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New England Banking Report
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What a Difference a Year Makes

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It may not have been the year that changed New England banking more than any other, but if 1999 was not number one, it was close. Probably number one was 1987 when the Bank of New England-CBT, Shawmut-Hartford National and Fleet-Norstar mergers were announced making regional banking a reality, and when we learned that bank stocks do not always go up. Not too far behind was 1991 when Bank of New England, among others, failed, and 1995 when four went down to two among banking leaders as BankBoston bought BayBanks and Fleet took over Shawmut. Only 1987 among these years, though, went beyond big banks getting bigger.

What made 1999 different was that not only was the big merger there with Fleet acquiring BankBoston, but again we were reminded that bank stocks do not always go up; landmark legislation occurred that changed the rules of the game; and internet banking went beyond the talk stage. New England also had a branch sale of proportions that have never seen before anywhere in the country, and two acquisitions have made a foreign-owned bank, Citizens, Fleet's major New England competitor.

What does all this mean going forward? In two earlier reports, "Financial Modernization: A Blueprint for Local Banks" and "Getting Ready for the 21st Century," I discussed the direction of banking in the new millennium, but these reports were national in scope. In this report, the focus is on New England and the impact of financial modernization and other trends on the region's financial services industry. This includes the internet, which is the "wild card" of the future, and it is a volatile, capricious "wild card."

In looking to the future of financial services in New England, a good starting point is the realities of change in the industry. These are:

- Financial services have become a high growth business, but traditional banking is not part of the high growth;
- All barriers between the common ownership and delivery of the various financial services have been eliminated;
- The combination of high growth, unfettered competition and the impact of new technologies, particularly the internet, is providing greater convenience and lower prices for financial services customers;
- The high stock prices of 1998 have gone with no certainty they will be back anytime soon; and
- The inevitable tendency for the big to get bigger.

What these sources of change mean is subject to various interpretations, but two of the them – high growth and the trend toward greater convenience and lower prices – are alien concepts to many bankers. Bankers talk about high growth, but the focus is still on gathering deposits – a source of funding that has a 2% growth rate – and producing loans – a use of money that for depository institutions is increasing at a rate of 4% to 5% annually. As to having greater convenience at lower prices, this suggests that the six year slide in margins is more than a cyclical movement and that the future may introduce competition that other industries, but not banking, are very familiar with – giving away services and products to build market share.

The impact of these changes will not treat all financial service companies equally, but those that ignore change or downplay its coming, better be either serving Dixville Notch or be a mutual. If not, they may not be around to enjoy the second half of the next decade, which is as true of Fleet and Citizens as it is of community banks.

The basic realities of change are national in impact, but every market has its own, unique elements impacting change. In New England, for example, Fleet is the sole representative of the truly large; there is an overabundance of banking organizations, including a large mutual content; and in Sovereign, a market leader has been created artificially.

The Fleet Umbrella

It is impossible to look at change in the financial services industry in New England without understanding the role of Fleet. It is the region's 800-pound gorilla, and New England is relatively unique in having only one of the nation's seven big banks as a major player.

Fleet has come a long way since it was a Providence bank with the rather unassuming name of Industrial National, and it is difficult to find a mistake in its decision-making process.

- In 1983, it changed its name from the cumbersome Industrial National to the short and very marketable, Fleet.
- In 1987, it talked Norstar into a “no premium” equal merger that kept the Fleet name upfront, the base in Providence and Fleet management in charge.
- In 1991, despite asset quality problems, it convinced the regulators it could absorb a failed Bank of New England. That kept Bank of America out of New England, and, at minimal cost, gave Fleet the Boston base needed to be the leading player in the region.
- In 1995, Fleet became the region's largest bank by acquiring Shawmut, and it did this at the bottom, rather than top, of a period of rising merger prices that reached ridiculous heights in 1998.
- In 1999, it acquired BankBoston at a cost much less than those of the large bank mergers in early 1998 when other big banks did their buying; and in so doing, eliminated its primary competitor and unloaded much of its low growth, traditional

banking on an outsider with little commercial lending background.

Even after all of this, it is not widely recognized that Fleet is not only the seventh largest bank in the country with both revenues and a market capital that approximate First Union's, but that it also is now much larger than J.P. Morgan. It also is bigger than the nation's ninth and tenth largest banks, U.S. Bancorp and National City, combined.

Financial Profile of Ten Largest Banks

	<u>Revenues</u>	<u>Market Capital</u>	<u>Nonint. Income/ Revenues</u>	<u>ROE</u>	<u>Annual Increase* EPS</u>	<u>Stock Price**</u>
	(In billions)					
1. Citigroup	\$57.0	\$177	65%	21.88%	15.1%	23.1%
2. Bank of America	32.5	82	43	17.13	6.4	9.6
3. Chase Manhattan	20.8	60	58	21.73	17.3	27.5
4. Bank One	17.4	36	47	19.85	12.9	.7
5. Wells Fargo	16.1	64	47	17.34	12.8	25.1
6. First Union	13.9	31	46	19.77	8.5	4.3
7. <u>Fleet</u>	<u>13.6</u>	<u>31</u>	<u>49</u>	<u>18.75</u>	<u>13.1</u>	<u>17.5</u>
8. J.P. Morgan	8.5	21	80	17.71	12.6	12.1
9. U.S. Bancorp	5.9	16	44	23.96	15.5	9.5
10. National City	5.2	14	42	22.42	14.0	9.4

*1995 to 1999.

**December 31, 1999.

Source: SNL Securities LC, Charlottesville, Virginia.

Fleet's performance also ranks with the best – an ROE of 18.75%, EPS increase of 13.1% per annum since 1995 and an annual stock price increase of 17.5% during that period. Perhaps even more impressive, is that noninterest-income was 49% of revenues as of September 30, 1999, and this percentage will increase with the sale of \$13 billion in deposits to Sovereign.

In doing this, Fleet has gone far beyond just being a New England bank. It has become the nation's sixth largest originator and seventh largest servicer of home mortgages; tenth largest credit card company; a major force in investment banking on the West Coast; and second only to Citigroup among American banks in South America.

Fleet also is not through growing, and its next move should be as good for local banks as the earlier ones – i.e., while Fleet moves up the ladder of the financial services elite, it eliminates local competition and moves further away from customers needing personal service. Whether the next move is Fidelity, John Hancock, Marsh & McLennan or an institution without New England ties, the end result will be an even larger Fleet, but a Fleet with even less interest in providing a high level of personal service in local markets.

In effect, what Fleet has done for New England is what NationsBank and First Union did for the Southeast. It has put an “umbrella” over the region that keeps outsiders from coming in while consolidating the local “big bank” business under a single name. Indicative of this was the lack of interest of large, outside banks in buying the \$13 billion package of deposits and branches that Fleet had to divest as part of the BankBoston merger.

This is not to suggest that Fleet will not have large bank competition in New England. Citigroup, Merrill Lynch and others will be a growing force through remote access, but there is more room for local banking alternatives when there is only one large bank with a strong physical presence than two or three, which is the situation in virtually every other region in the country. This is hard to quantify, but if the typical share of financial services available to local competitors in a market is 20% to 25% when there are multiple large banks present, then it could be as high as 35% to 40%, if only one is present.

There is no guaranty Fleet will continue to do as well as it has in the past, and, in this context, it is hard to forget one of the many interesting comments of ex-FDIC commissioner William Seidman. When asked in the early nineties how to recognize the next big bank failure, one of the answers he gave was – “see who was last year's banker of the year.” Even if Fleet were to stumble and sell, though, the “umbrella” would not go away. It would just have another name.

Overabundance of Local Competitors

The “Fleet Umbrella” may be good news for local banks, but the bad news is that in much of New England there is an inordinate number of local banks or bank branches competing for a limited amount of business. This is particularly so in Massachusetts where there is a bank for every 26,000 residents while in places like California, New York and North Carolina, there are 60,000 or more residents per banking organization. Even Connecticut has almost 40,000 people per bank. Massachusetts’ banks per person are consistent with national totals, but only because the Midwest is not far removed from unit banking and still has an unusually large number of banks – i.e., Illinois with 866 banks, or one for every 14,000 residents. New Hampshire, Maine and Vermont also have low numbers of residents per bank, but this is not atypical in less urbanized states.

Banking Density by State

	<u>Banks*</u>	<u>Branches</u>	<u>Population</u>	
			<u>Per Bank</u>	<u>Per Branch</u>
<u>New England</u>				
Rhode Island	19	210	51,900	4,696
Connecticut	84	1,293	38,954	2,531
New Hampshire	38	373	31,203	3,179
Maine	45	548	27,700	2,275
Massachusetts	237	1,817	25,944	3,384
Vermont	<u>29</u>	<u>341</u>	20,434	1,738
Subtotal	452	4,582		
California	388	6,086	84,029	5,357
New York	258	4,725	70,334	3,840
North Carolina	124	2,273	60,871	3,321
Illinois	866	2,736	13,804	4,369
United States	10,622	76,760	25,440	3,520

*Includes commercial banks, savings banks and savings and loans.

Source: Thompson/Polk North American Financial Institutions Directory July-December 1999, Thompson Financial Publishing, Skokie, Illinois and Sourcebook America, 1998, CACI, Arlington, Virginia.

While Connecticut can take some solace from its fewer banks per person, the state gives away that plus with an overabundance of branches. There was a bank

branch in Connecticut at the end of 1998 for every 2,500 residents while the national average was about 3,500. In Massachusetts, it was 3,400; in New York was at 3,800; and in California it was about 5,400.

While the lack of multiple large bank dominance leaves more room for local competition than in most markets, the number of local banks trying to fill that void is quite high in much of New England, and because of the large number of mutuals, it will not be significantly reduced in the near future. Mergers are doing little to ameliorate the situation as evidenced by just eleven of the 452 New England banks existing at the end of 1998 were sold in 1999, and only two of those, BankBoston and UST, were in Massachusetts where reduction is needed the most. Since two new banks opened in New England in 1999, the net decline was nine, or 2%.

The disappearance of “pooling” accounting in early 2001 and the negative impact on acquisition pricing of reduced bank stock prices, also make it unlikely that there will be an upswing in merger activity any time soon. The lack of investor interest in bank stocks, however, will also deter new bank openings.

Mutuality

The impact of mutuals on the competitive outlook for financial services in New England will be substantial. Of the region’s 452 banks – which includes commercial banks, savings banks and savings and loans - 223, or almost half, are mutuals, and in Massachusetts, 63% are mutuals. This excludes credit unions, but if they were included, almost all of them would be added to the mutual sector. In the United States, mutuals are only 7% of banking organizations, and just 5.1% excluding New England.

Admittedly, mutuals are a much smaller portion of bank assets than they are number of organizations, but they are a significant portion of local bank assets. If Fleet and State Street are taken out of the mix, the mutual share of bank assets in New England is almost 20%, and in Massachusetts it is 43%. In Connecticut, mutuals hold 34% of bank assets, and they are above 17% in Maine and New Hampshire. In most states outside of New England, mutuals have less than 2% of bank assets.

Thus, as the portion of financial services delivered by local banking alternatives is reduced nationwide, in New England there is a mutual segment that does about 30% of the banking that is not subject to investor pressure. As a result, these mutuals will be around even if they have minimal earnings unless they convert to stock organizations, a path that is being taken with much less frequency since it no longer offers the financial rewards that it once did. If a stock firm cannot deliver double-digit ROEs, and possibly ROE's of 15% or better, it will be under pressure to exit the business.

Mutuality of New England Banking

	<u>Banks*</u>			<u>Assets</u>	
	<u>Total</u>	<u>Mutual</u>	<u>Percent of Total**</u>	<u>Mutual (In mill.)</u>	<u>Percent of Total</u>
<u>New England</u>					
Massachusetts	237	150	63.3%	\$ 31,009	10.0%***
Connecticut	84	31	36.9	14,184	34.1
Maine	45	20	44.4	4,674	17.1
New Hampshire	38	13	34.2	2,625	18.1
Vermont	29	5	17.2	956	8.2
Rhode Island	<u>19</u>	<u>4</u>	<u>21.1</u>	<u>1,350</u>	<u>5.8</u>
Subtotal	452	223	49.3%	\$ 54,798	12.8%***
Illinois	866	71	8.2%	\$ 9,588	2.0%
California	388	1	.3	152	-
New York	258	39	15.1	10,303	.5
North Carolina	124	23	18.5	3,252	.3
United States	10,622	746	7.0%	\$164,790	2.3%

*Includes commercial banks, savings banks and savings and loans.

**Headquartered in state.

***43% and 29%, respectively, excluding Fleet and State Street.

Source: SNL Securities LC, Charlottesville, Virginia.

Since most mutuals also are primarily in traditional spread banking, their share of the total financial services “pie” will shrink, but their competitive impact goes well beyond their size. Since high ROEs are not necessary, mutuals can, and will, pay above-market for deposits and spend what is needed to introduce new services without investor concern. This can create problems for stock companies

battling for much of the same business and trying to keep investors happy at the same time.

Bank Stocks

Unfortunately, stock prices, which should be a reaction to and reward for performance and future prospects, also can act capriciously in the short-run and influence the direction of an industry and the fate of individual firms. In 1999, investors dealt a cruel blow to bank stocks, but they were democratic in being negative toward almost every bank.

At year-end 1999, the medians for New England's ten largest, publicly-traded commercial and savings banks were 35.7% and 38.4% off their highs, respectively. The prices of one of the commercial banks, Independent, and five of the savings banks – Peoples Heritage, People's of Bridgeport, FIRSTFED AMERICA, People's of Brockton and First Essex – were down more than 40% from their highs, and good arguments could be made that these six included some of the better performing New England banks.

These declines also reduced multiples of earnings and book to levels that many had thought would not be seen again. For the ten largest commercial banks, the median price times earnings was 11.3 at year-end 1999, and two of them, CCB&T and Merchants of Vermont, traded below ten times earnings. As a result of generally good ROE's, the median price as a percent of book was still a respectable 179%. For the savings banks, the medians were just 9.7 times earnings and 137% of book, and only three of the ten largest – Peoples Heritage, People's of Bridgeport and Medford Bancorp – traded at more than ten times earnings and 100% of book.

The investors favored the big over the mid-sized banks, but the big banks also took "hits" to their stock prices. Fleet's stock was 28.2% off its high, but this was below the commercial bank median and less of a decline than for most of the other leading commercial banks. State Street's stock was 26.8% off its 1999 high at year-end, but it was still selling at 23.7 times earnings and 453% of book. The message here is not that investors necessarily like size, but rather that the big banks, particularly State Street, are less dependent on spread income.

Stock Performance of New England Banks

	<u>Assets**</u> (In mill.)	<u>Price*</u>		<u>Change from High</u>
		<u>Times Earnings</u>	<u>Percent of Book</u>	
<u>Commercial</u>				
1. FleetBoston	\$185,295	11.7X	210%	(28.2)%
2. State Street	54,972	23.7	453	(26.8)
3. Chittenden	4,164	14.0***	227	(28.2)
4. Independent	1,565	10.9	188	(42.0)
5. CCBT	1,310	9.7	155	(37.5)
6. Washington Trust	1,082	18.0	235	(37.9)
7. Century	864	10.5	152	(29.1)
8. Granite State	851	12.0	158	(33.9)
9. Camden National	726	10.2	170	(39.8)
10. Merchants	667	9.0	148	(37.7)
Median		11.3X	179%	(35.7)%
<u>Savings</u>				
1. Peoples Heritage	\$ 18,363	10.9%	169%	(46.7)%
2. Webster	10,094	9.6	153	(36.6)
3. People's Bank	10,067	13.7	165	(49.2)
4. Seacoast Financial	2,048	10.2	96	(18.3)
5. Andover	1,473	9.8	134	(33.9)
6. FIRSTFED AMERICA	1,455	9.4	69	(48.9)
7. First Essex	1,346	9.0	115	(46.9)
8. BostonFed	1,224	9.6	90	(36.7)
9. Medford Bancorp	1,203	11.6	150	(25.4)
10. People's Bancshares	1,031	5.8	140	(40.1)
Median		9.7X	137%	(38.4)%

*December 31, 1999.

**September 30, 1999 (includes mergers in progress).

***Adjusted.

Source: SNL Securities LC, Charlottesville, Virginia.

The key questions relative to bank stock prices and the impact on financial services in New England are – What can we expect in the future? and – What impact could this have on industry trends? Predicting stock prices is a guessing game, but the direction of bank stocks will influence the future make-up of the industry.

Where are banks stocks headed? The safe answer is – Who knows? - but the combination of the large banks missing analyst estimates, the reduction in acquisition prices accompanying the elimination of pooling accounting, the likelihood of interest rate increases in 2000, and that sometime in the next three years there will be a correction in the stock market, does not bode well for bank stocks in the near future. It also is likely that when the climate for financial services stocks improves, which it should considering the industry’s growth potential and the large amounts of money looking for a home, that investors will distinguish between banks that are tied to traditional banking and those that have developed a profitable, high growth profile.

What this means to the industry structure is that by 2005, the financial services industry could be made up of “haves” and “have nots,” and that there will be tremendous shareholder pressure on the stock “have nots” to exit even if there are no lucrative sale opportunities. What will separate the “haves” from the “have nots” is ROE and spread income dependence, and the disappearance of the “have nots” should slightly reduce the number of existing banks.

Can a financial services company survive and reward investors with one and not the other – i.e., a good ROE with an emphasis on spread income or high growth with low ROE? The real winners will be those that have both, but a sustainable ROE at 15% or better with low growth – which is, in effect, a “cash cow” - could make investors happy via high dividends. Growth without a double-digit ROE, albeit consistent with the present investor love of non-earning internet stocks, is a more “iffy” proposition.

While a three or four year “down period” in bank stocks is not a good outlook for investors or those who are on the firing line relative to unhappy investors, this may be a “cloud” with a “silver lining.” If investors are not going to like bank stocks anyhow, it is a good time to spend the money to move into faster growing financial service businesses.

The Sovereign Factor

Sovereign, which is part of New England’s big banking story of 1999, will overnight become a factor in the region when it takes over the divested Fleet branches. Sovereign is a Pennsylvania success story in that it has defied the odds to become the Northeast’s biggest thrift, and, in so doing, has delivered annual returns on equity that have matched the largest banks. Its latest move, though,

looks a lot like Napoleon's march on Moscow – i.e., going to the wrong place at the wrong time.

Since 1990, Sovereign has been on an acquisition spree that increased its assets from \$1.3 billion to about \$25 billion even before acquiring the Fleet branches, and despite this rapid growth, it has had an average ROE of 14.16% since 1992. Its stock price rose from \$.88 in 1990 to \$22.19 at its peak in 1998. Its formula for success has been cost control, and through the first nine months of 1999, its net operating expense was 1.19% of average assets, which allowed it to be very profitable despite net interest income that was only 2.55% of average assets.

Sovereign Profile

	<u>Assets</u> (In bill.)	<u>Percent of Average Assets</u>			<u>ROE</u>
		<u>Net Int. Income</u>	<u>Net Oper. Expense*</u>	<u>Net Oper. Income</u>	
<u>Sovereign</u>					
1999**	\$25.2	2.55%	1.19%	1.36%	15.50%
1993	4.5	2.88	1.39	1.49	17.29
1990	1.3	2.29	1.27	1.02	9.26

	<u>Percent of Assets**</u>					
	<u>Loans</u>					
	<u>Res. Mtge.</u>	<u>Comm. R.E.</u>	<u>C&I</u>	<u>Consumer</u>	<u>Other</u>	<u>Total</u>
BankBoston	5%	7%	34%	8%	2%	56%
Sovereign	25	5	8	15	-	53

*Noninterest expense less noninterest income.

**September 30, 1999 or twelve months ending September 30, 1999.

Source: SNL Securities LC, Charlottesville, Virginia.

Its past success, though, was built on buying thrifts, cutting costs and paying up for deposits, and its lending profile is the opposite of the bank it is supposed to replace, BankBoston. Sovereign has only 8% of its assets committed to commercial and industrial loans and all commercial loans were 12% of assets as of September 30, 1999. Prior to its acquisition, BankBoston had commercial and industrial loans accounting for 34% of assets.

Under the best of circumstances, it would be difficult to manage \$13 billion in acquired deposits without an accompanying management infrastructure. For a savings and loan whose success is based on cutting expenses, to try to do so in an uncertain environment and in a market in which it has no recognition is an extremely bold move. With a stock price off its high by 67%, Sovereign has not inspired much investor confidence with this move.

The most likely outcome of the Sovereign entry is the transformation of a bank franchise into that of a traditional thrift with the emphasis on high priced deposits and cost control. If Sovereign can do this well, it could pleasantly surprise its investors, but its impact on New England banking beyond upward pressure on deposit prices would be minimal.

Internet

Finally, there is the internet, which is the “wild card” in financial services. That it will play a major role in the marketing and handling of financial services goes without saying, but - How pervasive will that role be? and - Who will reap the benefit from it? These are the “unknowns.”

The internet may be in its early stages of development, but it already has much of the world “hooked” whether it is to buy almost anything, trade stocks, send messages, play games, check stock prices and sports scores or just “kill time.” It has become a way of life, and internet usage rises with income and education levels - i.e., the most profitable bank customers - and it is a necessary tool in the financial departments of virtually every business. When the internet can provide these affluent and business customers convenience and/or value in the usage of financial services, it will be used.

For starters, there is little question that the internet will at least do the following:

- Reduce the number of meaningful transactions in branches even if it does not reduce the number of branches – i.e., bank branches could increasingly be a check-cashing service for the less affluent.
- Give customers access to the highest rates on deposits and the lowest rates on commodity loans and further reduce bank margins.
- Enhance the viability of “one-stop” shopping.
- Eliminate distance as a constraint on buying or selling financial services.

Even if it does no more than this, it is logical that in the future:

- Deposit rates will be higher and loan yields on commodity products will be lower than they would have been without the internet.
- Personal and corporate cash management accounts that include direct deposit, lines of credit, bill payment, mutual fund contributions and transfers, stock trading and insurance purchasing, among others, will become commonplace with the internet being the primary access vehicle.
- The less affluent will look to the “banking Wal-Marts” for their cash management accounts.
- The affluent and corporations will key on the investment function as a major determinant of which cash management account they use.

It is uncertain whether large numbers of cash management customers will insist on a local physical presence. Amazon.com’s success vis-à-vis Barnes &

Noble is an indication, though, that a local physical presence is not important to everybody, albeit books are not money.

With the internet, the hard question relative to financial services is – Who will benefit most from it? There are nonbank aggregators like AOL, Yahoo, Amazon.com and Microsoft that want to be in the business. Traditional stalwarts such as Citigroup, Bank of America, Bank One, Fleet, Wells Fargo and Merrill Lynch are not going to readily disappear. The nonbanks may have internet skill advantages, and if they avoid insured deposits – an element of little importance in a cash management account - they will have few regulatory constraints. The big banks and Merrill Lynch have the financial services knowledge and offices to back up an online presence. Citigroup is not noted for its bank branch network, but its Salomon Smith Barney offices should serve its cash management account needs quite well.

Predicting who will be the winners in this battle, other than Citigroup, is difficult, and the road to be traveled is full of “pot holes.” One problem is the inevitable price wars that will hurt industry profits, at least temporarily. Another is that strategic alliances between the various major players, which are already well underway, will intensify and could lead to mergers that might even force legislation to remove the restrictions between banking and commerce.

Conclusion

So what does all this mean? With so much happening and from so many different sources, it is increasingly difficult for bankers in New England and elsewhere to integrate the information being received and confidently draw a blueprint for the future. We are in an “information glut” era, and this is not going to change.

In trying to make sense out of all this information and plan for the future, it might be wise to focus on a likely three-part scenario that includes:

- Two years, 2000 and 2001, of incremental change that will not greatly alter the way financial services are sold or the structure of the industry doing the selling, but that will see some headline-generating mergers that will make it look like things are moving faster than they are.

- Three years, 2002 to 2005, when the battle for supremacy at the top includes many more players than can possibly survive and may bring with it price wars that create a Darwinian sorting out of the strong from the weak.
- The post 2005 era when the winners are pretty much in place and stability returns to an industry with tremendous growth and good profit potential.

While this may sound like a “Star Wars” scenario, it is no more than a textbook description of a newly created industry – i.e, a single financial services business - going through the natural evolution from separate businesses to the normal “one business” structure at an accelerated pace and with a new form of delivery, the internet, playing a major role. The debate is likely to be more about the pace than the steps, and there will be those that argue the pace described above is too slow.

The immediate concern is the next two years, and, although they may be difficult years, the problems are likely to be more cyclical and economy-driven than a reaction to the more extreme elements of change. The common wisdom is that the economy will remain strong, but that the Fed is likely to raise interest rates, and the latter is not good news for already beleaguered bank stocks. Bank stocks also may be hurt by more large bank reports of year-to-year earnings disappointments as banks, in general, have trouble maintaining the high earnings and revenue growth of recent years; if only because for many, the growth was higher than overall industry fundamentals. The almost certain elimination of “pooling” accounting will also force some significant mergers even while bank stock prices act as merger deterrents since acquirers, by-and-large, are not in a position to meet seller expectations.

New England should see little structural change in the next couple of years, as the Fleet umbrella stays in place, and the relatively small number of stock banks large enough to attract activist investors attention limits the pressure for a major exodus of players because of stock price disappointments. There will be mergers, partially driven by the need to beat the elimination of “pooling,” but those of the most significance will have only a peripheral impact on New England banking. The most likely bank mergers in New England and nationally over the next couple of years will be:

- Fleet making a major nonbank move with a mutual fund or insurance company with Fidelity and John Hancock being the most likely suspects.
- The acquisitions of Bank One and First Union with Bank of America and Wells Fargo the most likely acquirers, but these two beleaguered giants also could be the ingredients for the next big inter-industry merger with AIG, American Express or a European insurance company as possible partners.
- Midwest consolidations involving some combinations of Firststar, KeyCorp, National City, U.S. Bancorp and PNC with an outside possibility being that Wells Fargo or Bank of America could acquire one of them. The only impact in New England would be if KeyCorp were involved, and this would hasten its exit from Northern New England.
- Some small and mid-sized New England banks with Webster, Peoples Heritage and Citizens continuing to do most of the buying.

The above will create headlines, but in terms of structural change in New England, it will have a glacial impact during the next couple of years. Fleet will still be the 800-pound gorilla, and Webster, Peoples Heritage and Citizens will be a little bigger. If KeyCorp goes, Peoples Heritage and Citizens are the likely buyers.

The real change will be less obvious, but not lacking for media coverage, and that is the continual “roll-out” of remote access banking via the internet. Fleet will be a participant, and most local banks in New England will provide their better customers with some form of internet banking. The role of the outsiders like Citigroup, Merrill Lynch, AOL and others will be growing.

What happens after the next couple of years is impossible to predict in terms of players since we have not yet had the “shake out” among the major internet participants. It is only a matter of time before some large players lose big time with the inevitable negative results on stock prices, but this also is just a normal part of the consolidation process. Since the large banks outside of New England and major internet firms like AOL, Yahoo and Amazon.com are most at risk, the local carnage should be no more than what others bring through their price wars.

After all the shouting, a stable financial services industry will emerge with a continuing high growth potential, a handful of big firms at the top and a cadre of local financial service specialists filling the voids in the coverage of the very large. Many of these local specialists will be new firms with new thinking, but there also will be as many as 350 of the present 452 existing New England banks still around. Many will remain because they are mutual or highly-capitalized stock organizations that have nowhere to go and can eke out a profit based on capital alone. Banking is not like other businesses in that when the customer no longer needs their products, sale or failure are the only options.

Among the local specialists, there will be existing banks that find their niche and build a modern financial services business around the trust that they have built over the years. This will be more readily done in outlying parts of Northern New England than in Massachusetts, Rhode Island and Connecticut, but there will be numerous success stories in those states as well. The ingredients for success will be leadership in the traditional bank products least vulnerable to remote access – small business lending and local commercial real estate; the ready availability of other financial services desired by the natural customer base – i.e., a wide range of insurance products, annuities, mutual funds and various forms of asset management, but probably not brokerage services; and the ability to make the internet work to their advantage. In the fee areas, the big players will do the marketing for the local financial services firms, and the key may not be the ability to aggressively sell, but rather having the right products readily available at competitive rates.

While it may be unnerving to see change coming that can threaten one's business, New Englanders can take solace in that the changes that are coming are also likely to bolster the local economy, which has to be good for business, in general, and financial services, in particular, in the long-run. The strong university base, being home to the mutual fund industry and being a leader in technological development can only mean good things for the region; and a healthy side-effect will be a continuing aggregating of large amounts of personal wealth within the region. The positive effects of this should be felt more in a greater Boston that includes Providence, Worcester and Manchester and in Fairfield County, Connecticut than in cities like Springfield, Hartford, Bangor and Burlington, but even they should get a spill-over effect. Change always brings disruptions, but it also creates opportunities for those that know how to handle change and make it work to their advantage.

Massachusetts - Rhode Island Banking Leaders

	<u>Deposits*</u> (In mill.)	<u>Deposit Share</u> <u>June 30,</u>		<u>Nonint. Inc./</u> <u>Revenues**</u>	<u>ROE**</u>
		<u>1999</u>	<u>1998</u>		
1. Fleet	\$45,355***	31.5%	17.4%	49%	18.77%
2. Citizens	15,592	10.8	6.9	27****	14.45****
3. State Street	11,406	7.9	9.2	74	20.10
4. Sovereign	9,800***	6.8	-	17	15.50
5. Mellon	3,698	2.6	2.6	68	22.21
6. Peoples Heritage	3,031	2.1	.8	22	15.23
7. Eastern	2,461***	1.7	1.6	11	7.41
8. Middlesex Savings	1,584	1.1	1.1	10	10.83
9. Seacoast Financial	1,569	1.1	.7	13****	7.83****
10. Independent	1,367***	1.0	.7	19	17.53
11. Investors	1,341	.9	.7	80	18.65
12. Cambridge Financial	1,033	.7	.7	13	4.01
13. Andover Bank	906	.6	.7	8	14.80
14. Medford Bancorp	903	.6	.6	7	13.14
15. MASSBANK	833	.6	.6	6	10.42
16. CCBT	808	.6	.5	32	16.63
17. Salem Five	790	.5	.6	24	9.72
18. Plymouth Bancorp	746	.5	.5	30	10.50
19. Cape Cod Five	706	.5	.5	12	10.49
20. First Essex	668	.5	.5	11	12.33

*June 30, 1999.

**Twelve months ending September 30, 1999.

***The Fleet branch sale estimated.

****Twelve months ending June 30, 1999.

Source: SNL Securities LC, Charlottesville, Virginia.

Connecticut Banking Leaders

	<u>Deposits*</u> (In mill.)	<u>Deposit Share</u> <u>June 30,</u>		<u>Nonint. Inc./</u> <u>Revenues**</u>	<u>ROE**</u>
		<u>1999</u>	<u>1998</u>		
1. Fleet	\$15,076***	25.7%	25.6%	49%	18.77%
2. People's	7,023	12.0	11.4	46	11.60
3. Webster	7,014	11.9	9.8	22	16.53
4. First Union	3,750	6.4	6.8	47	19.84
5. Chase Manhattan	2,998	5.1	3.1	58	21.20
6. New Haven Savings	1,662	2.8	2.7	12	10.35
7. Sovereign	1,656***	2.8	-	17	15.50
8. Dime United	1,636	2.8	1.5	44	17.11
9. Citizens	1,584	2.7	2.6	27****	14.45****
10. Liberty	1,286	2.2	2.0	19	10.75
11. American Financial	1,165	2.0	1.9	9	6.76
12. Summit	909	1.5	-	23	16.59
13. Savings - Manchester	889	1.5	1.5	15	7.65
14. American Bank	644	1.1	.8	12	15.99
15. Union Savings	633	1.1	1.0	10	7.70
16. First Fed.-E. Hartford	603	1.0	1.0	15	8.31
17. Citigroup	533	.9	.7	64	18.21
18. First County	526	.9	.8	17	15.52
19. Torrington Savings	520	.9	.8	3	7.88
20. Bank of New York	451	.8	.9	58	33.39

*June 30, 1999.

**Twelve months ending September 30, 1999.

***The Fleet branch sale estimated.

****Twelve months ending June 30, 1999.

Source: SNL Securities LC, Charlottesville, Virginia.

Northern New England Banking Leaders

	<u>Deposits*</u> (In mill.)	<u>Deposit Share</u>		<u>Nonint. Inc./</u> <u>Revenues**</u>	<u>ROE**</u>
		<u>1999</u>	<u>1998</u>		
1. Peoples Heritage	\$7,549	18.7%	16.0%	22%	15.23%
2. Providian	5,401	13.4	9.7	52	66.38
3. Fleet	3,359***	8.4	8.8	49	18.77
4. Citizens	3,165	7.8	7.9	27****	14.45****
5. KeyCorp	2,251	5.6	6.4	40	17.94
6. Chittenden	2,301	5.7	3.3	28	(2.74)
7. Bangor Savings	940	2.3	2.3	16	4.42
8. Charter One	817	2.0	-	22	16.26
9. Granite Bank	641	1.6	1.7	13	13.25
10. Merchants	595	1.5	1.4	18	17.11
11. Camden National	549	1.4	1.2	15	16.57
12. Sovereign	544***	1.4	-	17	15.50
13. Laconia Savings	500	1.2	.8	11	13.77
14. Mascoma Mutual	426	1.0	.9	13	8.28
15. New Hampshire Thrift	381	.9	.7	19	12.30
16. Northway	332	.8	.9	10	8.35
17. Gardiner Savings	309	.8	.8	22	10.34
18. Androscoggin Savings	298	.7	.6	12	7.29
19. Northfield Savings	295	.7	.8	11	4.21
20. First Essex	293	.7	.8	11	12.33

*June 30, 1999 and adjusted for mergers in process and branch sales.

**Twelve months ending September 30, 1999.

***Fleet branch sale estimated.

****Twelve months ending June 30, 1999.

Source: SNL Securities LC, Charlottesville, Virginia.