New England Banking Conditions

Regional and Community Bankers Conference

October 11, 2006
Agenda

I. Overview of the First District

II. Strategies for a strong net interest margins

III. The competitive environment for deposits
Agenda

I. Overview of the First District

II. Strategies for a strong net interest margin

III. The competitive environment for deposits
Banks in New England

Community Banks
- Less than $1 billion in assets
- 237 institutions
- $78 billion combined assets

Regional Banks
- $1 to $10 billion in assets
- 31 institutions
- $60 billion combined assets

Note: All bank financial data are merger adjusted. S&Ls are excluded. Bank financial information is derived from FDIC call reports unless otherwise noted.
Asset growth continued at a moderate pace in 2006 due to loan demand.
1-4 family residential and construction loans lead demand

Average Growth Since 1996

Growth in 2006

Construction & Development

Home Equity

CRE

C&I

Individual

1-4 Family
Funding for loan growth was provided in part by reallocating securities into loans.
Liability funding came primarily from non-core sources, while core deposit growth remained flat.
Core funding shifted towards CDs less than $100,000; growth in all other core deposits categories was below historical averages.
Profits reflect continued pressures on the margin

![Graph showing Return on Average Assets for Community Banks and Regional Banks from 1995 to 2006. The graph indicates a fluctuating trend with peaks in 2000 and 2001 and troughs in 1998 and 2006. The values for Community Banks and Regional Banks are marked at specific years, showing variations in profitability.]

- Community Banks: 0.94, 0.91, 0.81, 1.01, 0.91, 0.77, 0.66
- Regional Banks: 0.87, 0.91, 0.81, 0.91, 0.87, 0.81, 0.77
The primary culprit causing management challenges for the banking industry
The margin on a Y-T-D basis for Regionals fell at a greater rate than Community Banks.
On a quarterly basis the margin is particularly hard hit for the Regionals.
Why are regional banks profit margins higher? Regional banks have responded to the earnings environment by reducing overhead.
Strategic issue: What can community bankers do to become more flexible?

**First District Overview**
- Margin Success
- Deposit Competition
Strategic issue: How do bankers respond to reduced deposit growth coupled with continued loan demand?
Future outlook: better positioning for declining rates
Agenda

I. Overview of the First District

II. Strategies for a strong net interest margin

III. The competitive environment for deposits
Methodology

• **Stable Margins**: selected the 20 banks with the lowest volatility in their net interest margins between 2004 and 2006

• **Highest Margins**: selected the 20 banks with the highest average net interest margins between 2004 and 2006

• **Excluded banks that did not fit the typical regional or community bank profile:**
  – Bank of America Rhode Island
  – Investors Bank and Trust Company
  – Mellon Trust of New England
  – State Street Bank and Trust Company
Banks with the Most Stable Margins
The “Stable 20” maintained a constant net interest margin—contrary to most New England banks.
The Stable 20 had interest income comparable to their New England peers with a slightly asset sensitive bias.
The Stable 20 had lower interest expenses than their peers.
How did the Stable 20 maintain their position?

- Slightly higher levels of core deposits, and within core deposits, lower levels of CDs
  - Free everything and no foreign ATM fees
  - Products such as Dow Jones and repricing CDs

- Cost of borrowed funds rose less quickly than district average

- Effective ALM management with slight asset sensitivity positions
Banks with the Highest Margins
Low interest expense most commonly drove the high net interest margins.
What did the banks with low interest expense have in common?

- No brokered deposits: 71%
- High levels of core deposits: 57%
- High levels of savings accounts: 50%
- High levels of MMDAs: 50%
What did the banks with high interest income have in common?

- High proportion of loans and low proportion of securities: 73%
- High levels of CRE: 64%
- High levels of C&I: 36%
Agenda

I. Overview of the First District

II. Strategies for a strong net interest margin

III. The competitive environment for deposits
Credit Unions remain a significant competitor in most banking markets in New England

*Source: CUNA Credit Union Statistics: State and Federal Combined*
ING Direct has built a large deposit base while focusing on gaining deposit market share using ebanking channels.
Asset management companies have significantly increased money market holdings while Regional and Community banks have experienced much slower growth.
Some bankers have adopted successful deposit strategies to improve their deposit base despite the competition

- Established loan officer incentives
- Found opportunities to bring the bank to the client
- Established money markets accounts with reasonable price tiering
- Rebranded an image
Questions