

Bank Executive Survey: Outlook and plans for growth

Q1 survey results February 2010

One of the lessons of the economic downturn is how quickly conditions can change. Grant Thornton LLP and *Bank Director* magazine are continuing to monitor those conditions, checking the pulse of the banking industry each quarter with the *17th Bank Executive Survey*.

The first installment of the survey, conducted Nov. 17 through Dec. 3, 2009, asked respondents about their outlook for the economy, their expectations for hiring, and how they plan to stabilize and grow their business in the year ahead.

Economic outlook and hiring

When it comes to bank executives' outlook for the U.S. economy, optimism has rebounded. The majority (86%) of respondents surveyed a year ago were pessimistic about the outlook for the national economy. By the end of 2009, the tide had shifted: Eighty percent of respondents now feel that the U.S. economy will either improve or remain the same in the next six months. However, private institutions tend to be more pessimistic than public institutions, with 30% of private institutions versus only 13% of public institutions expecting the economy to worsen. Respondents are more confident about their specific regions, with 81% expecting that their local economies will improve or remain the same over the next six months.

Table 1: Do you feel that the U.S. economy will improve/remains the same/get worse in the next six months?

	All respondents	Public institutions	Private institutions	Mutual institutions
Improve	24%	31%	14%	32%
Remain the same	56%	56%	56%	53%
Get worse	20%	13%	30%	15%

Table 2: Do you feel that your local economy will improve/remains the same/get worse in the next six months?*

	National	Northeast	Midwest	Southeast	Central	West
Improve	22%	25%	26%	27%	19%	3%
Remain the same	59%	60%	61%	56%	52%	66%
Get worse	18%	15%	13%	17%	29%	31%

*Percentages may not total 100 due to rounding.

When it comes to bank executives' outlook for the U.S. economy, optimism has rebounded.

Bank Executive Survey: Outlook and plans for growth

Table 3: Do you expect the number of people you employ at your bank to increase/remain the same/decrease in the next six months?*

	National	Northeast	Midwest	Southeast	Central	West
Increase	18%	25%	13%	17%	32%	3%
Remain the same	63%	68%	71%	65%	39%	62%
Decrease	18%	8%	16%	17%	29%	35%

*Percentages may not total 100 due to rounding.

Table 4: In what part of your loan portfolio do you expect the most losses in the next 12 months*

	All respondents	Northeast	Midwest	Southeast	Central	West
Commercial real estate loans	55%	45%	56%	65%	53%	48%
Commercial loans	17%	14%	18%	10%	27%	24%
Single/multifamily real estate loans	12%	22%	13%	10%	0%	3%
Construction loans	8%	5%	8%	8%	3%	21%
Consumer loans	5%	3%	2%	6%	17%	0%
None	2%	5%	2%	2%	0%	0%
Other	3%	8%	2%	0%	0%	3%

*Percentages may not total 100 due to rounding.

Table 5: What is your bank's primary approach to managing capital in the next 12 months?*

	All respondents	Public institutions	Private institutions	Mutual institutions
Shrinking the balance sheet	21%	27%	18%	18%
Reducing dividends	5%	4%	9%	0%
Reducing overhead	14%	11%	14%	18%
Public offering	4%	7%	0%	6%
Private offering	12%	11%	18%	2%
None of the above	30%	32%	27%	31%
Other	15%	8%	16%	25%

*Percentages may not total 100 due to rounding.

After dismal employment news over the past few years, the majority (81%) of respondents now say that the number of people their bank employs will either increase or remain the same over the next six months. However, as certain areas of the country recover, others still await relief. The Central and West regions are the most pessimistic about their economies and have the highest rates of anticipated staff decreases. Projected staffing needs also differ by type of institution: Mutual institutions (6%) are less likely than public institutions (23%) or private institutions (20%) to decrease staffing over the next six months.

Loan portfolios: Bracing for impact

With billions in commercial real estate loans coming due in the next few years, it is not surprising that the majority of respondents (55%) expect their loan portfolios to suffer the most losses from commercial real estate loans.

“A closer look at the regional data shows that 65% of bankers in the Southeast region and 45% of bankers in the Northeast are most pessimistic about expected losses in their commercial real estate loan portfolios,” says Rick Huff, a Financial Institutions partner in Grant Thornton’s Philadelphia office.

“Additionally, 22% of bankers in the Northeast expect to see most of their losses in single and multifamily real estate loans compared with 10% of bankers in the Southeast. It appears that Southeastern bankers believe that the worst is over regarding residential real estate losses, while Northeastern bankers seem to be predicting that the worst is yet to come in this area.”

Capital strategies

A major lesson of the economic crisis has been the importance of capital. Given the economic environment, banks have been rethinking their capital plans; last year, nearly one-quarter (24%) reported that they had already made significant changes to their capital plans. Over the next 12 months, the main approach for managing capital will be shrinking the balance sheet (21%). Public banks (27%) seem more likely than private banks (18%) or mutual institutions (18%) to manage capital by shrinking the balance sheet. The second most popular choice is reducing overhead (14%).

Thirty percent of respondents did not find any of the options representative of their approaches, but a number wrote in responses such as trying to grow their bank, controlling spending and retaining earnings.



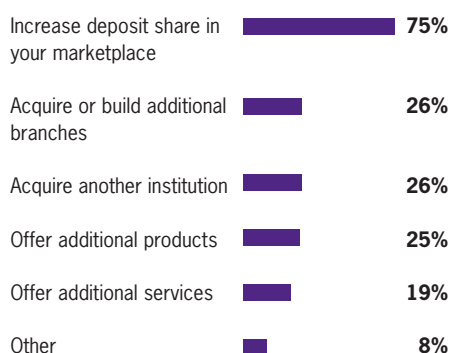
Bank Executive Survey: Outlook and plans for growth

Plans for growth

Although optimism is on the rise, banks' plans for the near future remain conservative, with three-quarters (75%) planning on increasing deposit share as their main vehicle for growth. A greater percentage of small banks (79%) than large banks (70%) are taking this route. However, when it comes to acquiring or building additional branches, a higher percentage of large banks (30%) than small banks (24%) plan to do so. Interestingly, more than one-quarter (26%) have no growth planned for the next 12 months.

Figure 1

Which of the following actions do you plan to take to achieve growth in the next 12 months?*



*Respondents were able to select more than one answer.

Acquisition of a failed bank's assets or deposits

The economic downturn and banking crisis have spurred an unprecedented increase of nearly 500% in the number of bank failures since 2008. Many of these troubled banks are being acquired by healthy banks through FDIC-facilitated acquisitions.

For qualified banks (generally well-capitalized and well-managed institutions), acquisitions of these failed banks present new opportunities to grow aggressively — in asset size and into new markets and geographies — with the potential of significantly reducing the risk of such acquisitions through FDIC loss-sharing agreements. FDIC-facilitated acquisitions can help create diversification in the marketplace — and help provide a competitive advantage for acquiring institutions.

The majority of bank executives (62%) report that their bank is interested in pursuing a failed bank. While 42% say their bank is interested in being a bidder for a failed bank's assets or deposits, only 2% have made an acquisition of a failed bank, and 7% have been unsuccessful bidders.

With regard to bidding on a failed bank's assets or deposits, size does matter: More small banks (46%) than large banks (36%) report that they are interested in being bidders. In addition, more small banks (21%) than large banks (15%) report that they are interested in learning more about the process.

“When you take into consideration that FDIC-assisted acquisitions require an almost immediate turnaround, a high level of banking experience and a significant amount of capital, it appears that larger institutions may be in a better position to execute these deals than smaller banks,” says George Mark, a Grant Thornton Financial Institutions Audit partner. “Larger institutions with greater resources would definitely have an advantage.”

A financial institution's location also seems to influence its interest in acquiring a failed bank. Nearly three-quarters of bankers in the West (72%) and Central (71%) regions of the country are interested in pursuing a failed bank, compared with just more than half (52%) in the Northeast. Bankers in the West (55%) and Central (52%) regions are also more interested in being bidders than bankers in other parts of the country (44% in the Southeast, 37% in the Midwest and 34% in the Northeast).

Table 6: Regarding the acquisition of a failed bank's assets or deposits, which statement(s) describes your bank's position? (Select all that apply.)

	All	Small bank	Large bank	Northeast	Midwest	Southeast	Central	West
We have already made an acquisition	2%	0%	4%	2%	0%	0%	0%	10%
We are interested in being a bidder	42%	46%	36%	34%	37%	44%	52%	55%
We have been an unsuccessful bidder	7%	7%	6%	2%	10%	6%	13%	10%
We are interested in learning more about the process	18%	21%	15%	17%	16%	21%	23%	10%
We are not interested in pursuing a failed bank	38%	34%	44%	48%	44%	33%	29%	28%

*Respondents were able to select more than one answer.

What you need to know about FDIC-assisted transactions

In order to take advantage of FDIC-assisted opportunities to acquire failed banks, banks and other acquirers must understand the unique aspects of these transactions. Grant Thornton's Financial Institutions practice has published two related white papers — *Troubled bank opportunities: What you need to know about FDIC-assisted transactions* and *Accounting for FDIC-assisted transactions: Acquisition of loans, application of ASC 310-30 and other issues* — exploring the accounting, tax, operational, legal, regulatory and other implications of these complex transactions. To download these white papers and listen to playbacks of our FDIC-assisted transactions webcast series, visit www.GrantThornton.com/troubledbanks.

Executive compensation and the role of government

Historically, executive compensation plans have been designed to attract, retain and motivate key management. Today, executive compensation has become synonymous with corporate excess and managerial recklessness. Regulators and the general public have decried egregious compensation practices, and financial institutions face a clampdown on executive pay. In particular, Troubled Asset Relief Program (TARP) participants must comply with a number of rules that better link executive compensation and risk.

Despite growing government regulation, nearly all respondents (96%) disagree that the government should play a role in setting compensation parameters and guidelines. More than three in five (61%) do not believe that the requirement to evaluate executive compensation will reduce excessive risk-taking.

Regulators and the general public have decried egregious compensation practices, and financial institutions face a clampdown on executive pay.

When it comes to the increased focus on enterprise risk management (ERM) and corporate governance, more than half (52%) of bank executives indicate that they intend to make changes to their bank's existing risk management programs, with a greater percentage of large banks (59%) than small ones (47%) planning to make changes. However, only one-third (33%) intend to implement new risk management programs, and a mere 13% intend to employ additional staff to address the increased focus on ERM and corporate governance.

“With new Federal Reserve Board (FRB) initiatives and new regulatory guidance in place, banks will need to conduct in-depth reviews of their incentive compensation plans to ensure that those plans don't create unnecessary risk or impair shareholder value,” says Henry Oehmann, national Executive Compensation Services director. “At the same time, TARP regulations, FRB guidance and new SEC disclosure rules have heightened the importance of public disclosures related to risk management concerning executive and incentive pay. Although most of the banks surveyed have not noted this increased role, federal regulators clearly see ERM as a key factor in executive and incentive pay practices.”

Few banks appear to believe that proposed executive compensation regulations and legislation will impact current compensation programs: Only 21% of respondents plan to change their pay programs over the next 12 months to reflect current and proposed legislation, with a greater percentage of large banks (34%) than small banks (13%) agreeing that they will change their pay programs.

Most respondents (84%) agree that executive pay programs should be evaluated based on bank performance metrics. The majority of bankers (58%) agree that increased government involvement will negatively affect their ability to successfully retain and recruit good executive management. Notably, respondents from banks headquartered in the Southeast indicated agreement with this statement at a significantly higher rate (71%) than the other regions — Northeast (46%), Midwest (55%), Central (63%) and West (62%).

Moving ahead

After a tumultuous few years, bankers are enjoying a return to optimism, albeit a cautious one. Plans for growth are conservative (e.g., increasing deposit share rather than acquiring another institution). In this changed environment, financial institutions must be prepared to address increased regulation and risk.

Contact information

Nichole Jordan

Partner and Sector Leader
Banking and Securities
Grant Thornton LLP
T 214.561.2266 E Nichole.Jordan@gt.com

Rick Huff

Audit Partner
Grant Thornton LLP
T 215.814.4029 E Rick.Huff@gt.com

About Grant Thornton

The people in the independent firms of Grant Thornton International Ltd provide personalized attention and the highest quality service to public and private clients in more than 100 countries. Grant Thornton LLP is the U.S. member firm of Grant Thornton International Ltd, one of the six global audit, tax and advisory organizations. Grant Thornton International Ltd and its member firms are not a worldwide partnership, as each member firm is a separate and distinct legal entity.

Content in this publication is not intended to answer specific questions or suggest suitability of action in a particular case. For additional information on the issues discussed, consult a Grant Thornton client service partner.

www.GrantThornton.com

© Grant Thornton LLP
All rights reserved
U.S. member firm of Grant Thornton International Ltd