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A man in a dark suit, white shirt, and red striped tie stands with his arms outstretched, smiling. He is positioned in the center of the frame against a light blue background.

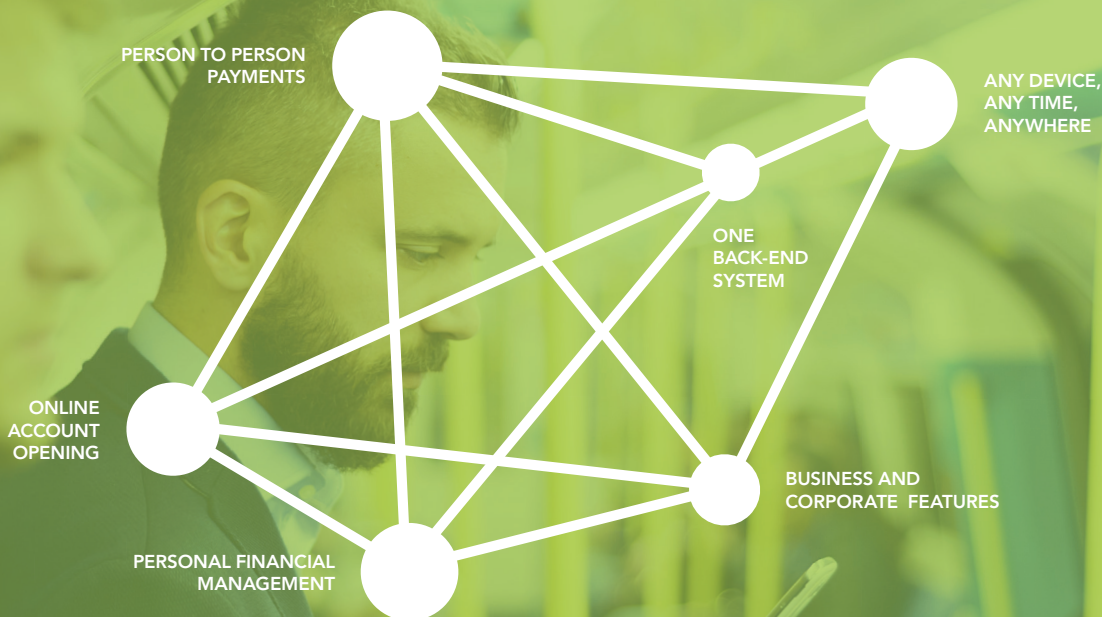
Jim Smith
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Banks with \$10 billion to \$50 billion of assets – subject to tougher regulations than smaller competitors without the scale larger ones have to absorb the expense – are pursuing creative strategies to improve profitability



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Contents

APRIL 2017 / VOLUME 127 / NO 4



COVER STORY

14 Head of the (Middle) Class

Banks with assets of \$10 billion to \$50 billion are subject to tougher regulations than smaller competitors without the scale larger ones have to absorb the expense. Yet some of these “tweeners” are thriving, thanks to creative strategies to improve profitability.



Briefings

- 4 Getting Perkier
Banks sweeten benefits to recruit and retain millennials
- 8 PACE Picks Up
- 8 Transparency Please

BankTechnology

- 9 Underwriter Helper
Lending decisions are the new frontier for data aggregation
- 10 Mapping Data Insight
- 11 Digital Lending Boost?

Metrics & Measures

- 12 M&A Adviser Ranking
Whole-bank and branch deals for 2016 by region

BankThink

- 20 Keep Hackers Out
Everyone from bank tellers to customers must do their part, Falk Rieker of SAP writes

BackPorch

- 24 Notable quotes from JPMorgan’s Mary Callahan Erdoes, the Fed’s Daniel Tarullo, and more

IN EACH ISSUE

- 3 Editor’s Note

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After the Trump administration issued an executive order calling for a review of the financial reform law, questions arose about the extent of the White House's authority to enact real change.



MOST SHARED

Now's the Worst Time to Have a Generic Website

Using your website to market the bank's brand — through compelling content and graphics — is crucial to wooing new customers and retaining existing ones, BankThink contributor Kevin Tynan wrote.



BANKTHINK

The Reputational Risk Of Regulatory Reform

Rolland Johannsen argued that the industry has to strike a balance between supporting post-crisis regulations that have worked well and trying to reform whatever has been ineffective.



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Editor's Note

BY BONNIE McGEER

A Community Banker's Fintech 'Aha' Moment

The revelation Julieann Thurlow had during last year's Super Bowl had nothing to do with football.

While watching the game on television, the president and chief executive of Reading Cooperative Bank saw a commercial for the online lender Social Finance. She decided to try out its loan process for herself right then and, before the game came back on screen, her application was approved. She had an \$89,000 personal loan.

"It hit me," she said. "There's nothing they can't take away from us."

Her worry about fintech challengers like SoFi – which considers millennials with student debt its main target and does not factor credit scores heavily into its loan decisions the way banks do – is how good they are at creating a fast and easy user experience. She feels pressure for community banks like hers to keep up, lest the fintech sector continue to expand at their expense from niche to mainstream.

"If they can deliver that quickly and that seamlessly, they are going to take all of the best customers with the best credit scores," Thurlow said. "We are going to be left with the lower credit scores."

The incident prompted her \$513 million-asset bank in Reading, Mass., to accelerate its mobile efforts. It is testing some new functions now – like account opening on its mobile app – and Thurlow said she is happy with the results so far. "I did it last night and, in less than two minutes, I actually had a new savings account and a new checking account opened up," she said.

In Thurlow's strategic planning sessions this year, mortgage applications for mobile moved to the top of the priority list. She said she feels strongly that Reading Cooperative needs to make that happen to stay competitive. "Everything needs to be mobile," Thurlow said. "If you can't apply for your mortgage on your mobile phone, then we're dead in the water."

She expects to partner with a vendor to roll out that functionality – possibly sometime later this year – and then perhaps add small-business lending to the list of mobile projects next.

As the mother of three college students, Thurlow said she has the benefit of seeing what's hot with that age group early on. "I got to see Venmo three years ago before we really saw it intersecting with our accounts," she said. "But there are just so many great ideas out there. I think it's an exciting time."

She thinks bankers in general need to adapt to change more quickly, though. She started attending the Finnovate conference several years ago – to see what new ideas fintech companies are coming out with – and she was surprised so few others like her showed up. "There were hardly any community banks there," Thurlow said.

She is happy more turned out this past year, because she considers it an encouraging sign that they are thinking about how to evolve. "We can't wait for the American Bankers Association to endorse the products that we need. We need to have our head up and we need to be looking to see what change is out there."

She is also happy about the general conversation shifting from how the brash fintech startups will disrupt the banking industry with their technology to more of a focus on how they can partner with banks, so that both can benefit.

"I shouldn't say this out loud, but compliance is our friend," Thurlow said. "We have complained about compliance for the last 10 years, but now compliance is our friend, and it's what's keeping the fintech companies in the game with us, instead of competing directly with us."

Thurlow concedes that many customers have yet to embrace the digital age. But she thinks banks can help them along in that transition by offering intuitive options that just make things easier.

"We still have 3,000 customers that actually choose to dial in to an 800 number, press 1 for their checking account, press 2 for the last five checks, and then listen to it," she said.

She wonders, what if they could use a digital personal assistant to do that instead? "Make it a voice prompt activity instead of punching buttons."

Whatever the technology, the point is to keep an open mind and not get bogged down in the way things have always been done. "We're at the intersection of some really great things that are going to make consumers happier about their banking relationship," Thurlow said.

That will be key to keeping the SoFis out there from siphoning off the best customers. After all, outspending them is not an option, she said.

"Who can afford to advertise at the Super Bowl, right?" □

Briefings

RECRUITING | GOVERNMENT LENDING | LAW & REGULATION



Perking Up: Banks Improve Benefits to Woo Millennials

Policies to promote work-life balance help banks compete for recruits with the hipper tech sector

By Kristin Broughton

MILLENNIALS GET A LOT OF ATTENTION in banking for prompting companies to adapt to the digital world, encouraging them, for instance, to use social media or develop apps. But they are reshaping the industry in other important ways, ushering in a wave of more generous employee benefits.

Financial services companies are sweetening their benefits packages in ways specifically designed to attract and retain younger workers. For a demo-

graphic group that loosely ranges from about 20 to 36 years old, many of the perks are targeted at young parents.

In the past year, megabanks – JPMorgan Chase, Bank of America and others – strengthened their parental leave policies, and regional banks are now beginning to follow suit. PNC Financial Services Group in Pittsburgh upgraded its policy in January, and Fifth Third Bancorp in Cincinnati plans to do so later this year.

“We know that flexibility and work-life balance are important” to millennials, said Teresa Tanner, chief administrative officer at Fifth Third.

The new premium benefits at some banks also include ways to help employees make a difference in the world and



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to pay down college debt – both well suited to the millennial mindset.

Citigroup now offers a “gap year” program to junior associates, allowing them to take a year off from work while earning a portion of their annual pay. First Republic Bank recently started helping students pay down their student loans, and other banks are exploring their options to do the same.

Lori Szerencsy, global head of benefits at Citigroup, downplayed the notion that banks are trying to outdo each other, but “we definitely have our eye out. It’s more about who is working here, how can I enhance the value of the employee proposition, and can benefits be a part of that?”

‘Really need to do something’

Linda Bacon, manager of employee relations at First Horizon in Memphis, Tenn., was caught off guard when she surveyed the benefits landscape. “It was easy to see really quickly that we were way behind the eight ball,” Bacon said.

From her perch in the back office, where she has worked since the early 1980s, Bacon has witnessed everything from mobile apps to post-crisis rules upending the industry. Yet when millennials – who make up nearly 40% of First Horizon’s workforce – began asking for longer parental leave a couple of years ago, Bacon was initially struck by their boldness.

The \$28 billion-asset First Horizon’s policy seemed competitive enough: several weeks off for new mothers, a handful of days off for fathers and other partners.

But Bacon wanted her longtime employer to keep pace with the times, so she began researching the local market. It turned out other large employers in the area – bigger banks, tech firms, even the U.S. military – were offering longer leave periods at full pay for young parents to bond with their newborns.

There were other factors at play. First Horizon acquired several branches in 2014 from Bank of America. Employees who joined the company through the deal were allowed to keep their existing,

more generous policies, creating a discrepancy among branch staff. “We really needed to do something,” Bacon said.

First Horizon revamped its leave policy last summer, extending it to up to eight weeks at full pay for new mothers and four weeks at full pay for fathers and other parents.

Peripatetic talent pool

Such changes come as the industry continues to repair its tarnished image and woo a generation of young people who came of age during the subprime mortgage meltdown.

Millennials entered the workforce at a time when entry-level banking jobs lost some prestige. Over the past few years, business students from top schools have increasingly gravitated toward the tech sector in Silicon Valley.

Most big banks, however, are “filling all of their slots” and recruiting top talent, according to Bhushan Sethi, a partner in the financial services practice at PwC.

Where they are facing some difficulty, though, is persuading younger people to stick around. “Their challenge is still with three or four years in, how do I keep [millennials] interested?” Sethi said. “Their challenge is still on retention.”

A plethora of survey data on millennials, who have earned a reputation as job-hoppers, underscores the problem. Most young people don’t expect to settle down with an employer for a long period. According to a recent PwC survey, 54% of millennial employees expect to have as many as five employers during their career, while nearly 20% expect to work at as many as nine different firms.

Asked about their likelihood of switching jobs, more than half of millennial-aged workers reported being open to a new job opportunity, according to a 2016 Gallup survey.

Culture change

When Citigroup rolled out extended parental leave in September, senior ex-

ecutives hoped to send a message to ambitious employees: Please prioritize your personal life.

Over the past decade, Citi has steadily expanded its paid time off for new parents. In 2005, the company instituted 13 weeks of paid pregnancy leave after previously offering new mothers short-term disability. Two years later, it introduced eight weeks of paid adoption leave for primary caregivers, and in 2015 it introduced two weeks of paid leave for secondary caregivers.

The company took another leap late last year, announcing it would offer 16 weeks of paid leave for new mothers at full pay. It also increased paid leave for second parents to eight weeks at full pay to encourage bonding time.

“We believe that the new program is attractive to millennials,” said Jill Rorschach, head of employee relations and human resources policies. “But more broadly than that ... we wanted to provide flexibility to families juggling lots of different priorities.”

The change followed other steps the company has taken to help young employees create a better balance between their work and home lives. For instance, in 2014 the company barred junior-level employees in investment banking from working on Saturdays.

Still, as Citi prepared to roll out the longer leave policy last year, there were lingering concerns in the human resources department that some managers would discourage top talent from taking the additional time off.

“We were worried that we were going to have some noise from people who felt that their managers weren’t supportive,” Rorschach said, noting that she was “hoping for the best and expecting the worst.”

But so far there have been no employee complaints to speak of, according to Rorschach.

“We had 50-year-old men saying, ‘I’m out of the child-rearing times, but wow, this is amazing,’” said Terry Hogan, glob-

al head of diversity at Citi, discussing employees' reactions to the policy change.

As more companies increase their parental leave policies, they are sending the message that a healthy home life is a top priority in business, according to Pamela Stone, a professor of sociology at Hunter College, and author of a 2007 book on why high-achieving women opt out of the workforce. "I think it legitimates that it's OK to take advantage of the policy – the institution supports you," Stone said.

Student loan help

In addition to offering more generous parental leave, more banks are looking into ways to help millennial employees pay down their student loans.

This addresses what has been a growing problem for young professionals. Over the past decade, student loan debt has nearly tripled to more than \$1.3 trillion, according to the Federal Reserve Bank of New York.

In November, First Republic in San Francisco began contributing up to \$200 a month toward employees' student loans, and promised to do so until the entire debt is repaid. The following month, the \$73 billion-asset First Republic bought Gradifi, a startup company in Boston that administers the repayment program.

"Banks are really seeing that to recruit and retain talent, this is a great differentiator," said Tim DeMello, Gradifi's founder and chief executive.

In the coming year, Gradifi expects to expand its services across the banking industry. The company recently received an endorsement through the American Bankers Association and hosted an informational webinar for ABA members in February.

DeMello said he expects to sign up as many as three banks per month in the months ahead.

First Horizon is also exploring the idea of helping employees pay off their student loans. Rather than making monthly contributions, though, the company

would likely provide a bonus-like lump sum for new hires, according to Bacon. Those who stay with the company for a set period could keep the money, while those who leave earlier could repay it like

a loan. Details are up in the air, including the timetable for offering the benefit.

"We are looking at what other people are doing and trying to figure out what's right for us," Bacon said.

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Banks Try to Slow PACE

Government loan program proves popular with states

A GOVERNMENT LOAN PROGRAM that irks bankers is getting traction in yet another state.

Two bills recently introduced in the Tennessee legislature would let local governments lend money to property owners for improvements that promote energy efficiency.

Bankers in the state are determined to keep those bills from becoming law, partly because in the event of foreclosure, the loans would be first in line to be repaid, ahead of any mortgage.

"I think things would be a lot better if government would stick to its job and stay out of lending," said Gordon Majors, president and chief executive of the \$443 million-asset Hardin County Bank in Savannah, Tenn., and chairman of the Tennessee Bankers Association.

If proponents are successful, Tennessee would become the 33rd state to authorize a property-assessed clean energy, or PACE, program. Local PACE programs are operating in 18 states, and 14 others have passed laws that would allow them to be created. Programs implemented so far have financed more than \$3 billion for energy efficiency projects, according to PACENation, a trade group that promotes the effort.

Despite their green intentions, the programs have opposition not only in banking circles, but in government. Some critics argue that PACE credits lack typical consumer protections and disclosure rules that are standard with conventional loans. Other critics have zeroed in on provisions that give PACE loans the same "super-priority" accorded to tax liens.

One housing finance regulator, the Federal Housing Finance Agency, has told Fannie Mae and Freddie Mac to avoid acquiring mortgages on a property

with a PACE lien.

The Tennessee bills would let local governments establish districts where PACE loans could be made, issue bonds to pay for them, and contract with nonprofit third parties to administer the programs. Borrowers would pay via an assessment added to their property tax bills.

"The more we looked at it and talked to folks around the country, we just didn't like the way the program worked," said Tim Amos, general counsel for the Tennessee Bankers Association.

PACE loans are "the only type of home improvement loans that jump over the main loans" in lien priority, Amos said.

— John Reosti

Shell Game

Big banks get behind ownership transparency bill

THE BIGGEST U.S. BANKS ARE throwing their considerable weight behind proposed legislation that would force shell companies to identify their owners in state government filings.

A trade group for the nation's largest banks is recommending that Congress prevent the 50 states from allowing the anonymous ownership of corporations. The recommendation is in a report written by The Clearing House, whose owners include JPMorgan Chase, Citigroup, Bank of America and Wells Fargo.

Proposals to require the disclosure of so-called beneficial ownership information have long enjoyed the support of law-enforcement officials and nonprofit organizations that advocate for a crack-down on illicit money flows. But they have drawn strong opposition from states that rely on the revenue generated from shell companies that incorporate within their borders. And so far, despite some bipartisan support, legislation has failed to gain momentum in Congress.

The big banks' endorsement is significant because of the clout they carry on Capitol Hill. Rep. Carolyn Maloney,

D-N.Y., who has sponsored the legislation in previous congressional sessions and plans to do so again, said she welcomes the support. "We should not be one of the easiest countries in the world for criminals and corrupt officials to set up anonymous shell companies and hide behind the walls of secrecy," Maloney said.

One academic study found that the United States is the second easiest country in the world, after Kenya, in which to incorporate an anonymously owned corporation.

Maloney's legislation could help the banking industry by easing the compliance burden. Last May, the Treasury Department's Financial Crimes Enforcement Network finalized rules requiring banks to keep better track of the owners of companies that have accounts at their institutions.

Greg Baer, president of The Clearing House, said that conducting due diligence on corporate customers can be challenging for banks when little information is available from the government.

"At a lot of banks, that's a substantial effort. And then of course, they are always running the risk that they are missing something," he said.

The big banks' report states that the current federal regime makes it easier for money launderers and terrorist financiers to obscure their identities from both law enforcement agencies and financial institutions.

Supporters of the beneficial ownership legislation argue that it will help stem the flow of illicit funds.

"There's an inherent tension between banks being told to know their customers and states allowing anonymous ownership," said Aaron Klein, a fellow at the Brookings Institution, a nonpartisan think tank in Washington.

But any push to reduce corporate secrecy is likely to draw opposition from states like Delaware, which has strict corporate secrecy rules and derives substantial revenue from incorporation fees.

— Kevin Wack

BankTechnology



Credit Analysis Is Changing, But Is It for the Better?

Lending decisions are the new frontier for data aggregation

By Mary Wisniewski

FINANCIAL DATA AGGREGATION IS being used to help speed up underwriting decisions for some lenders – a trend that is expected to become more widespread.

Rather than faxing in documents or submitting PDFs of data downloaded from multiple websites, consumers and small-business owners are granting on-line lenders permission to use aggregation technology to grab their financial transaction data.

“It’s what consumers have been doing for decades – just quicker,” said Nick Thomas, the executive vice president and co-founder of Finicity, a data aggregator in Murray, Utah, that Experian has invested in. “The credit-decisioning space is really the new frontier of data aggregation.”

Aggregation has long been used to power digital personal financial management tools, but this gives the technology more of a moneymaking role.

So long as the technology is working as intended, lenders will gain something they may have not been privy to before – years’ worth of transaction data, such as cash flows. Lenders can then include that information as part of their credit analysis in addition to credit history data.

Banks might already count some applicants as customers and have access to their financial transactions. However, most consumers have multiple bank accounts.

For now, the practice of using data aggregation for streamlining the application process is more typical of fintech companies like Quicken's Rocket Mortgage and Kabbage. But aggregators like Finicity and Envestnet-Yodlee predict that traditional banks will increasingly follow suit.

"Banks are definitely awake to this," said John Bird, vice president of product marketing and alliances at Envestnet-Yodlee. "Quickening lending decisions is going to be the No. 1 or No. 2 thing on the minds of large banks."

Even so, some have reservations. The Consumer Financial Protection Bureau has been seeking information on data access and, more recently, on alternative data for underwriting purposes. And regardless of what comes of the CFPB request, some industry observers are skeptical of the degree to which speed will serve as a competitive edge.

Lenders should not be overly hasty in underwriting a loan, warned Brian Riley, director of credit advisory services at Mercator Advisory Group. "It's precision over speed when it comes to putting out credit," Riley said.

But some lenders paint aggregation as essential to their underwriting precision.

Kabbage is a small-business lender that uses aggregation to underwrite loans in as little as a few minutes. It has established partnerships with several banks, including Banco Santander's U.K. operation, ScotiaBank in Canada and Celtic Bank in Utah.

Kabbage since its inception has required applicants to share data such as their transactions, revenue and expenses, and that decision has been "monumental" to its survival, Chief Executive Rob Frohwein said.

Many would-be borrowers, if they had been given the choice, likely would have

submitted the data through slower, traditional methods, and the fintech company in such cases would have lost its competitive advantage – real-time data that saves borrowers the trouble of gathering documents or visiting loan officers, Frohwein said.

Had Kabbage made the decision to offer a manual option, "I don't even know if we'd be in business," Frohwein said. "We'd be like everyone else on the street."

Some applicants bolt when Kabbage asks them for access to their data, Frohwein said, but enough borrowers are comfortable with the idea of turning over the necessary log-in information to aggregators for simplicity's sake.

It is similar, he said, to people's willingness to use their Facebook credentials to identify themselves on other websites. To some, the convenience outweighs any potential risks. "Now, it feels commonplace," Frohwein said.

It's because of offerings like Kabbage that traditional lenders need to refine their online experiences to compete on the quality of user experience, said Joel Prais, senior director at Cornerstone Advisors. "The pressure is on," Prais said.

As he sees it, the speed of decision-making is a critical competitive advantage. If lenders take too long, applicants will grow weary from the delay or wonder why the rates are not better by the time their offers arrive.

Lenders in other countries like Australia and Europe appear to be further along than U.S. banks, especially in building open application programming interfaces to simplify the flow of data among apps. National Australia Bank, like Wells Fargo and Silicon Valley Bank in the United States, has partnered with Xero, an accounting software provider, to share data via APIs. But NAB's partnership with Xero goes one step further. Since June, customers of Xero and NAB can get unsecured loans of up to \$50,000 based on 12 months of data pulled from Xero and in as little as 60 seconds.

"We are a firm believer in investing in aggregation of many data sources to transform our processes," said Dan Carr, general manager of small-business lending and transformation at NAB.

Compliments from customers have increased, and the change is noticeable in a part of the business known mostly for drawing complaints, Carr said.

NAB is happy enough with the progress that it plans to extend the product's credit limits, he said.

But it's just a small step on a massive industrywide journey to transform the lending experience for consumers and businesses alike.

Ian Benton, an analyst in Javelin Strategy & Research's small-business practice, said the vision for many lenders is about crunching many sources of data to provide lending offers when customers need it most.

It would be a more proactive future, in which lenders do not wait for applications but on their own find borrowers, deem them creditworthy and then initiate offers. "Eventually, we will see the death of the loan app," Benton said.

Pointing The Way

GIS maps help bankers make smarter decisions on branches, lending

BB&T CHAIRMAN AND CHIEF EXECUTIVE Kelly King wants to step up the pace of branch consolidations this year, even closing some branches that are profitable. The Winston-Salem, N.C., company will need fine levels of detail to pinpoint the correct branches to close and it plans to rely heavily on geographic information systems software.

As BB&T and other banks look for every possible competitive advantage, GIS software is playing a role in developing ever more precise views of data. While

GIS tools have been around for years, the software has become more advanced and banks are using it for an increasing variety of projects.

"You could look at a spreadsheet with 30 columns and try to figure out your decision, or you could look at a map and see it all in one place and the decision becomes much more apparent," said Jon Voorhees, a former senior vice president for retail distribution at Bank of America, who is now an adviser at Peak Performance Consulting Group in Austin, Texas.

As recently as 2010, banks' use of maps consisted of paper stapled to the wall marked up with Sharpies, said Helen Thompson, the financial services sector leader at Esri, the Redlands, Calif., company that makes ArcGIS software. Now, banks create maps using multiple layers of data, tracking everything from the rate of nonperforming loans to levels of homeownership in specific census tracts. Mapping software also can help banks monitor potential security threats and even manage where and how to deploy executive talent.

"If there is any sort of data that can be tied geographically to your business, we can incorporate that data into a map," said Elio Spinello, a partner at RPM Consulting in Northridge, Calif., which creates sophisticated maps for banks and credit unions.

Branch consolidation is one of the most widely used applications of GIS software. During the recent round of fourth-quarter earnings reports, several bank CEOs said they planned to accelerate branch closings this year in an effort to improve profits.

"We're being more aggressive in terms of branch closings," even in cases where a branch might be profitable, King said during the earnings call for the \$214 billion-asset BB&T. "By combining two profitable ones into a new branch, then two plus two becomes five."

For branch-consolidation decisions, a bank can map its own branches and its ri-

vals', as well as demographic data, housing data and physical barriers to branch access, such as a river or interstate highway that blocks traffic.

Banks are scrambling to hire talent with expertise in all types of data analysis, said Doug Rickart, a vice president and recruiting manager with Robert Half Financial Services. Because GIS applications can be used in a wide range of departments, candidates who understand geographic data are especially in demand.

"The job market for students with a geography degree is exceptional," said Alan Murray, a geography professor at the University of California-Santa Barbara who specializes in location modeling and regional planning.

Financial firms can use GIS software in a variety of ways, Spinello said. For example, RPM correlates economic data from the Fed with demographic census information, such as levels of car ownership, to help banks deploy new marketing campaigns for auto loans.

The Center for Responsible Lending, a consumer advocacy group in Durham, N.C., used GIS tools to create maps that showed subprime lenders had set up shop in areas where they could target vulnerable consumers, said Delvin Davis, a senior research analyst. The center has done similar projects for monitoring banks' lending to minorities.

"Having a map paints a picture that sometimes numbers by themselves can't create," Davis said.

It's primarily larger and regional banks that are using GIS software, but RPM's Spinello said geographic data tools may be more helpful for community banks in making decisions such as where to open or close branches.

"The smaller banks have a lot more on the line with each individual branching decision," Spinello said. "It's more important for them to make a sound decision with every branch. Bank of America or someone of that size, they can afford to make a few mistakes." — *Andy Peters*

Howdy, Partner?

Yet another online lender aims to work with banks

UPSTART, ONE OF THE NEW BREED OF Silicon Valley consumer lenders, is looking to license its technology to banks and credit unions.

The company is pitching its product — Powered by Upstart — as a way for banks to get into the digital lending business without building their own systems from scratch.

Upstart, which was founded by several former Google employees, began making personal installment loans in May 2014. Its three- and five-year loans range from \$1,000 to \$50,000 and carry average interest rates of 12%. Last year it lent out about \$300 million, a figure that it hopes to roughly triple in 2017 with help from a fresh round of funding.

The San Carlos, Calif., company is following a blueprint similar to the likes of Social Finance and Lending Club: launching with a particular loan product, refining its algorithms and then seeking to expand into other types of the consumer loans. Upstart's chief executive, Dave Girouard, said in an interview that one addition in the works is a financing option for shoppers who would like an alternative to paying with cash or a credit card.

Like SoFi, Upstart focuses on millennial customers who have strong earnings potential, but sometimes lack deep credit histories. The average Upstart borrower is 28 years old, with a salary of \$90,000, according to Girouard.

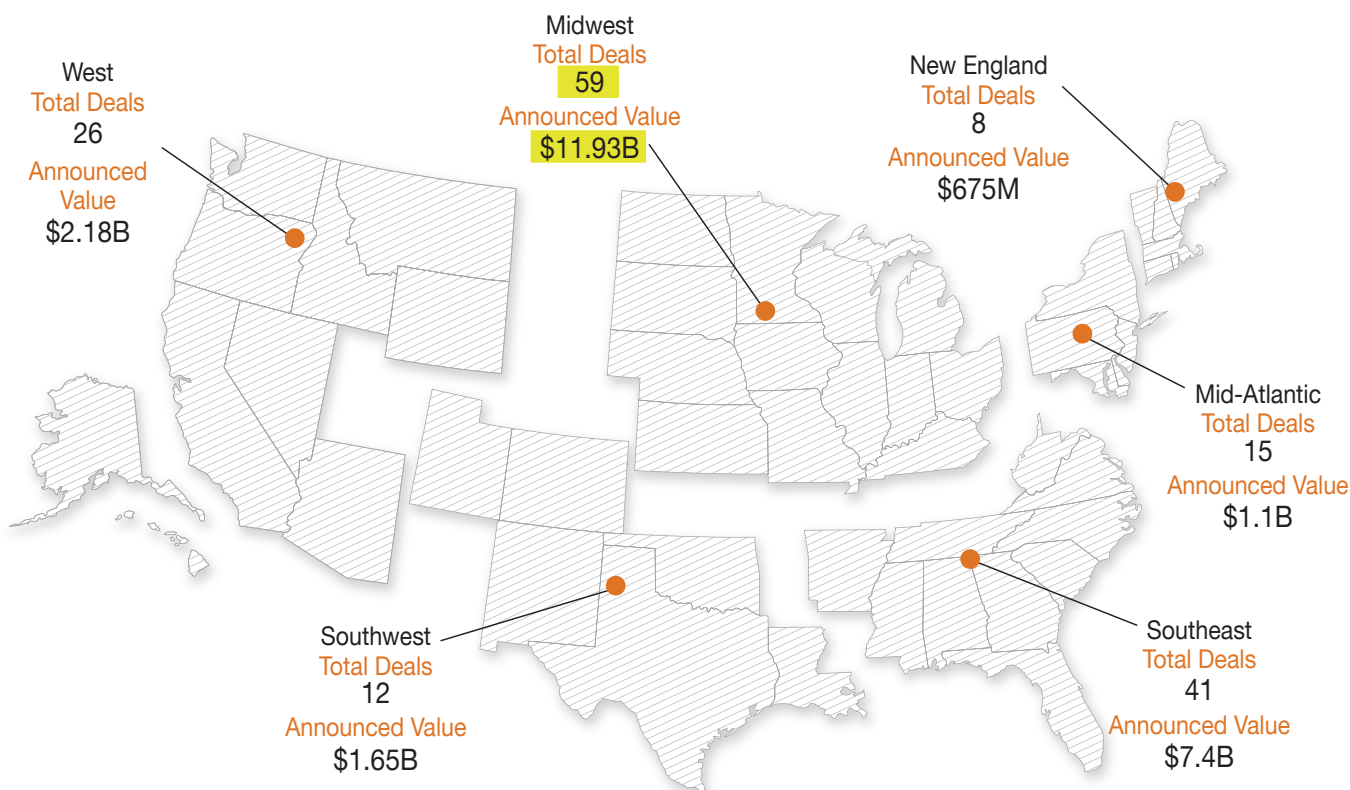
"They don't expect to have to go walk into an office to figure out if they qualify for a loan," he said.

The privately held Upstart, which has 100 or so employees, said in early March that it raised \$32.5 million in equity, led by Rakuten, an e-commerce firm in Japan, and an unnamed U.S.-based asset manager. — *Kevin Wack*

Metrics & Measures

MERGERS & ACQUISITIONS

ACQUISITIONS BY REGION Whole Bank and Branch Deals in 2016

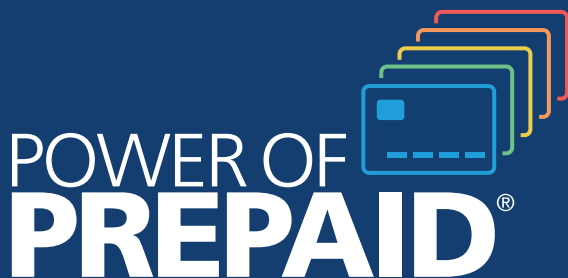


TOP ADVISERS BY REGION

Rank	Adviser	Announced Deal Value (\$M)	Total Deals	Rank	Adviser	Announced Deal Value (\$M)	Total Deals
NEW ENGLAND				MIDWEST			
1	Piper Jaffray & Co.	457	3	1	Sandler O'Neill & Partners	8,989	10
2	RBC Capital Markets	317	1	2	Goldman Sachs	8,530	3
3	Griffin Financial Group	254	2	3	Citi	5,171	2
4	Sandler O'Neill & Partners	218	4	4	JPMorgan	4,686	3
5	Stifel	79	2	5	CIBC World Markets	3,871	1
MID-ATLANTIC				WEST			
1	Sandler O'Neill & Partners	597	9	1	DA Davidson & Co.	642	7
2	Stifel	454	2	2	Piper Jaffray & Co.	604	2
3	JPMorgan	401	1	3	Barclays	587	1
4	Raymond James & Associates	239	2	4	Sandler O'Neill & Partners	580	6
5	Ambassador Financial Group	159	2	5	Stifel	551	9
SOUTHEAST				SOUTHWEST			
1	Sandler O'Neill & Partners	3,710	13	1	Stephens	1,174	4
2	UBS	2,663	1	2	Sandler O'Neill & Partners	847	3
2	Lazard	2,663	1	3	Stifel	729	3
2	JPMorgan	2,663	1	4	Morgan Stanley	237	1
2	Centerview Partners	2,663	1	5	Sheshunoff & Co. Investment Banking	165	3

Notes: Deal activity credited to regions where sellers were located. All advisers on individual deals assigned equal credit.

Source: Dealogic



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Midsize Makeovers

Banks with \$10 billion to \$50 billion of assets have to cope with more rigorous regulations than smaller competitors but lack the scale the bigger ones have to help absorb the expense.

Yet some of these ‘tweeners’ are thriving, thanks to creative strategies to improve profitability.

By Alan Kline

Photography by
David Yellen

Webster Financial in Waterbury, Conn., doesn’t rank among the nation’s 50 largest bank holding companies, but it is the industry leader in one fast-growing business line: health savings accounts.

Webster now controls 14% of the \$37 billion HSA market – far more than any other bank – thanks to a strategic decision it made in late 2013 to invest more heavily in the business and go after larger accounts. At the time, deposits from its HSA subsidiary were already funding much of Webster’s commercial loan growth and further expansion in that business was seen as a way to accelerate its push into new markets and business lines, lower funding costs and boost fee income.

The \$26 billion-asset Webster, once a traditional thrift, had begun reinventing itself as a commercial bank in the early 2000s, but its quest to diversify had taken on new urgency following the financial crisis as it grappled with changing customer behavior, slow economic growth in its home state, historically low interest rates and rising regulatory costs.

Though such pressures affect all banks, Jim Smith, Webster’s chairman and chief executive, contends that regional banks in the \$10 billion-to-\$50 billion asset class are feeling particularly squeezed and need to think creatively to remain competitive and deliver strong

returns to shareholders.

“We see ourselves as tweeners,” said Smith, a former co-chair of the American Bankers Council, a group within the American Bankers Association that represents the interests of midsize banks. “We’re not exempt from a lot of the regulations like the banks under \$10 billion, and we have the full brunt of the regulations for banks with over \$50 billion without having the cost efficiencies they do.”

Webster has differentiated itself by prioritizing HSAs, expanding its commercial lending into new markets and developing expertise in business lines like technology, media, telecommunications and health care.

Other “tweeners,” like the \$28.4 billion-asset First Horizon in Memphis, Tenn., the \$21.5 billion-asset TCF Financial in Wayzata, Minn., and the \$18.9



Webster's John Ciulla
and Jim Smith

billion-asset Bank of the Ozarks in Little Rock, Ark., have made bold moves as well. First Horizon last year bought a restaurant franchise lending business from GE Capital and in recent months has hired teams of bankers with expertise in health care lending, structured equipment finance and lending to the music industry. TCF has largely de-emphasized real estate lending in its traditional markets and built a national footprint in both automobile lending and specialty lending that includes financing dealers of recreational vehicles, boats, lawn and garden equipment and consumer electronics. Bank of the Ozarks has been an active acquirer of small banks in the South, and two years ago it bought a New York bank that gave it a national commercial real estate lending platform.

"Anyone over \$10 billion is trying to gain scale to improve profitability and they are trying to find new and different ways to do that," said Mark Fitzgibbon, the director of research and a principal at Sandler O'Neill. "Webster is an example of a company that has found a unique niche where they've become dominant."

For Webster, the investments in the HSA business included major systems upgrades that allowed it to quickly scale up the business and the creation of a multiaccount offering that lets customers access all health accounts – including flexible spending accounts and health reimbursement accounts – from one point of entry. A big break came in 2015, when JPMorgan Chase put its HSA operations up for sale and Webster won the bidding.

"We would never have been able to even bid on that if we hadn't made the decision" to go all in on HSAs, said Chad Wilkins, the president of Webster's HSA Bank unit.

The JPMorgan Chase deal more than

doubled the size of Webster's HSA business and set the stage for what Webster projects will be rapid organic growth. Total accounts increased by more than 20% last year, to more than 2 million, and Webster expects the business to grow at a similar pace for each of the next five years. Growth could come even faster if the Trump administration and Congress succeed in repealing and replacing the Affordable Care Act, as any change to the contentious law is likely to include expanded access to health savings accounts.

About 20 million Americans had health savings accounts at the end of 2016 "and we had anticipated the market maturing at around 70 million to 100 million in the next five years or so," Smith said in an interview. "Now when you look at health care policy at a national level and what the possibilities are, suddenly the opportunities could be exponentially larger than what had been thought before. That bodes well for what we already thought would be 20% annual growth for the foreseeable future."

It could bode well, too, for Webster's long-term strategic plan.

Over the last several years, Webster has opened commercial loan offices in Boston, New York, Providence, R.I., Philadelphia and Washington, and significantly ramped up asset-based lending operations in Baltimore, Atlanta and Philadelphia. While the bank is hardly abandoning Connecticut, where it has the No. 2 deposit share, its growth plan calls for continued expansion in markets where it is seeing greater demand for commercial loans.

Commercial and commercial real estate loans have increased at an average of 14% annually since 2011 – well above the industry average – and Smith said that "low-cost, long-duration" HSA deposits have funded that growth "almost dollar for dollar." Webster is allocating the bulk of its capital to business lines that

are generating the greatest returns and Smith told investors in January that the HSA business is the bank's highest strategic priority.

"Our obsession with the HSA business, and crucially, our commitment to invest in it, have enabled rapid growth and transformation," Smith said on Webster's fourth-quarter earnings call. "It has the potential to generate more economic profit than any other business by far."

In some ways this diversification is also a survival strategy. Unlike banks with less than \$10 billion of assets, Webster and its midtier peers are subject to stress tests, examinations from the Consumer Financial Protection Bureau and, most notably, caps on interchange fees. Larger banks are subject to even more strenuous stress tests, but by and large they have the scale to absorb the hit to interchange fees and the added compliance costs more easily. Plus their deeper pockets allow them to invest more heavily in technology that can improve efficiency and delivery of service over the long term.

Among these smaller regionals, few banks have undergone as thorough a transformation since the financial crisis as TCF.

Craig Dahl, TCF's president and CEO, said that the crisis hit many markets in its footprint hard, so traditional lending opportunities in cities like Chicago, Milwaukee and Detroit became increasingly scarce. Meanwhile, caps on debit interchange fees and new mandates governing banks' overdraft programs – both aimed at protecting consumers – combined to lower TCF's noninterest revenue by an estimated \$50 million to \$60 million a year, Dahl said.

"The changes to our revenue stream really forced us to look at other revenue sources," said Dahl, explaining the deci-

sion to focus on specialty lending.

Such expansion doesn't come cheaply, though. While the focus on specialty lending has helped to lift TCF's net interest margin – it was 4.41% in 2016 – the efficiency ratio has remained elevated even as TCF has shuttered roughly 100 super-market branches in recent years. Dahl said he expects expenses to level off as the specialty lending businesses mature and the bank continues to reduce its branch count within its seven-state market area.

"Our revenue is significantly higher, but we have higher expenses," Dahl said. "Optimizing that expense base is really what the investor is looking for."

Some midsize banks have opted to merge with larger institutions rather than fundamentally change their business models in the face of declining fee revenue and stricter regulations. Chris Marinac, the director of research and managing principal at FIG Partners in Atlanta, cited Susquehanna Bancshares and National Penn Bancshares, both in Pennsylvania, as examples of banks above or near \$10 billion of assets that opted to sell themselves rather than make the investments needed to expand. (BB&T acquired Susquehanna in 2015 and National Penn a year later.)

Marinac said it is only a matter of time before smaller regionals begin to more actively pursue acquisitions to try to gain the scale they will need to better compete with the larger banks.

"M&A is almost being forced upon these companies," he said. "They don't have to do it right away, but they really have to consider acquisitions to maximize their capital and their opportunities. It's tough to grow purely organically in that size range."

First Horizon Chairman and CEO Bryan Jordan agrees that more consolidation would be good for the industry, arguing that it would take out redundant costs



Craig Dahl, TCF's president and CEO, and Bryan Jordan, First Horizon's chairman and CEO and CEO Bryan Jordan

in retail operations and financial reporting that, ideally, would translate into additional investments in technology and new products and services.

But Jordan said many regional banks like First Horizon are reluctant to do more than bite-sized deals because they are uneasy about crossing the \$50 billion-asset threshold and suddenly being designated as "systemically important" and taking on even more compliance costs. (First Horizon's last whole-bank acquisition was in 2015, when it acquired the \$430 million-asset TrustAtlantic Bank in Cary, N.C.)

That "bright line," Jordan said, "has been an inhibitor to what might be some attractive and logical consolidation. While you won't find many bankers who think 'too big to fail' is a good thing, you're not creating systemically important financial institutions at \$50 billion or \$70 billion in assets, you're creating more capability to serve customers and communities."

Jordan is the current chairman of the ABA's midsize banking group, and he has spent a lot of time in Washington lately urging policymakers to raise the SIFI threshold and lobbying for relief from what he calls "redundant" supervision. All banks with at least \$10 billion of assets are subject to examinations from the CFPB, and many bankers contend that the threshold could be increased without weakening consumer protections.

"When it comes to consumer compliance, there is overlapping supervision between our regulators and the CFPB," Jordan said. "It's important to midsize banks to clarify the roles to eliminate that redundancy."

Jordan and other bankers believe that some new regulations put in place following the financial crisis have made the banking industry safer.

Webster's Smith cites stress testing as an example. "It may not need to be as expensive as it is – maybe it should be part of the safety-and-soundness exams – but if [regulators] were stress testing 10 years ago the way they are today, [the banking industry] might have avoided some pitfalls. I know a lot of our midsize peers agree with that," he said.

Even so, in this climate of heightened regulatory scrutiny, midtier banks have to rethink their business strategy to survive, Smith said.

"On a national scale, you're seeing a lot of companies investing in alternatives in which they can differentiate themselves, which is what we are doing with HSA and commercial banking," he said.

Select retail banking expansion is also part of Webster's growth plan, as evidenced by its decision to take over 17 former Citibank branches in Boston and neighboring suburbs in early 2016. The move nearly doubled its branch count in Massachusetts and increased its total branch locations in the Northeast to roughly 175.

Since the deal was just for the leases – it excluded loans and deposits – it allowed Webster to enter New England's largest retail banking market more cheaply than it might have had it bought a bank or pursued de novo expansion, Smith said. Though deposit and loan growth in

those branches has been slightly slower than expected to date, Smith said he is confident that the bank will hit its target of \$1 billion of deposits and \$500 million of loans within five years given the size and strength of the Boston market.

"We're a little behind, partly because we stepped back from the pricing war, so we're a little indifferent as to where we are at the end of year one," Smith said. "We are looking at this as a five-year opportunity."

Webster is offsetting the cost of the Boston expansion somewhat by continuing to consolidate branches in other markets. The bank has closed roughly 20 branches in Connecticut since 2009 and planned to close eight more in Connecticut, New York and Rhode Island in the first quarter of this year. The median distance between closed branches and existing ones is 1.75 miles, Webster said.

Even adding in the new hires in Boston, Webster has reduced the head count at its branches by roughly 27% since 2009, said Nitin Mhatre, the bank's head of community banking.

Webster is also trying to keep marketing expenses in check in Boston by confining its advertising to digital channels, like the music streaming site Pandora, rather than buying up airtime on local television and radio. "The media costs in Boston are four times that of our core footprint, so we have to be selective," said Dawn Morris, Webster's chief marketing officer.

Still, it is in commercial and HSA banking where Webster is seeing the most opportunity for growth.

The shift to commercial banking began roughly a dozen years ago – when Webster switched to a commercial charter and John Ciulla, now Webster's president, joined the company from Bank of New York Mellon – and has

accelerated in recent years as Webster moved more deeply into new markets and business lines.

Today commercial and commercial real estate loans account for nearly 60% of Webster's total loans, compared with roughly 47% in 2009 and 39% in 2004, according to Federal Deposit Insurance Corp. data.

Ciulla said its approach to expansion is to hire local bankers with a deep understanding of real estate values and the industries that drive local economies.

"We do not export people from our markets into new markets; we always find people that had been operating successfully in Boston or Providence or New York or Philadelphia," Ciulla said. "Most of them had embedded customers who were willing to follow them over to Webster. That's really how we have built the business."

HSAs, meanwhile, have been a key driver of that growth, providing Webster with a stable stream of low-cost deposits to support its commercial lending ambitions. It is no coincidence that Webster's funding costs have declined sharply in recent years – from 95 basis points in 2010 to 56 basis points in 2012 to 40 basis points last year – as HSA deposits have continued to increase. At Dec. 31, HSA deposits totaled \$4.4 billion, up 144% from just two years earlier, according to Webster's annual report, filed in early March.

Last year the HSA business generated \$71.7 million of fee income as well, up 151% from 2014, mainly from interchange fees on HSA cards and monthly maintenance fees that, for most account holders, are paid by employers. The business also brings in significant net interest income, which for HSA accounts represents the difference between the funding credit received reflecting the value of longer-duration deposits, minus the interest paid. All told, net income from HSAs more than doubled last year from two

years earlier, to \$38.2 million, even as expenses related to the business soared.

Fitzgibbon at Sandler O'Neill called Webster's HSA business "uniquely profitable" and said it has the potential to "grow at a rate that's much faster than traditional banking businesses and generate returns that are well in excess of what's feasible" for others in the industry.

Webster entered the HSA business in 2005 when it bought HSA Bank in Milwaukee, and for the first eight years, grew the business steadily, if unspectacularly, by targeting smaller employers and insurers. Today it counts two of the nation's five largest insurers as clients and controls 14% of the country's total HSA assets, according to the Devenir Group, an HSA consultancy.

It is now the second-largest HSA administrator in the country, behind only OptumBank, the HSA arm of United Health Care Group. Among traditional banks, its two closest competitors are Bank of America and UMB Financial in Kansas City, Mo., each of which has 5% market share, according to Devenir.

Fitzgibbon, who has been following Webster for more than 15 years, recalls that the bank invested in other nontraditional businesses over the years in an effort to boost profits – with mixed results at best.

Webster has owned a national mortgage warehouse lending unit, a wealth advisory firm, an insurance-premium finance company and an insurance subsidiary, but eventually sold them all because, as Smith said, "they were all smaller businesses that were sucking up management time and resources and were not earning their cost of capital."

With HSAs, though, Webster finally found a scalable, nontraditional business line that earned its cost of capital – and then some.

"I like to tell [Webster's executives] that they kissed a lot of frogs before they found their prince," Fitzgibbon said. □

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BankThink

BY FALK RIEKER

Get Customers to Help You Protect Their Data

Never have customer demands so directly influenced every aspect of the banking ecosystem; they're forcing banks to undergo massive digital transformation processes to meet new needs and pushing for new platforms and services to go live faster than ever before. Therein lies the problem.

Digital transformation and rapid product and platform development are happening at the same time that hacker culture has taken off, escalating the security risks. According to a Verizon study of data breaches, hackers are breaking in faster and it's taking longer for banks to find them. In 2015, 84% of hacks were completed in days or less but only 25% of breaches were caught within days.

Soon, hacks will happen in hours – if not minutes – and the channels through which hacks can take place will grow as consumer use grows. Today it's mobile apps and online channels; tomorrow it will be biometric devices and virtual reality.

But processes can be put in place to prevent breaches and protect customer data – no matter what channels it comes in on or how it's stored, today and in the future.

The first and perhaps most important step is education – for everyone, not just the compliance team. Some of the most high-profile hacks in recent years may have started with something as benign as an easy password (passwOrd! is not going to do it) or failure to enforce two-step authentication.

For information to be truly secure, everyone from the bank tellers to the customer must be aware of how easily it can be compromised and how to keep it secure. If employees sign on to a device in the workplace on a connected network, they need to be taught to take proper security measures – preventative security only works when everyone is on board.

From there, educate customers. For instance, are customers aware that signing on to their bank account from unsecured Wi-Fi could mean trouble? Or that emails or texts from a bank should never ask for personal information? Do they ignore notices about an account being signed onto from an unusual location? Give customers a clear, easy way to flag a problem – it may stop a small issue before it becomes a bigger one.

The enemy of good security protocol is “doing things how we've always done it.” Banks must regularly re-evaluate not only security processes – such as cyber-risk controls – but the culture that supports those processes. Cybersecurity governance must be enforced steadily and proactively, and it all starts with the right processes.

Legacy systems are a great example of doing things as they've always been done – they're big, complex and expensive to overhaul. But banks running on outdated legacy systems may not realize how vulnerable they are to threats. Think of it like a locked door on a house. When the lock was first installed, it prevented very specific types of lock picks. As time passes, the lock picks get better. While the old lock may still serve its primary job, it isn't helping against the flashy new tools lock picks use.

Falk Rieker is global vice president and global head of industry business unit banking at SAP.



Today, banks need a new lock. The rise of the digital age and the size and frequency of customer data breaches necessitate massive security upgrades.

Customers have to change too. They expect banks to have their back – if a card gets lost, they call the bank and a new one magically appears in a few days. But with the increased risks today, customers need to understand the role they play in controlling access to information. Banks should prioritize proactive customer communication – what customers don't know can hurt them.

Education has been driven mostly by major credit card companies so far – for example, Amex commercials about fraud detection. These are great awareness generators for a particular part of the banking experience, but there's much more to be done.

Banks should engage in social media campaigns; create pop-up reminders for those using online banking; and have branch employees chat with customers. Ad campaigns that go beyond fraud detection also could help, perhaps showing the impact of lax security habits for checking accounts, for example.

Now is one of the most pivotal times in banking security in modern history. Never before have banks been at such a crossroads between extreme risk and unlimited potential. With the value and relevance of data surging, banks must be hypervigilant to keep their most valuable asset – customer data – secure. □

OPINION

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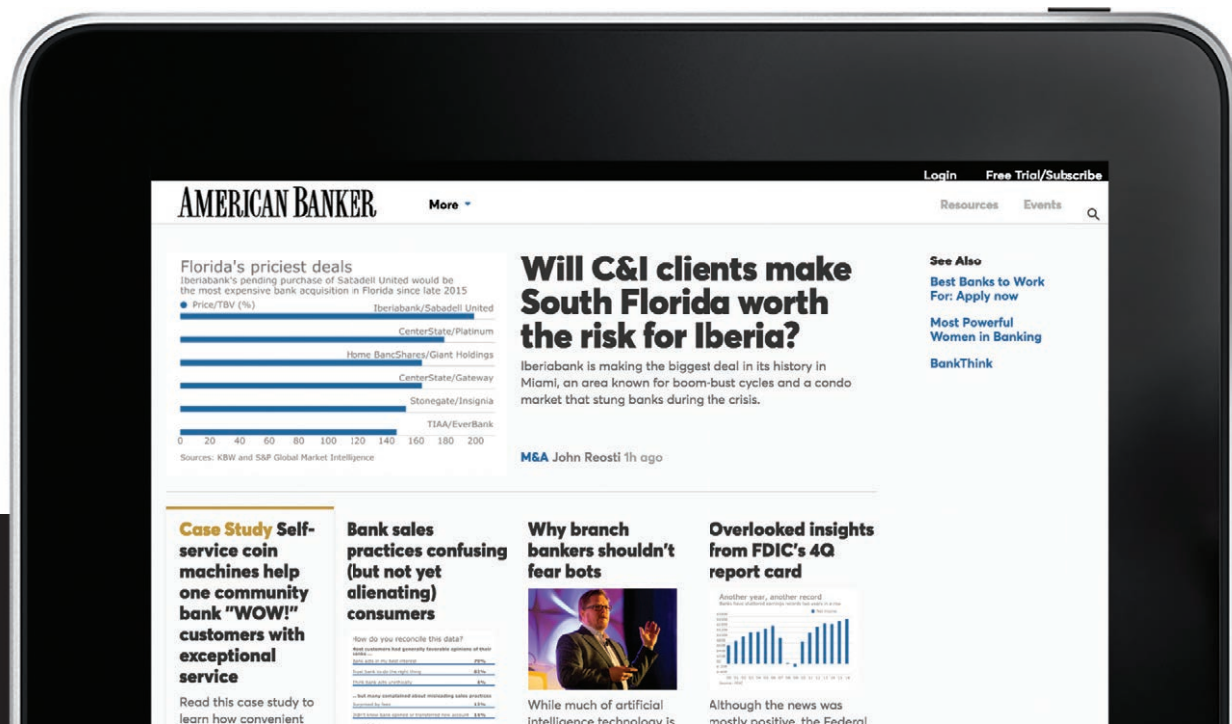
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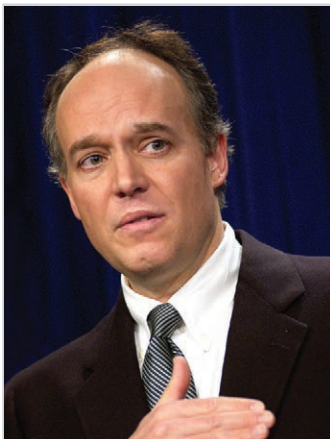
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BackPorch



PETER FITZGERALD

"It's like the horseshoe when the automobile came along."

Former U.S. senator from Illinois and founder of Chain Bridge Bank in McLean, Va., calling the iPhone the death of bank branches

ALLEN PARKER

"There's no doubt in my mind that it will be a highly challenging job."

Wells Fargo's new chief lawyer, who joins the bank as it works to recover from the phony-accounts scandal

BRUNO IKSIL

"I have to retrieve my reputation, my intellectual property and, simply, my life. So far, all of this has been stolen."

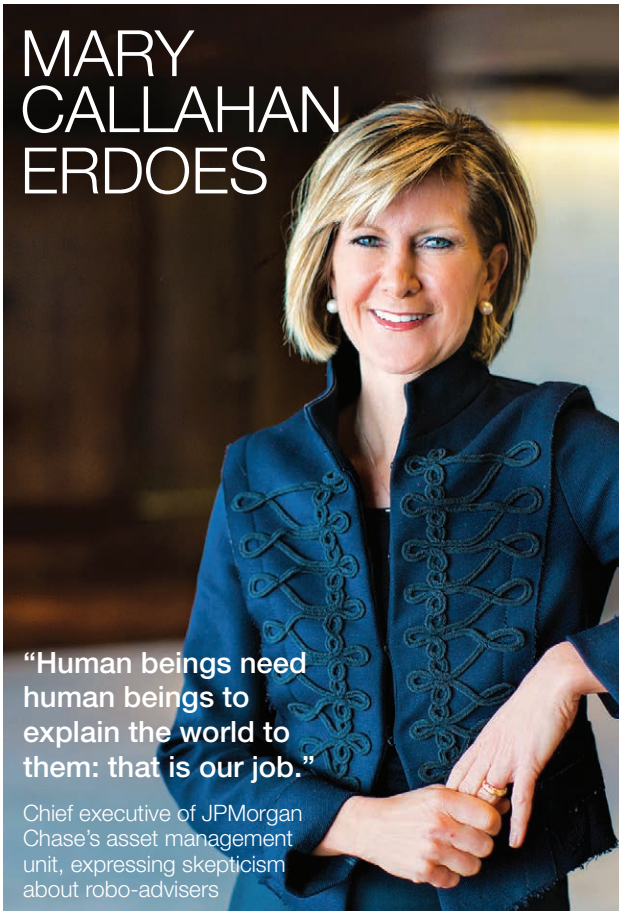
JPMorgan Chase trader known as the "London whale," reflecting on how he's been affected following a \$6.2 billion trading loss at the bank in 2012

ROB NICHOLS

"The change to the statutory dividend rate upended Federal Reserve System policy that has been in place for more than 100 years."

American Bankers Association president, on why the trade group is suing over a 2015 law that cut Fed dividend payments to banks to divert the money to the federal highway trust fund

MARY CALLAHAN ERDOES



"Human beings need human beings to explain the world to them: that is our job."

Chief executive of JPMorgan Chase's asset management unit, expressing skepticism about robo-advisers

WARREN BUFFETT

"It's something that billions and billions and billions are spent on, and brains are being involved in it, so it could easily come sooner than I think. And it will be negative for auto insurers."

Berkshire Hathaway chairman, predicting self-driving cars will take at least a decade before they are in use enough to be a major threat to insurance companies

LAURA KNAPP CHADWICK

"We're hoping it doesn't get ugly on the House floor, but we are preparing to go down that route."

A policy director at the National Restaurant Association, vowing to fight a proposal to repeal the Durbin amendment

DANIEL TARULLO

"They are the single most important supervisory innovation, not just since the crisis, but really for the last 20, 25 years."

Federal Reserve governor, reacting to lawmakers proposing changes that could weaken the bank stress tests he helped design

BILL COOPER

"I certainly don't need some clown in Washington telling me what to do."

TCF Financial's outspoken chairman, who died Feb. 7, speaking after the financial crisis about the new regulations being imposed on the industry



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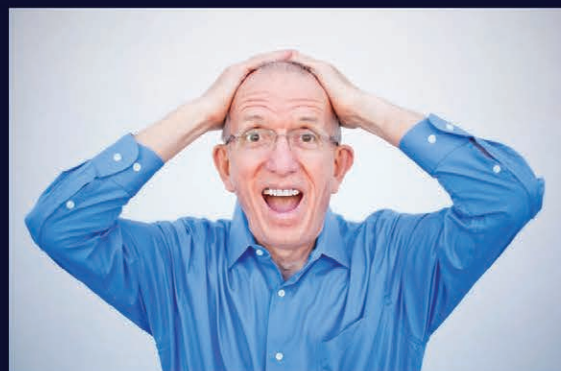
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