

# What are large commercial banks focusing on?

Dean Ungar, CFA

*UBS Wealth Management Research*

September 9, 2013



# Topics of discussion

---

- State of the banking industry
- Banks that focus on agriculture
- The impact of Dodd-Frank and other regulatory developments
- The outlook for bank mergers
- The movement to an omni-channel world

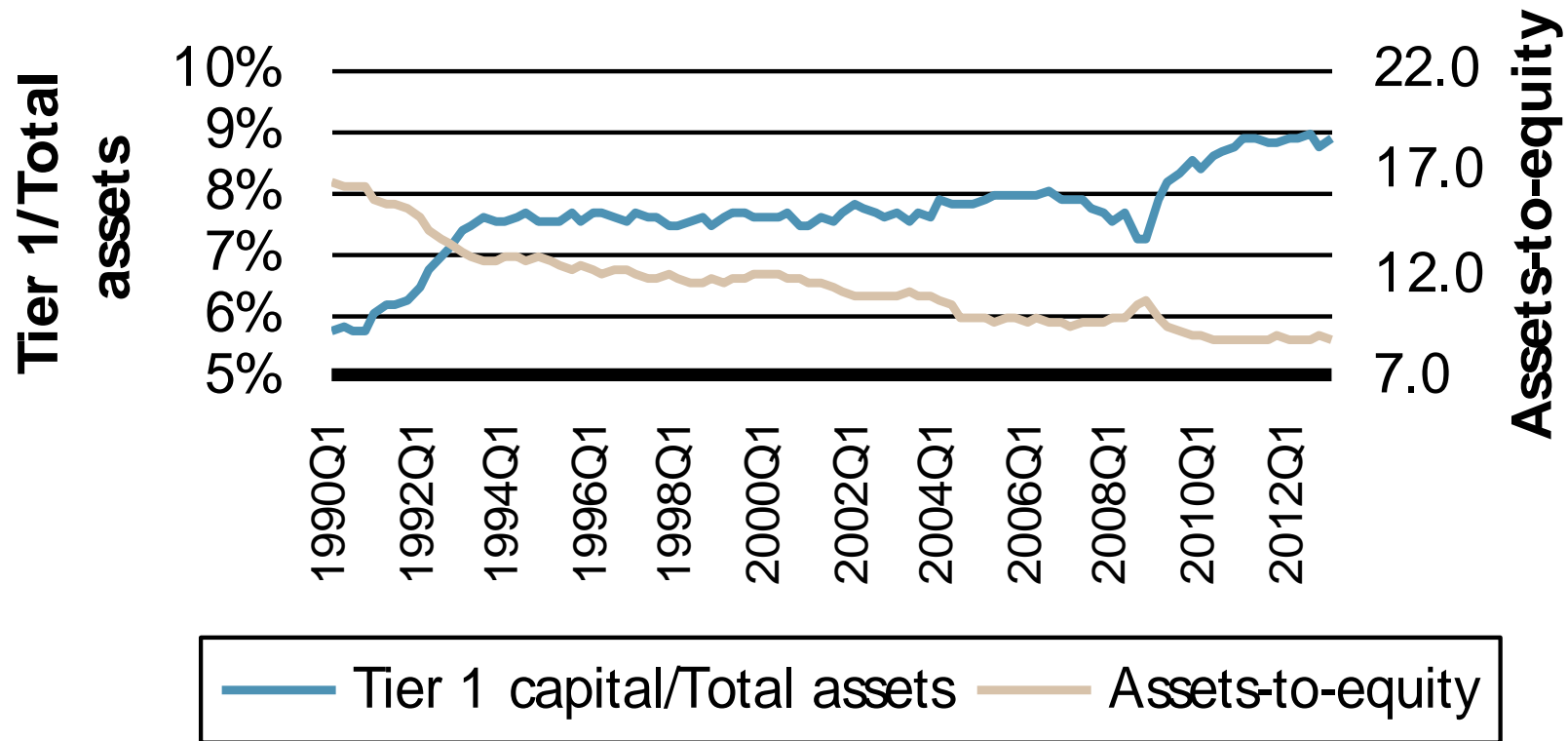
# State of the banking industry

---

- Record levels of capital and most banks already in compliance with stricter Basel 3 capital rules.
- Significant levels of liquidity, but will need to maintain and possibly even increase liquidity to meet Basel 3 requirements.
- Asset quality has been improving dramatically, which has been the main driver of improved earnings. There is still room for more improvement.
- Revenue growth has been fairly weak, growing at an average annual rate of less than 1% over the last 3 years.
  - Low rates have hurt net interest margins
  - Overall loan growth has been muted as decent commercial loan growth has been offset by runoff in construction, home equity and also commercial real estate.
- Given modest economic growth expectations, banks are focusing on expenses and continuing to work off bad loans.

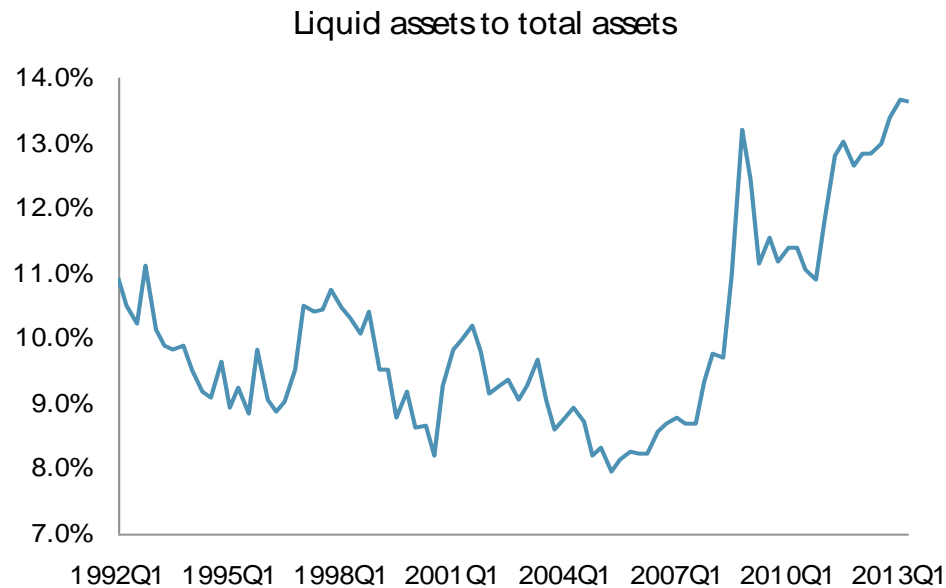
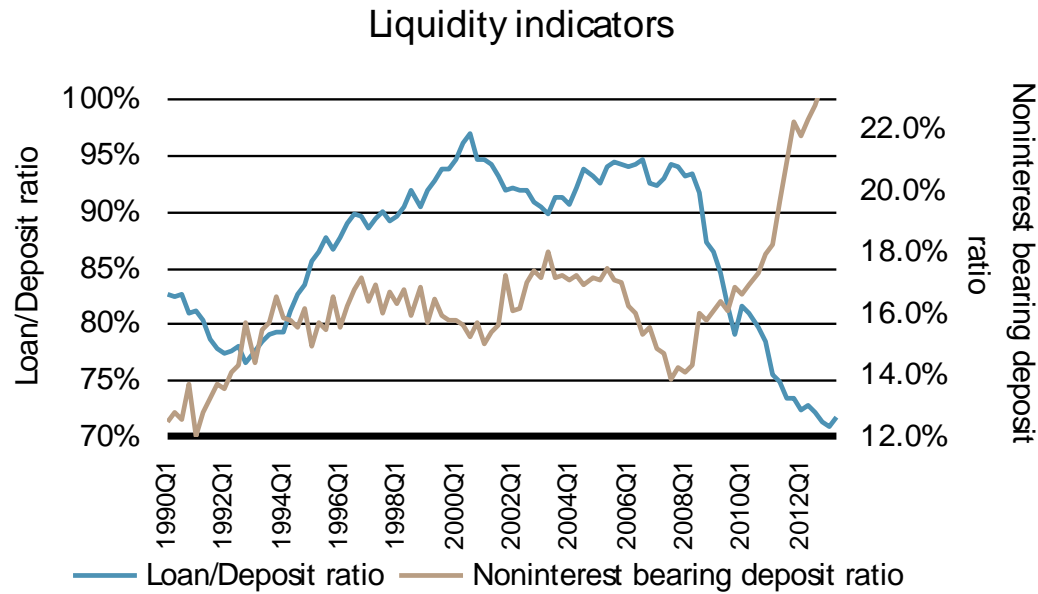
# Record levels of capital

## Tier 1 capital/Total assets



Source: FDIC

# So much liquidity

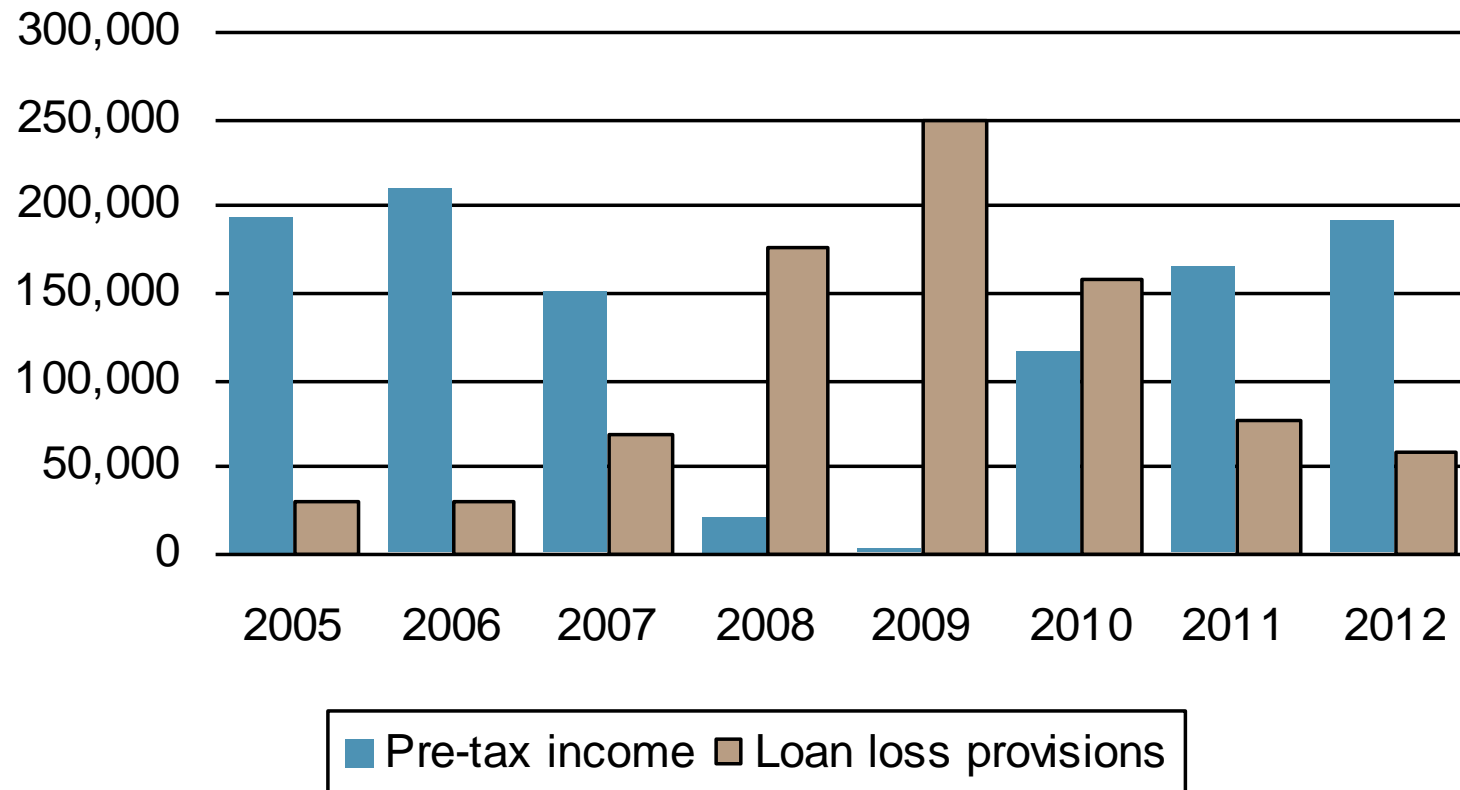


Source: FDIC

# Earnings going up, credit costs going down

---

## Earnings and loan loss provisions



Source: FDIC

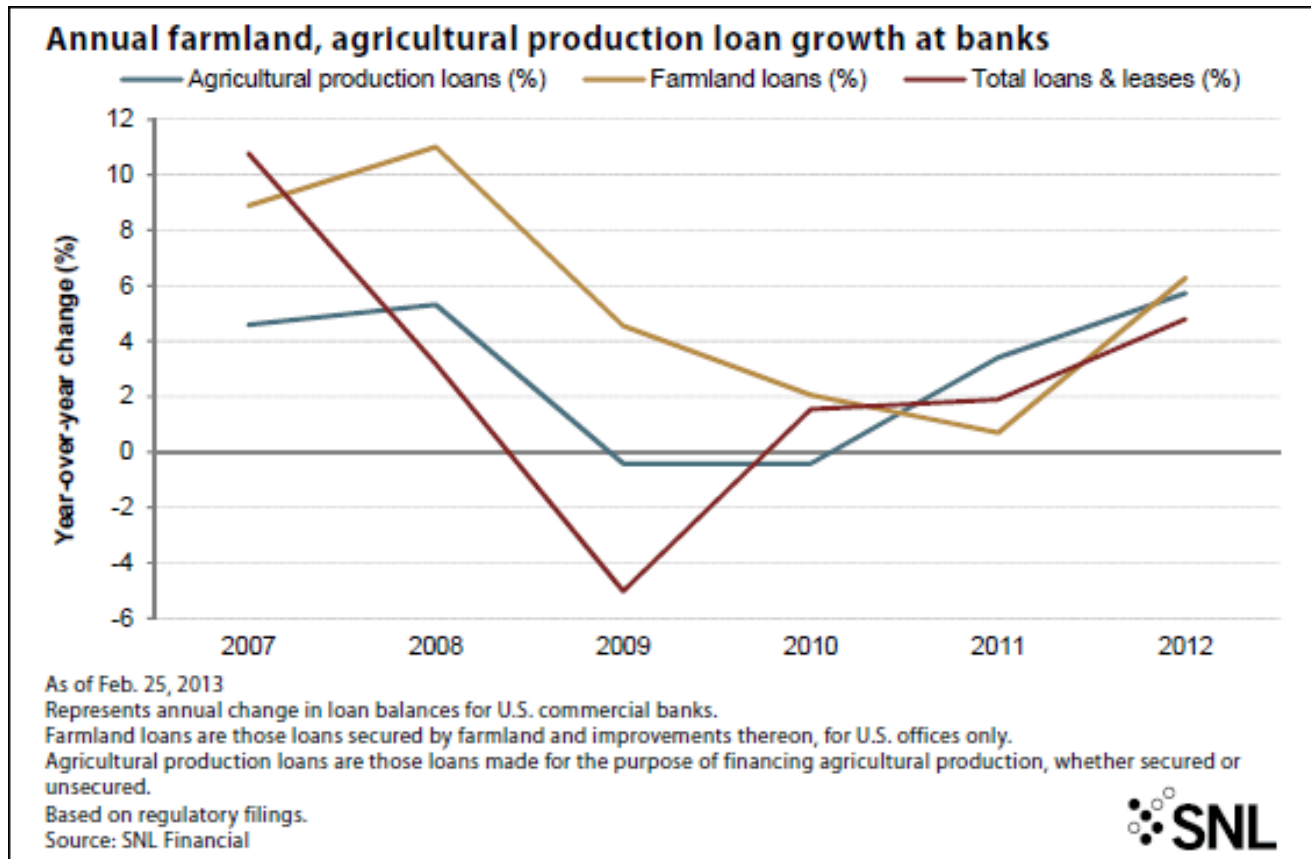
# Big U.S. banks not leading in farm lending

---

6/30/2013 in billions	Ownership	Total Assets	Total loans	Total farm and ag production loans	Farm and ag as % of total loans	Tangible common equity ratio(%)	Farm CAGR since 2006
Rabobank America	Foreign	49	28	9.36	33.9%	-0.74	25.5%
<b>Wells Fargo &amp; Company</b>	<b>US - Public</b>	<b>1,441</b>	<b>838</b>	<b>7.54</b>	<b>0.9%</b>	8.25	0.6%
BancWest Corporation	Foreign	80	55	3.28	6.0%	8.44	7.6%
<b>Bank of America Corporation</b>	<b>US - Public</b>	<b>2,126</b>	<b>961</b>	<b>2.27</b>	<b>0.2%</b>	6.87	-3.7%
<b>U.S. Bancorp</b>	<b>US - Public</b>	<b>353</b>	<b>231</b>	<b>1.78</b>	<b>0.8%</b>	7.24	-1.8%
National Americas Holdings LLC	Foreign	9	6	1.49	23.8%	5.91	11.7%
BMO Financial Corp.	Foreign	112	55	1.35	2.4%	8.93	32.8%
Pinnacle Bancorp, Inc.	US - Nonpublic	7	5	1.19	24.9%	8.91	7.2%
<b>Regions Financial Corporation</b>	<b>US - Public</b>	<b>119</b>	<b>76</b>	<b>0.96</b>	<b>1.3%</b>	8.56	-4.2%
First Financial Banc Corporation	US - Nonpublic	1	1	0.52	77.3%	9.11	8.7%

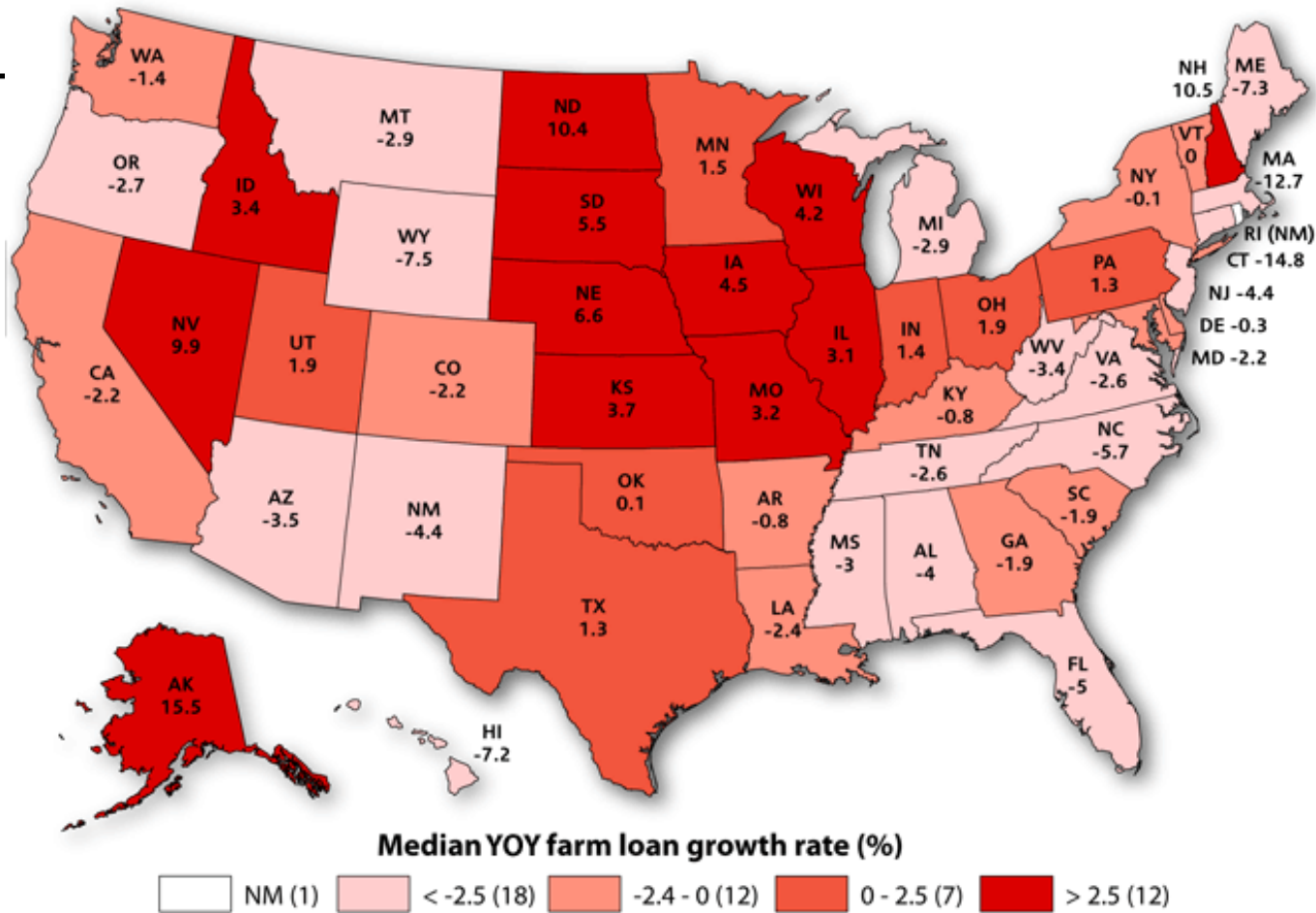
Source: SNL

# Farm & Ag lending growth





## Median YOY farm loan growth for US commercial banks by state\*



\* State-wise data is based on the median value of all operating commercial banks headquartered in each U.S. state as of June 10, 2013. Financial data is based on call reports for the period ended March 31, 2013.

The analysis includes only those commercial banks that reported farm loans data for the first quarters of 2012 and 2013. Includes both farm and agricultural production loans.

Agricultural production loans include all loans for the purpose of financing agricultural production, whether secured (other than by real estate) or unsecured and whether made to farm and ranch owners and operators (including tenants) or to nonfarmers, for domestic offices only. Includes loans and advances made for the purpose of financing agricultural production.

Farm loans include all loans secured by farmland and improvements thereon, as evidenced by mortgages or other liens, for domestic offices only. Includes all land known to be used or usable for agricultural purposes, such as crop and livestock production.

NM = not meaningful

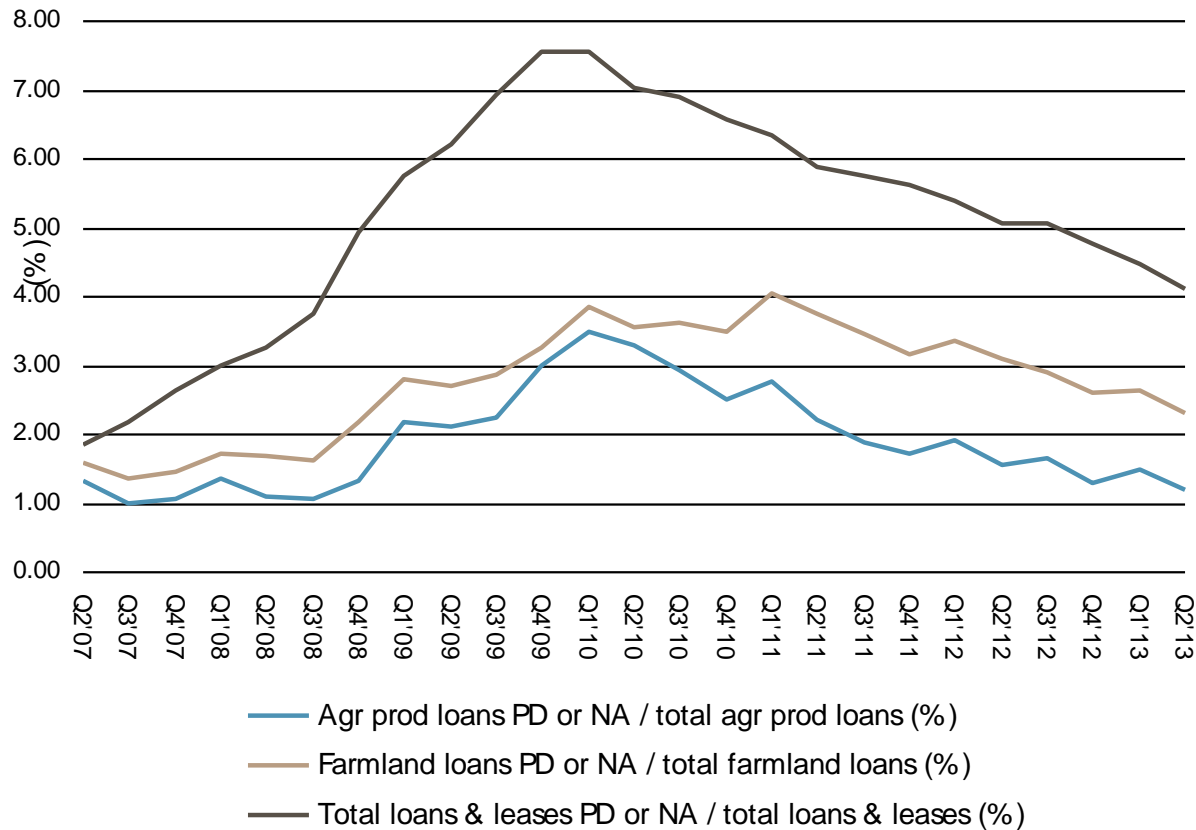
Source: SNL Financial

Map credit: Whit Varner

**SNL Financial**

# Asset quality trends – Farm and ag loans

U.S. commercial bank loan quality by loan type

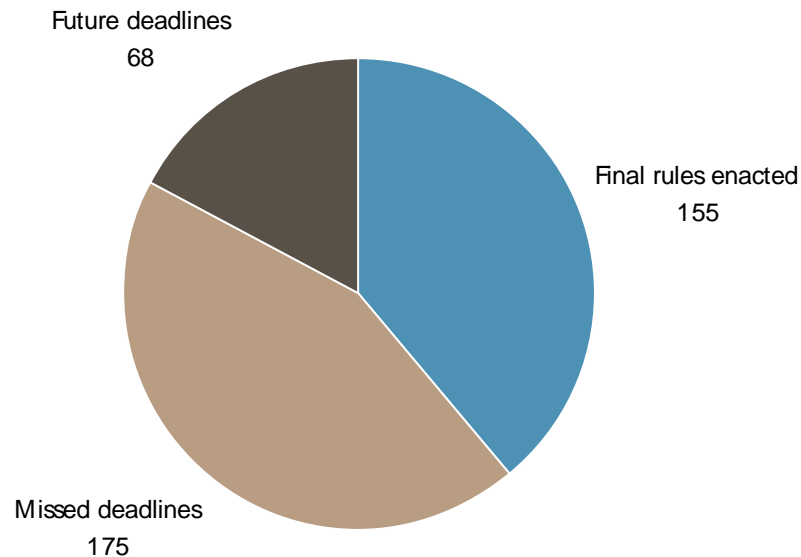


Source: SNL

# Dodd Frank status as of July 1, 2013

---

- So far, 13,789 pages of rules have been written, mostly by the SEC, CFTC, CFPB (which was created by Dodd-Frank), Fed, OCC, and FDIC.
- Still, only 39% of Dodd Frank's estimated 398 rules had been enacted as of July 1, 2013, three years since the passage of the law.
- 44% of pending rules have missed the deadline, many have not yet even been proposed.



Source: Davis Polk

# Important new rules

---

- Creation of the Consumer Financial Protection Bureau.
  - Higher capital and liquidity requirements (Basel 3).
  - New stress testing requirements for all banks over \$50bn in assets.
  - Limits on debit interchange (swipe fees that go to banks) fees.
  - Qualified mortgage (QM) and Qualified residential mortgage (QRM) rules, which effectively minimize the dangerous types of mortgage lending that helped cause the crisis.
  - Most derivatives transactions moved into clearinghouses or exchanges.
  - Volcker rule limiting proprietary trading still pending.
- 
- All of this adds to the cost of doing business or reduces revenues

## Other regulatory developments.

---

- Farm loans spared from higher capital requirements. Risk weighting on farm loans remains at 100% in Fed's final capital rule. In proposal, risk-weighting had been increased to 150%.
- If the rule had gone through as proposed, bank lending would have been adversely affected.
- Esther George, president and CEO of the Kansas City Fed, cited agricultural land as a potential bubble during a speech last January.

# Mergers & Acquisitions

---

- Mergers are down significantly since the financial crisis.
- Deals have tended to be smaller.
- The pricing on deals is much lower.

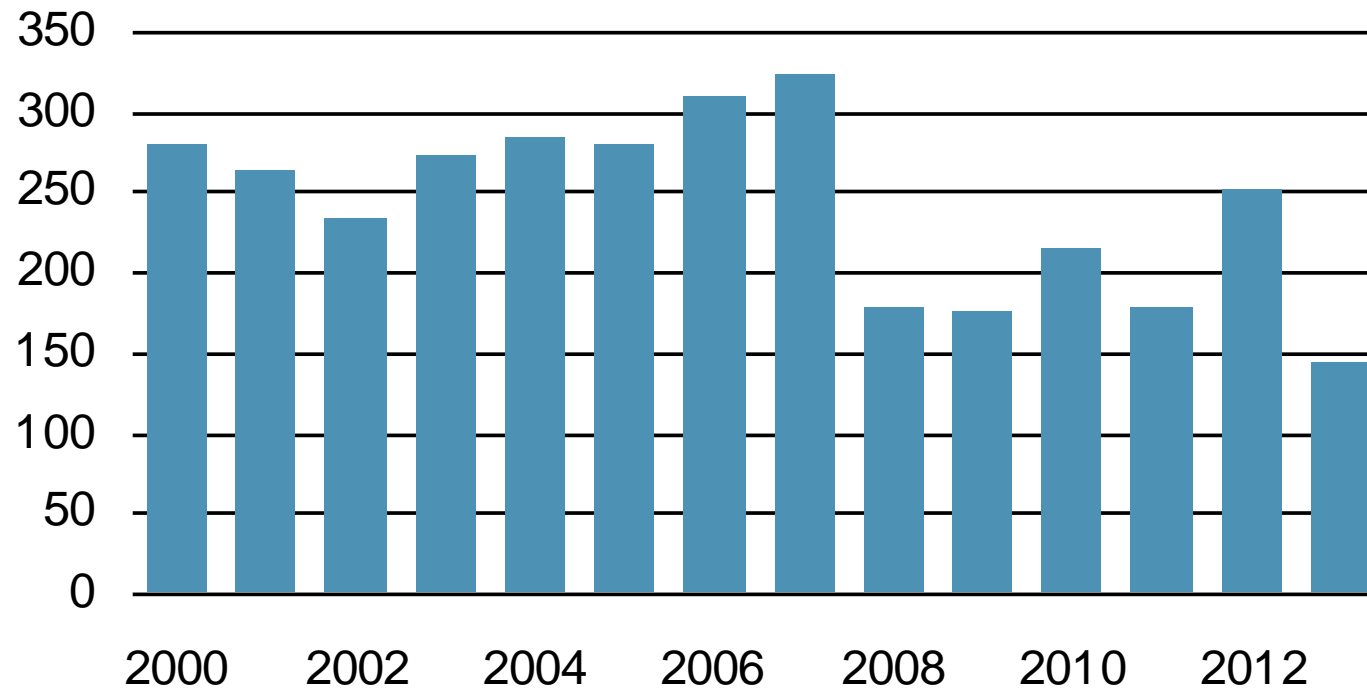
## WHY?

- Bank board's do not want to inadvertently buy someone else's problems.
- If a bank passes certain size thresholds, it is subject to greater regulatory scrutiny.
- Mergers are being more scrutinized by regulators.
- Sellers are reluctant to sell at low valuations.

# Bank mergers 2000 – 2013 YTD

---

Number of deals

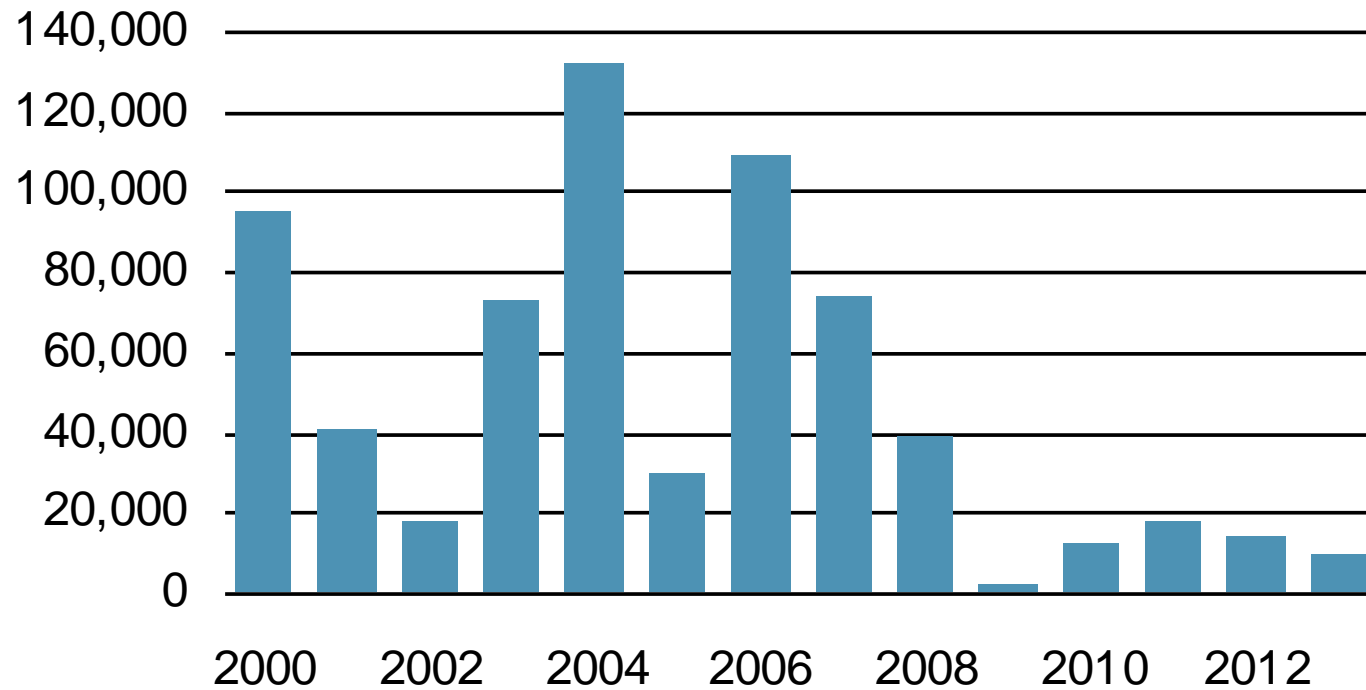


Source: SNL

# Bank merger deal value

---

Deal value



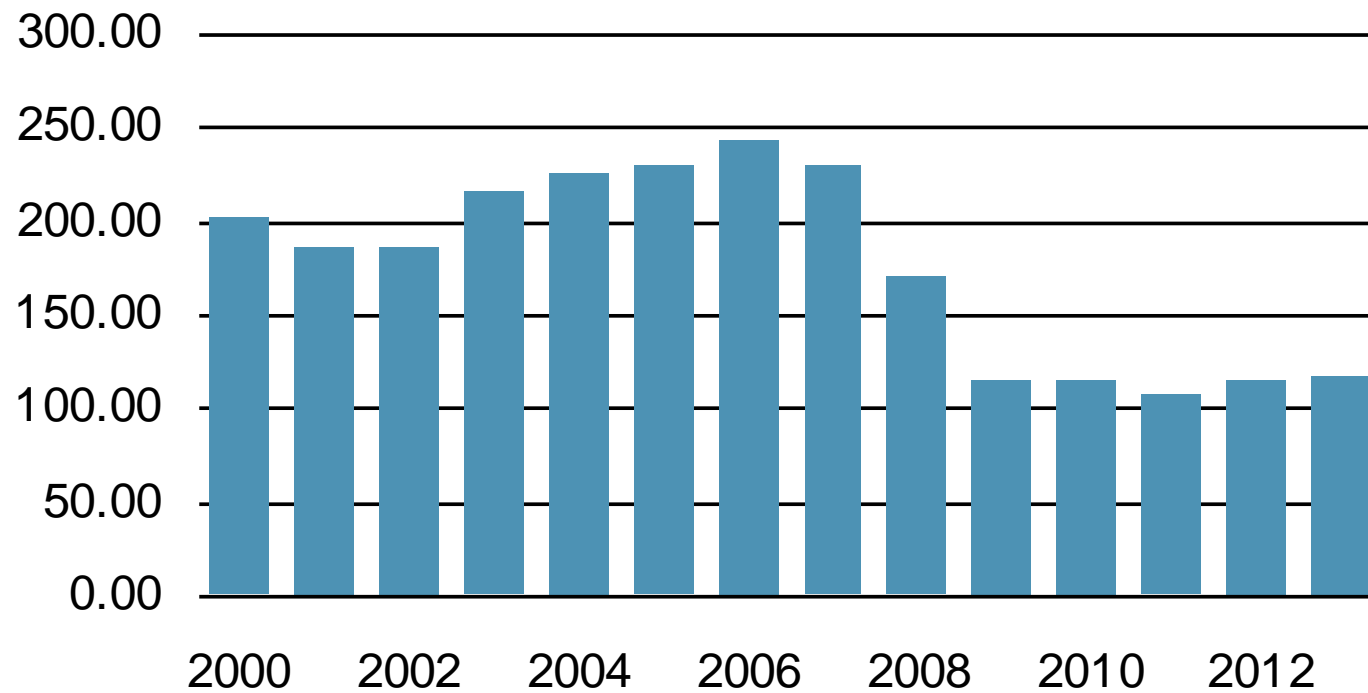
Source: SNL



# Bank deal pricing has declined post crisis

---

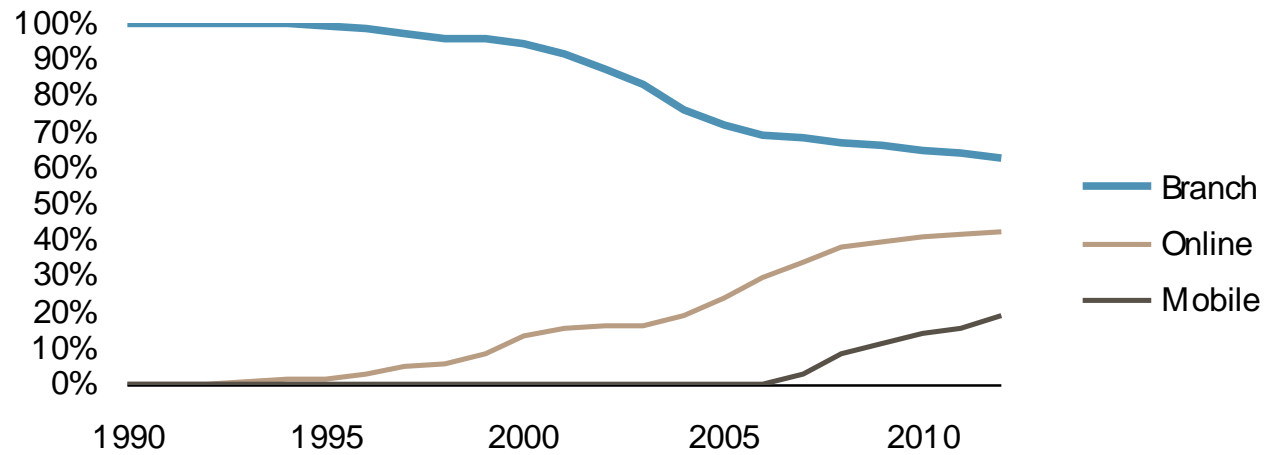
## Median Price/Tangible Book



Source: SNL

# Channel penetration in retail banking

---



Source: Capital One

# Appendix

---

## Disclaimer

Wealth Management Research is published by Wealth Management & Swiss Bank and Wealth Management Americas, Business Divisions of UBS AG (UBS) or an affiliate thereof. Wealth Management & Swiss Bank brands its publications as Chief Investment Office (CIO) Wealth Management Research outside the US. In certain countries UBS AG is referred to as UBS SA. This publication is for your information only and is not intended as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product. The analysis contained herein does not constitute a personal recommendation or take into account the particular investment objectives, *investment strategies*, financial situation and needs of any specific recipient. It is based on numerous assumptions. Different assumptions could result in materially different results. We recommend that you obtain financial and/or tax advice as to the implications (including tax) of investing in the manner described or in any of the products mentioned herein. Certain services and products are subject to legal restrictions and cannot be offered worldwide on an unrestricted basis and/or may not be eligible for sale to all investors. All information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness (other than disclosures relating to UBS and its affiliates). All information and opinions as well as any prices indicated are currently only as of the date of this report, and are subject to change without notice. Opinions expressed herein may differ or be contrary to those expressed by other business areas or divisions of UBS as a result of using different assumptions and/or criteria. At any time UBS AG and other companies in the UBS group (or employees thereof) may have a long or short position, or deal as principal or agent, in relevant securities or provide advisory or other services to the issuer of relevant securities or to a company connected with an issuer. Some investments may not be readily realizable since the market in the securities is illiquid and therefore valuing the investment and identifying the risk to which you are exposed may be difficult to quantify. UBS relies on information barriers to control the flow of information contained in one or more areas within UBS, into other areas, units, divisions or affiliates of UBS. Futures and options trading is considered risky. Past performance of an investment is no guarantee for its future performance. Some investments may be subject to sudden and large falls in value and on realization you may receive back less than you invested or may be required to pay more. Changes in FX rates may have an adverse effect on the price, value or income of an investment. This document may not be reproduced or copies circulated without prior authority of UBS or a subsidiary of UBS. UBS expressly prohibits the distribution and transfer of this document to third parties for any reason. UBS will not be liable for any claims or lawsuits from any third parties arising from the use or distribution of this document. This report is for distribution only under such circumstances as may be permitted by applicable law.

Distributed to US persons by UBS Financial Services Inc., a subsidiary of UBS AG. UBS Securities LLC is a subsidiary of UBS AG and an affiliate of UBS Financial Services Inc. UBS Financial Services Inc. accepts responsibility for the content of a report prepared by a non-US affiliate when it distributes reports to US persons. All transactions by a US person in the securities mentioned in this report should be effected through a US-registered broker dealer affiliated with UBS, and not through a non-US affiliate. The contents of this report have not been and will not be approved by any securities or investment authority in the United States or elsewhere.

Version as per October 2011.

© 2013. The key symbol and UBS are among the registered and unregistered trademarks of UBS. All rights reserved.