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**Pennsylvania Banking Report – Spring 2004**

**Waiting for the Next Shoe to Drop**

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Major changes in the Pennsylvania banking structure have been almost nonexistent since the Royal Bank of Scotland announced the acquisition of the Mellon branches in July 2001. M&T had caused a few ripples when it bought Allfirst from the Allied Irish, but this was, in effect, just a transferring of a South Central Pennsylvania franchise from one mid-sized out-of-state bank to another. Aside from that, most merger activity had involved small banks and stock thrifts in the Philadelphia and Pittsburgh areas.

The sense that big change may be on the way, though, is growing as two megamergers, Bank of America buying Fleet and J.P. Morgan aligning with Bank One, the increased acquisitiveness of Sovereign and continuing expansion of Royal Bank of Scotland have the rumors mills running overtime. The two large mergers have had only a modest impact on Pennsylvania, but they have many “waiting for the next shoe to drop.”

Pennsylvania also gets a lot attention as to what will happen next as it has the most fragmented banking structure of any state on the East Coast and of any large state nationally other than Illinois. In other words, consolidation still has a long way to go in the Keystone State.

Pennsylvania’s bank consolidation, though, has been, and will continue to be, unlike that in other East Coast states as it is very diverse with five distinct regions – Southeast Pennsylvania, South Central Pennsylvania, Northeastern Pennsylvania, the Upper Susquehanna and Western Pennsylvania. Only two areas, Southeast and South Central Pennsylvania have remotely similar banking structures, and with the emphasis more on “remotely” than “similar.” Thus, change will not have a common impact throughout the state.

Consolidation will continue, however, to move through Pennsylvania in a barbell fashion at three levels. At the top-end, change will be driven by the decisions of PNC and Sovereign. In the middle, the primary motivator of change will be the decisions to sell by some, but certainly not all, of the remaining mid-sized banks. There also will be the continuing sale of stock thrifts and small banks, many of which have opened in the last dozen years.

What happens in the “middle” is of particular interest as there is a cadre of high performing, mid-sized banks in the state that have resisted the urge to sell for years. Their days of “feasting” on the problems of Wachovia/First Union and Mellon, though, are over, and, as has happened elsewhere, when one of the core members of a group sells, others usually follow.

### Statewide Structure

The fragmentation of banking statewide can readily be seen in the most recent deposit market shares. What could be considered big banks hold about half of Pennsylvania’s bank deposits, but just two, PNC and the Royal Bank of Scotland’s Citizens affiliate, operate statewide, and they have only about 20% of the deposits between them. Wachovia is second in the state with an 11% deposit share, but all of its branches are in eastern Pennsylvania. National City is the western Pennsylvania equivalent of Wachovia – i.e., a big bank with a leading position in a major metropolitan area - but with Pittsburgh being much smaller than Philadelphia, it has a statewide deposit share under 5%.

Mellon, M&T, Sovereign and Bank of America are the other large banks with a Pennsylvania presence, but despite their overall size, they are neither statewide factors nor major players in retail banking in either of the state’s two large markets, Philadelphia and Pittsburgh. Mellon looks big with its \$10.9 billion deposits and a statewide share of 4.8%, but this is private banking business generated through three offices. M&T’s focus is almost exclusively on South Central Pennsylvania, and Sovereign is a second-tier bank in Southeast Pennsylvania. That description also will apply to Bank of America when it completes the Fleet acquisition.

## Pennsylvania Deposit Share

	Deposits 2003 (In millions)	Market Share			
		June 30,			
		2003	2002	2001	2000
<u>Large Banks</u>					
PNC	\$ 27,119	11.9%	11.9%	12.5%	13.5%
Wachovia	25,525	11.2	10.5	11.2	10.9
Royal Bank of Scotland	19,140	8.4	6.9	-	-
National City	11,078	4.9	5.1	5.2	5.2
Mellon	10,853	4.8	4.2	10.3	11.2
Sovereign	8,785	3.9	3.0	2.4	3.5
M&T	7,842	3.4	2.2	2.6	.4
Bank of America	<u>3,338</u>	<u>1.5</u>	<u>-</u>	<u>-</u>	<u>-</u>
Subtotal	\$113,680	50.0%	43.8%	44.2%	44.7%
<u>Local Bank Leaders</u>					
Fulton	\$ 5,105	2.2%	2.1%	1.9%	1.9%
First Commonwealth	3,936	1.7	1.6	1.7	1.6
Commerce	3,824	1.7	1.3	.8	.6
F.N.B.	3,057	1.3	1.5	.7	.7
National Penn	2,742	1.2	.9	.9	.8
Susquehanna	2,689	1.2	.9	.9	.9
Sky	2,466	1.1	.8	.8	.8
Harleysville National	2,028	.9	.9	.8	.8
S&T	1,930	.9	.8	.8	.8
Sterling	<u>1,644</u>	<u>.7</u>	<u>.7</u>	<u>.7</u>	<u>.5</u>
Subtotal	\$ 29,421	12.9%	11.5%	10.0%	9.4%
<u>Local Thrift Leaders</u>					
Northwest	\$ 4,673	2.1%	1.7%	1.6%	1.5%
Dollar Bank	2,625	1.2	1.1	.9	.8
Beneficial	<u>1,564</u>	<u>.7</u>	<u>.7</u>	<u>.7</u>	<u>.7</u>
Subtotal	\$ 8,862	4.0%	3.5%	3.2%	3.0%
Other Banks	\$39,272	17.3%	22.2%	24.1%	25.2%
Other Thrifts	16,814	7.4	10.6	10.6	10.4
Credit Unions	<u>19,029</u>	<u>8.4</u>	<u>8.4</u>	<u>7.9</u>	<u>7.3</u>
Total	\$227,078	100.0%	100.0%	100.0%	100.0%

Source: SNL Financial, Charlottesville, Virginia.

This has left a lot of room for the small and mid-sized banks and thrifts, some of which are major players in the parts of the state they serve. In eastern Pennsylvania the largest of these are Commerce, technically a New Jersey bank, but based in one of Philadelphia's suburbs; National Penn; Harleysville National; Firsttrust; Uninvest and Beneficial. In the central part of the state, the major local banks are Fulton, Susquehanna, Sterling and Community Banks. Out west, three thrifts – Northwest, Dollar Bank and Parkvale – and four commercial banks – First Commonwealth, F.N.B., S&T and the Ohio-based Sky – have significant presences. Banks with less than \$1 billion deposits, which includes none of those mentioned above, hold about 20% of the state's deposits.

To reach the level of concentration in other states, the most logical path would be consolidation among the Pennsylvania leaders, but this is unlikely beyond the much rumored take-over of Sovereign by Royal Bank of Scotland. Even that would add less than 4% to the latter's statewide deposit share. PNC is the most likely large player to sell, but overlaps with National City in Pittsburgh, Wachovia in Philadelphia and New Jersey and the Royal Bank of Scotland throughout the state make it unlikely that any banking leader in the state would be a buyer of PNC.

Bank of America, the fourth largest company of any type in the world when measured by earnings, normally is the 800 pound gorilla in Pennsylvania after gaining a "foothold" through the acquisition of Fleet. With that acquisition taking it to the "cap" on allowable national deposit share, though, it will be on the merger sidelines for a long time, if not forever.

Citigroup and J.P. Morgan Chase, the other members of the banking's "big three," could buy their way in, and after the latter's purchase of Bank One, Pennsylvania is a natural "filler" between Bank One's Ohio franchise and J.P. Morgan's New York branch network. If either were to enter the state, it would be through the acquisition of Wachovia or PNC, and while this might change the competitive situation, it would not impact the concentration level.

Consolidation is coming to Pennsylvania, but it will continue to be more regional than statewide, and other than what happens to Sovereign, it will be primarily through acquisitions of mid-sized banks by the Royal Bank of Scotland, M&T and Sovereign, along with the internal growth of Commerce. There also could be an in-state merger between mid-sized banks that creates the mass to be an even more important player in the statewide consolidation.

## Southeast Pennsylvania

Southeast Pennsylvania, has always been the part of Pennsylvania most subject to a changing banking structure because of its size and proximity to other large markets. Philadelphia is too large for banks with national ambitions to ignore, and from a marketing perspective, it is part of a regional market running from Boston to Washington.

Since Pennsylvania was late getting into the interstate banking game, the Boston to Washington consolidation has been slow in coming to Philadelphia and surrounding Southeast Pennsylvania. What change there has been in the area's banking leadership was primarily an in-state game until the mid-nineties – i.e., PNC and Mellon came out of Pittsburgh to be major players. Then, a series of acquisitions put the franchises of almost all the remaining, locally-based, large commercial banks under the First Union banner, which was later to change its name to Wachovia.

This made Wachovia, by far the largest bank in Southeast Pennsylvania, but with so many franchises – i.e., CoreStates, Fidelcor, Meridian and their pre-1994 acquisitions – under one banner, it was inevitable that confusion and branch consolidations would cause a substantial customer run-off. The culture clashes within CoreStates flowing from its acquisition of Meridian and the “customer-be-damned” attitude of Fidelcor's New Jersey parent contributed to Wachovia's problems.

For several years, the small and mid-sized banks enjoyed a very favorable competitive environment with Wachovia losing customers and its two large Pittsburgh-based rivals, Mellon and PNC, having with either lost interest or the capability of capturing most of these lost customers. During much of this period, the area's largest thrift, Sovereign, was relatively dormant locally as it struggled to absorb its ambitious purchase of about \$12 billion of branch deposits in New England.

## Southeast Pennsylvania\* Deposit Share

	Deposits <u>2003</u> (In millions)	Market Share			
		<u>June 30,</u>			
		<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>
<u>Large Banks</u>					
Wachovia	\$21,510	23.7%	22.0%	23.7%	23.2%
Royal Bank of Scotland	10,061	11.1	9.4	-	-
PNC	8,415	9.3	9.0	10.3	10.0
Sovereign	5,301	5.9	6.2	5.2	7.6
Bank of America	2,863	3.2	-	-	-
M&T	<u>1,378</u>	<u>1.5</u>	<u>1.0</u>	<u>1.1</u>	<u>-</u>
Subtotal	\$49,528	54.7%	47.6%	40.3%	40.8%
<u>Local Bank Leaders</u>					
Commerce	\$ 3,824	4.2%	3.2%	2.0%	1.5%
National Penn	2,596	2.9	2.3	2.3	2.1
Harleysville National	1,742	1.9	1.8	1.7	1.6
Fulton	1,685	1.9	1.4	1.3	1.3
Univest	1,250	1.4	1.3	1.3	1.3
Royal Bancshares	848	.9	.9	.9	.6
Susquehanna	820	.9	.2	.2	.2
Hudson United	<u>621</u>	<u>.7</u>	<u>.8</u>	<u>.9</u>	<u>1.2</u>
Subtotal	\$13,386	14.8%	11.9%	10.6%	9.8%
<u>Local Thrift Leaders</u>					
Beneficial	\$ 1,564	1.7%	1.8%	1.8%	1.9%
Firsttrust	1,340	1.5	1.6	1.8	1.7
KNBT	1,218	1.3	.9	.9	.9
Fox Chase Bank	<u>654</u>	<u>.7</u>	<u>.7</u>	<u>.7</u>	<u>.7</u>
Subtotal	\$ 4,776	5.2%	5.0%	5.2%	5.2%
Other Banks	\$ 8,792	9.7%	16.7%	25.1%	25.4%
Other Thrifts	5,661	6.3	9.6	10.3	10.9
Credit Unions	<u>8,481</u>	<u>9.3</u>	<u>9.2</u>	<u>8.5</u>	<u>7.9</u>
Total	\$90,624	100.0%	100.0%	100.0%	100.0%

\*Berks, Bucks, Chester, Delaware, Lehigh, Montgomery, Northampton and Philadelphia counties.

Source: SNL Financial, Charlottesville, Virginia.

In the most recent years, the situation changed significantly. Wachovia is no longer losing market share; a disinterested Mellon has been replaced by an aggressive Royal Bank of Scotland; and Fleet/Summit has been replaced by the nation's largest retail bank, Bank of America. Add to this a Commerce that has almost tripled deposit share in just three years, and it is a much more difficult banking market than existed in the mid- and late nineties.

This changing banking environment in Southeast Pennsylvania is readily seen in the changing deposit shares of some of the leading players. Wachovia, Royal Bank of Scotland, even excluding its acquisitions, and PNC joined with Commerce in gaining deposit share in 2003. This is neither reminiscent of the nineties nor can it be dismissed as big banks buying deposits since 2003 was a year when deposit availability ran well ahead of loan availability.

Most of the region's local commercial bank leaders also gained modest deposit shares in recent years both internally and through acquisition. The only mid-sized bank to lose share was an outsider, Hudson United. Thrifts did not fare as well, but their share losses were modest.

Some of the deposit share change in the last couple of years in Southeast Pennsylvania, as elsewhere, was structural rather than competitively-driven. The flow of money out of stock market into banks has been directed more toward MMDAs than CDs. This is a function of both a low interest rate environment and most of the "outflow" belonging to upper income customers. This favors large banks and banks in affluent markets over thrifts and commercial banks with an urban orientation in that it is their customers that had the most money in the market, and these customers are not CD-oriented.

The short-run implications of this changing environment in Southeast Pennsylvania do not suggest dramatic change. Wachovia appears to be through losing share; Royal Bank of Scotland and Commerce will continue to show good gains; but some of this should come out of stumbling PNC, recent share gains notwithstanding, Sovereign and a Bank of America that cannot immediately reverse Fleet/Summit's slide. The net effect for everyone else is that, collectively, their market share may not change much, but, unlike in the past, what market share gains there are for small and mid-sized banks will come at the expense of each other and not the big banks.

In the longer term, it is likely that PNC and Sovereign will be sold, and that the local “big four” will look much the same as it does throughout most of the East Coast. Wachovia will continue to be number one, but the next largest market shares will belong to Royal Bank of Scotland, Bank of America and whomever ends up with PNC with J.P. Morgan, Citigroup and Wells Fargo being the most likely candidates. There will still be a lot of small local banks, but some of the present local leaders will have become fond memories.

### South Central Pennsylvania

South Central Pennsylvania with its close proximity to Philadelphia and Baltimore and good economic dynamics may be destined to have a similar bank structure in time – i.e., Bank of America, Wachovia and Royal Bank of Scotland in leadership positions – but this would be a major change from what exists today. M&T as a result of its Allfirst and Keystone acquisitions is the market leader, and the only other banks with more than a 10% deposit share are Fulton and Sovereign when its Waypoint acquisition is completed.

Right behind these leaders, though, the likely determinants of long-term change are in action. Wachovia has stopped its market share slide; Royal Bank of Scotland is gaining share, albeit from relatively small base; and the fastest growing local bank is Pennsylvania Commerce, a clone of the New Jersey-based Commerce.

One unique feature of South Central Pennsylvania is the almost total disappearance of thrifts. Sovereign and the Royal Bank of Scotland’s Citizens affiliate are banks that technically still operate with thrift charters, but these two aside, after the sale of Waypoint, thrift deposits will be only about 3% of total deposits.

The short-term change in South Central Pennsylvania may already have experienced its most significant nearterm transformation in Sovereign buying Waypoint. M&T is going nowhere soon; Sovereign is looking less-and-less like a nearterm sale; and Fulton, Susquehanna, Sterling and Community Banks are feeling no pressure to sell in an environment in which they are facing familiar competition.

## South Central Pennsylvania\* Deposit Share

	Deposits 2003 (In millions)	Market Share			
		June 30,			
		2003	2002	2001	2000
<u>Large Banks</u>					
M&T	\$ 3,606	14.1%	3.1%	3.7%	-
Sovereign	2,644	10.4	.8	.7	.8%
Wachovia	2,142	8.4	8.1	8.2	8.7
Royal Bank of Scotland	1,312	5.1	4.0	-	-
PNC	<u>1,230</u>	<u>4.8</u>	<u>5.2</u>	<u>5.3</u>	<u>5.6</u>
Subtotal	\$10,934	42.8%	21.2%	17.9%	15.1%
<u>Local Bank Leaders</u>					
Fulton	\$ 2,907	11.4%	11.4%	9.8%	9.6%
Sterling	1,644	6.5	6.6	6.2	3.9
Susquehanna	1,212	4.8	4.8	4.9	5.0
Community Banks	852	3.3	3.4	3.0	2.2
Pennsylvania Commerce	783	3.1	2.6	2.2	1.8
ACNB	640	2.5	2.3	2.1	2.1
PennRock	469	1.8	2.0	2.0	2.0
Ephrata National	391	1.5	1.5	1.5	1.4
Franklin	<u>377</u>	<u>1.5</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>
Subtotal	\$ 9,275	36.4%	36.2%	33.3%	29.6%
<u>Local Thrift Leaders</u>					
Northwest	\$ 731	2.8%	2.3%	2.1%	1.9%
Other Banks	\$ 3,038	12.0%	24.3%	30.6%	37.1%
Other Thrifts	103	.4	10.4	10.9	11.5
Credit Unions**	<u>1,430</u>	<u>5.6</u>	<u>5.6</u>	<u>5.2</u>	<u>4.8</u>
Total	\$25,511	100.0%	100.0%	100.0%	100.0%

\*Adams, Cumberland, Dauphin, Franklin, Lancaster, Lebanon, Perry and York counties.

\*\*Excludes Pa. State and Members First Credit Unions.

Source: SNL Financial, Charlottesville, Virginia.

In the longer term, it is a very different story, albeit “longer term” may be 2010 or later. It is unlikely M&T, Sovereign or PNC will all be around more than five years, and they can only be bought by very large banks such as Royal Bank of Scotland, J.P. Morgan and Wells Fargo. Wachovia could be added to the buyers for M&T, but its overlaps are such that it is not a logical acquirer of Sovereign or PNC. Bank of America as the leader in Baltimore and a growing factor in Southeast Pennsylvania eventually will be a factor in South Central Pennsylvania, but it will do this through *de novo* branching. This takes time and is unlikely to even begin in the foreseeable future.

As for the local banks, few thrifts and major changes at the top are good news that will push the pressure to sell beyond 2010. Margin pressures and offers too good to refuse, though, will further significantly reduce their ranks long before then.

### Northeastern Pennsylvania

The other segment of Pennsylvania that is, at least technically, within the urbanized Washington to Boston corridor is Northeastern Pennsylvania. Scranton, Wilkes-Barre and the other communities in the region will never be high priority locations for big bank coverage, but they are not far from New York City and just across the river from North Jersey.

The “near proximity with low priority” syndrome suggests that increased penetration by large banks will be reactive rather than proactive. Wachovia and Royal Bank of Scotland may continue to gain share with the existing coverage, but they will not be making acquisitions in the area nor will Bank of America expand significantly by *de novo* branching. What gains these banks make also could be partially offset by continuing share losses by PNC and M&T.

The reactive part is what happens to Community Bank Systems and NBT. These Upstate New York banks are the primary buyers of small banks in the region that want to sell, but as they pass \$5 billion in assets, they, themselves, may become sellers. This could expand the positions of Royal Bank of Scotland, M&T or Sovereign in Northeastern Pennsylvania or bring in a new large player – i.e., Charter or Banknorth.

**Northeastern Pennsylvania\* Deposit Share**

	Deposits <u>2003</u> (In millions)	Market Share			
		June 30,			
		<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>
<b><u>Large Banks</u></b>					
PNC	\$ 2,567	15.4%	16.2%	17.3%	18.0%
Wachovia	1,851	11.1	10.0	9.6	9.0
M&T	1,231	7.4	7.6	7.9	5.1
Royal Bank of Scotland	951	5.7	4.9	-	-
Bank of America	447	2.7	-	-	-
Sovereign	<u>302</u>	<u>1.8</u>	<u>2.0</u>	<u>-</u>	<u>.8</u>
Subtotal	\$ 7,349	44.1%	40.7%	34.8%	32.9%
<b><u>Local Bank Leaders</u></b>					
Community Bank Systems	\$ 875	5.3%	3.1%	3.4%	-
NBT	768	4.6	4.8	5.1	2.9%
First National Community	574	3.5	3.4	3.4	3.0
Comm Bancorp	464	2.8	2.8	2.7	2.5
Fidelity D&D	433	2.6	2.7	2.6	2.3
Penseco	404	2.4	2.7	2.5	2.6
Norwood	309	1.9	1.8	1.8	1.7
Palm Bancorp	<u>300</u>	<u>1.8</u>	<u>1.7</u>	<u>1.6</u>	<u>1.5</u>
Subtotal	\$ 4,127	24.9%	23.0%	23.1%	16.5%
<b><u>Local Thrift Leaders</u></b>					
Northeast Pa. Financial	\$ 523	3.2%	3.3%	3.0%	2.1%
East Stroudsburg Savings	<u>321</u>	<u>1.9</u>	<u>2.0</u>	<u>1.9</u>	<u>1.9</u>
Subtotal	\$ 844	5.1%	5.3%	4.9%	4.0%
Other Banks	\$ 2,761	16.6%	22.4%	29.2%	38.1%
Other Thrifts	542	3.2	2.9	2.7	3.4
Credit Unions	<u>1,011</u>	<u>6.1</u>	<u>5.7</u>	<u>5.3</u>	<u>5.1</u>
Total	\$16,634	100.0%	100.0%	100.0%	100.0%

\*Carbon, Lackawanna, Luzerne, Monroe, Pike, Schuylkill, Susquehanna, Wayne and Wyoming counties.

Source: SNL Financial, Charlottesville, Virginia.

Northeastern Pennsylvania by geography is not far removed from urban markets dominated by big banks, but the change from what presently exists will be slow. Thus, the present environment of a handful of large banks with varying degrees of interest competing with numerous local banks along with the Upstate New York entrants, will continue. This also means that there will continue to be too many banks chasing too few loans.

In time, the regional leader, PNC, will be part of a national bank, and a regional “big three” could easily carry the names of J.P. Morgan, Wachovia and Royal Bank of Scotland. For them to have more than 35% to 40% of the local business, though, requires others to consolidate the many small banks in the region and then deliver this to the big banks through acquisition. This would require a two step operation – i.e., one of the Upstate New York banks acquires more local banks and then sells to Banknorth, which is later bought by Wachovia or J.P. Morgan. This may be a logical outcome, but on pure logistics it cannot happen quickly.

#### Upper Susquehanna Valley

Change may come slowly to Northeastern Pennsylvania, but unlike the Upper Susquehanna Valley, change will come. In the Upper Susquehanna, the big banks held only 18% of the deposits as of mid-2003, and this modest share continues to decline.

The largest of the big banks, M&T and Sovereign, also are regional rather than national players. The only truly large bank, Royal Bank of Scotland, has less than a 1% deposit share.

The dominance and growing shares of the small banks in this segment of Pennsylvania extends even to the state’s regionals with a presence, Susquehanna and Fulton. They were fourth and sixth in deposit share in mid-2003 in the Upper Susquehanna, but each had a smaller deposit share than in 2001. Thrifts also have a rather insignificant 5% in the region.

**Upper Susquehanna Valley\* Deposit Share**

	Deposits 2003 (In millions)	Market Share			
		June 30,			
		2003	2002	2001	2000
<b><u>Large Banks</u></b>					
M&T	\$ 765	9.7%	11.2%	13.6%	-
Sovereign	479	6.0	6.1	5.7	8.9%
PNC	136	1.7	2.0	2.1	2.4
Royal Bank of Scotland	<u>49</u>	<u>.6</u>	<u>.4</u>	<u>-</u>	<u>-</u>
Subtotal	\$1,429	18.0%	19.7%	21.4%	11.3%
<b><u>Local Bank Leaders</u></b>					
Citizens & Northern	\$ 658	8.3%	8.1%	7.6%	7.2%
Sun	517	6.5	6.5	7.1	5.3
Susquehanna	501	6.3	6.4	6.4	6.5
Fulton	444	5.6	6.0	6.4	6.5
Citizens Financial	392	5.0	5.0	5.2	4.2
Penns Woods	291	3.7	3.6	3.4	3.5
Juniata Valley	290	3.7	3.5	3.5	3.5
First Keystone	<u>256</u>	<u>3.2</u>	<u>3.0</u>	<u>2.9</u>	<u>2.9</u>
Subtotal	\$3,349	42.3%	42.1%	42.5%	39.6%
<b><u>Local Thrift Leaders</u></b>					
Northwest	\$ 263	3.3%	3.0%	3.1%	1.1%
Other Banks	\$2,305	29.1%	27.8%	26.2%	41.5%
Other Thrifts	162	2.0	2.5	2.2	2.1
Credit Unions	<u>559</u>	<u>5.3</u>	<u>4.9</u>	<u>4.6</u>	<u>4.4</u>
Total	\$8,067	100.0%	100.0%	100.0%	100.0%

\*Bradford, Clinton, Columbia, Juniata, Lycoming, Mifflin, Montour, Northumberland, Potter, Snyder, Sullivan, Tioga and Union counties.

Source: SNL Financial, Charlottesville, Virginia.

These trends and the existing small shares of even the in state regionals suggest that the personal delivery of financial services in the Upper Susquehanna Valley will be in the hands of the small banks for many years to come. Miles and trees will isolate these numerous small banks, each serving its own pocket of this sparsely populated area. They will not be totally free of competition from large banks, but it will come from the less personal remote access rather than from readily accessible branches.

### Western Pennsylvania

Western Pennsylvania is another region that is dissimilar to all other parts of Pennsylvania, but with Pittsburgh as its focal point, it is part of the urbanized world. As such, banking in Western Pennsylvania was and still is dominated by fairly large banks, but by ones that have a local flavor as PNC and Mellon are Pittsburgh-based and National City calls nearby Cleveland home. When Mellon sold its retail branches, it gave Royal Bank of Scotland a foothold in the area, but this was only about 8% of the region's deposits in mid-2003, and it is the entire share held by very large banks.

The decisions made by PNC and National City will determine how fast Western Pennsylvania moves from dominance by large regionals to national banks. Each is likely to sell, PNC sooner than National City, but their sales are not necessarily imminent. In time, though, their branches are likely to carry names such as Wells Fargo, Wachovia or whichever retail brand J.P. Morgan chooses, Chase or Bank One.

The nearterm action in Western Pennsylvania will be the continuing sale of stock thrifts and local commercial banks with First Commonwealth, S&T, Sky, FirstMerit and Northwest doing most of the buying. The biggest change in the second tier in the next couple of years is the possible sale of F.N.B., which has recently spun-off its Florida affiliate bank to maximize shareholder value. If maximizing value is truly the motivation, then a second step sale would be logical with Royal Bank of Scotland, FirstMerit and Sky being possible buyers. If not, then F.N.B. joins the others as a buyer of small banks and thrifts.

**Western Pennsylvania\* Deposit Share**

	Deposits 2003 (In millions)	Market Share			
		June 30,			
		2003	2002	2001	2000
<b><u>Large Banks</u></b>					
PNC	\$14,773	17.6%	17.7%	17.7%	20.3%
National City	11,078	13.2	14.2	14.4	14.2
Mellon	10,536	12.6	10.0	16.1	17.1
Royal Bank of Scotland	6,767	8.1	6.5	-	-
M&T	862	1.0	1.2	1.8	-
Subtotal	\$44,016	52.5%	49.6%	50.0%	51.6%
<b><u>Local Bank Leaders</u></b>					
First Commonwealth	\$ 3,936	4.7%	4.2%	4.5%	4.3%
F.N.B.	3,057	3.7	4.1	1.9	1.9
Sky	2,466	3.0	2.3	2.3	2.3
S&T	1,930	2.3	2.2	2.3	2.1
FirstMerit	916	1.1	.6	.4	.4
Omega	770	.9	1.0	1.1	1.0
AmeriServ	655	.8	1.0	1.0	.9
CNB	579	.7	.7	.7	.7
Subtotal	\$14,309	17.2%	16.1%	14.2%	13.6%
<b><u>Local Thrift leaders</u></b>					
Northwest	\$ 3,657	4.4%	3.6%	3.4%	3.3%
Dollar Bank	2,625	3.1	3.1	2.5	2.3
Parkvale	1,330	1.6	1.8	1.7	1.5
ESB	621	.7	.8	.8	.7
Subtotal	\$ 8,233	9.8%	9.3%	8.4%	7.8%
Other Banks	\$ 7,687	9.2%	11.4%	13.6%	14.2%
Other Thrifts	4,545	5.4	7.3	7.7	7.1
Credit Unions	4,988	5.9	6.3	6.1	5.7
Total	\$83,778	100.0%	100.0%	100.0%	100.0%

\*Allegheny, Armstrong, Beaver, Bedford, Blair, Butler, Cambria, Cameron, Centre, Clarion, Clearfield, Crawford, Elk, Erie, Fayette, Forest, Fulton, Greene, Huntingdon, Indiana, Jefferson, Lawrence, McKean, Mercer, Somerset, Venango, Warren, Washington and Westmoreland counties.

Source: SNL Financial, Charlottesville, Virginia.

Over the longer term, the second-tier of Western Pennsylvania banks will undergo the inevitable attrition by sale as competitive pressures and the desire to maximize shareholder value take their toll. The pressure to sell, though, will be stronger on the second-tier banks based in the urban Ohio markets to the west, Sky and FirstMerit, than First Commonwealth and S&T that receive much of their business from the small towns in West Central Pennsylvania.

### Conclusion

It is inevitable that Pennsylvania's banking structure will move toward a barbell structure that features the same national banks that dominate in nearby states, but a region-by-region look at the state suggests that only Southeast Pennsylvania is moving in that direction. For most of the rest of the state, the "next shoe would have to drop" – i.e., the sale of PNC, National City and/or Sovereign – to even start the process, and even that would have no impact in the Upper Susquehanna Valley.