A Quarterly Journal

BANCOLOGY

FEBRUARY 2018 VOLUME 65

THE ART OF POSITIONING
bancography
BRANCH PRODUCT RESEARCH BRAND

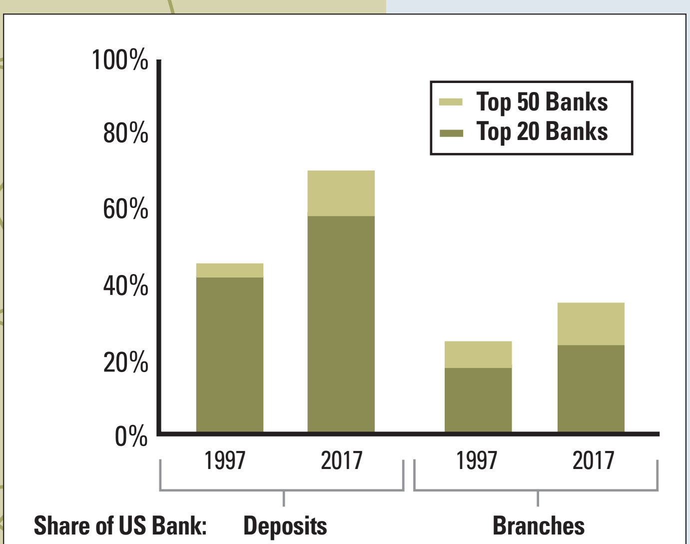
By the 2017 reporting period, the count of U.S. banks had been sliced nearly in half, to 5,797 banks and thrifts.

Credit Unions: The New Community Banks

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 allowed full interstate expansion for banks, whether through de novo branching or mergers. The full provisions of the law took effect in 1997, and in the 20 years since, the banking industry saw a wave of consolidation.

In the June 30 FDIC reporting period in 1997, there were 11,189 banks nationwide (including thrifts). By the 2017 reporting period, the count of U.S. banks had been sliced nearly in half, to 5,797 banks and thrifts. Though several hundred of those banks left the industry due to failure in the financial crisis of 2008 and ensuing years, most of the decline in bank counts occurred through merger.

The consolidation in the industry also led to great increases in concentration. In 1997, the 50 largest U.S. banks held 38% of all bank deposits, and the 50 largest branch networks accounted for 27% of all bank branches. In 2017, the 50 largest banks held 70% of bank deposits and the 50 largest networks accounted for 45% of bank branches. Even the top-50 peer group grew more concentrated, with the 20 largest banks holding 57% of U.S. bank deposits compared to 25% in 1997.



The growth of the top institutions arose at the expense of local community banks, and as smaller institutions merged into larger ones, locally owned banks evaporated from the upper competitive tier in many U.S. markets. As a result, in 40 of the 50 largest metropolitan areas in the U.S., the three largest institutions by deposit share are all regional or national banks[1].

In some of the nation's largest markets, the seven or eight top-ranking banks (by deposits) are all large institutions based out of state; for example, Baltimore, Orlando, Philadelphia, San Jose, Tampa and Washington. Other markets such as Atlanta and San Francisco include locally based banks in their top-share tiers, but those institutions (SunTrust and Wells Fargo, respectively) still maintain operating models typical of regional and national banks. In sum, the raft of consolidation in the industry over the past 20 years has left many markets devoid of sizable but locally owned institutions, and consumers who value the combination of local decision making, reinvestment of their deposits within their home markets, and widespread branching convenience may find their options limited.

In many such markets, community-chartered credit unions have grown into the void left by bank consolidation. In 17 of the 50 largest metros, credit unions represent the largest locally based provider (when ranked by deposits), including markets as widespread as Baltimore, Tampa, Phoenix and Seattle[2]. In 35 of the top-50 metros, at least one credit union ranks among the three-largest locally based providers, allowing those institutions to use a marketing premise historically employed by community banks – that is, the option for consumers to use a locally based, community-invested provider. At a time when much of the commercial banking side of the industry is bifurcating into divergent segments – the largest regional / national banks and boutique providers emphasizing business over consumer clients – credit unions can fulfill a vital role not only as banking providers, but also as employers, philanthropic contributors and municipal leaders in a manner historically performed by community banks.

All these top-ranking credit unions originally arose from Select Employer Group (SEG) or Trade, Industry, Profession (TIP) charters, but most have since converted to community *(continued on page 3)*

[1] Defined as multi-state institutions maintaining at least 150 branches; or institutions operating branches in five or more states and at least 50 branches overall. The study also excludes non-branch based competitors from the market deposit rankings, including online banks such as Ally, brokerage affiliates such as E-Trade Bank, industrial loan corporation banks, bank-chartered investment banks such as Goldman Sachs, and other specialty institutions such as State Street Bank.

[2] Unlike banks, credit unions are not required to disclose deposits at the branch level. This analysis assigns deposits to a credit union's home market based on the proportion of its branches in that market. This method is conservative, as Bancography's empirical research shows average branch size to be larger in a credit union's home market. Credit unions are not ranked outside their home markets, i.e., credit unions are considered only in their home markets for this analysis.

Findings from the 2017 FDIC / NCUA Deposit Statistics

Across the nation, the increased deposit growth, even with reduced branch counts, bodes well for the industry's profitability in the year ahead.

In October 2017 the FDIC and NCUA released the latest deposit summary information, reflecting the balance sheets of banks and credit unions as of June 30, 2017. Consumer and small-business deposits grew by 4.8% from 2016 to 2017, the fastest pace since the 'flight-to-quality' jump in 2009 that followed the severe stock market devaluation of the prior year. Over the past four years, consumer and small-business deposits grew at a 4.1% compound annual rate. Total deposits, including corporate and public-funds balances, grew by 5.2% over the past year and at a 5.9% clip over the past four years annualized, the difference reflecting corporations retaining sizable cash holdings on their balance sheets versus immediately investing those funds.

Five states, all in the western part of the nation, posted consumer / small-business deposit growth in the 7% - 8% range over the past year: Washington, Utah, Oregon, Arizona and Idaho. At the opposite extreme, five states languished with deposit growth of less than 3%: South Dakota, Wyoming, Alaska, North Dakota and Louisiana. Notably, all five of those bottom-ranking states show significant dependence on the energy sector (oil, gas, coal), underscoring the volatility of economies so highly dependent on energy prices.

The nation shed more than 2,000 branches over the past year, with the greatest reductions occurring in Texas, Florida and New York, each of which contracted their branch networks by more than 150 branches from 2016 levels. Seven other states showed declines of 100 -120 branches over the past year: Illinois, Ohio, Michigan, Wisconsin, Georgia, California and Virginia. In contrast, branch counts remained stable, with net changes in the +/- 5 branch range, in a group of smaller states that included Rhode Island, Vermont, Delaware, Hawaii, Maine, Montana, Wyoming, North Dakota, Alaska, Oklahoma and Nebraska.

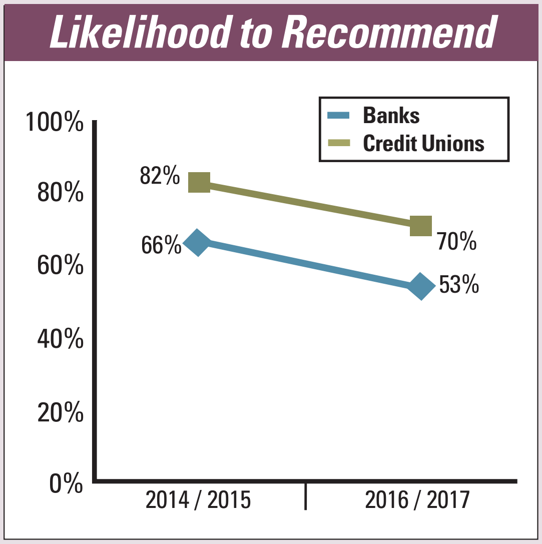
Notably, the nation's largest state in terms of population and branches experienced only modest declines, as the contraction of 100 branches in California represented only 1.2% of that state's 2016 inventory of more than 8,000 branches. However, branch counts declined by 2.5% - 3.0% in seven of the nation's other ten largest states, with Pennsylvania (-1.8%) and Michigan (-4.2%) representing notable outliers in opposite directions. Across the nation, the increased deposit growth, even with reduced branch counts, bodes well for the industry's profitability in the year ahead.

For information about deposit growth and branch trends in your state or local markets, contact Bancography at info@bancography.com

Loyalty Decreases for Banks and Credit Unions

Branding studies evaluate an institution's brand awareness and market potential in a market by assessing the strengths, weaknesses, opportunities and threats of the institution and its competitors, as well as the banking behaviors and preferences of consumers. Bancography's Brand Evaluator conducts telephone interviews with a random sample of households in a market. The survey itself is masked, i.e., interviewers do not reveal the name of the sponsoring institution.

One of the survey questions asked the respondents if they would recommend their primary financial institution to friends and associates. The chart to the right shows that, in the markets that Bancography studied in recent years, the likelihood to recommend decreased *(continued on page 4)*



Credit Unions: The New Community Banks *(continued from page 1)*

charters. Still, the historic origins of the institutions typically encouraged member recruitment based on workplace convenience or affinity reasons. As a result, average branch deposit bases in these leading credit unions tend larger; said another way, the institutions typically operate fewer branches than community banks of similar deposit size, and that may impede the institutions' ability to fulfill a traditional community-bank role. Still, many of the top-tier credit unions maintain sizable deposit bases and broad branch networks; for example, Desert Financial (formerly Desert Schools) with 43 branches in Phoenix; Golden 1 with 39 branches in Sacramento; State Employees' (37, Raleigh); Vystar (36, Jacksonville); and Bellco (21, Denver). Overall, credit unions maintain the largest local-provider branch networks in 16 of the 50 largest metros, and hold top-three branch network rankings among that peer group in 33 of the top 50 metros.

The rise of credit unions into the niche created by the erosion of mid-tier, marketwide community banks creates distinct implications for four segments of the banking industry.

- ***Regional and national banks need to recognize the larger credit unions as legitimate competitors*** that can approach, if not match, their level of branch convenience.
- ***Credit unions aspiring to market-leadership positions must assume the community-leadership roles historically fulfilled by local community banks.*** That role can include participation in government and quasi-governmental roles (e.g., economic development commission) as well as philanthropic leadership. Examples of such partnerships are growing, including prominent branding initiatives such as Golden 1's sponsorship of the new arena in Sacramento that hosts the Kings' basketball games in addition to concerts and other events; and more localized efforts such as WSECU's long-term partnership for educational programs at the Hands On Children's Museum in its home market of Olympia, Washington.
- ***The surviving cohort of marketwide, traditional, consumer-oriented consumer banks must reemphasize their own community ties*** and leverage any advantages in product depth or service quality they can create.
- ***And smaller banks that lack marketwide branch convenience must either consider expansion*** (de novo or merger) to broaden coverage, ***or specialization*** in a less convenience-driven segment such as commercial, mortgage or wealth management.

Numerous industries have migrated to the dichotomy shown in the commercial-bank sector, where success in the middle sales tiers has become increasingly difficult to maintain. For example, in consumer retail, firms such as Walmart and Amazon leverage massive-scale economies to compete on price; and small boutiques can thrive on the personalized service the retail giants could never deliver; but the once-sizable middle ground that department stores previously owned continues to erode. In the banking industry, years of consolidation have yielded steady increases in concentration, and the loss of 870 more banks over the past three years suggests these trends will continue.

Where is equilibrium? One possible model lies to the north. In Canada, five national banks dominate the landscape, joined by a handful of smaller banks with limited geographic footprints[3]. However, there are no institutions that most American bankers would view as traditional community banks, i.e., consumer-focused, branch-based institutions serving a specific geographic market. Rather, Canada contains approximately 300 credit unions, including 38 institutions with at least $1B in total assets and more than 20 institutions with 20 or more branches. In that context, credit unions fulfill a role in Canada similar to that of community banks in the U.S.

The U.S. population is roughly nine-times larger than that of Canada, so a proportionate scaling of the Canadian model would suggest the end result of consolidation equilibrating at 45 national banks, possibly backed by an assortment of single-market, commercial-banking specialists (a model adopted by many of the de novo institutions of the past 20 years); and with credit unions filling the middle ground once occupied by traditional community banks. Whether the U.S. reaches that stage remains speculative; but one certainty is that credit unions are increasingly assuming a role among the leading locally based, consumer-banking options within their respective markets.

Top-50 Markets with Credit Unions as Largest Community Provider

Market	Leading Community-Based Instition	Overall Deposit Rank	Branch Rank*	Leading Community Bank (Overall Deposit Rank)
Atlanta	Delta	7	5	Fidelity Bank (10th)
Baltimore	SECU	7	1	The Columbia Bank (11th)
Cincinnati	General Electric	6	7	First Financial Bank (7th)
Jacksonville	Vystar	3	1	Ameris Bank (8th)
Milwaukee	Landmark	7	4	North Shore Bank (8th)
Orlando	Fairwinds	7	2	Seacoast NB (11th)
Portland	Onpoint	5	2	Columbia State Bank (9th)
Raleigh	State Employees'	2	1	Paragon Bank (10th)
Richmond	Virginia	5	3	Union Bank (6th)
Sacramento	Golden 1	4	1	Rabobank (8th)
Salt Lake City	Mountain America	5	2	First Utah Bank (12th)
San Jose	Star One	6	5	Western Alliance (10th)
Seattle	BECU	3	1	Columbia State Bank (8th)
Tampa	Suncoast	5	1	USAmeriBank (9th)
Washington	Navy Federal	5	1	EagleBank (12th)
San Diego	San Diego County	5	1	Western Alliance (9th)
San Francisco	Patelco	10	2	Fremont Bank (11th)

** Among community institutions only*

[3] Canada also hosts a number of offices of U.S. and other foreign-owned banks, but almost all are major-metro commercial lending, investment banking, or wealth-management offices; none are traditional retail-banking branches.

Loyalty Decreases for Banks and Credit Unions (continued from page 2)

for both banks and credit unions over the last two years. Yet even with this drop, credit union customers still showed greater loyalty.

The decline in loyalty across the industry may reflect increased online bill pay and mobile-banking usage. While online and mobile customers are more likely to continue to use their primary financial institution, they may become less likely to recommend it because they have an electronic relationship with the institution rather than a personal one; and personal relationships lead to increased cross-sell and loyalty.

A secondary cause of waning loyalty is continued merger and acquisition activity. Conversions can bring product and service changes that impact customer loyalty, and require increased systems and sales training for financial-institution staff, which can shift their focus away from the customer experience.

The banking industry will continue to fluctuate due to the broadening array of alternative banking channels and the changing competitive landscape. In this environment, management must keep sight of the importance of loyalty and how it contributes to customer retention and profitability.

THE ART OF POSITIONING
bancography
BRANCH PRODUCT RESEARCH BRAND

1827 First Ave. N., Suite 200
Birmingham, AL 35203
205.251.3227

Return service requested

Presort Standard
U.S. Postage
PAID
Birmingham, AL
Permit No. 148

THE ART OF POSITIONING
bancography
BRANCH PRODUCT RESEARCH BRAND

Welcome to Bancology,
a Quarterly Journal from Bancography