Creating Competitive Advantage: 
2016 Priorities in Community Bank Technology

TechMecca    February 11, 2016
IBAT Annual Technology Survey

- About the survey
  - Conducted January, 2016
  - Collect data on the technology investment priorities of member banks
  - Provides vital information for the Services Board
  - Provides insight to members

- What’s different this year
  - Expanded to include strategic issues facing member banks
  - Understand technology investment in the context of member bank’s goals and opportunities
  - Enables IBAT to provide better resources to membership and align recommendations with the most effective strategies to create competitive advantage in today's environment.

- IBAT's survey was administered by Austin-based Peak Performance Consulting Group, which compiled and analyzed results
About Us:

• Based in Austin, TX
• Specialty focus on banking and financial services
• Disciplined process and deep expertise
• Results oriented, with proven success with clients ranging from community banks to “Top 10”

What We Do

• Distribution
• Productivity
• Market Strategy
• Strategic Planning

How We Do It

• BankPower® market and distribution analytics
• Peer benchmarking and process improvement
• Marketing assessment and sales optimization
• Strategic analysis and risk management tools
Today’s discussion

1. Overview of Survey

2. Key issues facing the industry

3. Roadmap for success
Responses representative of membership

73% of Respondents C-Level

- CEO: 24%
- CFO, CIO, etc.: 49%
- All Other: 27%

Median Respondent $250 Million in Assets

- $1 Billion and over
- $500-$999.9 million
- $250-$499.9 million
- $100-$249.9 million
- $50-$99.9 million
- Under $50 million

Median Respondent $250 Million in Assets
Most respondents in rural markets – but good representation from banks facing larger competitors

- Typical respondent operates primarily in rural areas competing with other community banks. One respondent noted: “Poorest county in Texas”
  - Rural composition may be overstated. Some banks on fringes of expanding metropolitan areas described their market as rural even though customers primarily worked in Austin, Houston or Dallas
- But others had broader mix: “On the edge of the Dallas-Ft. Worth Metroplex”
Core processors: 3 firms control 65% of the market

- Highly concentrated
- Only 4% reported plans to change core processors (compared to 8% in 2015)
Mobile and internet banking providers: more competition

Providers dispersed among the following (in order of number of respondents):

1. Jack Henry
2. Q2
3. First Data
4. FIS
5. CSI
6. Digital Insight

Equal number of responses
Near term priorities for IT investment

- Solve EMV transition
- Upgrade cybersecurity
- Make branches more efficient
- Don’t get left behind by Apple Pay and other new payment initiatives

<table>
<thead>
<tr>
<th>IBAT Member IT Priorities, 2016</th>
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<tbody>
<tr>
<td>EMV transition</td>
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<tr>
<td>Additional IT compliance</td>
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<tr>
<td>Payment initiatives (Apple Pay, etc.)</td>
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<tr>
<td>Branch automation (teller capture, cash dispenser, etc.)</td>
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<tr>
<td>Regulatory compliance support</td>
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<tr>
<td>Document imaging</td>
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<tr>
<td>Upgraded mobile banking</td>
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<tr>
<td>Customer engagement tools (personal financial management, text...)</td>
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<tr>
<td>Cloud storage</td>
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<tr>
<td>Data dashboard</td>
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<tr>
<td>Board doc support</td>
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<tr>
<td>Branch transformation initiatives</td>
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<tr>
<td>Social media compliance support</td>
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<tr>
<td>Treasury management</td>
</tr>
<tr>
<td>Other</td>
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<tr>
<td>CRM or data analytics tools</td>
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</table>
1. Overview of Survey

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More change in last 5 years than in past 3 decades

Pressure on profitability

- Increased regulatory burden
- Increasing costs from new technology to keep pace
- Low rates continue to pressure margins

Pressure on revenue

- “No fee zone” – can’t charge for services that were important revenue drivers in the past
- Aggressive competition – many who are unburdened by bank regulation
- Assets growing faster than deposits

Changing customer behavior and expectations

- Changing branch and channel usage
- Changing use of technology
- Changing customer profitability mix with increased competitive emphasis on upper end
Key priorities: rank ordered by survey respondents

1. Regulatory pressure and compliance cost
2. Low interest rates and margin pressure/reduced ability to charge fees
3. Keeping up with emerging technology/increased competition from new entrants
4. Increased use of alternative channels (mobile, internet, social media)

<table>
<thead>
<tr>
<th>Issue</th>
<th>% ranking #1 or 2</th>
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<tbody>
<tr>
<td>Regulatory pressure and compliance costs</td>
<td>64%</td>
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<tr>
<td>Low interest rates and margin pressure</td>
<td>59%</td>
</tr>
<tr>
<td>Reduced ability to charge fees</td>
<td>26%</td>
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<tr>
<td>Impact of emerging technologies</td>
<td>20%</td>
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</tbody>
</table>
Quarterly net interest margin near historic lows

- Almost 70 percent of community banks reported higher net interest income than third quarter 2014

- But average NIM was down 3 bp as asset yields declined more rapidly than funding costs.
Banking industry income remains flat

- Earnings up, but profitability flat
- Lower non-interest expense key to higher earnings

Quarterly Net Operating Revenue
All FDIC-Insured Institutions

Source: FDIC.
### Key industry trends: % planning to implement

<table>
<thead>
<tr>
<th>Strategy</th>
<th>% Planning to Implement</th>
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<tbody>
<tr>
<td>Branch staff will have stronger cross selling and sales skills</td>
<td>67%</td>
</tr>
<tr>
<td>Branch staff will have greater responsibility for outside calling or local marketing</td>
<td>48%</td>
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<tr>
<td>We will shift resources to digital marketing and on-line account opening</td>
<td>45%</td>
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<tr>
<td>We will implement Universal Banker model, with greater convergence between teller and personal banker roles</td>
<td>40%</td>
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<tr>
<td>Branches will be more automated</td>
<td>40%</td>
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</table>
Strategies to improve earnings

IBAT Member Strategies to Improve Earnings

- Reducing back office expense and improving efficiency: 78%
- Improving sales and cross-selling skills: 59%
- Offering new products and services: 41%
- Expanding into new geographic areas: 29%
- Reducing branch staffing and labor cost: 27%
- Developing new channels of distribution: 27%
- Reducing branch distribution cost: 22%
Bank channels are adapting and changing

The physical distribution network needs to evolve: the number, the average size, what’s inside and the type of employee.

Yesterday
- Transaction center
- High traffic
- Structured roles
- Internally focused, traffic management and cross-sell

Tomorrow
- Advice center, integrate multiple channels
- Low traffic
- Flexible roles
- Community focused, outside sales and relationship management
Re-allocate staff

- Branch transactions declining
- Staff re-allocated to sales, with positive improvement in customer acquisition, relationship depth

Source: Fifth Third Bank investor presentations
Universal Banker

- Decreased need for specialization, especially around transactions

- Refocus staff away from transaction handling and toward relationship growth

- Universal Banker model is not just a training program but a major shift in focus, staff roles

- Sales and revenue will improve when combined with disciplined process
Shift to mobile: branch usage declining while mobile, on-line, RDC increasing

From: The Bancorp 4th Q 2014 Investor Presentation
Trend will increase as Millennials reach maturity

Millennials are Largest Population Group
Population by Generation in millions

Population Projections by U.S. Generation

Source: Pew Research Center, U.S. Census projections
Penetration of Mobile Banking low, with 10% of banks not offering.

IBAT Survey: Mobile Banking Sign Up and Usage

- 0% to 10% signed up, 0% active users
- 10% to 25% signed up, 15% active users
- 25% to 50% signed up, 25% active users
- 50% to 75% signed up, 30% active users
- >75% signed up, 5% active users
Customers less dependent on branch convenience

- Deposits growing despite decline in branches

![Number of Branches and Total Deposits](chart.png)
Mobile banking critical to decision to switch banks

% Who Said Mobile Banking Was Extremely Important or Important in Their Decision to Switch Banks Among Smartphone/Tablet Owners Who Switched Primary Banks in the Past Year, Q2 2010 – Q2 2014

From: Second Curve Capital
Today’s discussion

1. Changing world, many headwinds
2. Brief overview of Peak Performance
3. Finding the optimal pathways
Banking and customer behavior is in transition

- The physical distribution network needs to evolve: the number, the average size, what’s inside and the type of employee.

- We have to be better about capturing value: targeting the right segments, pricing effectively, optimizing returns.

- Investment is critical as customers adopt new technology, but we have to be careful to invest for value – not every new idea is a ‘good idea’.

- Operating processes need to be simplified in order to reduce cost, reduce complexity, and improve effectiveness.
3 big themes

- **Re-emergence of bank sales culture: 41% rated as top priority**
  - Tighter margins
  - Increased competition
  - Need to improve training and support to cross sell bank services and deepen relationship profitability

- **Re-thinking the role of the branch: 63% placing greater responsibility on branches for sales**
  - Re-structuring branch roles
  - Greater responsibility for outside sales
  - Responding to changes in customer channel usage

- **Creating efficiencies**
  - Branch automation
  - Digital account opening
What are we missing?

- Sales management support for new roles
- Re-structuring of physical facilities
  - Teller pods/cash recycler?
  - Re-direct drive up using video teller?
- Workflow management
- Training support for new roles (Universal Associate)
- Self service: Interactive Teller Machines (ITM)
To recap our discussion

1. Headwinds won’t go away: continued margin pressure
   - Fed may delay rate increases due to external events, world economic weakness
   - Many banks have high loan to deposit ratios and will increase deposit rates to attract funds, offsetting gains

2. Consumer change will accelerate, diminishing relevance of traditional branches
   - Many banks now experiencing 10% annual decline in branch transaction activity
   - Harder to justify traditional branch structure

3. Leading banks will move more aggressively to reconfigure distribution
   - Increase emphasis on self service
   - Implement Universal Banker staffing
   - Learning to acquire accounts – not just service customers – via digital channels

4. Financial institutions that don’t move aggressively to test, learn and reconfigure will be left behind
Thank you!

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