MID-SIZE BANK COALITION OF AMERICA

"Main Street" Is Well-Served by Healthy Moderate-Sized Banks

Discussion Points

James M. McCormick, President

First Manhattan Consulting Group

To: MBCA Members:

We are pleased to offer this perspective in the hopes that it can play some role in helping the industry we have served for 32 years. (This is a pro bono contribution.)

— The Officers of First Manhattan Consulting Group

This document is intended to accompany an oral commentary.
By itself, it is an incomplete record of the presentation.
Address comments or questions to:

James M. McCormick
President

First Manhattan Consulting Group
(212) 557-0500
www.fmcg.com

This material may not be reproduced in whole or in part without express written consent of First Manhattan Consulting Group.

Notes:

1. *Data shown is from FMCG analysis of SNL data as of 2Q 2012 unless otherwise noted*
2. *Please refer to Appendix A to see which specialty / nontraditional banks were excluded from this analysis.*

Executive Summary

"Main Street" Is Well-Served by Healthy Moderate-Sized Banks

I. Largest banks dominate assets, but smaller banks remain material to Main Street

II. Mid-size and small banks invest greater % of capital in services for Main Street

III. There is a low-risk formula that serves Main Street well and previously delivered sustainable ROE

IV. Recent regulations and interest rates are penalizing the low risk formula

V. Mid-size banks will be key if consolidations of small banks are necessary

VI. Regulation should focus on defining "alarm bells" that foreshadow higher risk taking. Pre-crisis, those with bells ringing tended to be among the largest banks.

The next pages amplify these points.

I. Largest banks dominate assets, but smaller banks remain material to Main Street:

1. Banks greater than $50B hold 78% of U.S. assets
2. Banks smaller than $50B hold 22% of assets but provide ~50% of banking to Main Street:
   a. “Retail” deposits: Hold 48%
   b. Branches: Operate 56%
   c. Total C&I loans under $1mm: Provide 50%
   d. Provide greater branch coverage of less populated areas.

Note: (1) Herein, the term “Main Street” refers to SMEs and consumers. (2) “Retail” branch and deposits exclude HQ and other nontraditional retail branches

II. Mid-size and small banks invest greater % of capital in services for Main Street:

1. Mid-size banks $10B to $50B. Relative to banks >$50B, on an asset-indexed basis:
    a. Branches: *Operate 2.7 times as many*
    b. Retail deposits: *Hold 2.6x*
    c. C&I loans LT$1mm: *Provide 2.5x*
    d. Total C&I loans: *Provide 1.4x*
2. Banks $1B to $10B:
    a. Branches: *Operate 4.1x*
    b. Retail deposits: *Hold 2.8x*
    c. C&I loans LT$1mm: *Provide 3.4x*
    d. Total C&I loans: *Provide 1.1x*
3. Banks less than $1B:
    a. Branches: *Operate 5.6x*
    b. Retail deposits: *Hold 4.0x*
    c. C&I loans LT$1mm: *Provide 5.0x*
    d. Total C&I loans: *Provide 0.9x*

***Net:* Banks less than $50B have a greater Main Street "DNA."**

III. There is a low-risk formula that serves Main Street well and previously delivered sustainable ROE:

1. Back-to-Basics (BtB) banks have outperformed in both the pre-crisis and post-crisis periods. From 1Q ’00 to 2Q ’12, among the 70 largest regional-type banks:
   a. The 20% most BtB oriented saw a *123% increase* in total shareholder return over the cycle
   b. The 20% least BtB oriented *fell 55%*
2. BtB banks derive a greater % of spreads and revenues from low risk services, e.g.:
   a. Higher retail deposits and payments as a % of assets
   b. Lower rates paid on core deposits
3. BtB banks have gained retail market share on an organic basis evidencing their service emphasis. Market research of customers confirms their advantage.

***The result:* BtB banks did not need to pursue higher risks in order to achieve acceptable returns.**

Note: See Appendix B for additional information on “Back-to-Basics” banks as defined by First Manhattan Consulting Group

By size, mid-sized banks tend to be more BtB / lower risk oriented:

1. Banks greater than $50B with 78% of assets:
   a. Only ~1/3 of these largest banks were BtB oriented
   b. Held ~93% of the assets of all non-BtB banks
   c. Received 91% of TARP
   d. On average, they stretched their loan to core deposit ratio, often with adverse consequences
2. Banks $10B to $50B with 6% of assets:
   a. ~2/3 of these mid-sized banks were BtB oriented
   b. Held only ~3% of the assets held by all non-BtB banks
   c. Received 4% of TARP.

IV. Recent regulations and interest rates are penalizing the low-risk formula:

1. Reg E
2. Durbin
3. Low interest rates and a flat yield curve
4. Extra costs associated with more demands related to, e.g., stress testing, compliance, examinations, etc.

Among the consequences of penalizing low risk activities are:

1. Inability to achieve sustainable profitability without, e.g.:
   a. Reducing service levels
   b. Seeking returns from higher risk activities
2. A reduction in convenience, e.g., ~15,000 branches operated by banks less than $50B have less than 60% of their “fair share.”

V. Mid-size banks will be key if consolidations of small banks are necessary:

1. Banks $1 to $10B are material to Main Street:

   a. Retail deposits: Hold 16%

   b. Branches: Operate 20%

   c. Total C&I loans under $1mm: Provide 18%

2. Banks less than $1B are also material to main Street:

   a. Retail deposits: Hold 22%

   b. Branches: Operate 26%

   c. C&I loans under $1mm: Provide 23%

3. Pressure on earnings at smaller banks is high, in part due to scale deficiencies exacerbated by regulation

Mid-size banks share Main Street "DNA" and can be effective consolidators that will preserve that emphasis.

VI. Regulation should focus on defining "alarm bells" that foreshadow higher risk taking:

1. FMCG analyzed the largest 70 regional-type banks. Banks were given an "alarm bell" if their performance was in the bottom third of the peer group during the pre-crisis period of 1Q 2005 to 2Q 2007 on any of these measures:
   a. Loan to core deposit ratio
   b. Cost of deposits
   c. Net charge off (NCO) volatility
   d. Same-store deposit growth
   e. Faster growth in loan categories with higher yields
2. The more "alarm bells" a bank had pre-crisis, the further its stock fell from its peak:
   a. Those with no bells only lost 8 percent of their stock price from their peak in 2Q '07 to 1Q '11
   b. Those with one bell fell 20 percent
   c. Those with two bells fell 24 percent
   d. Finally, the 18 banks that had three or more bells incurred massive declines, and five failed. On average this group was down 93 percent
3. Surprisingly, banks with fewer alarm bells did not sacrifice stock performance in the pre-crisis period. Banks with fewer bells gained more value between 1Q '00 and 2Q '07 than those with a high number of bells ringing.

BtB banks achieved higher returns at lower risk in both stages of the cycle.

Note: Higher loan yields tend to be indicators of higher risk. There are exceptions where a bank has distinctive expertise that can mitigate higher levels of expected risk or volatility

Appendix A: Specialty / Nontraditional Banks Excluded

	Bank	Assets, as of 2Q 2012 ($B)
1	MetLife	$825
2	Bank of New York Mellon	$330
3	State Street	$200
4	Ally Financial	$179
5	Principal Financial Group	$152
6	American Express	$147
7	Ameriprise Financial	$135
8	Charles Schwab	$112
9	United Services Automobile Association	$111
10	Discover Financial Services	$73
11	Deutsche Bank Trust	$65
12	E*TRADE Financial	$49
13	CIT Group	$43
14	UBS	$41
15	GE Capital Retail Bank	$27
16	Scottrade Financial Services	$21
17	SVB Financial Group	$21
18	Raymond James Financial	$21
19	Barclays Delaware Holdings	$17
20	Blackrock Institutional Trust Company	$16
21	State Farm Bank	$15
22	GE Capital Bank	$14
23	Franklin Resources	$14

Source: SNL data; FMCG analysis

M B C A

MID-SIZE BANK COALITION OF AMERICA

Appendix B—Supplemental Information

Back-to-Basics Banking:

James M. McCormick, President

First Manhattan Consulting Group

In early 2009, we searched for a banking success formula

- Analyzed regional franchise-type banks
- Assessed drivers of profit, growth, and risk

Found a "Back to Basics" (BtB) model with

HIGH RETURNS & LOW RISK

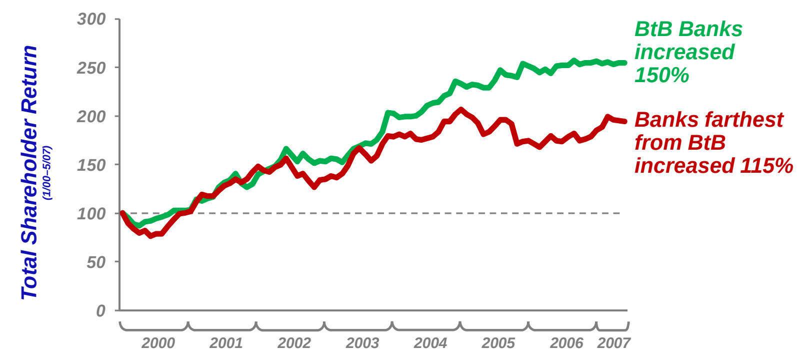
Note: See also FMCG's article "Death by Strategy" in *Bank Director Magazine*, 3Q 2011

POST-CRISIS, BtB banks outperformed

Note: TSRs shown are the median values of the respective quintile groups. Analysis of a Regional Franchise Bank peer group; excludes money center and other specialty banks

Source: FMCG Back to Basics Model; Regulatory data

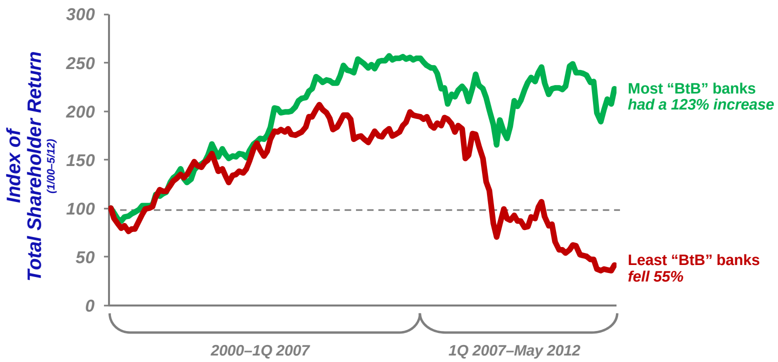
Surprisingly, in the PRE-CRISIS risk quiescent phase, BtB banks also outperformed



Note: TSRs shown are the median values of the respective quintile groups. Analysis of a Regional Franchise Bank peer group; excludes money center and other specialty banks

Source: FMCG Back to Basics Model; Regulatory data

The difference over the cycle is huge

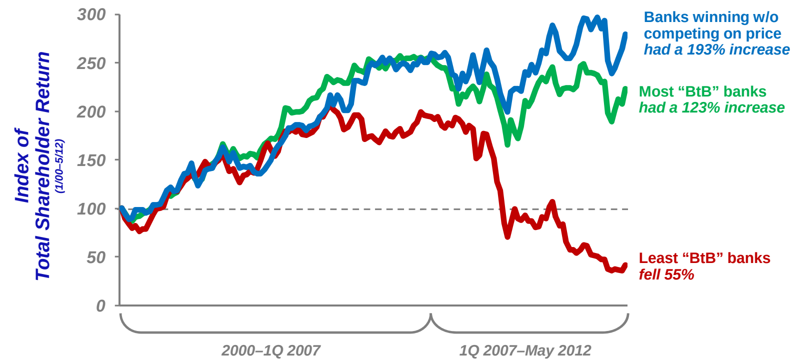


Note: TSRs shown are the median values of the respective quintile groups. Analysis of a Regional Franchise Bank peer group; excludes money center and other specialty banks

Source: FMCG Back to Basics Model; Regulatory data

© 2012 FMCG MBCA 01 AppB 12 0918 2p (jmc)bd 4

BtB banks that did not compete on price did even better



Note: TSRs shown are the median values of the respective quintile groups. Analysis of a Regional Franchise Bank peer group; excludes money center and other specialty banks

Source: FMCG Back to Basics Model; Regulatory data

© 2012 FMCG MBCA 01 AppB 12 0918 2p (jmc)bd 5

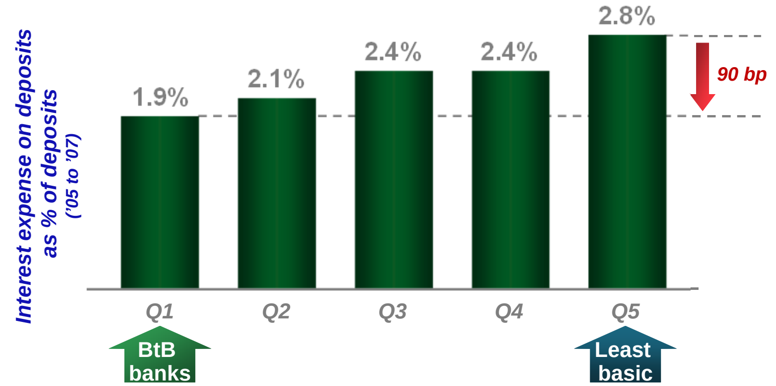
BtBs focused on ROE vs. stretching for EPS

	BtB Banks	Least Basic Banks
• EPS growth		
– Pre-crisis ('00–1Q'07)	10%	14%
• Recurring ROE		
– Pre-crisis ('00–1Q'07)	15%	13%
– '05–'07	15%	11%
• Loan-to-core deposits		
– Early pre-crisis ('00 to '01)	100%	120%
– Later pre-crisis ('05 to '06)	100%	160%

Source: FMCG Back-to-Basics Model. Analysis of a Regional Franchise Bank peer group; excludes money center and other specialty banks

© 2012 FMCG MBCA 01 AppB 12 0918 2p (jmc)bd

Pre-crisis, low funding cost was a key success underpinning



Source: FMCG analysis of regulatory FDIC call reports and Federal Reserve Y-9 reports. Analysis of a Regional Franchise Bank peer group; excludes money center and other specialty banks

© 2012 FMCG MBCA 01 AppB 12 0918 2p (jmc)bd

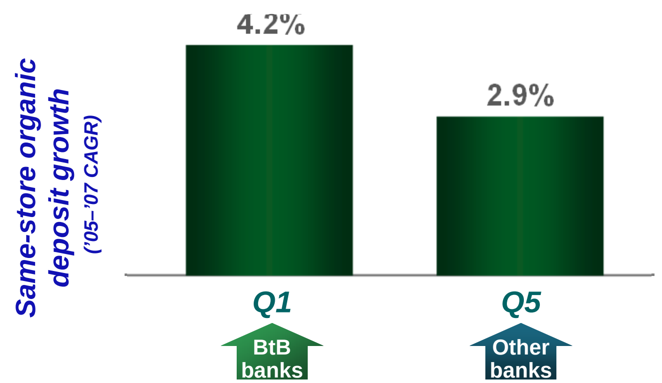
Banks that stretched loan-to-deposit ratios were

- More dependent on wholesale funding
- Less frequently lending to deposit relationship customers

Ultimately this

- Decreased NIM
- Resulted in originating riskier assets

Notwithstanding lower rates paid, BtBs achieved higher deposit growth



Source: FMCG analysis of regulatory FDIC call reports and Federal Reserve Y-9 reports. Analysis of a Regional Franchise Bank peer group; excludes money center and other specialty banks

As per "Death by Strategy," signs of trouble were evident from regulatory data

- **"Alarm bells" were often unappreciated**
- **Banks with 3+ bells ringing incurred stock price declines averaging 91%**
- **Many were ranked highly by some sell-side analysts right before the crisis**

Note: FMCG's article, :Death by Strategy" appeared in *Bank Director* magazine, 3Q 2011

© 2012 FMCG MBCA 01 AppB 12 0918 2p (jmc)bd

"Alarm bells" ringing at banks furthest from the Back to Basics model

- **High loan-to-deposit ratio**
- **High relative cost of deposits**
- **Low same-store deposit growth**
- **Growing loan categories with higher yields (particularly out of market)**
- **Higher charge-off volatility**

© 2012 FMCG MBCA 01 AppB 12 0918 2p (jmc)bd

Partial list

Strategy is more important than size or geography

Back to Basics Banking

Least "BtB" Banks	***Most "BtB" Banks***
~~Wachovia~~	BB&T (NC)
~~National City~~	Wells Fargo (legacy)
~~Colonial~~	Commerce (MO)
~~UCBH~~	Cullen/Frost (TX)
~~South Financial~~	City National (CA)

Note: Universe includes Regional Franchise Banks; Regional Franchise Banks include approximately 80 regional banks over $4B in assets excluding money center and specialty banks (e.g. State Street, Countrywide, and MetLife banks)
Source: FMCG analysis of market data, regulatory FDIC call reports and Federal Reserve Y-9 reports

Strategy at top performers

1. Did not sacrifice profitability for EPS growth
2. Emphasized low-cost funding
3. Focused on profitable, organic growth
4. Had an answer to "Why should I bank with you?"
5. Emphasized deep, in franchise relationships
6. Served them distinctively; got paid for doing so
7. Defined and enforced "What we don't do"

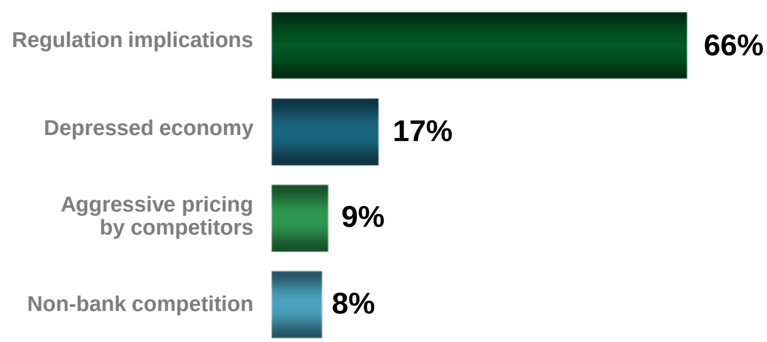
Punishing forces include

- Low/flat yield curve
- Regulations impacting revenue
- Regulations impacting capital
- Regulations impacting liquidity
- Regulations adding compliance cost
- Higher FDIC insurance cost
- Low loan growth

© 2012 FMCG MBCA 01 AppB 12 0918 2p (jmc)bd

Survey: What pressures on ROE will be the most challenging to mitigate?

(Nov 2010 NYBA survey; % of votes among C-level executives and Board members)



© 2012 FMCG MBCA 01 AppB 12 0918 2p (jmc)bd

Pre-crisis, most banks had attractive results from branch-based banking

- Margins were often 50+% (fully loaded)
- ROE typically exceeded 25%
- Achieved with low risk
- For many, retail was 50+% of income and increased bank ROE
- Additionally, most consumers got a good deal

© 2012 FMCG MBCA 01 AppB 12 0918 2p (jmc)bd 16

Ways to improve ROE:

REDUCE SUBSIDIZATIONS

- Pre-crisis, powerful units bolstered overall ROE
- Hidden in most banks are low return activities
  - Businesses/products
  - Customers, individually and by segment
  - Branches
  - Employees, e.g., RMs with low return portfolios

© 2012 FMCG MBCA 01 AppB 12 0918 2p (jmc)bd 17

Actions to reduce subsidizations

1. Analyze risk-adjusted results at a granular level
   – Line of business profitability
   – Product profitability
   – Customer and segment profitability
2. Act on findings
   – Reduce cost
   – Change pricing
   – Modify marketing; target segments
   – Shrink to a profitable core
   – Exit

© 2012 FMCG MBCA 01 AppB

RETAIL BANKING:
All the Strategic Dimensions Are in Flux

What Retail Will Achieve
- Outlook downgraded
- Revenues punished
- Share shift to increase
- Some new formula bank winners will emerge

Where Retail Will Focus
- Product line in flux
- Payments features in flux
- Pricing in flux
- Segments in flux
- Distribution in flux
- Nonbank innovation is intense

How Retail Will Win
- Value propositions are being re-examined
- Customer analytics will finally have impact
- Selectivity in innovation will be key
- IT weakness will hurt some
- Avoiding attrition while cutting / streamlining is key
- HR needs are in flux

How Retail Will Be Managed
- Metrics in flux
- Organizations in flux
- Focus is a priority, but more difficult now
- Accountability and incentives are in flux

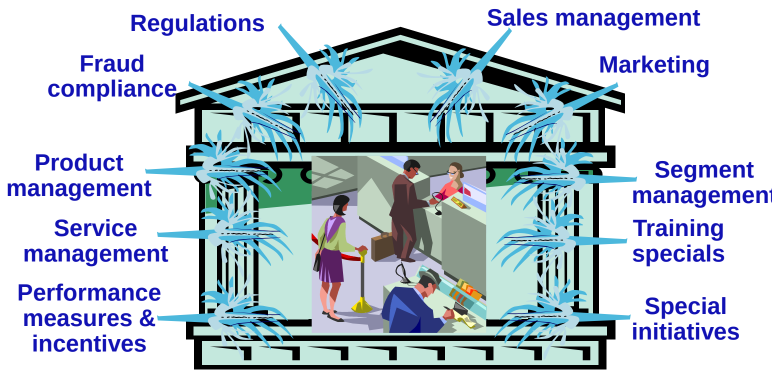
© 2012 FMCG MBCA 01 AppB

Consumers prefer community banks and the people in them

Survey: Is your bank…	Large banks	Community banks
• Easy to do business with	53%	81%
• A bank you trust	48%	78%
• Responsive staff	46%	74%
• Quick in resolving problems	41%	70%

Source: BAI research report – "Navigating in Turbulent Times – Competing for Deposits and Relationships" (Q1 2010)

Opportunity: Reduce the "fire hose" of initiatives aimed at the front line



9 opportunities to maximize Retail

1. Define an elevator pitch; why bank here; make it real
2. Use elasticity-based pricing on deposits and loans
3. Redesign fees on checking/payments/channels
4. Reduce subsidization of unprofitable accounts
5. Evolve branches, call center, and self-serve channels
6. Reduce complexity and the bandwagon of associated costs
7. Streamline regulatory compliance and other processes
8. Replace/cut non-productive marketing
9. Realign performance metrics and incentives

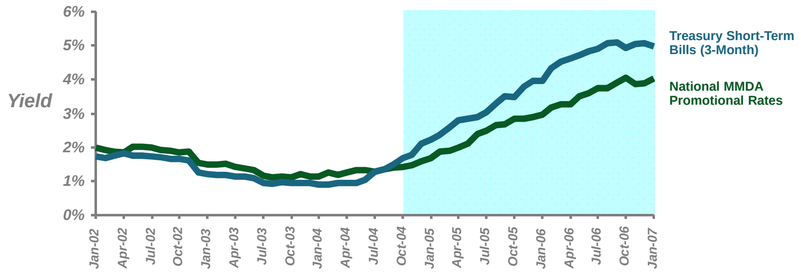
© 2012 FMCG MBCA 01 AppB 12 0918 2p (jmc)bd

Breakthroughs have been achieved using targeted marketing

- **Small Business:** 1,000+% ROMI, double growth rate in new customers, accounts and balances
- **Consumer deposits:** 300% ROMI for customer cross-sell, and 100% for prospects
- **Home equity:** 360% ROMI
- **Mortgage:** 530% ROMI
- **Wealth management:** 200% ROMI

© 2012 FMCG MBCA 01 AppB 12 0918 2p (jmc)bd

Experience suggests that deposit spreads will widen when rates increase



Note: Analysis of MMDA promotional ("lead offer") rates weighted by regional deposits
Source: Bloomberg, Informa, FMCG Branch Database 2010

The value of reducing complexity

- Customers happier; lower attrition
- Employees more satisfied; lower attrition, lower training costs
- Lower rework
- Lower HQ, IT, and compliance costs

CORPORATE BANKING

Opportunities to reduce subsidizations

© 2012 FMCG MBCA 01 AppB

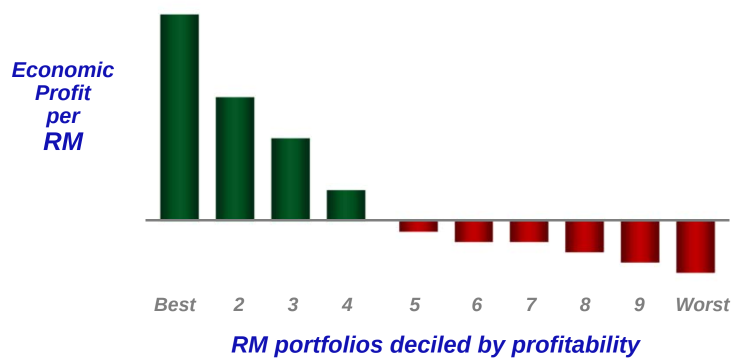
Case study

In Commercial/Corporate banking, many customers are being subsidized

© 2012 FMCG MBCA 01 AppB

Illustrative

RM effectiveness is skewed. ~40% provide all the shareholder value



Source: FMCG case studies of multiple banks

© 2012 FMCG MBCA 01 AppB

WEALTH MANAGEMENT

Opportunities to increase revenue

© 2012 FMCG MBCA 01 AppB

In targeting investors, awareness of customer engagement preference and decision-making style is key

U.S. Investment Account Holders

Broker-Reliant Delegator	Savvy Sounding-Board Seeking Investor	Price-Sensitive, Self-Directed Investor	Insecure Investing Novice	Skeptical, Fund-Oriented Investor	Undistinguished/ Disengaged
Incidence: ~15% Investable assets Index:190	Incidence: ~15% Investable assets Index: 110	Incidence: ~15% Investable assets Index: 170	Incidence: ~20% Investable assets Index: 40	Incidence: ~15% Investable assets Index: 70	Incidence: ~20% Investable assets Index: 60

© 2012 FMCG MBCA 01 AppB 12 0918 2p (jmc)bd

Banking Outlook

- Near-term under pressure
- The best will
  - Emerge with attractive ROEs
  - Gain share

© 2012 FMCG MBCA 01 AppB 12 0918 2p (jmc)bd

Strategic Issues: Illustrative list

- **Do we focus on the right metrics and "alarm bells"?**
- **Have we identified low ROE activities and actions?**
- **Do our businesses have a compelling elevator pitch?**
- **Is our front line equipped to be heroes with customers? Are incentives aligned?**
- **Are there opportunities to streamline/reduce complexity?**
- **Do we have a manageable set of priorities?**
- **Are we making the right moves related to**
  - **Distribution?**
  - **Segmentation?**

First Manhattan Consulting Group

Thank you

www.*FMCG*.com