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The New Financial Services Industry

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The convergence of the various segments of the financial services industry is far from complete, but two years after the passage of a financial modernization act, the key elements of a new financial services industry structure are in place. The Citicorp-Travelers merger was the impetus to the enabling legislation, and the major step in the formation of the new structure, but a series of mergers announced in the second half of 2000 also have had a significant impact. This report describes the new industry structure as it presently exists; suggests what changes can be expected in the next few years; and indicates what this could mean to local banks.

Highlighting the emergence of the new industry structure are:

- The dominance of the broader financial services business by the largest commercial banks in United States and overseas.
- The gradual disappearance of domestic, mid-sized full-service banks.
- The non-participation of American insurance underwriters.

It is no surprise to see the big banks get bigger, but it is a bit unexpected to have seven banks leave all others so far behind. Today, the smallest of these largest domestic commercial banks when measured by revenues, First Union, is bigger than the eighth and ninth largest banks combined. This will be altered by the merger of Firststar and U.S. Bancorp, but that merger also further thins the ranks of the nation's second tier banks. The net effect has been to create a "bar bell" structure – i.e., a lot of big and small firms with little in-between.

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What may be more of a surprise to some is the near total disappearance of the mid-sized, full-service banks. With the recently announced sales of Summit and Old Kent, there are only three traditional, domestic banks outside of the Mid-South with revenues between \$1 and \$2.9 billion, which is roughly equivalent to \$20 to \$50 billion in assets. Huntington, M&T and Zions - along with five banks based in Alabama and Tennessee - are what remains between the large and the local banks.

The non-participation of country's large insurance underwriters, other than Travelers, in the formation of the new financial services industry may partly be a result of the mutuality and limited stock history of the large insurance companies. Mutuality has some advantages, but acquisition experience and adjusting quickly to change are not among them.

In this new financial services economy, the big company end of the "bar bell" can conveniently be divided into five categories. They are:

- National, or near national, full-line financial services firms – Citigroup, Bank of America, Wells Fargo, Fleet, Bank One, First Union and U.S. Bancorp.
- National corporate/investment banks – J.P. Morgan Chase, Morgan Stanley, Merrill Lynch, Goldman Sachs, Lehman Bros., Charles Schwab and GE Capital.
- Regional full-line financial services firms – National City, PNC, SunTrust, KeyCorp, Wachovia, Fifth Third, BB&T and Comerica.
- Specialty financial services companies – Bank of New York, Mellon, Northern Trust, State Street and several credit card firms, finance companies and mortgage banks.
- Insurance underwriters – Prudential, MetLife, State Farm, AFLAC and AllState.

Like with any groupings, there are firms that defy easy categorization. GE Capital, AIG, American Express, Charles Schwab and Mellon are examples of this. For our purposes, GE Capital, despite a large consumer content has been included with the corporate/investment banks; AIG with insurance underwriters; and American Express, Schwab and Mellon with specialty finance companies.

The increasing globalization of financial services also cannot be ignored. The acquisition of Bankers Trust, and indirectly Alex Brown, by Deutsche Bank; the recent purchases of American investment houses by Credit Suisse and UBS; and the continuing merger activity of ABN AMRO, HSBC and AXA has put an indelible foreign stamp on the domestic financial services industry.

National Full-Line Financial Services Firms

Sitting at the top on the retail side are six large banks – Citigroup, Bank of America, Wells Fargo, Fleet, Bank One and First Union – that have moved away from the crowd. Citigroup is in a class by itself with revenues approaching \$80 billion and earnings of about \$15 billion. Also, the merger of Firststar and U.S. Bancorp may turn this “big six” into a “big seven.”

Moving away from the crowd and maintaining a national position, though, are very different things. It is probably a “given” that Citigroup is a national and global leader into perpetuity, and that even if Bank of America slips, it is large enough to “muddle through” like its namesake did in the mid-eighties. After that there are no “sure things,” albeit the performances of Wells Fargo and Fleet have them looking good.

Less certain are Bank One, First Union and the “new” U.S. Bancorp. The first two are struggling and highly dependent on branch networks at a time when technology is making branches less important. Investors also are not likely to give them much time to “catch up.” U.S. Bancorp’s problem is “catching up” as it is late to the party in terms of integrating a large merger and diversifying away from traditional banking.

National Full-Line Financial Services Companies

	<u>Revenue*</u>	<u>Net Income*</u> (In billions)	<u>Market Capital**</u>	<u>Revenues/ Branch*</u> (In mill.)	<u>Nonint. Income/ Revenue</u>
<u>Domestic</u>					
Citigroup	\$77.9	\$15.0	\$246	\$200.8	70%
Bank of America	33.3	8.2	64	7.6	44
Wells Fargo	17.0	4.2	77	7.9	41
Fleet	16.8	4.0	37	9.9	53
Bank One	14.6	-	39	8.1	39
First Union	14.6	(.7)	25	6.5	48
U.S. Bancorp	10.8	2.8	34	5.1	43
<u>Foreign</u>					
ABN AMRO	\$ 3.5	\$.9	\$ 33	\$ 6.0	39%
HSBC	2.7	.7	122	5.9	28
Bank of Tokyo-Mitsubishi	2.4	.6	49	9.9	29
Royal Bank of Scotland	1.4	.2	-	4.8	25
Bank of Montreal	1.4	.2	12	8.2	48

*Nine months ending September 30, 2000 annualized in this and subsequent tables.

**December 1, 2000 in this and subsequent tables unless otherwise stated.

Source: SNL Securities LC, Charlottesville, Virginia and Yahoo Market Guide.

Bank One, First Union and U.S. Bancorp are far from alone in a heavy dependence on branches and traditional banking. Bank One is actually less dependent than all but Citigroup and Fleet; albeit that lesser dependence comes from a large, troubled credit card business.

Revenues per branch and noninterest income as percent of revenues are imperfect measurements of lesser dependence on traditional banking, but they are a start. These measurements show Citigroup and Fleet to be the least dependent on traditional banking, but the latter has moved back toward the others with its acquisition of Summit. U.S. Bancorp and, surprisingly, Wells Fargo are the most dependent.

What happens to any laggards among these big full-line financial services firms also will be impacted by the strategies of two world-class European banks - HSBC and ABN AMRO. They are about the size of Bank of America; have good American positions; and have shown a strong American interest through recent acquisitions – i.e., HSBC’s purchase of Republic and ABN AMRO’s recent announcement that it was acquiring Michigan National from the National Australia Bank. With these acquisitions, HSBC is number four in deposits in New York state, and ABN AMRO is number two in Illinois and Michigan and a significant force in metropolitan New York; and they have the motivation and size to become national financial services powerhouses through acquisitions. Bank of Tokyo-Mitsubishi, Royal Bank of Scotland and Bank of Montreal also have major retail positions in United States, but they cannot pull off a First Union or Bank One acquisition.

What can be expected from these retail giants in the next few years?

- Citigroup will “push the envelope” with mergers until the regulators say “no more” with American Express, Allstate and the big Swiss and Dutch banks being possible targets.
- Bank of America could win a First Union sweepstake as a result of massive cost savings, Charlotte loyalties a la Fleet-BankBoston – i.e., they do not like each other until out-of-area ownership looms – and limited interest by others.
- Fleet and Wells Fargo will concentrate on nonbank mergers with the likes of Fidelity, Countrywide and John Hancock.
- Bank One, like First Union, is likely to sell with ABN AMRO and Wells Fargo being possible acquirers.
- U.S. Bancorp will be given time to put its merger together and may even add a KeyCorp, Huntington or National City to the mix to give it more clout.

National Corporate/Investment Banks

While there has been an initial move for most of the large banks to expand on both the retail and corporate side of the ledger, only Citigroup, and to a lesser extent, Merrill Lynch are a major players on both sides. Chase and Bank of America looked like candidates to go “both ways,” and still may, but Chase’s acquisition of J.P. Morgan has put it solidly in the corporate/investment banking camp, and Bank of America has its hands full making the transition away from a heavy dependence on branches.

National Corporate/Investment Banks

	<u>Revenue</u>	<u>Net Income</u> (In billions)	<u>Market Capital</u>
<u>Domestic</u>			
GE Capital	\$34.7	\$5.0	-
Morgan Stanley	28.5	5.6	\$74
Merrill Lynch	27.3	3.8	49
J.P. Morgan Chase	32.0	8.2	73
Goldman Sachs	17.6	3.2	38
Lehman Bros.	12.0	1.6	12
Charles Schwab	5.6	.8	39
<u>Foreign</u>			
Deutsche Bank	\$ 6.0	\$(.5)	\$47*
Credit Suisse	-	-	51*
UBS	-	-	58*

*March 31, 2000.

Source: SNL Securities LC, Charlottesville, Virginia and Yahoo Market Guide.

Thus, in the world of handling of big money through investment banking, corporate loan syndication and asset management, Citigroup, J.P. Morgan Chase, Morgan Stanley, Merrill Lynch, Goldman Sachs and GE Capital are a national elite doing battle domestically and worldwide with the likes of Deutsche Bank, UBS and Credit Suisse. The Swiss banks recent acquisitions of Paine Webber and Donaldson Lufkin Jenrette signal their readiness to play.

These are all big time players, and it is hard to picture any of them exiting via a sale, albeit a merger between a Merrill Lynch, Morgan Stanley or Goldman Sachs with HSBC, Dutch or a Swiss bank is not out of the question. More likely are selective acquisitions to improve their status geographically and in lines of business with asset management appearing to be a favorite target.

Regional Full-Line Financial Service Firms

Back on the retail side, among the survivors of inter- and intra-industry consolidation are eight large, but still regional, full-line financial services companies. National City, PNC, SunTrust, KeyCorp, Wachovia, Fifth Third, BB&T and Comerica have revenues roughly between \$3 and \$6 billion, and although they are much smaller than the biggest American banks. The bigger among them have revenues that are only about one third that of First Union and Bank One, but they are major factors over broad geographic regions.

Regional Full-Line Financial Services Companies

	<u>Revenue</u>	<u>Net Income</u> (In billions)	<u>Market Capital</u>	<u>Revenues/ Branch</u> (In mill.)	<u>Nonint. Income/ Revenue</u>
National City	\$5.3	\$1.3	\$13	\$4.7	43%
PNC	5.1	1.3	18	7.1	57
SunTrust	4.9	1.3	14	4.2	36
KeyCorp	4.6	1.0	10	4.9	41
Wachovia	4.4	.8	10	6.5	42
Fifth Third	3.8	1.1	26	4.1	38
BB&T	3.1	.5	12	3.8	32
Comerica	2.9	.8	8	8.4	31

Source: SNL Securities LC, Charlottesville, Virginia.

This group is interesting not only because they are so few and are almost all that stands between the very large and local banks, but that there are contrary views as to their eventual role. It rationally can be argued that they are a) too small to “stay the course;” b) have an attractiveness and market capitalization that makes them likely to be acquired by bigger financial services companies; or c) are well-positioned as regional chains to be long-term purveyors of financial products.

Although these banks are not all the same, if they make the right moves in the future, they are large enough to “stay the course” and are well-positioned as regional chains to be a major part of the financial services industry long-term structure. Their challenge is execution since as a group they are more dependent on branches than the large retail banks, PNC being a notable exception, and, thus, have more vulnerability to remote access banking and investor concern.

What differentiates these banks from each other are location, momentum and diversification, which greatly affects investor perception and, hence, the ability to stay around. SunTrust, Wachovia and BB&T benefit from serving a high growth southeastern market that creates underlying growth momentum. Fifth Third and BB&T have strong investor appeal reflecting momentum and, presumably, superior management. PNC has diversified to the degree it may soon be in a different category. Missing from these positive categorizations are National City, KeyCorp and Comerica. The latter gets a lot of favorable press, but it still trades at only about ten times earnings.

What happens to this “regional eight” is a guessing game, but they are too large to be free of investor pressure, which may determine their futures. The very large banks also have a diminishing interest in acquiring branch networks, which is what these banks generally are, but Fleet’s buying Summit and ABN AMRO’s purchase of Michigan National suggest there are exceptions, and Wells Fargo is far from through buying banks.

As to the future of these banks, it is likely that:

- SunTrust, Wachovia and BB&T will feel little investor or acquirer pressure to sell because of their location in high growth markets and the natural “playground” of Bank of America and First Union, large banks not likely to acquire further in their home market. Three going down to two through an equal merger, though, is always possible.
- National City, KeyCorp and Comerica have location and momentum against them and could be involved in major mergers either equally among themselves or in which they become part of Wells Fargo, U.S. Bancorp, ABN AMRO or Bank of America.

- Fifth Third differs from its Midwest brethren primarily in momentum and investor perception, and its vulnerability is that of another world – i.e., new economy stocks that pay a tremendous price if they fail to meet expectations.
- PNC shares the low growth markets of its Ohio and Michigan neighbors, but diversification creates different dynamics that in time could allow it to minimize traditional banking as part of its profile. This also would make it attractive to a wider range of acquirers.

The only certainty is that this “island of eight” between the very large and local banks will be reduced in numbers over the next few years through mergers. Firststar and U.S. Bancorp reduced it from ten to eight by moving toward a more national stature, and they may take one of the other eight with them. Another equal merger among the group also is possible as is Wells Fargo dipping into the group to strengthen its Midwest franchise. The only way the group can grow is through the acquisition of a Union Planters, Hibernia or First Tennessee by one of the leading Alabama banks – SouthTrust, Regions and AmSouth.

Mid-Sized, Full-Service Banks

Before moving on to the specialty financial services firms, bank-based or other, a discussion of that handful of mid-sized, full-service banks with 2000 revenues in excess of \$1 billion, but far less than \$3 billion that approximates the \$20 to \$50 billion asset range is pertinent. They are a vanishing breed having lost Summit and Old Kent in recent months, which was two-fifths of banks of this size outside of Alabama and Tennessee. Huntington, M&T and Zions are all that is left in the rest of the country with revenues for each being not much in excess of \$1 billion. Even combined, the three would be at the low end of the regionals discussed in the preceding sector. One other non-Mid-South commercial bank, Banknorth, just misses the \$1 billion revenue cut.

Mid-Sized, Full-Line Financial Services Comparison

	<u>Revenue</u>	Net <u>Income</u> (In billions)	Market <u>Capital</u>	Revenues/ <u>Branch</u> (In mill.)	Nonint. <u>Income/</u> <u>Revenue</u>
<u>Mid-South</u>					
AmSouth	\$ 2.3	\$.3	\$ 5	\$ 3.9	37%
Regions	2.0	.5	5	2.6	28
SouthTrust	1.9	.5	5	3.0	27
Union Planters	1.8	.4	4	2.2	30
First Tennessee	1.5	.2	3	7.5	61
<u>Other</u>					
M&T	\$ 1.5	\$.4	\$ 6	\$3.2	27%
Huntington	1.4	.3	3	2.7	31
Zions	1.1	.1	5	2.9	25

Source: SNL Securities LC, Charlottesville, Virginia.

While the mid-sized banks disappear nationwide, they are still alive and healthy in the Mid-South with three Alabama banks – AmSouth, Regions and SouthTrust – and two from Tennessee – Union Planters and First Tennessee – having revenues between \$1 and \$3 billion. Another Alabama bank, Compass, falls just short of \$1 billion. The concentration of banks of this size in such a small part of the country is primarily the result of their determination to stay independent, but it also reflects the region not having been of strong interest to the most aggressive acquirers in the late eighties and nineties.

What happens to these remaining mid-sized banks? M&T and Zions may be around awhile since their geographic locations limit the number of buyers with sufficient size to acquire them. For Huntington, a sale may be just a matter of time. When, and if, the Mid-South “cracks,” one merger should follow another with pairings taking place between the Tennessee, Alabama and Louisiana banks and what is left selling to SunTrust, Wachovia or BB&T.

Specialty Financial Services Companies

The specialty financial services firms, which is sort of “catch-all” for all financial firms that are not full-line financial services firms, investment banks or insurance companies, includes some substantial firms. This also is a repository for that famous “nonbank,” but the majority of the large firms in this category are banks or thrifts that gather insured deposits. Bank of New York, Mellon, Northern Trust, State Street, M&I, Washington Mutual, Golden West and Charter One are in this group as are the large independent credit card banks – MBNA, Provident and Capital One - which also are banks regulated by the FDIC and the Federal Reserve. In fact, with the sale of Associates First to Citigroup, the only company in this group with substantial size without bank or thrift origins are American Express, Household, Fidelity, Countrywide and the Ford and General Motor financial affiliates.

Many of these specialty finance firms are presently highly valued, but their long-term value depends on the growth momentum and profitability of the sector they serve and the ability to execute. The positive investor perception of mutual funds, asset management, processing for others and credit cards has created high values for Bank of New York, Mellon, Northern Trust, State Street, the mono-line credit card companies and American Express. Consumer finance companies and mortgage specialists, which includes most of the large thrifts have valuations similar to traditional banks. Whether mutual funds and credit card companies keep their high valuations depends on how well their sectors fare in the overall growth of the financial services industry as well as their individual performance.

In general, the outlook for these financial services specialists is good, but it is unlikely they will move much beyond their specialties, which may be a plus. Asset management firms, in particular, have strong underlying fundamentals that create growth potential and high acquisition value, and this also could be true of the credit card firms, but with more risk. Mortgage banking may never attract high valuations because of volatility, but home mortgages represent about half of the nation’s private debt and provide a lot of room for making money.

Specialty Financial Services Companies

	<u>Revenue</u>	<u>Net Income</u> (In billions)	<u>Market Capital</u>	<u>Nonint. Income/ Revenue</u>
<u>Specialty Financial Services Banks</u>				
Bank of New York	\$ 4.7	\$1.4	\$39	61%
Mellon	4.5	1.0	22	69
State Street	3.6	.6	20	75
MBNA	2.6	1.2	30	80
Provident	2.5	.6	12	-
Capital One	2.1	.4	10	-
Northern Trust	2.1	.5	19	73
M&I	1.6	.3	4	58
<u>Specialty Financial Service-Other</u>				
American Express	\$23.5	\$2.7	\$71	-
Ford	19.1	1.8	-	-
GMAC	15.1	1.6	-	-
Household	7.8	1.6	25	-
Fidelity	-	1.4	-	-
<u>Mortgage Companies</u>				
Washington Mutual	\$ 6.2	\$1.9	\$23	31%
Countrywide	2.0	.4	4	-
Golden West	1.3	.5	8	11
Charter One	1.3	.4	5	28
Dime	1.0	.1	3	39

Source: SNL Securities LC, Charlottesville, Virginia and Yahoo Market Guide.

Among the non-captives, only American Express is in the size class of the big retail corporate investment banks, and the best of the rest at some point may feel the need to maximize value through sale. Bank of New York, State Street, Mellon, Northern Trust and Fidelity represent such positive diversification for a larger financial services firm that they may have to take advantage of this value through a sale. The mono-line credit card firms may sell for similar reasons if they continue to execute well or because of the exaggerated negative effect a recession can have on that business. Likely buyers include the usual domestic suspects -

Citigroup, Bank of America, Wells Fargo, Fleet and J.P. Morgan Chase – but the appeal of these specialists may be even stronger to European financial services firms that want to have more of their base in United States.

Insurance Companies

The insurance companies have been non-participants in the early stages of inter-financial services consolidation beyond the Travelers-Citicorp merger. This is not what was anticipated considering the size of the big insurance firms and the large number of insurance companies. Thus, how the insurance industry figures in the future consolidation of financial services is still an open question.

Leading Insurance Companies

	<u>Revenue</u>	<u>Net Income</u> (In billions)	<u>Market Capital</u>
<u>Stock</u>			
AIG	\$41	\$5.5	\$216
AllState	29	2.1	27
MetLife	27	1.3	22
Cigna	20	1.0	19
AFLAC	10	.6	18
<u>Mutual</u>			
State Farm	\$44	\$1.3	-
Prudential	34	1.1	-
<u>Foreign</u>			
AXA	\$82	\$2.0	\$57
Alliance	62	2.2	82*

*March 31, 2000.

Source: SEC 10-Qs and Yahoo Market Guide.

Although, insurance is the “wild card” in financial services consolidation, there are market forces that should influence the insurance industry’s future direction. Among these are:

- The underlying need for insurance is growing rapidly as wealth accumulates and people live longer.
- The existing agency-based delivery system is inefficient and a growth impediment.
- Inbred thinking and a predominance of mutuals may have the industry, in general, thinking more about protecting its turf rather than joining in the financial services “boom.”
- European insurance companies have grown much faster than their domestic brethren over the last decade despite the much stronger economic dynamics in the United States – i.e., fifteen years ago Prudential was the biggest insurance company in the world ranked by assets, but today, it does not even make the top ten.

What these insurance market forces suggest for future financial services consolidation is that unless there are some major directional shifts, what could happen relative to the insurance segment is:

- A major change in the delivery of insurance products that improves customer access and reduces the cost to consumers.
- Domination of the new delivery system by aggressive, large financial services companies that can move quickly and may include a large European content. Citigroup, AIG, AXA and Allianz are likely winners, but even with late starts, financial services giants like Bank of America and Wells Fargo could become major players.
- The gradual disappearance, and gradual could mean as much as twenty years, of most existing domestic insurance firms, and they even may become the savings and loans of the early 21st

century – i.e., a product mix that does not match general customer needs. Assuming insurance has to be sold rather than being made available at maximum convenience at much reduced prices may be a dangerous misconception.

This is not a pleasant outlook for the insurance companies, and it sounds much like what is being said about traditional banking. The difference is that banks have been hearing this for years and are adjusting. The insurance industry is still mired in the past and may be more than five years behind banking, which creates opportunities for banks.

Foreign Competition

Throughout the discussion of the various sectors of the new financial services industry there has been considerable talk of foreign competition, and it might be helpful to highlight the foreign banks that are in the best position to play a major role in United States; and have shown an interest. There are six banks in Europe – Deutsche Bank, BNP Paribas, UBS, HSBC, ABN AMRO and Credit Suisse – with assets in excess of \$450 billion and earnings of more than \$2 billion, and they all have shown a strong interest in American banking.

Deutsche Bank, UBS and Credit Suisse's interest is asset management, corporate banking and investment banking. This is evidenced by Deutsche Bank's acquisitions of Bankers Trust, and indirectly Alex Brown, and National Discount Brokers; UBS's purchase of Paine Webber; and Credit Suisse adding Donaldson Lufkin Jenrette to its already strong American position.

HSBC and ABN AMRO are major players on the retail side domestically, which was documented earlier in the report, and this is the main interest of BNP Paribas as well. It owns the \$10 billion asset Bank of the West in California, but this Paris-based bank has been preoccupied in recent years with its European expansion.

Not far behind these banks in asset size, and sometimes ahead in earnings and market capital, are Lloyds, Barclays, ING and the Royal Bank of Scotland. The latter, which owns the \$30 billion Citizens in New England is a much bigger international force now that it has acquired National Westminster.

Leading European Banks*

	<u>Assets</u>	Net <u>Income</u> (In billions)	<u>Market Capital</u>
Deutsche Bank	\$844	\$2.4	\$ 47**
BNP Paribas	702	2.4	40**
UBS	615	3.7	58**
HSBC	569	5.1	122
ABN AMRO	460	2.4	33
Credit Suisse	452	3.1	51**

*Assets over \$400 billion and earnings of at least \$2 billion.

**March 31, 2000.

Source: American Banker and Yahoo Market Guide.

There are two factors other than size that influence the interest of foreign banks in United States financial services – home country and corporate/retail orientation. Large banks in small countries have to be globally oriented, and this is evidenced by UBS and Credit Suisse in Switzerland; the Amsterdam-based ABN AMRO and ING; HSBC, which moved its headquarters from Hong Kong to London; and the Royal Bank of Scotland, which as the name suggests was a “small country” bank before it acquired Natwest. Deutsche Bank is in a large country, but its corporate orientation forces it to go beyond Germany if it wants to grow.

Impact on Local Banks

What does the new financial services industry structure mean to the local banks? First and foremost, the debate over the reality of the “bar bell” structure and the long-term viability of mid-sized banks is over. The “bar bell” has won, and the emerging structure is clearly one of giant financial institutions competing against specialty firms and local boutiques. The mid-sized banks already are almost gone. Second, if a primary sector in the new economy is local financial boutiques – Who is better to fill that role than today’s local banks?

The widening size gap between the large financial services companies and local competition also is a plus for local banks. This creates a clearer distinction between local and national and some portion of the mid-sized bank customer base

will prefer local financial service firms over national ones. This will be most pronounced among small businesses, which is the fastest growing segment of the business community.

The size of the gap between large and small also could grow wider if the “clean out” in the \$20 to \$50 billion assets size broadens to the \$10 to \$100 billion range. The \$100 billion top of the range is likely to “kick in” as growth, internal and by acquisition, or selling out, will take most, if not all, of the eight full-line banks in that size grouping either beyond that range or out of play. Lowering the bottom end is also possible since the only independent commercial banks left with assets between \$15 and \$20 billion are Compass, Banknorth and Hibernia – and it might be noted that two of the three are in the Mid-South.

The growing importance of the local boutique in the new financial services economy suggests opportunities for local banks, but it does not change the fact that, except in isolated communities, a traditional “spread” bank built around teller stations is going the way of the local hardware store and corner drugstore. As a result, most local boutiques will come in two forms, which are:

- Full-service, technologically-advanced alternative to the large banks.
- Business banks.

The first will continue to have the “local touch,” but it will provide its customers with convenient remote access to a full range of transferable products built around deposits and a line of credit and includes in the transfer process the ability to move deposits and/or credit line funds to mutual funds and other forms of securities and investments, buy insurance directly and pay bills. There will be more than banks trying to fill this role, but banks start with good access to the best customers and a high level of trust, which is important when investment is part of the mix. On the downside, this is far more than “business as usual,” and there may not be room for more than one or two local alternatives per market.

The business bank is nothing new to banking. In California, commercial banks historically have been business banks and most start-ups have assumed this profile. A successful business bank in the future, though, may have to accept the size parameters of its market as to commercial loan availability, which may result

in less size than some desire. What is lost in size could be more than made up in the ability produce a high ROE and good dividends.

These are different structures, but a successful local full-line alternative to the large banks will normally have a business bank segment. Not only is this an earnings plus, but it also is a major step toward accessing the best customers for other services.

Another structure that may not result in great numbers of institutions, but can fill a major need, is the specialized transaction bank – i.e., it makes money through fees from providing transaction convenience to the unwanted customers of others. Commerce in New Jersey and parts of Pennsylvania and Chevy Chase in the Washington area are making a financial success of this.

While the new financial services economy is likely to leave as much as 15% to 20% of an industry moving toward a quadrillion dollars in assets by 2020 to local banks, the same sorting out among local players will occur that has already taken place at the top. Those that cannot compete exit the industry or stay around with little customer relevance. The alert few make the right adjustments and go on to bigger and better things.

The biggest threat to local banks is not their inability to compete in the future, but rather thinking they can do so without substantial change – i.e., the enemy is complacency. Thus, over the next ten years, no more than one in ten long-established banks may make it to 2010 as viable investment entities. The survival rate of new banks should be better since most will fit easily into the business bank model, but the new bank's investor pressure seldom allows for independence beyond ten to twelve years. While the odds may not sound good, they have a strong historical precedents – i.e., only two of the thirty largest banks in Pennsylvania in 1982 are still around, and this is repeated in state after state. Nevertheless, survival and prosperity for local banks, and thrifts as well, is not pre-ordained, it is a matter of choice.

**1996-2000* Nationwide Bank Acquisitions
Leading Financial Advisor Rankings – Sell Side**

<u>Rank</u>	<u>Adviser</u>	<u>Headquarters</u>	<u>Number of Deals Announced</u>	<u>Aggregate Deal Value (In mill.)</u>
1.	Goldman Sachs	New York	16	\$149,086
2.	Credit Suisse First Boston	New York	15	84,265
3.	Merrill Lynch	New York	10	52,582
4.	J.P. Morgan	New York	6	23,934
5.	Morgan Stanley	New York	7	22,049
6.	Keefe, Bruyette & Woods	New York	39	15,429
7.	Sandler O'Neill	New York	18	4,715
8.	Lazard Freres	New York	3	3,832
9.	Hovde Financial	Washington, DC	34	3,092
10.	Alex Sheshunoff	Austin, Tx.	65	2,680
11.	Danielson Associates	Rockville, Md.	23	2,231
12.	McDonald Investments	Cleveland, Oh.	12	2,017
13.	Fox-Pitt Kelton	New York	5	1,859
14.	CIBC World Markets	New York	3	1,537
15.	Carson Medlin	Tampa, Fl.	29	1,528
16.	ABN AMRO	Chicago, Il.	15	1,303
17.	McConnell Budd & Downes	Morristown, N.J.	12	1,255
18.	Belle Plaine Financial	Rancho Santa Fe, Ca.	3	1,159
19.	Baxter Fentriss	Richmond, Va.	22	1,087
20.	Hofer & Arnett	San Francisco, Ca.	37	1,061

*January 1, 1996 through December 4, 2000.

Source: SNL Securities LC, Charlottesville, Virginia.