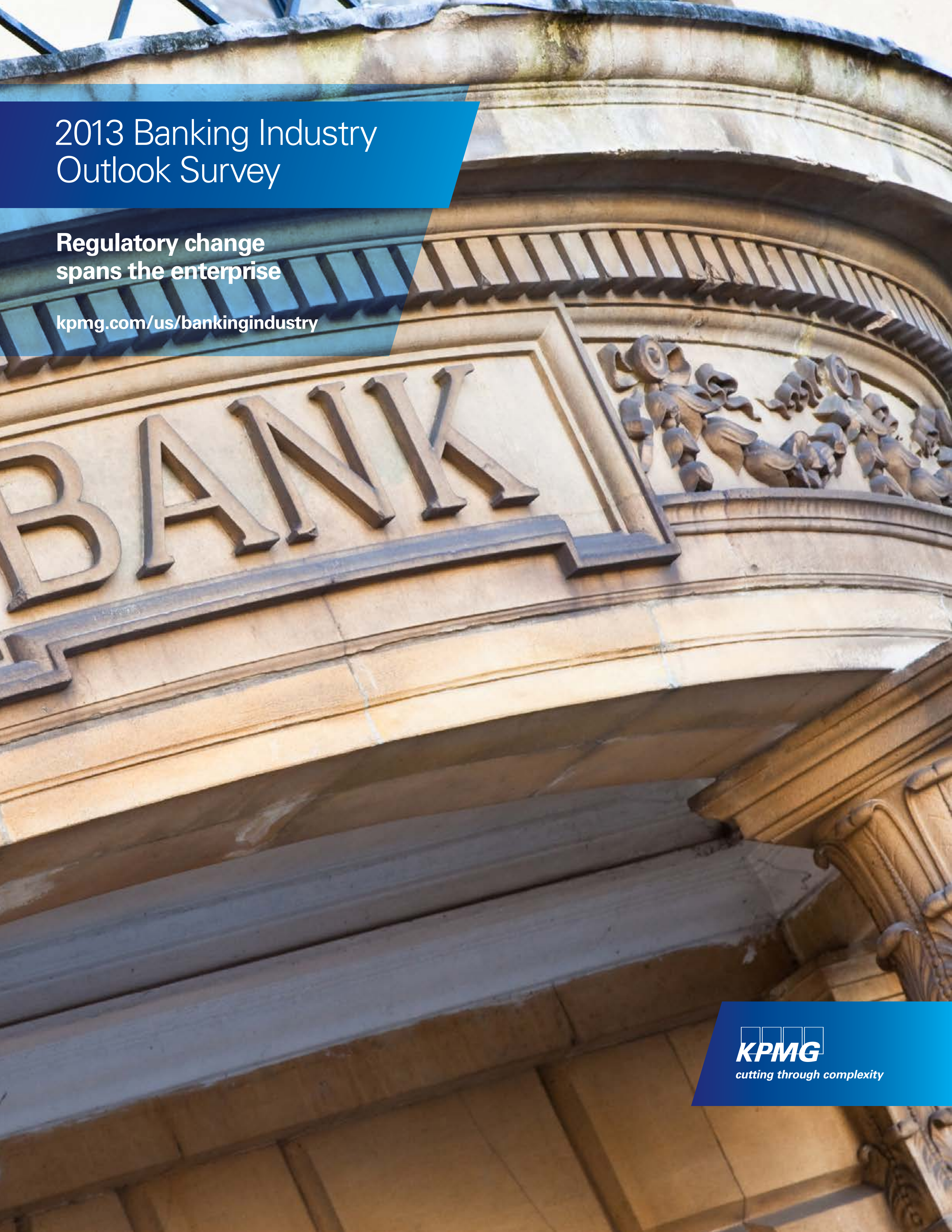
2013 Banking Industry Outlook Survey

Regulatory change spans the enterprise

kpmg.com/us/bankingindustry



KPMG
cutting through complexity


7%
2%
1%
1%
15%
74%

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Realizing the impact of regulation

The 2013 Banking Industry Outlook Survey marks the fifth consecutive year we've surveyed senior banking executives for their industry perspectives on a variety of topics. Those five years may as well be a lifetime ago in the banking sector. The landscape has changed dramatically since then, and in many respects, it appears to be just the beginning. More change lies on the horizon as the regulatory environment continues to develop in reaction to the financial and economic crisis.

Therefore, it's not surprising that navigating regulatory change is a dominant theme throughout our survey responses and certainly at the top of the banking agenda. Banks are increasingly concerned that complex regulations will hinder growth, increase costs and significantly impact traditional business models and operating structures. Yet, it's worth noting these early impacts represent a relatively early indicator of a larger wave of change to come considering we are still in the initial stages of a new regulatory timetable. For example, there are hundreds of rules coming out of the Dodd-Frank Act–including the Volcker Rule, living wills, and consumer protection–that are still being written. In fact, less than 40 percent overall have been finalized to date. Meanwhile, exams and interactions with regulators continue to increase for banks and there is little indication that this will end any time soon.

As a result, the responses to our survey may signal a call to action for those in the industry who may have been taking a wait-and-see approach and encourage them to move forward. By accepting and embracing a culture of change, banks can help innovate and help reshape the future of the industry. These organizations will ultimately find themselves better positioned to comply with the ever-evolving regulatory environment, achieve operational efficiencies, simplify platforms, enhance risk management, and achieve competitive advantage.

And what will drive growth? Over the last several years, many banking institutions have relied on cutting costs and increasing operational efficiencies to maintain profitability but have struggled to grow the top line. According to the executives in this year's survey, banks are relying less on traditional services for growth and focusing more on seizing cross-selling opportunities, developing new products and services, and expanding into new geographies and customer segments.

Overall, this year's survey confirms many existing industry challenges but also reveals some encouraging signs of opportunity. Banks continue to spend on technology, which should help drive innovation and facilitate a transition from product-centric strategic thinking toward embracing today's customer-centric focus. Moreover, banks are increasingly realizing the value of data, using analytics to extrapolate insights that help improve risk management and compliance, drive customer growth, increase operational efficiency, develop and refine product offerings, and more. We expect this to be a continuing trend that will ultimately enhance business functions moving forward.

On behalf of KPMG LLP (KPMG), I would like to thank those who participated in this survey. I hope the findings are useful to you in addressing market challenges and opportunities. I also welcome the chance to discuss this study and its implications for your business in the year ahead.

Brian Stephens
National Sector Leader, Banking and Capital Markets
KPMG LLP

Survey highlights

Regulatory pressures rise

The complex regulatory environment continues to pose challenges as banking executives indicate increasing concerns over the impact these requirements will have on growth and business models. For example, almost three quarters of executives surveyed cite legislative and regulatory pressures as the most significant barrier to growth over the next year, while nearly 80 percent believe political and regulatory uncertainty poses the greatest threat to their bank's traditional business model.

The search for growth continues

Banks are looking at numerous ways to grow the top line, including new products and services and expansion into new geographies and customer segments. Cross-selling of services is viewed as a key growth driver in the year ahead, moving into the top spot over traditional banking products, which dropped significantly from its position as top growth driver last year.

Spending trends emphasize IT

Information technology (IT) remains a key priority for most banks as executives increasingly recognize the value of leveraging data to optimize customer development as well as improving operational efficiencies in managing regulatory compliance and platform simplification. In addition to increasing IT spending, banking executives in the survey said they plan to spend more on their regulation and control environment and geographic expansion over the next three years.

M&A activity stalls

Despite improving economic and business fundamentals and high liquidity on bank balance sheets, banking executives feel less likely that their institutions will participate in a merger or acquisition than they did a year ago. Interestingly, more than half of the executives believe anticipated regulatory actions or issues are the greatest impediment to M&A in the banking industry.

Focusing on regulatory change

The complex regulatory environment is top of mind for banking executives, according to survey respondents.

Q: What initiative do you expect to undertake over the next year that will consume the most time, energy and resources, from a management perspective?

Top initiatives on the mind of management	% in 2013	% in 2012
Navigating significant changes in the regulatory environment	35	18
Significant cost reduction initiatives	16	15
Improve enterprise risk management programs/processes	10	7
Significant improvement of operation processes and related technology	9	19
Merger/acquisition	8	12
Entering into new markets	6	N/A
Significant changes to financial processes and related technology	6	2
Strategic divestiture of assets	4	8
Significant investment in organic growth[1]	3	13
Significant changes in business model	2	6
Other	1	0

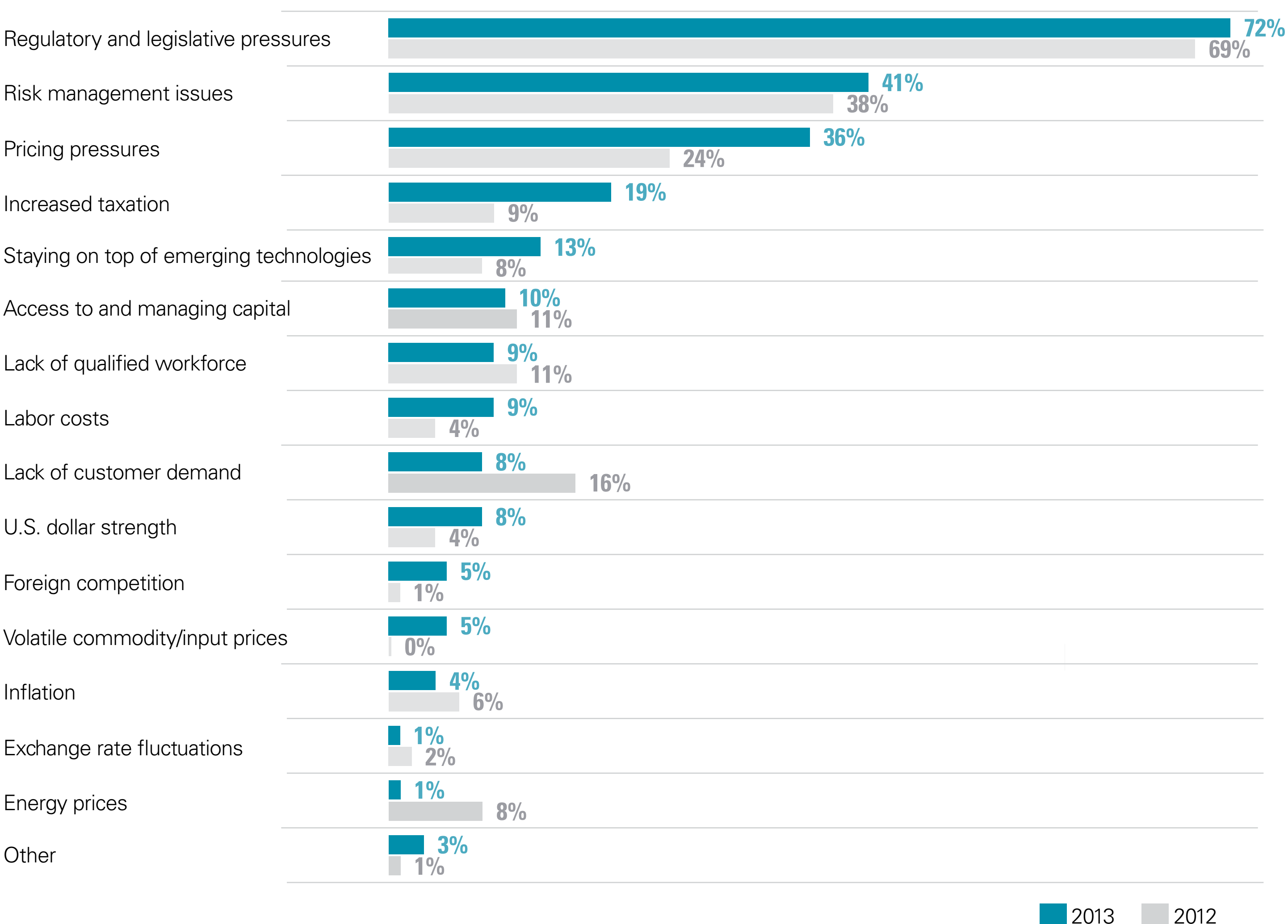
In fact, concerns over navigating regulatory change nearly doubled in responses rising to 35 percent this year over 18 percent in 2012. Other initiatives garnering management attention include cost reduction and risk management programs.

[1] (New product development, pricing strategies, geographic expansion)

Identifying growth obstacles

Not surprisingly, regulatory and legislative pressures are viewed as a primary impediment to growth over the next year by 72 percent of survey respondents.

Q: Which of the following are the most significant growth barriers facing your company over the next year?



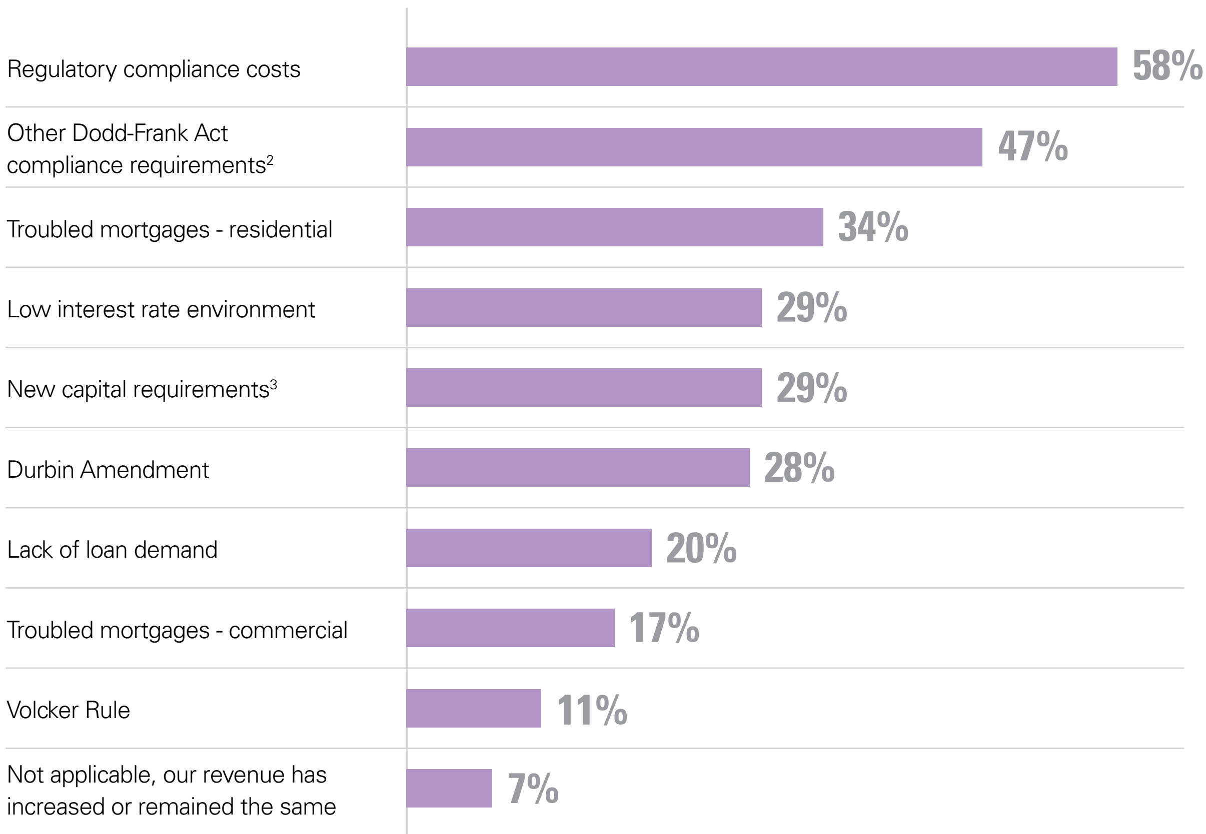
(Multiple responses allowed).

Other top hurdles include risk management issues, increased taxation, and pricing pressures, which represent a continuing trend from the prior year.

Negatively impacting bank revenue

More than half (58 percent) of the banking executives surveyed believe that the costs involved with regulatory compliance is having the greatest negative impact on bank growth.

Q: Which of the following are having the greatest negative impact on growth for your bank?



(Multiple responses allowed).

This is closely followed (47 percent) by other costs related to Dodd-Frank mandates, such as consumer protection and OTC-derivatives-related issues.

[2] (Consumer protection, OTC derivatives-related issues, etc.)
[3] Resulting from regulatory reform initiatives (such as Basel III and the Dodd-Frank Act)

Challenging business models

Evolving regulation has the potential to dramatically impact traditional banking business models.

Q: What issues pose the biggest threat to your business model?

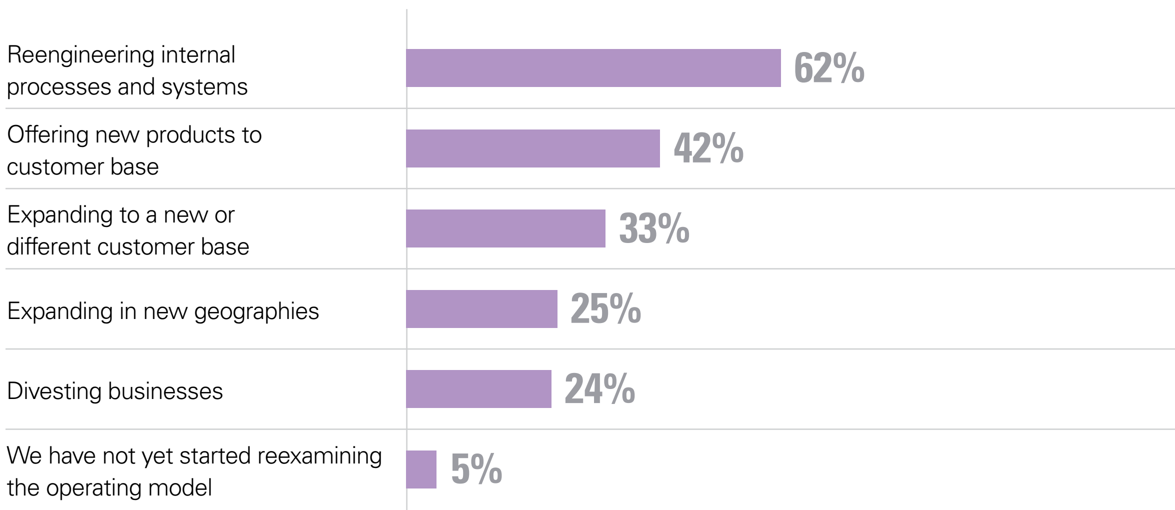
In fact, a large majority (77 percent) of survey respondents indicate that the top threat to their business models stems from political and regulatory uncertainty.

(Multiple responses allowed).

Changing the operating model

Last year, 90 percent of banks said that they had started reexamining their operating model. This year we asked executives to describe how their operating model had changed in response to economic and regulatory challenges.

Q: What aspects of your bank's operating model changed as a result of the economy and regulatory pressures?



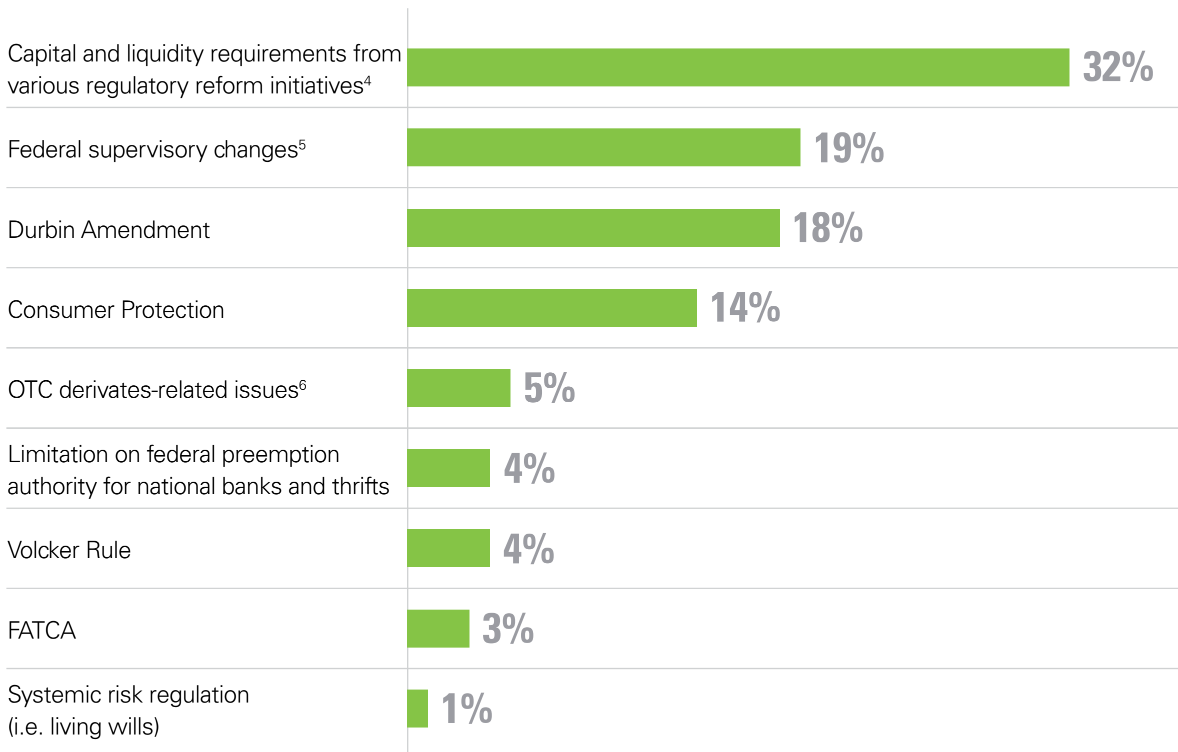
(Multiple responses allowed).

More than half (62 percent) of respondents noted that the greatest change resulted in the reengineering of internal processes and systems followed by introducing new products to their customer base. Encouragingly, a third (33 percent) of respondents indicated that their bank organization has expanded its offerings to new or different customers.

Regulations most affecting business

Of the types of government regulations listed below, respondents believe that capital and liquidity requirements from various regulatory reform initiatives, such as the Dodd-Frank Act and Basel III, are having the most impact on their business.

Q: Of the regulatory issues below, which has had the greatest impact on business?



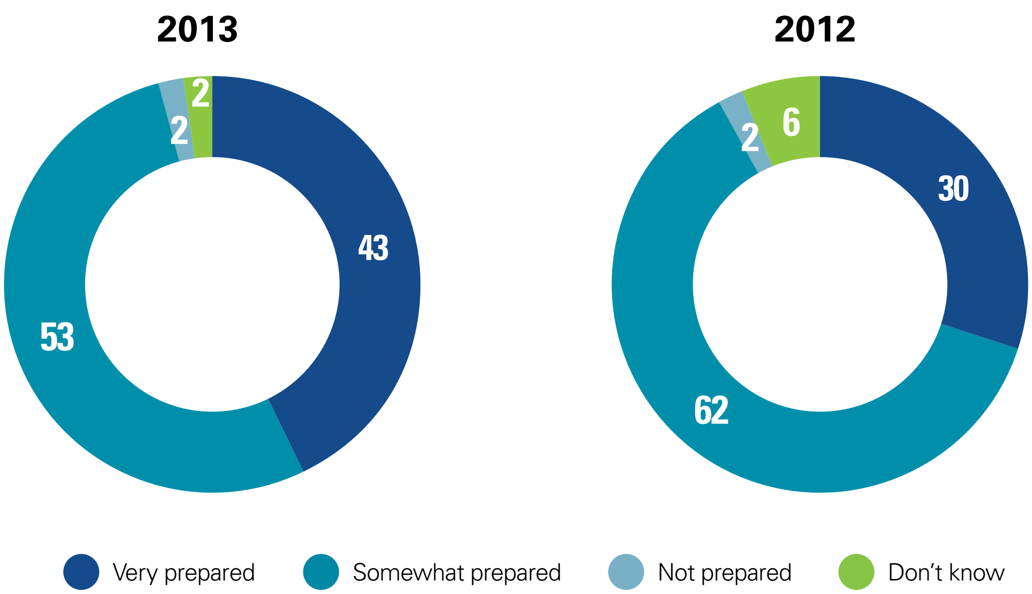
(Multiple responses allowed).

[4] *Reform such as the Dodd-Frank Act and Basel III*
[5] *Powers and duties of OTS being transferred to OCC, FDIC, Fed, and CFPB*
[6] *i.e.,swaps "push out" rule; clearing, trading, and reporting rules on Section 1256*

Seizing opportunities from regulatory change

Despite obvious challenges, executives are increasingly confident that their institutions are able to proactively manage the impact of public policy and regulatory reform.

Q: How prepared is your company to proactively manage the impact of public policy and regulatory changes?



"It's no surprise that bank executives continue to remain focused on dealing with regulatory-related matters due to the pervasive impact they are having on their respective institutions and, as a result, many are strengthening their risk management and compliance programs."

—Brian Stephens, National Sector Leader, Banking and Capital Markets, KPMG

Adopting a formal risk policy

Evolving regulation and changing marketplace dynamics have heightened the need for companies to implement a strong internal risk framework.

Q: What challenges exist within your organization that may impede or have impeded adopting a formal risk policy?

When asked to identify any existing challenges preventing the adoption of a formal risk policy, 43 percent of survey respondents believe that process integration and operational efficiency pose significant obstacles.

43%
Process integration/efficiency of operations

31%
Culture and behavior

30%
Governance framework

28%
Clearly defined roles and responsibilities

14%
Shared resources across the organization

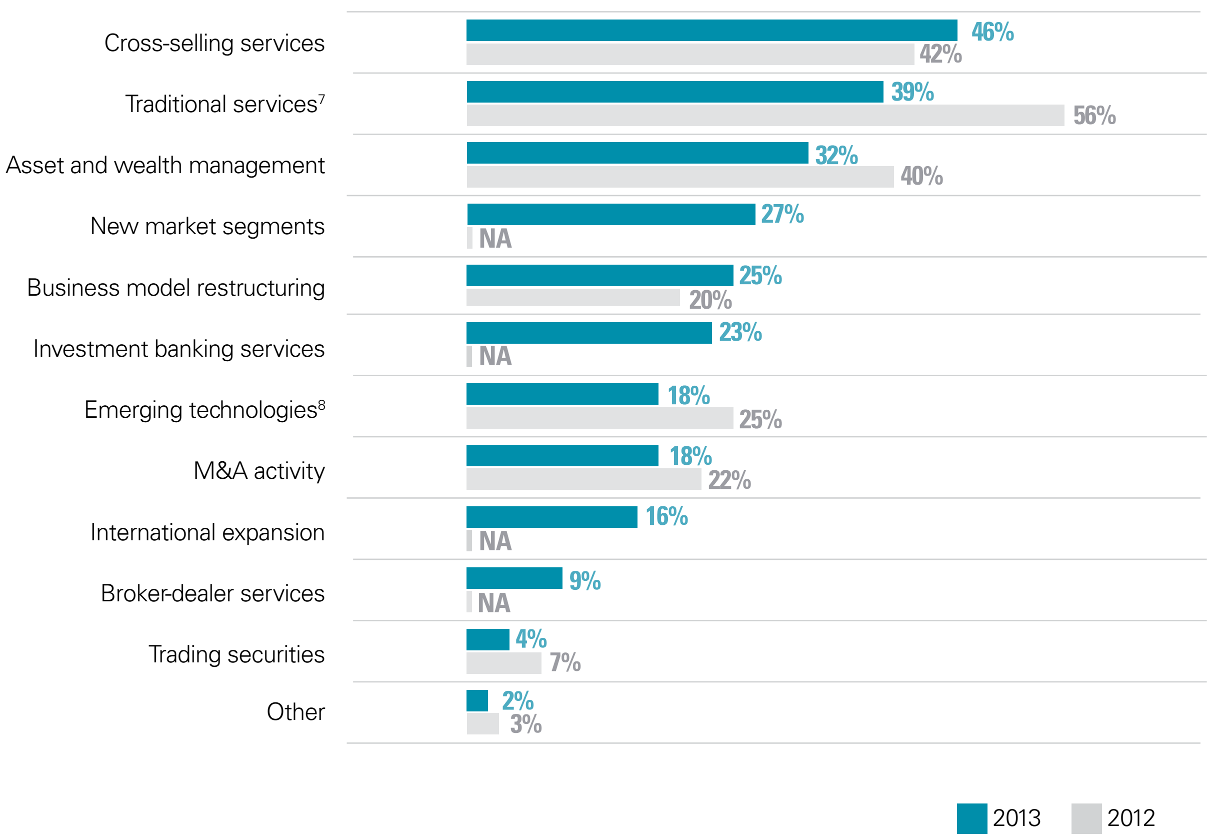
13%
Don't know

(Multiple responses allowed).

Driving revenue growth

While regulation is expected to hinder growth, executives predict that the cross-selling of services will be a key driver of revenue growth in the near future.

Q: Which of the following areas do you believe will be the three biggest drivers of your bank's revenue growth in the next 1-3 years?



Notably, traditional banking products are considered less of a revenue driver than last year, dropping to 39 percent from 56 percent of respondents last year.

[7] Loans, savings, mortgages, etc.
[8] i.e., mobile payments, etc.

Attracting the right customers

According to executives, specific customer segments such as the mass affluent (25 percent), young rising professionals (24 percent) and commercial customers (18 percent) offer the greatest growth opportunities for their institutions.

Q: Which of the following customer segments present the greatest growth opportunity for your bank?

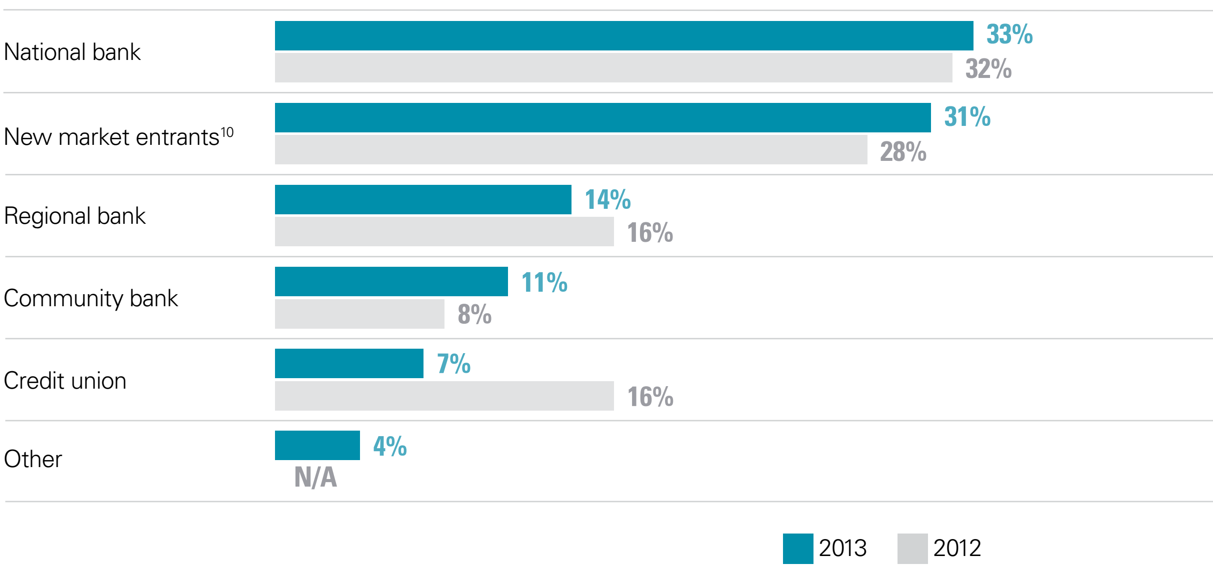
	% in 2013	% in 2012
Mass affluent (top 10% of income earners)	25	37
Young rising professionals[9]	24	23
Commercial customers	18	N/A
Consumers underbanked (consumers w/o access to incremental credit)	12	15
Consumers nearing retirement age (50–65)	11	19
Unbanked (consumers with no transaction account)	5	5
Retirees	5	1

[9] *(Upwardly mobile young professionals who earn good income, about to buy first home, etc.)*

Assessing the competition

Banking executives consider national banks (33 percent) and new market entrants (31 percent), such as PayPal and retail outlets like Wal-Mart, as the biggest competitive threat to their banks. These results are in line with last year's responses.

Q: Which of the following represents the biggest competitive threat to your bank?



[10] (PayPal, retail outlets such as Wal-Mart, etc.)

Spending more on IT

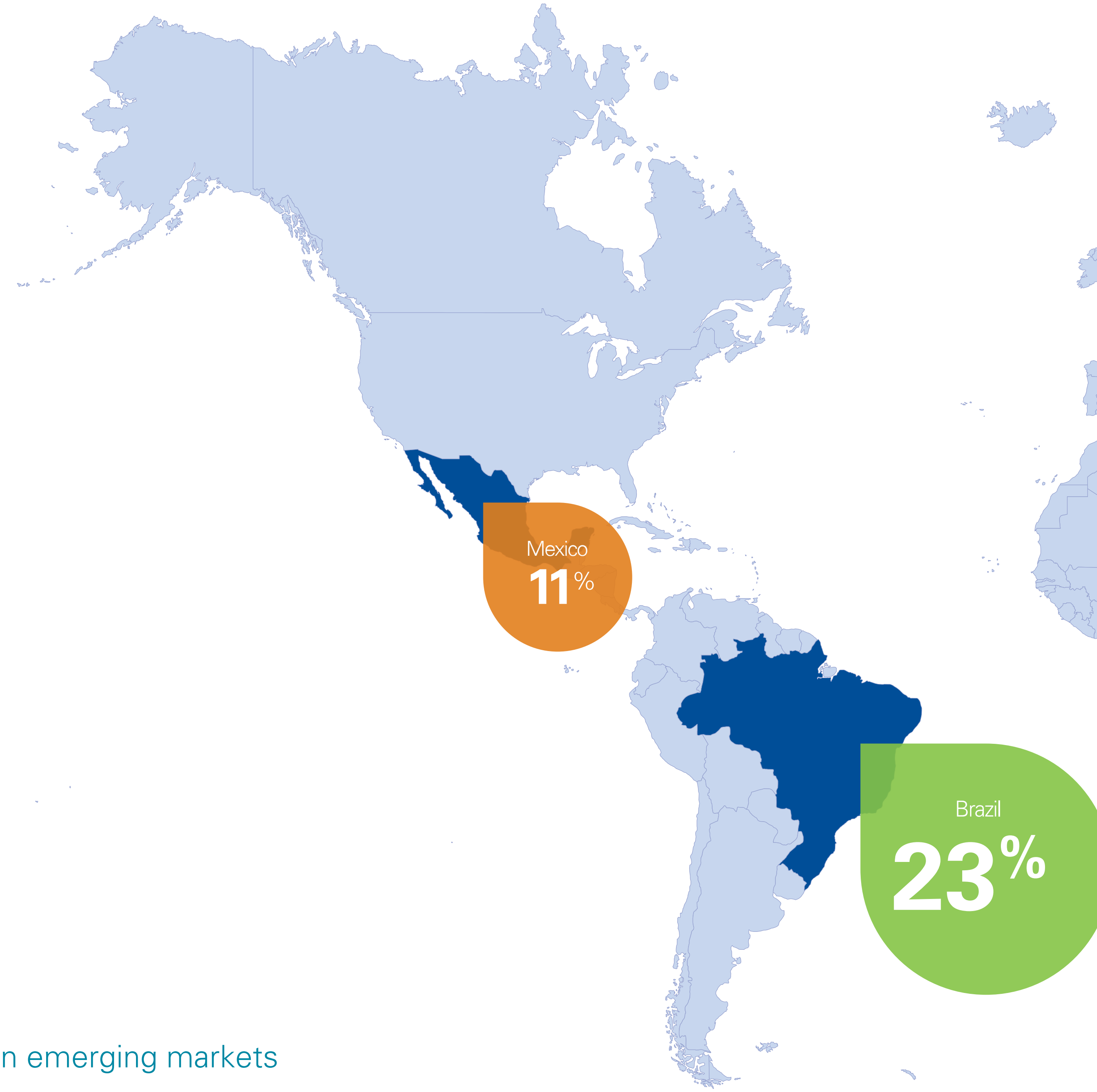
Nearly half (46 percent) of survey respondents predict their institution's capital spending will increase, while 34 percent expect it to stay the same.

Q: In which areas do you expect your company to increase spending the most over the next year?

	% in 2013	% in 2012
Information technology	54	58
Regulation/control environment	44	40
Geographic expansion	37	14
New products or services	29	37
Advertising and marketing	19	15
Business model transformation	17	20
Acquisition of a business	14	32
Employee compensation and training	11	13
Expanding facilities	5	5
Green/sustainability initiatives	4	8
Research and development	3	7

(Multiple responses allowed).

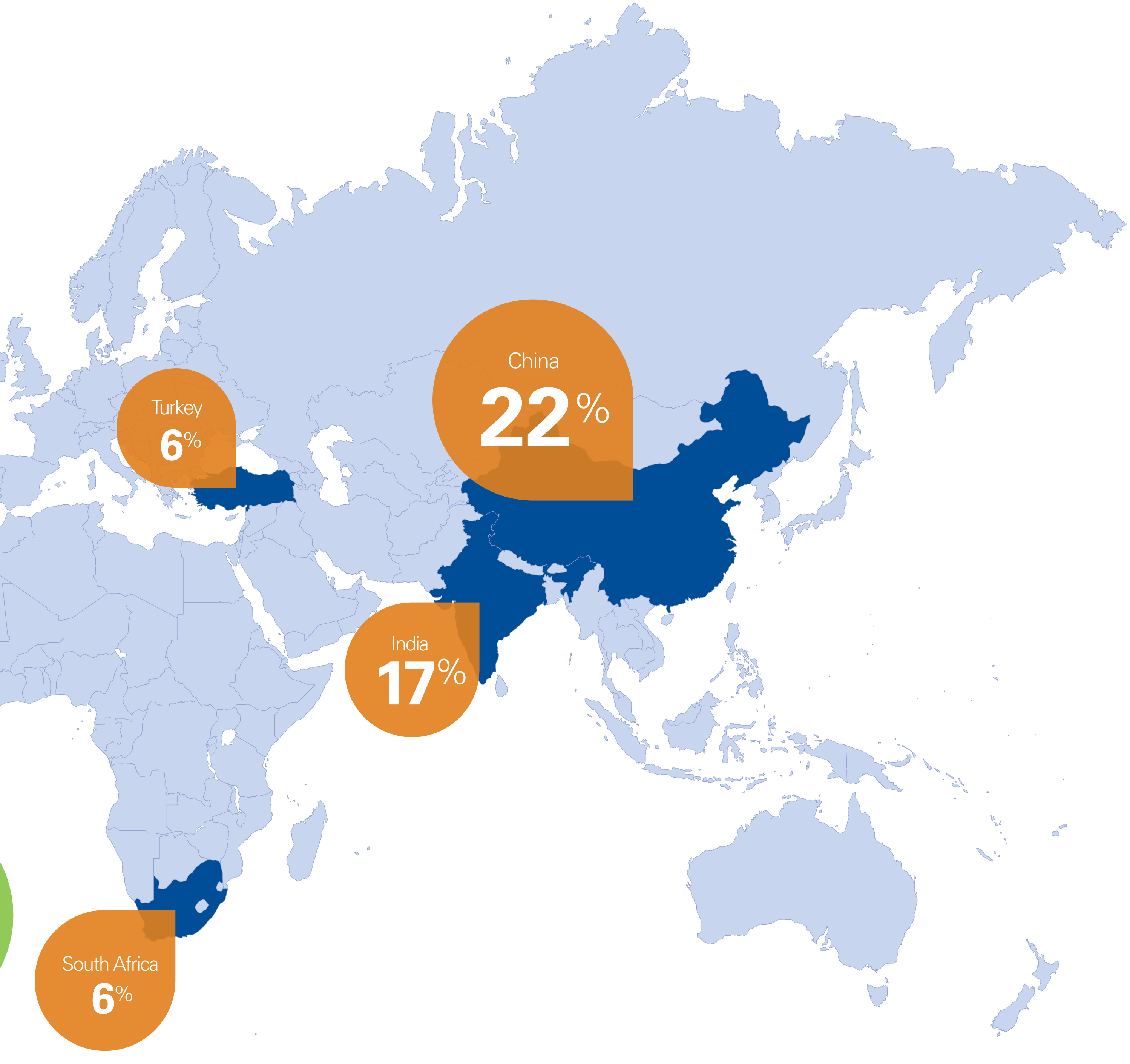
Much of this spending is expected in the areas of information technology, regulation/control environment, and geographic expansion.



Investing in emerging markets

Q: In which new high-growth emerging markets does your bank plan to make capital investments of more than $5 million over the next year?

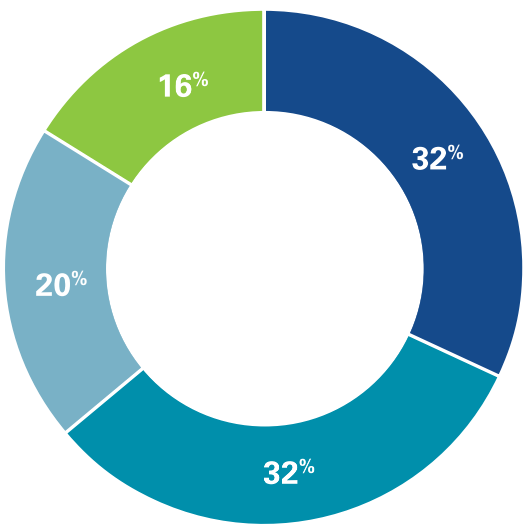
Of the survey respondents planning to make a $5 million or more investment in emerging markets, nearly one quarter (23 percent) said they would invest in Brazil.


Turkey
6%
China
22%
India
17%
South Africa
6%

Data focus for infrastructure and compliance

When it comes to IT investment, 64 percent of the executives surveyed believe leveraging data for infrastructure and compliance and platform simplification will dominate their focus over the next year.

Q: Which of the following IT-related projects will be the most important focus for your bank in the next year as it relates to infrastructure and compliance?

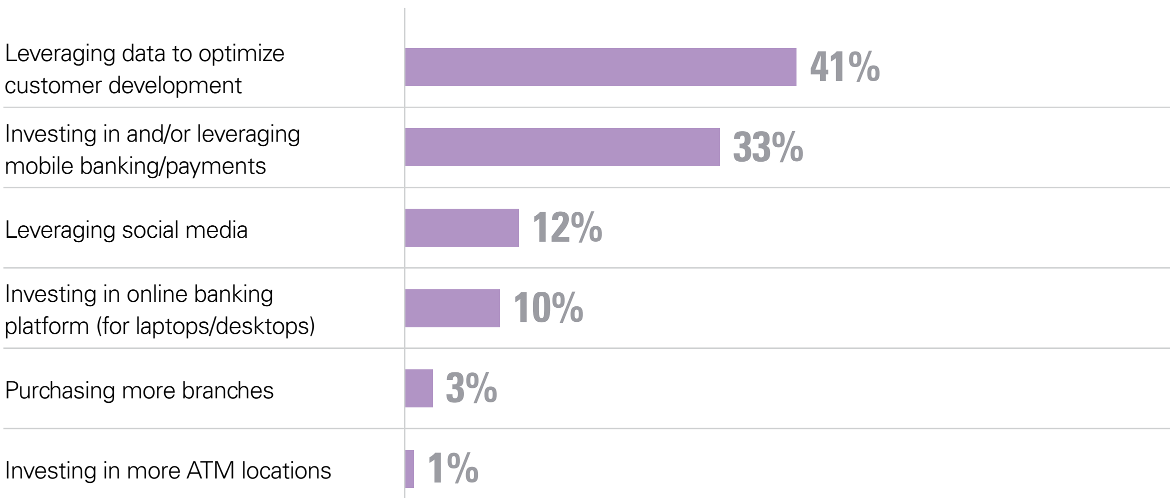


- Leveraging data more effectively for regulatory requirements — private companies
- Platform simplification (IT infrastructure, applications) — private companies
- Investing in mobile banking/payment platform (for mobile devices)
- Catching up on deferred maintenance

Data focus for customer growth

The growing importance of customer-centric banking strategies has catapulted the need for knowing your customers.

Q: Which of the following IT-related projects will be the most important focus for your bank in the next year as it relates to customer growth?

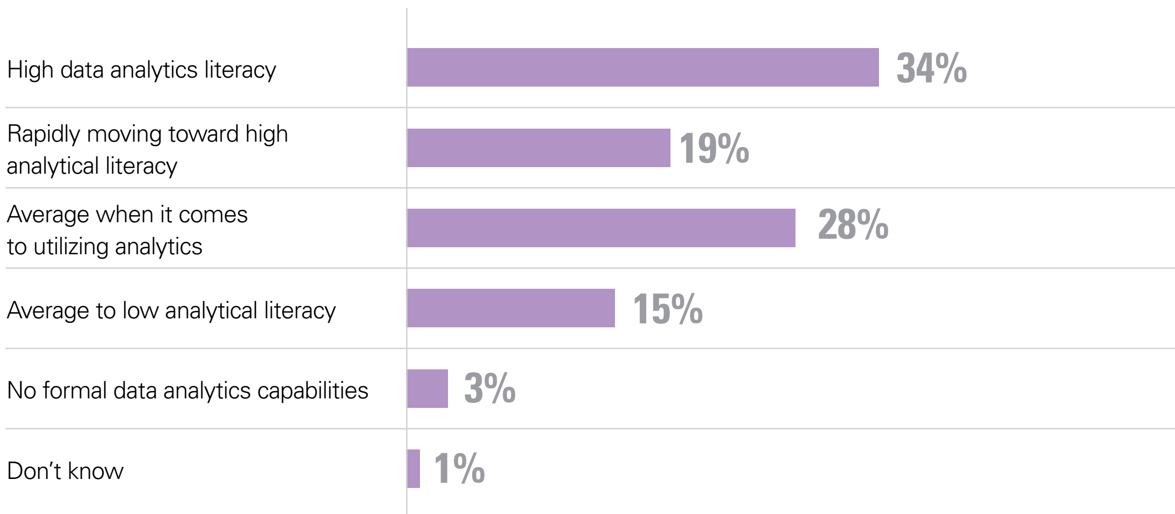


Therefore, it's easy to see why leveraging data to optimize customer development is a key initiative for bank executives, followed by the investment and deployment of mobile banking and mobile payments.

Growing awareness of data analytics

When asked to describe the organizational maturity regarding usage of data analytics, over half (53 percent) of executives rate the data analytics literacy of their organization as higher than average.

Which of the following best characterizes the data analytics maturity of your bank?



"Banks are becoming more actively engaged in using data and analytics to extrapolate insights that help improve risk management and compliance, drive customer growth, increase operational efficiency, develop and refine product offerings, and more. We expect this trend to continue as banks hire more data and analytics experts that can utilize information to help enhance business functions."

—Judd Caplain, Advisory Industry Leader for Banking and Diversified Financials, KPMG

Using data effectively

With Dodd-Frank regulations requiring more reporting transparency from banks, executives are embracing the recent advances in data analytics technology to increase their use of data aggregation to better predict risk issues.

Considering the relevance of data and analytics at your bank, which of the following items represent the best use of data and analytics in driving actionable insights?

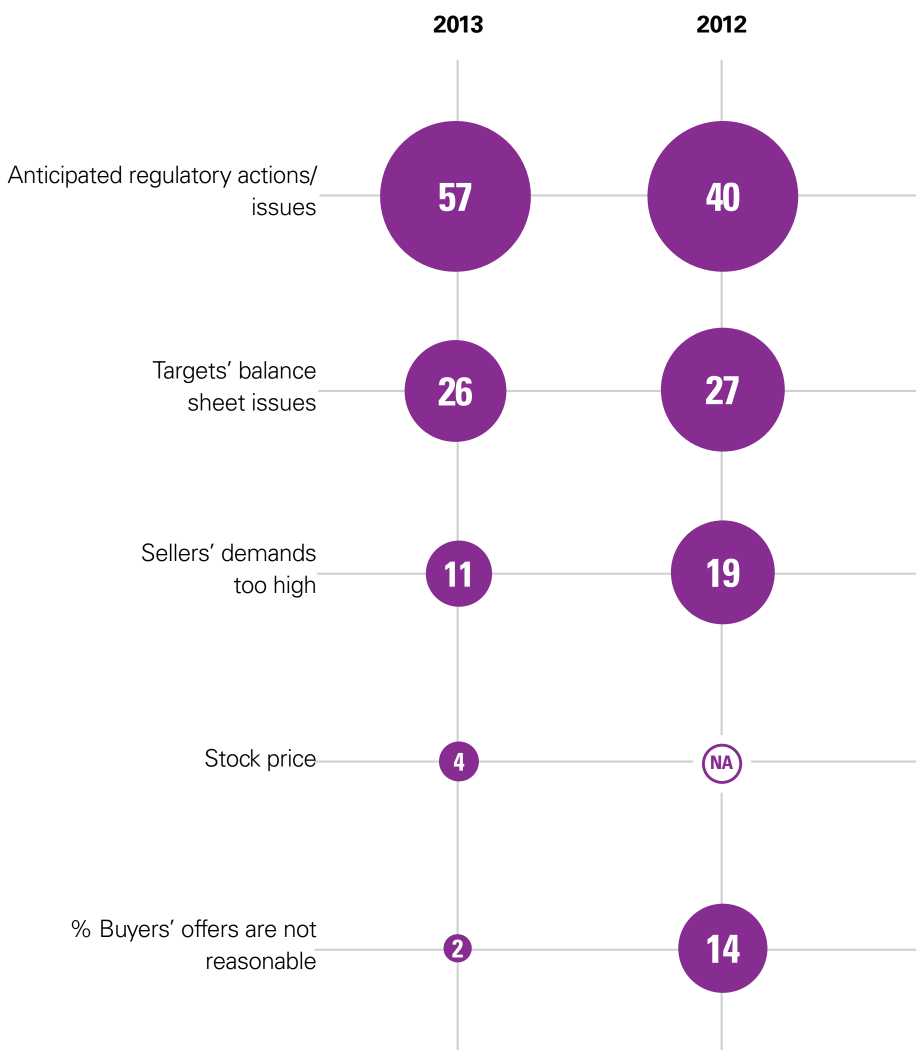
	Banking	Technology	Commercial Real Estate	Media & Telecom	Energy & Utilities	Food & Beverage	Insurance	Retail
Product positioning	20%	26%	18%	40%	16%	42%	30%	21%
Acquiring customers	32%	37%	32%	45%	19%	35%	35%	36%
Competitive intelligence	25%	30%	37%	28%	30%	32%	33%	26%
Human capital	7%	14%	16%	12%	15%	18%	10%	17%
Operational excellence (operations, supply chain)	33%	34%	39%	39%	48%	49%	27%	50%
IT infrastructure	25%	24%	20%	18%	20%	16%	17%	31%
Finance	16%	14%	29%	16%	14%	19%	21%	20%
Government regulation	24%	11%	10%	10%	22%	9%	13%	6%
Risk management	51%	15%	17%	12%	31%	9%	37%	9%
Other	2%	0%	1%	1%	3%	2%	0%	1%

(Multiple responses allowed).

Lackluster environment for M&A

Despite recurring predictions for a consolidation wave to occur in the banking sector, M&A activity once again failed to gain traction.

Q: What do you believe has been the greatest impediment to M&A in the banking industry?

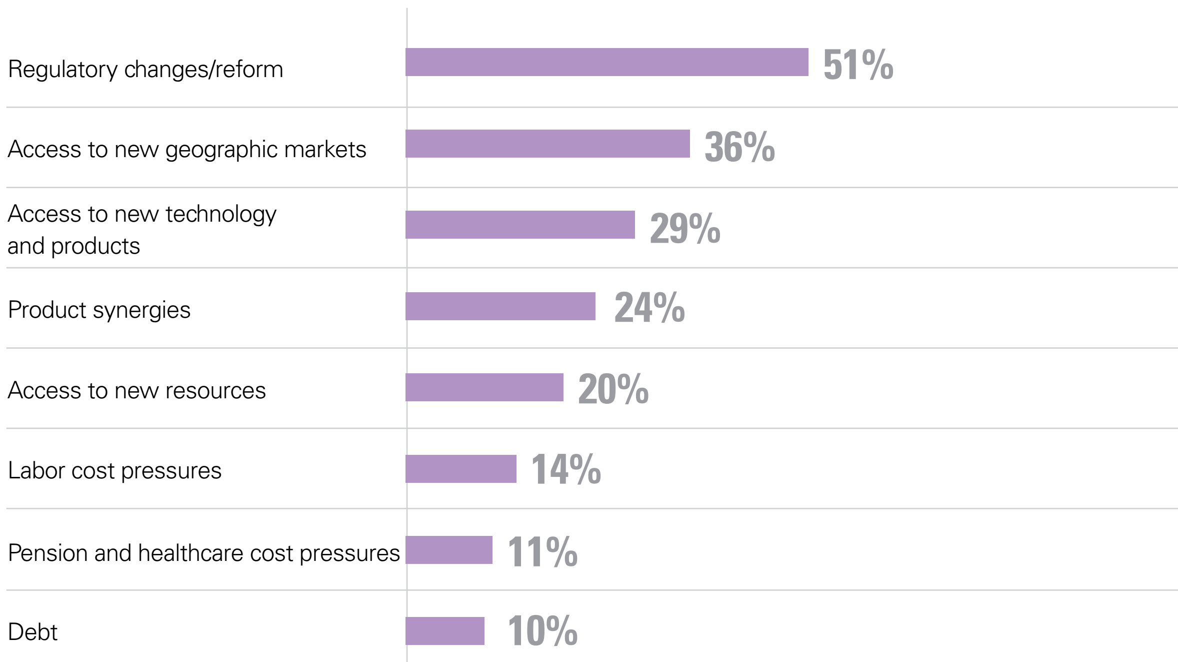


Fifty-seven percent of survey respondents believe that this is due to market uncertainty and anticipation of regulatory actions and related issues, such as the discrepancy between bid and ask prices.

Potential M&A drivers down the road

Meanwhile, 51 percent of survey respondents believe that regulatory reform will be a key driver of M&A in the future.

Q: Which of the following do you think will be among the most important drivers of alliances, mergers and acquisitions in the industry?



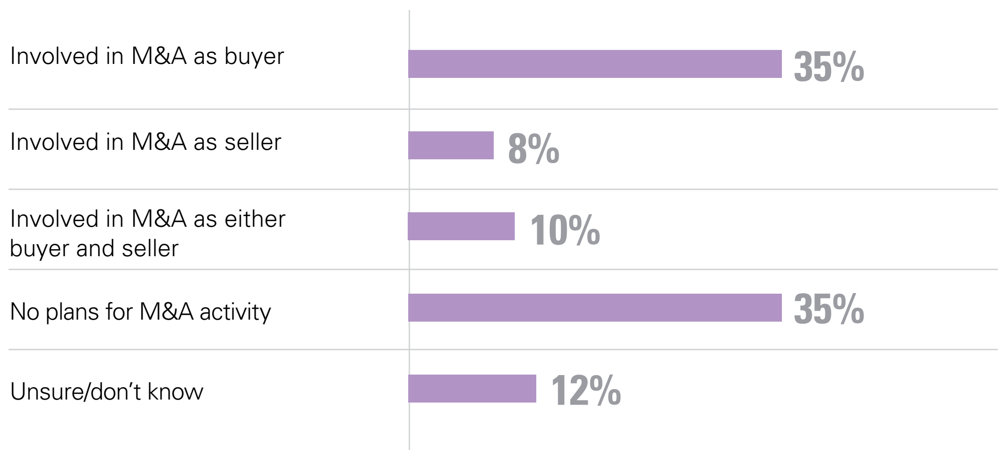
(Multiple responses allowed).

This is followed by new geographic markets (36 percent) and new technology (29 percent). These results closely mirror the responses seen in last year's survey.

Likelihood of M&A participation

Looking forward, 53 percent of banking executives think it is likely their institution will be involved in a merger or acquisition either as a buyer or seller over the next year.

Q: What is the likelihood that your firm will be involved in a merger or acquisition in the next year?



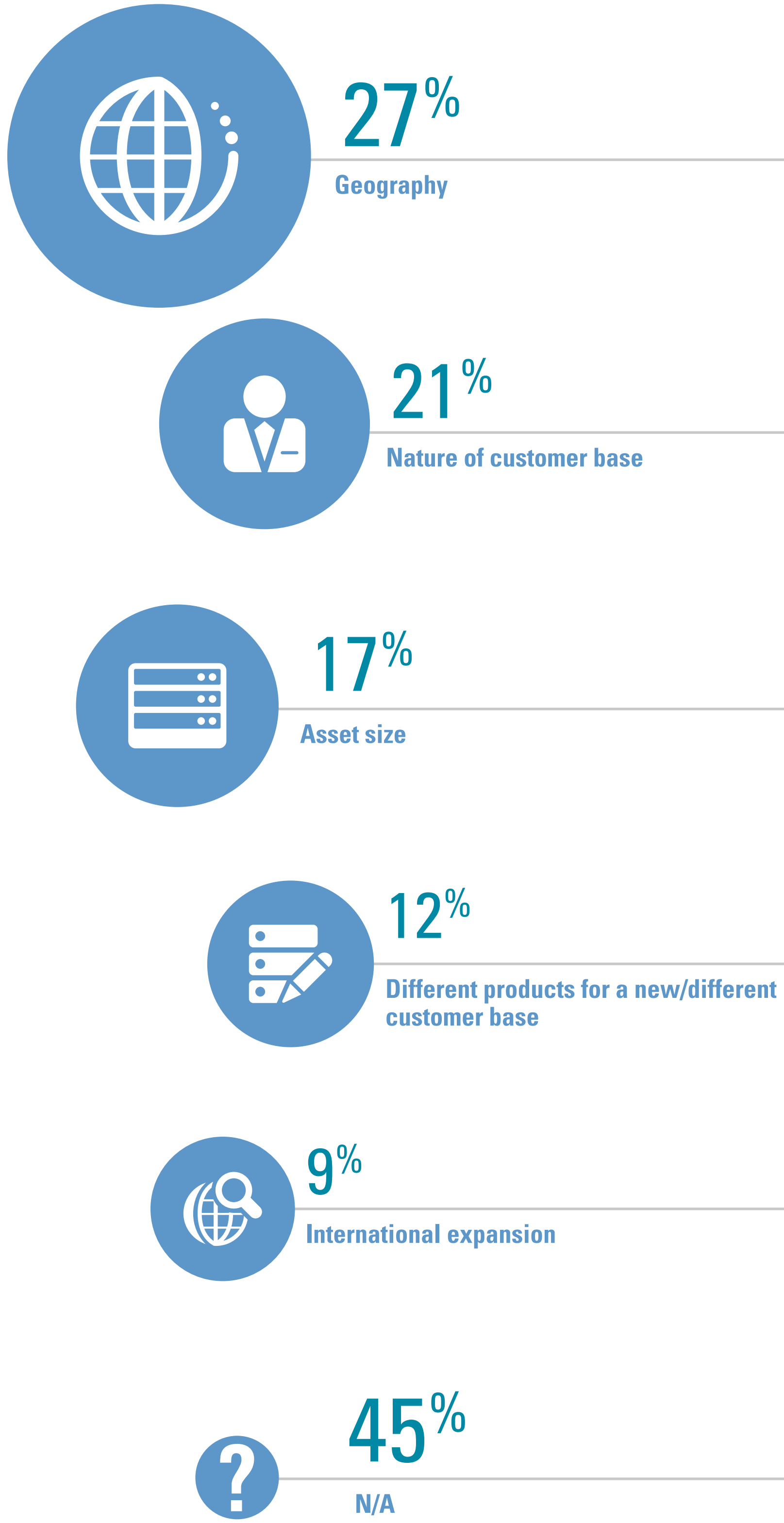
"The fact that bank executives view M&A activity as less likely over the next year is somewhat counterintuitive, as the economy and business fundamentals are improving, the value of bank currency in the form of stock has increased, and liquidity on bank balance sheets remains high. But the findings reinforce what we've been seeing in the marketplace as banking executives perceive deals as more difficult to get done due to the large gap between bid and ask prices, regulatory-related issues, and targets' balance sheet issues."

—Brian Stephens, National Sector Leader, Banking and Capital Markets, KPMG

M&A attributes

Geography will play the biggest role in targeting a potential deal candidate, according to 27 percent of survey respondents.

Q: If your bank is planning an M&A transaction in the next year, what criteria will be used in selecting your target?

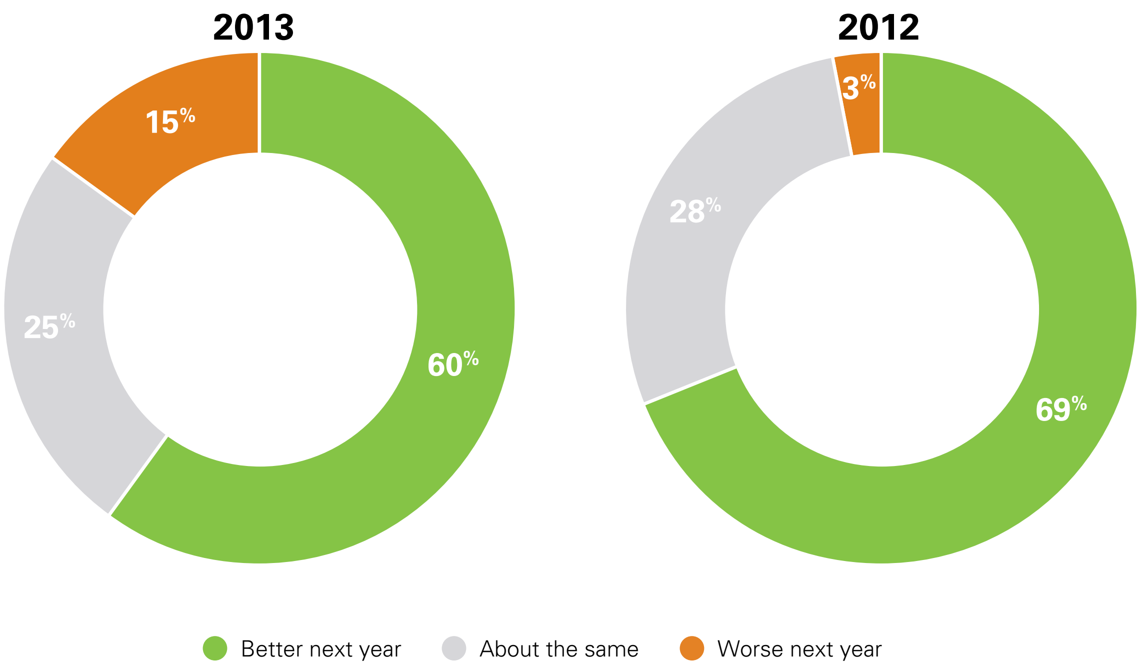


(Multiple responses allowed).

Economic outlook

Executives have a slightly tempered economic outlook for the coming year.

Q: A year from now, what are your expectations for the U.S. economy?

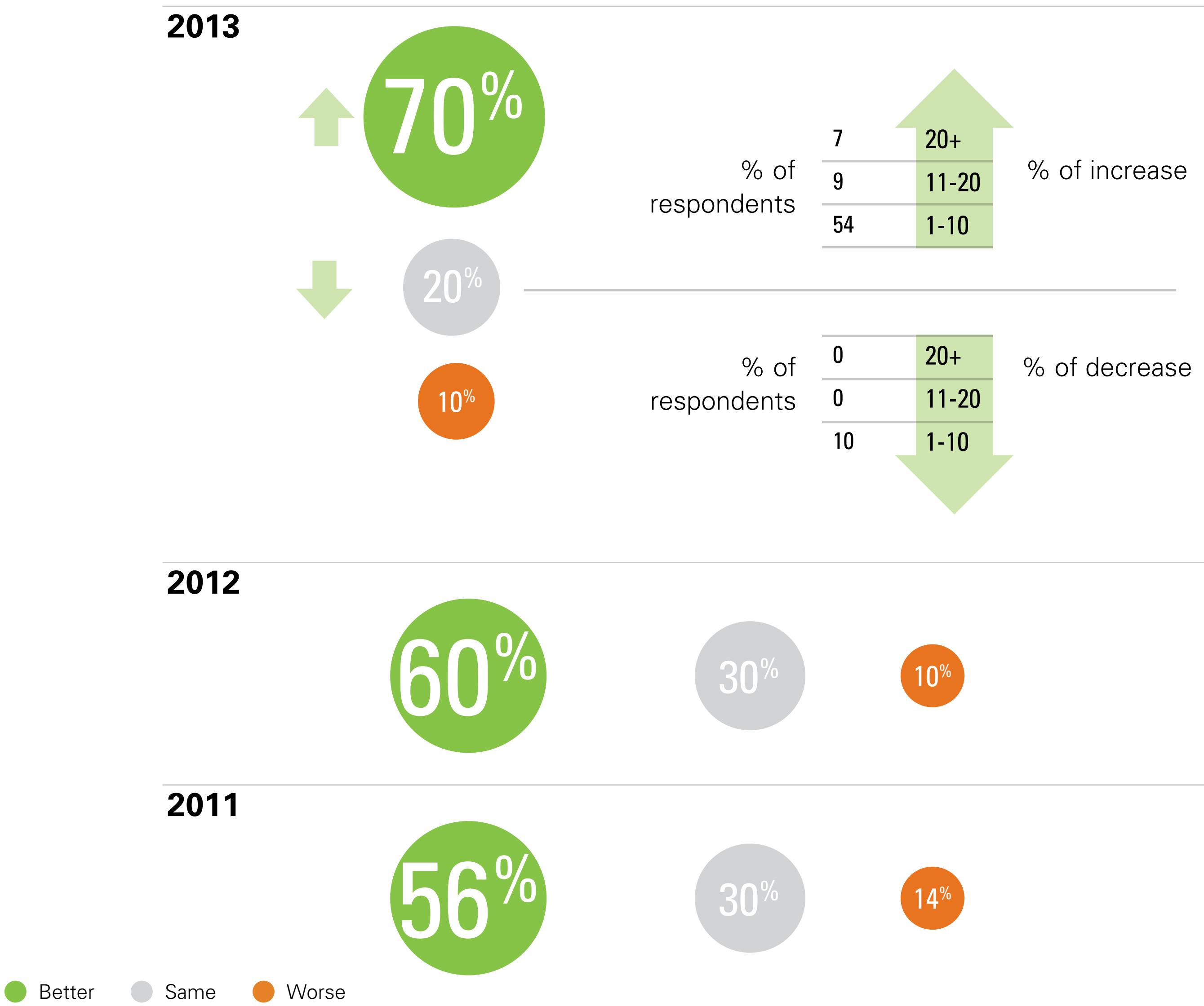


Sixty percent of respondents believe the economy will improve over the next year, which is slightly lower than 2012, when 69 percent thought so.

Current revenues

Revenues showed modest signs of improvement over last year.

Q: Compared with this time last year, how would you describe your company's current revenue?

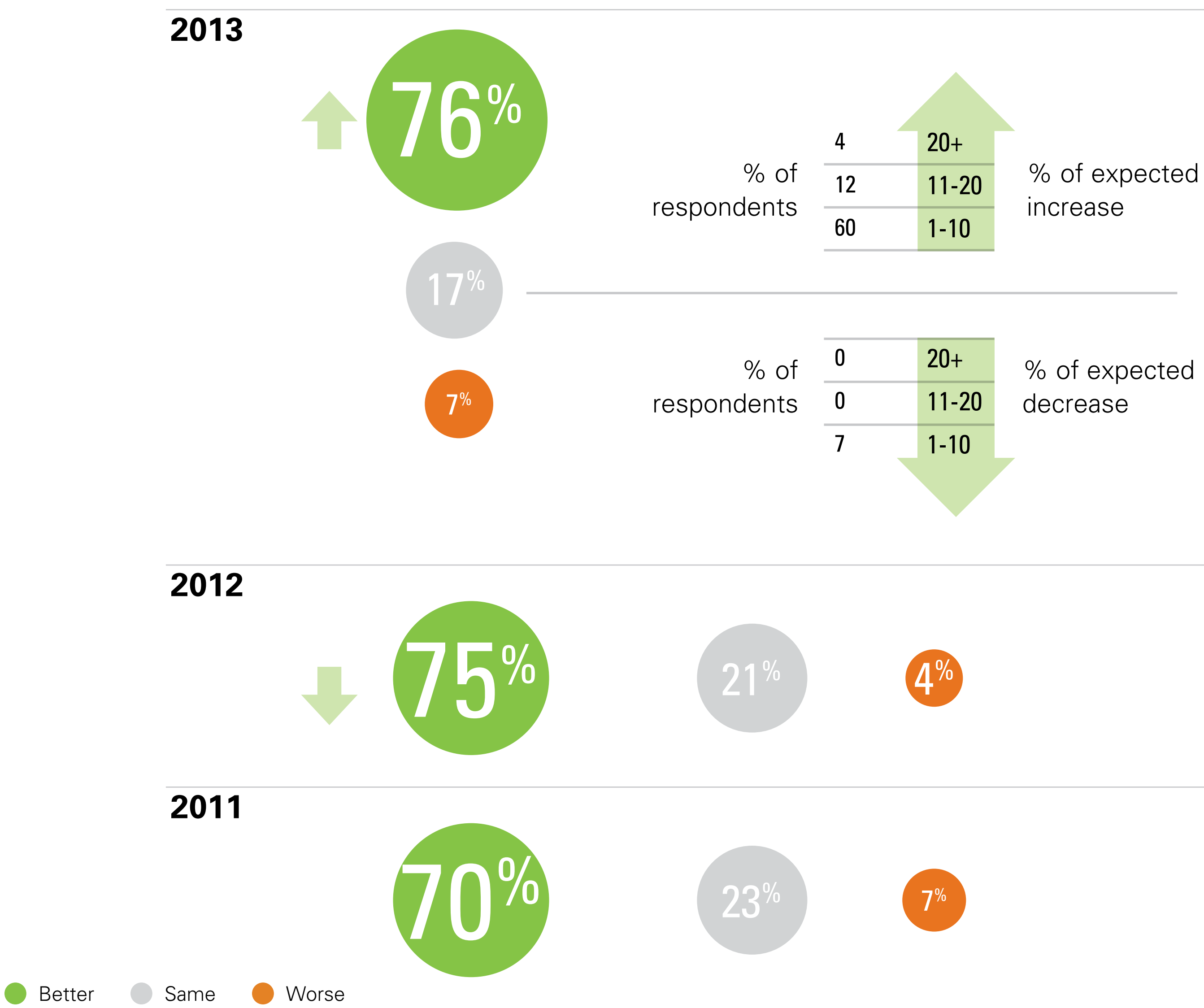


Seventy percent of respondents in 2013 reported an increase in revenues over the last year, up from 60 percent the previous year. The data also shows that executives in 2012 (75 percent) were fairly accurate in their prediction of increased revenue for 2013.

Revenue expectations

Most (76 percent) of the executives surveyed believe that revenues will increase, which closely mirrors the expectations of the previous year.

Q: What do you expect your bank's revenue to be like one year from now?

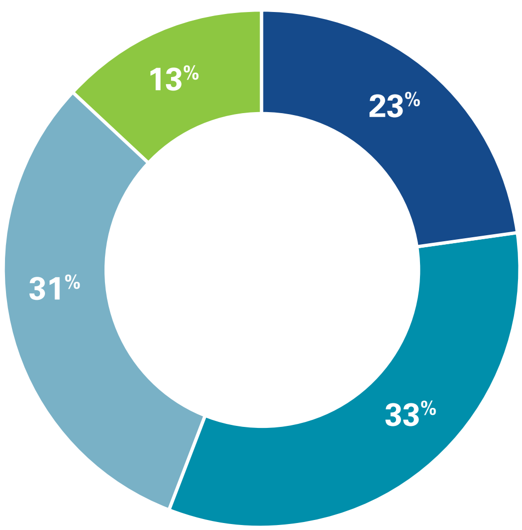


Lending

The significant majority of banking executives believe that their banks will increase both commercial and consumer lending over the next year.

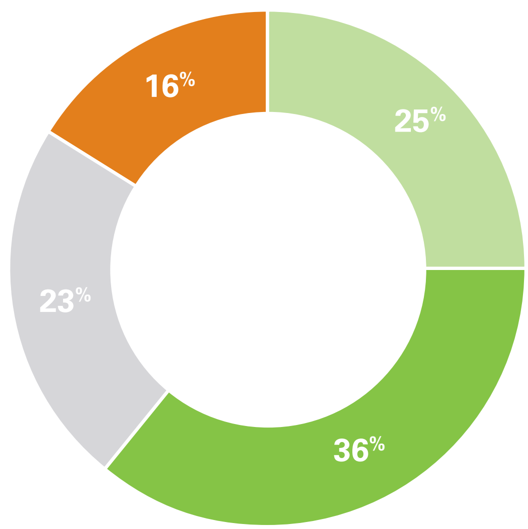
In the coming year, do you anticipate that your bank will increase lending?

Commercial lending



- Will significantly increase lending by over 10%
- Will moderately increase lending from 5–9%
- Will slightly increase lending 0–4%
- No increase in lending

Consumer lending

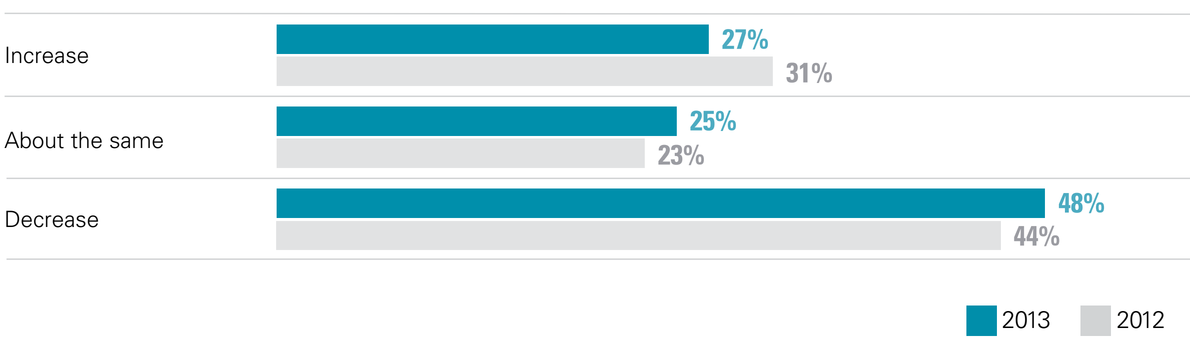


- Will significantly increase lending by over 10%
- Will moderately increase lending from 5–9%
- Will slightly increase lending 0–4%
- No increase in lending

Current headcount

The ongoing costs of regulatory compliance and other revenue impacts facing the banking sector may be impacting staffing levels.

Q: Compared with this time last year, how would you describe your company's current U.S. headcount?

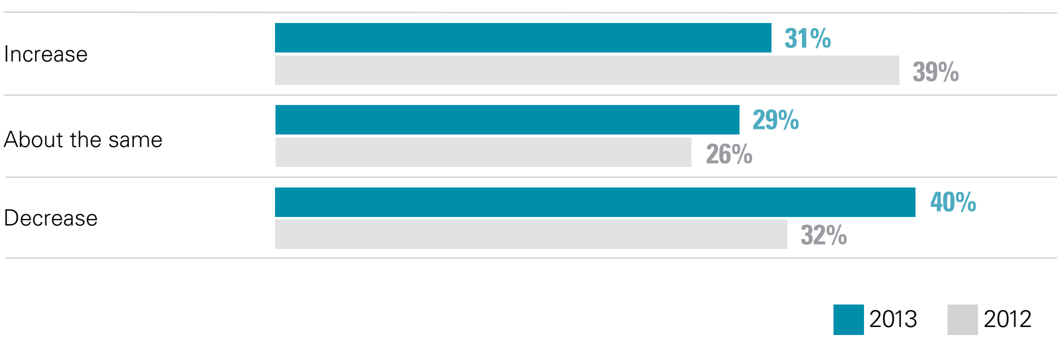


Executives report current headcount levels much lower than they had hoped for in last year's survey. For instance, 27 percent noted they added personnel over the last year, which is 12 percent less than this year's reality. In comparison, 48 percent of executives report a decrease in current headcount, which represents a 13 percent higher number of lost jobs than they anticipated in 2012.

Future headcount expected

Executives have similar expectations for the year ahead, with 31 percent predicting an increase in hiring and 40 percent expecting a decline in headcount.

Q: How do you expect your company's U.S. headcount to change one year from now?



Conclusion

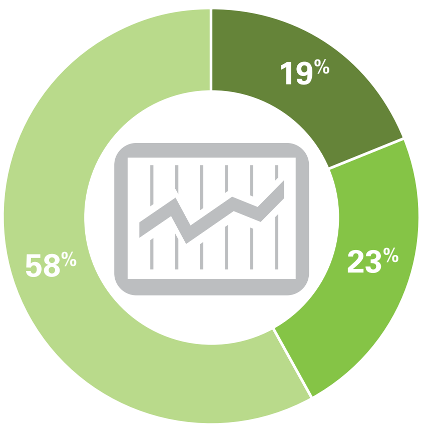
As we've seen, banking executives remain focused on dealing with regulatory-related matters since these are having a pervasive impact on their institutions. Forging ahead in this evolving regulatory environment will require fundamental changes to traditional business models and operating structures, while effectively managing the rising costs of reform and its impact on growth. Such changes are bringing about the need to redesign and implement governance and risk management frameworks that support the unfolding regulatory landscape, as well as managing the business complexities of a dynamic and fiercely competitive marketplace.

In the current climate of complex regulation, customer-centricity and narrow profit margins, it's clear the banking industry has no shortage of challenges. At the same time, many opportunities exist for those willing to accept and embrace a culture of change to help shape the strategic direction of the industry moving forward.

Demographics & methodology

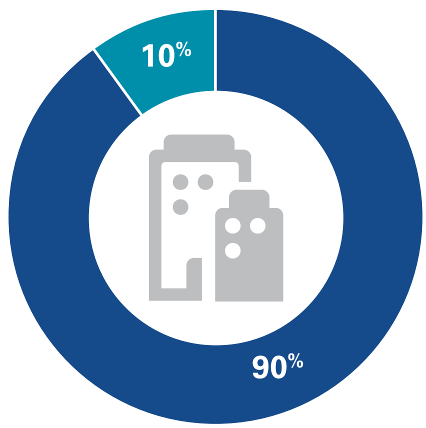
KPMG's 2013 Banking Industry Outlook survey reflects the viewpoints of 100 banking industry executives in the United States. It was conducted during the first quarter of 2013.

Revenue



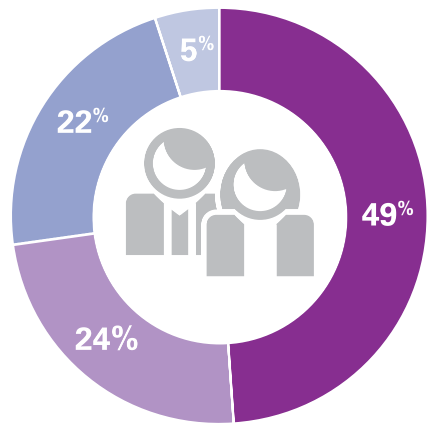
- $100 million to less than $1 billion (19%)
- $1 billion to $10 billion (23%)
- More than $10 billion (58%)

Company Type



- Public (90%)
- Private (10%)

Title/Position



- Senior Vice President or Director level (49%)
- Executive Vice President/Managing Director level (24%)
- C-Class (CFO, COO, CTO, etc) (22%)
- CEO, President (5%)

ABOUT KPMG

KPMG LLP, the audit, tax and advisory firm (kpmg.com/us), is the U.S. member firm of KPMG International Cooperative ("KPMG International"). KPMG International's member firms have 152,000 professionals, including more than 8,600 partners, in 156 countries.

Contact Us

Brian Stephens
National Sector Leader, Banking & Capital Markets
202-533-3534
bbstephens@kpmg.com

Judd Caplain
National Advisory Industry Leader, Banking & Capital Markets
212-872-6802
jcaplain@kpmg.com

Bill Cline
National Advisory Industry Leader, Banking & Capital Markets
704-335-5552
wcline@kpmg.com

John Depman
National Segment Leader, Banking & Capital Markets
267-256-1631
jdepman@kpmg.com

Mark Price
National Tax Leader, Banking & Capital Markets
202-533-4364
mhprice@kpmg.com

Dave Reavy
National Audit Leader, Banking & Capital Markets
212-909-5496
dreavy@kpmg.com

Peter Torrente
National Client Leader, Banking & Capital Markets
212-872-5815
ptorrente@kpmg.com

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