial business is a more complex business and benchmarking is therefore impossible. Yet reason tells us that the menu of products and services is finite and therefore a common list of core offerings could be defined. Similarly, a common definition around customer segments could be derived. The key to building reliable benchmarks is to start simply. The effort would pay dividends in the form of much improved management information.

Commercial banking generates a significant portion of the revenue at most institutions and in recent years it has been the focus of growth and investment. The business is too complex and the profit pressures too great for executives to be hamstrung using the same crude analytics developed years ago. Commercial executives need reliable, comparable benchmark data to enable them to make better informed business decisions, to direct resources to the areas of greatest opportunity for improvement, and to better gauge their institution's performance vis-à-vis industry norms.

Bank Stocks: First Half Report Card



The three banks with the highest total return for the first half of 2015 among U.S. Banks with assets between $5B and $10B were:

1. Pinnacle Financial Partners; Nashville, TN
2. Heartland Financial USA; Dubuque, IA
3. Customers Bancorp; Wyomissing, PA

Despite a rocky start, bank stocks generated a higher return than the overall market for the first half of 2015. Among the various groups by asset size, banks with assets between $5B and $10B produced the highest total return. Pinnacle Financial Partners (Nashville, TN) recorded an impressive total return of 38.2%. The bank achieved an impressive 15.44% return on average tangible common equity during the first half of the year by growing wealth management income and interest income from robust growth in commercial real estate loans.

Source: SNL Financial, LC, 2015.
Note that the SNL indices includes all Major Exchange (NYSE, NYSE MKT, NASDAQ) Banks in SNL's coverage.