BEST IN BANKING 2016

AMERICAN BANKER

Bank of the Year: USAA

Community Bankers of the Year [p. 20]
Lifetime Achievement [p. 30]
Top Innovator [p. 34]

Jamie Warder, Bank president, USAA
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Greg Pratt, Military affairs relationship director, USAA

December 2016 | americanbanker.com
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Shortchanged
By Short-termism

To understand one way that the financial system fails the people it is meant to help, consider the story of three hypothetical sisters — triplets.

Each sister earned the same salary and saved the same amount of money for retirement over the same timeframe. But because they lived in different countries — one in the United States, one in the United Kingdom and one in the Netherlands — one of them ended up far better off financially in the end. The sister in the Netherlands accrued a nest egg 50% larger than the other two sisters.

The reason? Fewer fees going to intermediaries in asset management.

The extraction of fees — “through commissions most of you don’t really know about” — can add up to an enormous amount, said Stephen Davis, during a panel discussion at the University of Delaware’s John L. Weinberg Center for Corporate Governance in early November. The focus of the discussion was a new book, “What They Do With Your Money: How the Financial System Fails Us and How to Fix It,” which Davis co-wrote with two others also on the panel, John Lukomnik and David Pitt-Watson. The book calls our retirement savings a virtual ATM for Wall Street, with assorted fees going to as many as 16 intermediaries.

If you pay 2% in management fees a year — even though it doesn’t sound like a lot — “you would wind up with 50% less than you should have” for retirement, Davis said. At 1.5% in fees, you lose 38%.

“And part of the problem is we don’t really know where all that money goes,” he said. By “we,” he means not just the typical 401(k) saver, but also financial professionals. He cited an example of a pension fund for U.K. railway workers that hired an outside consultant to figure out how much it was paying in fees. Turns out, it was paying about four times the amount it expected — £290 million a year versus £75 million.

According to Pitt-Watson, the overarching question that needs to be asked is: What is the point of our financial services system and how is it delivering against its goals?

Rather than adopting regulations to manage specific issues that flare up, a smarter approach would be rethinking the governance of financial institutions more holistically, he said, noting that the book offers dozens of suggestions for improvements.

Among the changes the authors see as necessary is a shift away from the focus on daily fluctuations in stock prices and toward investing for the long term. That would help reign in excessive trading and make it less likely that questionable business practices at corporations would go unchallenged.

Decades ago, individual investors owned 70% of all equity in the United States. Today, institutional investors do. Though corporate boards have become more competent and more responsive to shareholders over the past 40 years, the shareholders — now that they are largely “huge financial bureaucracies” — have been lax, Davis said.

“They have not been sufficiently looking after our interests when they take equity in public companies. And as a result we have a lot of public companies with managers that have gone awry,” he said. “You only need to look at the 17 vivid minutes of Sen. Elizabeth Warren’s grilling of Wells Fargo CEO John Stumpf” — who resigned over its phony-accounts scandal not long after that hearing — “to see how much this can cause damage across the country and undermine trust in our business sector.”

Davis said the need to improve the governance of institutional investors is paramount. “How transparent are they? How accountable are they?” he asked. “I think what we conclude in the book is that they fall short in many ways.”

In his remarks, Lukomnik cited two research papers to illustrate that point. One study found that mutual funds that manage money for a company in its 401(k) plan disproportionately do not vote as a shareholder of that company in ways that have implicit criticisms of management. The other found that mutual funds that manage money for the 401(k) plans of companies own those companies disproportionately.

“So you add those two papers together and what you’re getting is disproportionate ownership by the people least inclined to do anything about poor management — little bit of a problem,” Lukomnik said.

The net result has been what they refer to in the book as “economic ADHD” — a system fixated on short-term goals. This kind of “short-termism” is irrational, expensive and destructive to the economy, Lukomnik said, adding that the fixes they suggest aren’t meant to be anti-capitalist.

“We are doing to Wall Street what Wall Street does to every other business,” he said. “They put out an analyst report and they say, ‘If you did this, you can make more money.’ What we’re saying is, ‘If you did these steps, the economy would grow faster’ and the financial system would be closer to fulfilling its purpose.”
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WITH LOW RATES CRIMPING MARGINS and loan growth spotty at best, many banks are mining their data to find existing customers — or prospects at other banks — who offer better-than-average potential for generating profits.

They’re getting an assist from credit bureaus, which are developing new ways to parse data and better profile those who fit an attractive niche.

In one example, banks are using a new Equifax product that identifies consumers who show signs they could move into the ranks of the mass affluent, if they could cut back on their spending.

There is even a nickname that retail consultants and bankers use for this demographic: high earners, not rich yet (HENRYs).

Many of the big banks are developing innovative ways to analyze data and generate marketing leads — in some cases, drawing on some type of alternative data, said Christine Barry, research director for Aite Group’s wholesale banking practice. Their goal is to increase the pool of potential new customers.

Figuring out a way to kick HENRYs up to a higher service tier can generate more fees for banks, said Brad Jones, retail banking leader at Equifax. It will cost banks more up front in marketing expenses, but the trade-off is that they can sell additional wealth-building or insurance products in the long run, he said.

“You may want to offer them a more expensive cost and service model, maybe for a fee, so you can show them you see the value in them,” Jones said.

Banks do possess scads of data themselves, but they need help to make it a source of actionable insight, said Christopher Liechty, vice president of marketing at the $1.5 billion-asset People’s Intermountain Bank in American Fork, Utah.

“All the data is there, but it’s all in different buckets,” Liechty said. “Getting everything into one place is a challenge.”

Equifax’s product helps banks find consumers who have too little in the way of investable assets to make them jump out as marketing targets, Jones said. The average HENRY has about $214,000 in assets, but the industry standard for an affluent customer is $1 million in assets.

The statistics show that HENRYs are especially promising. They’re young, with an average age of 43. They also make up about 13% of U.S. households and their average yearly income rose 8% from 2012 to 2015, to $135,865.

Their problem, however, is that they live it up, or they’ve amassed an oppressive amount of debt, such as student loans and auto loans. Many also live in urban areas where housing costs tend to be high, Jones said.

“These folks make a lot of money, and they spend a lot of money,” Jones said. “They’re just a few tweaks away from becoming mass affluent.”

Equifax’s HENRYs product uses alternative data points, such as the types of deposit accounts they have opened and the official code number for financial securities held in their portfolios. The data is then run through analytical criteria such as estimated financial capacity, likely investment style and demographic bits such as where a person lives.

The onus is on banks to reach these potential customers and to educate them on how to move into a higher service tier.

Eager to do some movin’ and groovin’ with HENRYs, banks mine data to find high earners

**By Andy Peters**
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The onus is on banks to reach these potential customers and to educate them on how to move into a higher service bracket, Jones said. The most effective lures for HENRYs are wealth management products and travel-based rewards credit cards, he said.

Rival data firms offer similar products, including TransUnion’s CreditVision Link and Experian’s Wealth Insight Services. FICO and Lexis/Nexis Risk Solutions also sell products along these lines, Barry said.

Banks can opt to search only their own customers’ data for targets, but that approach eliminates a huge portion of the population, said Brett Huff, an analyst at Stephens. It’s better for a bank to buy a data set from a vendor or credit bureau “so they don’t have to go find the extra data themselves or build a new analytical environment to do the math,” he said.

People’s Intermountain Bank recently purchased data on its own customers that it didn’t already have (from a vendor it declined to identify). The bank used the information to search for existing customers who could save money by refinancing a mortgage, Liechty said. The bank mailed letters to its customers, signed by individual loan officers with their direct phone numbers.

The effort generated enough new business that the bank would like to do more such projects.

“Our dream would be to do a couple of mailings like this on a monthly basis, but the reality is that we have limited time and budget,” Liechty said.

**What Banks Lack Online**

Can a nudge from Congress help propel online account opening?

**DESPITE CONSUMERS’ COMFORT with online and mobile banking, there is one function they still perform in person more often than not: opening an account.**

Experts say banks themselves are partly to blame for that. Digital account opening would more popular if only the tools for it — when they exist at all — were easier to use.

“As an industry, when it comes to remote account opening, I believe we’re underachieving,” said Andy Hernandez, the head of digital banking for Regions Financial in Birmingham, Ala. “Even for the largest banks in the country — all of us — the majority of the sales are still happening face to face in branches.”

Customers’ interest in using digital channels is on the rise. A report from Aite Group last year found that in the preceding 24 months, nearly one-fourth of new checking accounts had been opened using a computer or mobile device. The percentage is significantly higher when considering account openings that began online or via mobile and were completed at a branch, according to various surveys.

In light of changing consumer expectations, said David Albertazzi, a senior analyst at Aite, banks have to offer “a quick and simple experience that spares applicants a trip to the branch.”

Banks are ramping up to do that, and lawmakers are looking for ways to make it easier to comply with regulations and fight fraud while allowing customers to open accounts remotely. If these efforts work, before long a majority of customers, especially younger ones, could be signing up for checking and savings accounts on their phones.

Regions is among the banks leading the way. In January, the $125 billion-asset
company introduced an interactive tool that helps new customers decide which checking account best meets their needs. At the end they are given the option to sign up for an account online, rather than making an appointment to visit a branch.

Regions has seen an “exponential increase” in use of the tool since it launched and Hernandez said that the majority of users want to finish the process online. He declined to disclose the percentage of new accounts being opened online but said the tool has become so popular that Regions has since extended it to cover savings accounts, investment products and various types of loans.

But legal and technical hurdles remain for many banks. The biggest issue with online applications is one of identity, said Robert Rowe, vice president of regulatory compliance at the American Bankers Association. Simply put, a bank needs to know for certain that the person applying for an account “is that person,” Rowe said.

Such verification is essential not only to comply with federal Know Your Customer regulations but to prevent fraud. “There’s a lot of bad guys out there,” said Hernandez, “and that’s just the nature of this business.”

The solution sounds simple enough. Banks would like to take a picture of each customer’s driver’s license and keep it on file, Rowe said.

But there are obstacles. Five states – Colorado, Kansas, Mississippi, North Dakota and Tennessee – have laws that prevent banks from capturing and storing images of customers’ IDs. Two others, Illinois and Oregon, have restrictions. The patchwork of state regulations makes online account opening difficult for banks that have branches in multiple states.

Enter Congress. In October, two Republican lawmakers, Rep. Scott Tipton of Colorado and Rep. Randy Hultgren of Illinois, along with Rep. Terri Sewell, a Democrat from Alabama, introduced the Making Online Banking Initiation Legal and Easy (MOBILE) Act, which, if it passes, will supersede those laws and clarify that it is legal for banks in all states to electronically capture and store information from customers’ ID cards.

The bill would be most beneficial to people who lack close proximity to a bank, such as those in Colorado’s rural third district, which Tipton represents.

Along with verifying customers’ identities, the MOBILE Act could help reduce the “friction” involved in filling out forms using a smartphone keyboard. According to a survey released by the digital ID-verification startup Jumio, 94% of millennials want their banks to offer digital ID scanning as a way to confirm their identities and automatically fill out forms.

“Most people have smartphones and financial institutions have the technology” to serve customers digitally, an aide to Rep. Tipton said. “It’s a matter of having the law catch up.”

Banks are playing catch-up too. More than 50% of visits to Regions.com are now made using mobile devices, but until late September the bank’s online checking-account application wasn’t optimized for them. It is too soon to say just how well the mobile-responsive application is doing, but Hernandez said he is encouraged so far.

Aite’s Albertazzi said that 81% of new accounts today are being opened by millennials and Gen Xers. A large percentage of them – 37% of the former and 52% of the latter – start their applications online but wind up completing the process in a branch – perhaps because they can’t find answers to their questions on banks’ websites, he said.

The Jumio survey found that 80% of millennials had applied – or at least attempted to apply – for a bank account using a mobile device. Many ultimately abandoned the transactions because of banks’ technical shortcomings.

“There’s no doubt that today banks’ [online] solutions are not up to par,” Albertazzi said. “Once we see that resolved, we’re going to see the number [of online applications] spike.” – Brian Patrick Eha

A Legal Break At Last

Court ruling goes in favor of nonbank lenders this time

THE BIGGEST PLAYER IN PRIVATE student loans is, by far, SLM Corp., better known as Sallie Mae. But it hasn’t always been a bank.

Until 2010, the company primarily originated private student loans in partnership with banks, referring borrowers to third-party institutions and then purchasing the loans afterward.

This arrangement allows nonbank lenders to skirt state caps on the interest rates they can charge. Federal law allows banks to export the interest rate cap in their home state to other states with lower limits. By piggybacking on a bank’s charter, nonbank lenders can do so too.

This strategy is common among independent mortgage originators, payday lenders, and marketplace lenders. And a recent federal court decision affirming the right of a servicer to collect on private student loans originated on Sallie Mae’s behalf is good news for all of these lenders who rely on bank partnerships.

The plaintiffs in Jamie Beechum v. Navient Solutions argued that the interest rates on loans they obtained in 2003 and 2004 from a bank in Oklahoma exceeded the 10% general usury cap in their home state of California. In 2015, they sued Navient, the servicer of the loans.

But in September, the U.S. District Court for the Central District of California dismissed the case, based on the usury law exemption for national banks.

Two other recent cases had less favorable outcomes, including the high-profile Madden v. Midland Funding, in which the 2nd U.S. Circuit Court of Appeals found federal preemption of state usury laws available to banks no longer applied once the loan was sold to a nonbank and the originating bank no longer retained an interest in the loan. – Allison Bisbey
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WHEN ANDREW VARGA JOINED Republic Bank & Trust Co. in Louisville, Ky., about 16 months ago as its chief innovation and strategy officer, he was tasked with developing innovative products. In the early months, the former advertising executive and onetime chief marketing officer of Papa John’s brainstormed with Steve Trager, Republic’s chief executive, on various ways to ramp up the bank’s digital transformation. The idea that they settled on was ambitious. They decided to launch a digital-only bank, dubbed MemoryBank, that would stand apart from Republic and would use simplified products to court those in Generation X. The bank launched in late October.

“It was evident that this was the best opportunity for us,” as Republic has a small, regional footprint, and the digital bank can attract customers nationwide, Varga said in an interview. “From a branding perspective, we thought it was better to establish an entirely new brand name,” he added.

By launching MemoryBank, the $4.2 billion-asset Republic joins a small but growing list of banks that have digital-only arms. For instance, Customers Bancorp’s BankMobile, which focuses
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on millennials, has attracted 1.5 million customers since its January 2015 launch. BBVA has Simple, a neobank it acquired in 2014, and earlier this year Groupe BPCE acquired Fidor Bank, a German challenger bank.

But it’s difficult for a digital-only bank to scale up because many customers still want the option of face-to-face interaction that the branch network provides, said Mark Schwanhausser, director of omnichannel financial services at Javelin Strategy & Research. “Even the Simples and Moven of the world, which have a great concept and execution, find it tough,” he said.

One way for a digital-only bank to stand out is by positioning itself as “a financial guide” for the customer, Schwanhausser said. “If you can bring that to the digital world, and offer the customer a deep, digital financial relationship, that could be very appealing.”

While MemoryBank is envisioning a scenario similar to what Schwanhausser described, its first product is a bet on simplicity. Its EarnMore deposit account melds the functions of high-interest savings accounts and day-to-day checking accounts. It has a 1% annual percentage yield, an additional 0.5% on all deposits for the first year, no minimum balance and a Mastercard that offers cash-back rewards. “The banking world has too many products out there, and too much confusion,” Varga said.

MemoryBank has entered into agreements with ATM providers that give its customers access to 80,000 ATMs nationally, Varga said. Also, it mobile app supports remote deposit capture, and features Eyeprint ID and fingerprint ID login functionality.

MemoryBank customers can reach bank representatives via a call center or live chat from their mobile device. Varga said the bank has “already gotten great feedback” from its beta customers. He added that the bank aims to have 20,000 to 30,000 active deposit accounts in the first year.

According to Republic’s third-quarter earnings, the bank has spent $754,000 on its digital bank initiative. Varga said most of that was earmarked for MemoryBank, though some went toward improving Republic’s digital offerings.

Starting a digital bank can be an attractive option for those banks that want to break free of their existing legacy infrastructure and bond with customers through a new brand, said Nicole Sturgill, principal executive advisor at CEB.

“The challenge is to not just recreate the traditional products and services under a new name, but to offer new products and services that meet customers’ needs better than anything on the market,” she said. “Biometric security and personalized alerts are a good start.”

MemoryBank is hoping to differentiate itself by going after Gen-Xers. Varga said the bank sees Gen-Xers, defined loosely as those born from the late 1960s through the early 1980s, as the ideal customer. They are typically comfortable with technology, but have accrued more wealth than millennials.

“You have millennials on the one end. They are really digital but haven’t accumulated much wealth yet. And the boomers on the other end. They have money and are dipping their toe in the water [of digital] but not completely gravitating there,” Varga said. “We felt Gen X was where the greatest return on investment was.”

Sturgill agrees that courting Gen X is a smart move. “So much of the marketing bandwidth is focused on millennials and the transfer of wealth from boomers to millennials that it’s easy to overlook Gen X, which has unique and vast financial needs at this stage of their lives,” she said.

But the approach has to go further than just marketing, Sturgill added. “To be revolutionary, MemoryBank will need to add services that meet Gen X-specific needs, such as college savings plans for their children and financial planning for elder care,” she said.

To attract customers, MemoryBank is using digital ads and, in select markets, television spots and billboards. The ad messages have a nostalgic aspect. The ad messages have a nostalgic aspect. The ad messages have a nostalgic aspect. The ad messages have a nostalgic aspect. Varga said. After all, 1990s nostalgia is trending and this demographic, just by the virtue of their age, has amassed more memories than its younger counterparts.

Indeed, Varga said the name MemoryBank is meant to invoke “the literal idea of digital storage with the positive emotional memories collected over a lifetime.”

To Pay or Not to Pay

With ransomware on the rise, banks ponder how to respond to attacks

Banks and their customers grapple with ransomware, a form of malware that encrypts files and databases and keeps them locked until the victim pays a ransom, typically in the digital currency bitcoin.

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In a September alert, the FBI said that new ransomware variants are emerging regularly, and Beazley, an insurance company that provides protection against ransomware attacks, said it’s seeing a 400% increase in ransomware attempts among its clients this year, with 20% of those targeting financial institutions.

At Bank of the West, “we’ve seen a significant increase in ransomware attempts on the bank as well as among our customers,” said David Pollino, deputy chief security officer. “Anyone who’s not taking ransomware seriously needs to re-evaluate their security approach.”

Financial services victims tend to be smaller banks and credit unions, according to Paul Nikhinson, data breach response manager at Beazley. “A Bank of America or Chase has taken the technical controls to make this be a hiccup but not a crisis,” he said. "A $100 million credit

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To Pay or Not to Pay

With ransomware on the rise, banks ponder how to respond to attacks

CYBERCRIMINALS HAVE BEEN RAMPED up ransomware attacks, with financial services firms as one of their top targets.

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One contributing factor in the rise of ransomware is bitcoin, which, despite the auditability of the public blockchain, can be difficult to trace if users know how to cover their tracks. Money orders don’t work because they have to be sent to an address that can be tracked.

“Without a mechanism to get your ransom in an anonymous fashion, this isn’t something that could work long term, “ Nikhinson said. “Bitcoin has significantly helped this become a big deal.”

The ransom amounts tend to be small numbers of bitcoin, which equates to hundreds or thousands of dollars. Pollino speculates that the tactic might be a way to avoid attention from law enforcement. A large sum could get regional or even international authorities interested.

Banks and their customers grapple with the question of whether the ransom should be paid. The FBI at one point suggested victims in some cases should pay up. In its September bulletin, however, it reversed that guidance.

“Paying a ransom does not guarantee the victim will regain access to their data; in fact, some individuals or organizations are never provided with decryption keys after paying a ransom,” the agency wrote.

To help with the decision of whether to pay, one thing Nikhinson’s company does is try to figure out which ring is behind the attack. “Certain groups are known to be more reliable in the sense that if you pay them, they do what they say, versus others, not so much,” he said.

“If you pay, you’re making yourself more likely to get attacked again — you go on a list of folks that are willing to pay ransom,” Nikhinson said. “But if you’re running a bank and you’re going to be in trouble unless you pay these guys $5,000 to give you your data back, you might have a different thought process.”

Victims are usually given tight deadlines, such as 24 hours, within which to pay. It can be a scramble to get the bitcoin fast enough.

“I’ve seen folks drive cross-state to find a bitcoin ATM to get the bitcoin in time to do all this,” Nikhinson said.

“What’s been fascinating to me is some of the new attack groups have created customer service departments that will help walk customers through the process.”

— By Penny Crosman
Not unlike the military, USAA’s corporate culture eschews stars and insurance conglomerate — which focuses on those in the military as innovation. And it’s why our annual Banker of the Year award isn’t celebrating teamwork. That ethos is a big reason the banking and its customers going forward.

By Kevin Wack | Photography by Jeff Wilson
From left to right: Greg Pratt, military affairs relationship director; Paul Vincent, senior vice president, bank operations and direct channels; Maggie Hahn, military affairs relationship director; Jamie Warder, president of USAA Bank; Prianka Advani, assistant vice president of daily experiences; Vikram Parekh, assistant vice president of savings assurance; John Harrell, vice president of mortgage product management.

BANK OF THE YEAR: USAA

Not unlike the military, USAA’s corporate culture eschews stars and insurance conglomerate — which focuses on those in the military as innovation. And it’s why our annual Banker of the Year award isn’t celebrates teamwork. That ethos is a big reason the banking and its customers — is an industry pacesetter in customer service and going to a single individual as it usually does.

From left to right: Greg Pratt, military affairs relationship director; Paul Vincent, senior vice president, bank operations and direct channels; Maggie Hahn, military affairs relationship director; Jamie Warder, president of USAA Bank; Prianka Advani, assistant vice president of daily experiences; Vikram Parekh, assistant vice president of savings assurance; John Harrell, vice president of mortgage product management.
It looks a bit like a doorbell that has yet to be installed, or perhaps the most rudimentary remote control you’ve ever seen.

It’s a small, unadorned, blue and white device that features a single button. You can place it in your car, beside the bathroom sink, on top of the microwave, wherever you want. If you press the button once a day, $1 gets transferred from your checking account into savings. Press it a second time, and you transfer an additional $2.

The Saver Button is an experiment by USAA, meant to encourage its customers to set aside a little money each day. The idea is to make savings a habit, like brushing your teeth or washing the dishes. Rather than relying on reason — “Let me explain why saving is good for you” — the button is an attempt to engage the instinctive part of the brain. It’s an appeal to the inner toddler in all of us.

“See a button, want to push it?” Vikram Parekh, a USAA executive who is running the trial, explained.

USAA, the military-focused banking and insurance conglomerate, is testing the Saver Button with hundreds of its customers this fall. The company is tracking where users place the buttons and how often they press them.

If the experiment is deemed a success, USAA might eventually send a Saver Button to everyone who opens a bank account. And if the devices wind up in junk drawers, the failure will happen quickly and without rancor, and the folks who volunteered to test the buttons will have a quirky souvenir to keep.

“Will it work? Will it not work? I don’t know,” Parekh said.

USAA is fundamentally different from other large banks, and the Saver Button study illustrates two key reasons why.

First, the experiment demonstrates the company’s commitment to improving the long-term financial health of its depositors. Banks often pay lip service to this concept, but USAA does far better than most of its competitors in aligning its interests with those of its customers.

Second, the Saver Button experiment is an example of USAA’s nimble, failure-is-not-a-dirty-word approach to innovation. The San Antonio-based company has embraced internal processes popularized in Silicon Valley in an effort to keep up with the rapidly evolving expectations of its customers.

USAA stands out in other ways too. The $144 billion-asset company, which serves only current and former members of the military and their families, elicits unusually strong loyalty from its customers (or “members,” as it likes to say). Long a pioneer of operating without a large branch network, USAA now stands on the leading edge of the digital banking revolution.

Traditionally, American Banker names a Banker of the Year, an honor that gets bestowed on a single individual. But USAA has a corporate culture that — much like the U.S. military — eschews stars and celebrates teamwork. And it has earned the more fitting distinction as our Bank of the Year for 2016.

Yes, Sir, Lieutenant

USAA was founded in 1922 by a group of 25 Army officers. Automobile sales were soaring, and military men were having trouble insuring their Model Ts and Studebakers since they moved frequently from base to base. The officers gathered at the Gunter Hotel in downtown San Antonio and formed their own insurer, which was originally called the United States Army Automobile Insurance Association.

“Nobody would insure them, and so they got together and insured each other,” says Carl Liebert, USAA’s chief operating officer.

The company’s name was eventually shortened to United States Automobile Association, and over the years USAA sprouted into the nation’s 22nd-largest financial holding company. Its membership ranks were expanded beyond just officers, to include all current and former members of the military, as well as their spouses and children. Today the company has 11.7 million members.

Despite all the growth, USAA has retained the same basic ownership structure — it remains privately held, which protects against the quarter-to-quarter mindset that often drives decision-making at publicly traded companies. And members continue to share in the profits. Last year USAA insurance policyholders received roughly $1 billion in dividends and other distributions.

USAA got its banking charter in 1983. And even in its early years in banking, it never operated a big branch network. Members often made transactions using the company’s toll-free phone number. A geographically untethered bank for members of the military filled a real niche — service members were still moving frequently in the 1980s, just as they did in the 1920s, so they had little reason to open accounts at locally based institutions. And USAA worked to become indispensable in the lives of its members.

An important part of the formula was, and remains, a demonstrable respect for its members. USAA’s advertising carries
and the tag line “We know what it means to serve.” At the company’s sprawling headquarters, American flags are everywhere. During a recent visit, preparations were underway for events marking Oct. 13 as the birthday of the U.S. Navy.

Roughly a quarter of USAA’s 29,000 employees are either former members of the military or their spouses. That list includes Chief Executive Officer Stuart Parker, a former Air Force combat pilot who says the company – having been founded by people in the military for people in the military – is on a mission to understand its members’ needs and to work to meet those needs.

“We put our members first,” Parker said. “They deserve nothing less than our absolute best.”

USAA’s new employees get trained on certain basics of the armed services, including the phonetic alphabet – Alpha, Bravo, Charlie, etc. – which they may hear during phone calls with members.

Call center representatives in San Antonio greet members by their military rank if that is how their profile says they prefer to be addressed. Inside the company, employees joke about the proverbial 80-year-old retired military officer who calls USAA just to hear someone greet him as “Lieutenant.”

“Our members would tell you USAA is their company. I’ve had 60-year members put their finger in my chest – not negatively, but they’ll say, ‘Sonny, what are you doing with my company today?’” said Greg Pratt, a military-affairs relationship director for USAA. “They feel that the company’s been good to them for so many years; they want to know that we’re still taking care of it.”

Customer-experience metrics back up that assertion. A recent report by Temkin Group found that USAA’s members are more likely to recommend the company to a friend or relative than customers of other big banks and even credit unions.

USAA recorded a net promoter score of 62 for its banking business – higher than any other bank studied, and 30 points above the industry average. USAA’s scores also were ahead of highly respected consumer brands like Apple, Amazon and Trader Joe’s.

“I think a strong customer focus is ingrained in the culture of the organization,” said Bruce Temkin, managing partner of Temkin Group.

USAA’s culture is especially notable in light of the scandal at Wells Fargo. On a recent fall day, USAA was holding an internal event where Warder and a few other executives offered feedback to employees who were making presentations. The bigwigs wanted to put the presenters at ease, so they decided to wear costumes. Warder dressed up as the shock jock Howard Stern.

Later that day, after shedding his long black curly wig, Warder sat down in his office for an interview. Only hours earlier, the news had broken that Wells Fargo CEO John Stumpf was resigning amid the scandal there.

Warder said that before taking the job at USAA, he figured that the company’s key competitive advantage was its low expense base, which stems from the fact that it does not have a big branch network. But over the last year and a half, he concluded that USAA’s real secret sauce is its mission, which focuses on facilitating the financial security of members.

“Just like Wells’ culture was cross-sell, our culture is member first, mission first, always,” Warder said. “If you really boil the mission down, it’s just, ‘Don’t goof our members,’ just, ‘Do right by our members.’ ”

There are lots of examples of that philosophy in action.

DECEMBER 2016 AMERICAN BANKER 17
USAA's checking accounts do not include monthly service fees. Variable interest rates on credit cards start at a rock-bottom 7.15%.

USAA does not charge overdraft fees on debit card transactions. It's exploring the concept of real-time overdraft, which would give users the option to pay an overdraft fee before completing a specific transaction, in much the same way that out-of-network ATMs users are asked whether they want to accept a fee.

"We're not driven by more profit or more revenue," said Paul Vincent, senior vice president of bank operations and direct channels at USAA.

USAA has proven willing to invest in projects that may benefit its members even if they will not have a short-term financial payoff for USAA. An example is the company’s efforts to encourage members to save more. Roughly a third of USAA’s members live paycheck to paycheck, and the company is investing significant resources into figuring out how to get them to save more. The Saver Button is one experiment, but others are in the works.

Anne Arvia, USAA’s senior vice president of primary banking, said that when she joined the company, she was astounded by the extent to which the corporate culture was biased in favor of helping customers. "This bias is what the success of USAA is," she said.

If the U.S. banking industry is looking for an antidote to the reputational hit it has taken from the Wells Fargo scandal, USAA’s compensation scheme could provide a useful model. The company does not grant incentive pay based on a particular employee’s performance; instead, everyone’s bonus is based on a single score that’s generated for the entire organization.

But Warder said that when it comes to doing what’s in the best interest of the company’s members, there is room for improvement.

Even though employees’ pay is not linked to their own sales, the sales performance of individuals does get tracked internally at USAA. In the future Warder wants to do away with that tracking.

He wants employees to have no reason to care whether a customer chooses a USAA product or one from a competitor, which might be offering a better deal. "I want to get to the point ... where our employees are absolutely, completely, 100% indifferent," he said. "I think we can get to the point where we don’t even have to track it, we don’t even talk about it."

The Tweaks Never Stop
Inside a big church hall across town from the company’s headquarters, scores of USAA employees are huddling in front of dozens of large posterboards. There are baked goods to munch on. The room looks less like a corporate setting and more like a seventh-grade science fair.

This is a quarterly exercise known as "big-room planning" – an opportunity for teams of USAA employees to map out, in fine detail, how they will spend the next three months. The idea is that if everyone spends a few days planning under the same roof – not just business people, but lawyers and information technology folks too – everyone will save time later on.

USAA is adopting a so-called agile framework for developing software, and big-room planning is part of that effort. The basic goal is to act more like the nimble fintech startups that are trying to take USAA’s customers.

"I think the world has changed," Warder said. "It’s, ‘How easy are you?’, ‘How fast are you?’, ‘How do you compare to Amazon and Netflix?’ Not how do you compare to other banks.”

There is a lot of talk on USAA’s campus about the need to focus on user experiences, rather than products. To that end, the company has identified 250 discrete banking "experiences" – depositing a check through a mobile phone is one example, and making a credit card payment is another. One midlevel executive gets put in charge of continually improving each experience and is given the resources to make that happen.

The goal is to create an endless process of tweaks based on the needs and preferences of users. One recent example involved making improvements to

"If you really boil the mission down, it’s just, ‘Don’t goof our members,’ " says Jamie Warder, a former Army officer and president of USAA Bank.
at Javelin Strategy & Research, said that USAA is competing directly with the largest U.S. banks, which are investing heavily in their mobile apps, and is more than holding its own.

He said that USAA is on par with the megabanks with respect to digital banking functionality, but has an edge in user experience. “When it comes to how satisfied their customers are with how they deliver that functionality, USAA is often head and shoulders above the top five banks,” Higdon said.

But Can This Model Be Copied?
USAA has certainly had missteps. In September the company announced plans to close 17 of its 21 financial centers across the country, reversing a physical expansion that began in 2009. Executives attributed the decision to a shift in customer preferences toward digital channels.

In the mortgage business, USAA has struggled to adjust to the post-crisis environment. Before the financial meltdown, the company did not require mortgage applicants to provide full documentation, according to John Harrell, its vice president of mortgage product management. That became a problem when the Dodd-Frank Act brought a slew of new requirements.

In mortgages, “our service levels have not really been up to standard – the USAA standard,” Harrell said.

USAA embarked on a process of rebuilding its mortgage business from the ground up in 2014, and Harrell said the effort is starting to pay off. “We’ve been on defense for two years,” he said. “Now we’re going on offense.”

Its regulatory challenges are not limited to the mortgage business. Warder said that USAA is just like other banks that need to evolve in the face of changing regulations.

“I don’t see us as being ahead of the industry,” he said. “We’ve got problems and headaches as big as any bank our size out there. We’re fighting the fight every day. We’re making mistakes. We’ve got to get better.”

But even if USAA looks like other banks in some ways, overall it is something of an odd duck — a membership-based, privately owned institution that has $77 billion in banking assets but does no commercial lending.

There is no doubt that USAA’s business model is working from a financial standpoint. USAA Federal Savings Bank, which accounts for the bulk of the company’s banking business, has doubled its assets over the last six and a half years. And compared with all banks with more than $10 billion in assets, it has recorded a higher return on equity for 34 consecutive quarters.

So here’s the big question: Is USAA’s strategy replicable?
Steven Reider, founder of the consulting firm Bancography, has his doubts. He notes that USAA relies heavily on affinity-based marketing, much like credit unions do. Other banks have tried that approach — Amalgamated Bank, which is known for its ties to unions, is reaching out to political progressives across the country — but none have found as much success as USAA.

“I see that as nearly impossible to replicate,” Reider said.

USAA’s Warder argues that it is possible to find success in banking by mimicking the critical ingredient of the company’s formula: the focus on its members’ financial well-being.

Banks that have a reputation as places that look for ways to nickel-and-dime their customers will have a hard time overcoming those negative perceptions. Warder urges patience.

“You can’t declare tonight I’m going to be, you know, the trusted bank,” he said. “I think it takes time and history.”
It was September 2008—a few days after Freddie Mac and Fannie Mae were taken into conservatorship and a few days before Lehman Brothers imploded—when Center Financial announced that Kevin Kim would join its board as part of an effort to recruit a new generation of leaders.

The lawyer and former accountant had no reservations despite the daily headlines. While the banking industry was clearly in crisis, the extent of it was underestimated.

Many thought the trouble was concentrated in mortgages and would mostly hurt big banks. The expectation was that smaller institutions focused on areas such as commercial real estate and small-business lending would be spared.

Kim certainly believed that about Center, a well-respected institution started by Korean entrepreneurs in Los Angeles.

“They paid a nice dividend and the stock price was pretty good,” Kim recalled. “Then I joined and soon earnings turned to losses.”

Kim’s title expanded over the years, from director to chairman and chief executive. He became CEO of the parent company in March 2013 and of the bank unit in April 2014.

But he played an active role in the company’s strategic direction from the start.

Kim pushed Center to raise capital and avoid disaster in 2009. His business acumen and agreeable demeanor helped bring two of the biggest Korean-American banks together in 2010, creating BBCN Bancorp. The institution then set out to diversify its business and become less reliant on commercial real estate.

Earlier this year, the 59-year-old Kim led BBCN through another Koreatown merger, this time with Wilshire Bancorp. It is now the nation’s largest Korean-American bank, with assets of $13.5 billion and offices in nine states.

Although the Wilshire deal is still fresh, Kim’s deft hand in steering the company—which has been renamed Hope Bancorp—has investors, board members and analysts optimistic.

Rescue and Rev Up

It didn’t take long for Kim’s fresh perspective to be put to use.

By 2009, the crisis had cratered the economy. Community bank failures were quickly piling up. Center’s losses were eroding capital and it became apparent to Kim that the company needed to raise money.

Many other directors—largely the founders whose net worth was wrapped up in Center—didn’t see it so clearly. It was easier for Kim, who was trained as an auditor and didn’t have a significant ownership stake, to recognize the seriousness of the trouble.

“They were very resistant,” Kim said. “The stock price was pretty low and all they could remember was how expensive their shares were about a year [earlier]. But that was the past, that’s gone.”

Center announced in December 2009 that it had raised $86.3 million. “In hindsight, had we not raised capital at that time, the bank might have failed,” Kim said.

Now a survivor, Center had to figure out what to do in the new banking climate. The crisis had changed banking; adding loans would be tougher and earnings would be thinner. Center’s board decided one of the best bets was the Koreatown neighborhood.

Koreatown, the Los Angeles neighborhood many Korean-American banks call home, had already seen its fair share of bank consolidation, but Kim and other industry observers also described the market as one with a lot of egos that can make dealmaking tough.

The four major Korean-American banks at the time: Center, Hanmi Bank, Nara Bank and Wilshire, each with $2 billion to $3 billion in assets.

Center decided its best potential partner was the $3 billion-asset Nara. And Center’s board picked Kim to lead the negotiations.

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Chung Hyun Lee, one of Center's founding directors, said the board saw Kim as "the right person" for several reasons. First, he was one of the youngest board members. "Some of us can't hold meetings all night long," Lee said. Then there is Kim's professional experience — those skills align well with negotiating a deal. And there was the capital raise.

"He had shown us that we could trust him," Lee said.

Kim's personality helped, too. He is likable and friendly. Several of his colleagues used "sincere" and "decent" to describe him. He is the kind of guy who could get two rivals to set their differences aside and come together.

In December 2010, the companies announced a deal under which Nara's shareholders would control 55% of the combined company, with Center, which was smaller at $2 billion of assets, getting 45%. Though banks often refer to deals as mergers — rather than one buying the other — few really involve two companies combining into one in the way Nara and Center sought to do. That's particularly true in Korean-American banking, Kim said. "Merger-of-equals is a new concept in Koreatown," he said.

The deal closed in November 2011, and BBCN was born.

A Quick Ascent
Center and Nara were similar organizations. Both had major focuses on commercial real estate and small-business lending. Many Koreatown bankers had moved back and forth between the banks over the years. But the similarities only went so far.

"Everyone knows everyone, but still they were two organizations that were different; they had different policies and procedures," Kim said. "We didn't know
what to expect.”

The biggest obstacle involved getting the board and management on the same page, Kim said.

BBCN initially announced a structure that had a mixture of Center and Nara executives and directors, with Kim serving as chairman of the bank.

The company cast about over the next couple of years trying to find solid leadership. “The board spent a lot of time recruiting,” Kim said. “It is a tough task because we needed to find a banker who was familiar with U.S. banking, Korean culture and the Korean way of doing business.”

During that time, Kim increasingly stepped up his responsibilities. In March 2013, Kim gave up his law practice to become the chief executive of BBCN Bancorp.

“I was wearing too many hats,” he said.

An Outsider’s Perspective

With the new CEO, Kyu Kim, BBCN’s chief operating officer, felt herself pause for a second before entering his office to consider where to start. How far back did she have to go to explain the issue to a nonbanker boss? If she went too far back, she wondered, would she offend him?

“From banker to banker, you don’t think about it,” said Kyu Kim, who now serves as head of community banking at Bank of Hope (and is not related to Kevin Kim).

It took about three or four months for that feeling to subside. Though Kevin Kim didn’t understand everything then—and still doesn’t—“there’s no ego problem,” she said. “It is well known that he’s not from banking and he doesn’t hide it.”

In some ways, Kevin Kim’s inexperience is an advantage, she said. His business background has given him perspective into what clients need, and there are times that he sees problems and opportunities that a traditional banker might not.

“The true contribution is that, because he doesn’t have the operational background, he can focus on big things,” Kyu Kim said. “He doesn’t try to force you to follow his way [like] a CEO who has been in banking for 30 years.”

As Kevin Kim sees it, his job is “like an orchestra conductor.”

“You put the right people in the right positions so they can do their jobs well,” he said.

Another Major Merger

As the longtime chairman of Wilshire, Steven Koh wanted to meet the man who had brought together two of his Koreatown competitors.

“I’ve always thought that consolidation would happen, that there were too many Korean-American banks,” Koh said. The merger that created BBCN “was an instrumental deal in our industry.”

The two met informally shortly after the Center-Nara deal was consummated. While it wasn’t the right time to start talking about another deal, Kim left a good impression.

“It was the start of this merger for us,” said Koh, who is Hope Bancorp’s chairman.

Imagine Koh’s surprise when he read in 2015 that Hanmi and BBCN were in discussions on a possible merger.

Kim assured Koh that they were only rumors and that BBCN, as a company, was not talking to Hammi about a deal. But perhaps it was time to consider an additional acquisition.

Kim said Wilshire seemed like a better option. “It was a better-run company,” he said. “It was more profitable.”

The then-$7.6 billion-asset BBCN agreed to buy the then-$4.7 billion-asset Wilshire last December for $1 billion. The companies have described the deal as a merger, rather than a takeover, despite their size differences. BBCN’s shareholders own 59% of the combined company, while Wilshire’s own 41%.

There was some noise around the deal. Hammi went public with a disruptive bid to merge with BBCN, which it withdrew after the Wilshire deal was announced. Two BBCN directors who voted against the Wilshire deal resigned, claiming that there were corporate governance issues. BBCN, for its part, said the men stepped down after they were told about plans to exclude them from a slimmed-down board.

Kim stood firmly behind the deal, which easily gained shareholder support and closed in late July.

There are a few auspicious markers that suggest the integration should go well, Kim said.

First, the merger received regulatory approval in less than six months. The Center-Nara deal took nearly a year to get approved and other M&A deals, specifically ones between larger community banks, are taking longer to get regulators’ blessings. The approval time “goes to show how comfortable” the regulators are with how Hope Bancorp and its Bank of Hope proposed to conduct business, Kim said.

The company also has the benefit of merger experience. Having gone through the Center-Nara deal, as well as two much smaller acquisitions in subsequent years, Kim has some learned some lessons. The primary problems with the Center-Nara integration were differences between management and the board, Kim said.

Now, the combined organization is run by someone who started at the board.

“I’m not the banker who grew from the bottom to the top. I jumped from the board down,” Kim said. “So I understand the relationship, the cooperation needed. I think that puts us in a good position.”

The company is expecting to deliver $11 million of cost savings by year-end, thrown through the merger and the planned acquisition with Wilshire.

“Growth is the key to going,” said Koh, at Sankyu, which, like any Korean immigrant bank, lessly.

But absent any problems that cause a loss of customers or employees, “it should be OK,” he said. “They’ve done a good job in the past, and I think they will do a good job in the future.”

To Lee, he represents a link between the immigrant founders and the future. To Lee, he represents a link between the immigrant founders and the future. To Lee, he represents a link between the immigrant founders and the future. To Lee, he represents a link between the immigrant founders and the future.
The company is expecting to deliver $11 million of cost savings by year-end through a branch consolidation. It is also planning to combine branches that are within a quarter-mile of each other.

"Obviously, they still have a good ways to go," said Aaron James Deer, an analyst at Sandler O’Neill. "I don’t know that any bank integration has ever gone flawlessly."

But absent any problems that cause a loss of customers or employees, "it should be OK," he said. "They’ve done a good job in the past, and I think they have a good road map for avoiding certain pitfalls."

Kim is also optimistic that one culture will emerge.

“We want to develop and cultivate a Bank of Hope culture that is something different from BBCN or Wilshire,” Kim said. "We are going area by area, issue by issue, and taking the better of two.”

**Big Hopes**

In October 1904, A.P. Giannini, a first-generation American, opened the Bank of Italy in San Francisco to serve the immigrant community. In the 1920s, through a merger, that bank became Bank of America. Yes, that Bank of America.

Chung Hyun Lee, one of Center’s founding directors, views that history as an inspiration of what he and his colleagues envisioned when they started a bank with $4.5 million in capital in the 1980s. They were a group of Korean immigrants who had become successful entrepreneurs. Their bank would initially serve the Korean-American community, but they also thought it could someday become a major mainstream bank.

“If we start up a bank – that could last forever,” Lee said.

Recruiting Kim was an investment in that future. To Lee, he represents a link between the immigrant founders and the next generation.

Kim was born in South Korea and attended Hankuk University of Foreign Studies in Seoul, where he received a bachelor’s degree in English. He and his wife, Okee, met in college. And after he concluded his compulsory military service, the couple moved to the United States in 1982 so Kim could pursue a master’s in business administration at the University of California at Los Angeles.

From there, Kim joined Arthur Andersen, and later KPMG, as an accountant. He then pursued a law degree from Loyola Law School in Los Angeles and opened his practice in the mid-1990s.

His daughter, Debbie, is a teacher. Her son, Philip, is pursuing an MBA at Columbia University.

Essentially, Kim is an immigrant similar to the founders, but he is younger and was a professional in the U.S. business world long before he was running Hope.

Kim also sees himself as a connector between Hope’s founders and the next generation. "Most of them came with very little money. Some may not have even had legal status. But they worked hard, saved money and opened a bank,” Kim said.

The Korean-American banks are very successful, he said. “They’re publicly traded companies and are good investments. That is a tremendous achievement. The next leaders don’t have to be Korean-American, but I would imagine they’ll be more American than I am ... My unique role in that process is to be a bridge so that this bank becomes a successful American bank founded by Koreans in the U.S.”

Mergers will play an important role in creating that future, as Kim sees it. Hope Bancorp could buy some of the remaining Korean banks once the Wilshire integration is complete.

But acquisitions can’t be the only method of growth. In recent years, BBCN had launched several consumer-oriented products such as mortgages, wealth management services and credit cards as a way to diversify its portfolio. Wilshire had also been moving in that direction, buying a mortgage company last year.

“When the economy is good, [CRE and SBA loans] are good, but it can be real damaging when real estate goes south,” Kim said, now sounding like a crisis-tested banker.

Although the bank aspires to be mainstream, Kim said this will wait until after it has fully leveraged its opportunities within the Korean-American community. For instance, BBCN in late 2014 opened a representative office in Seoul. It is now working with U.S. and Korean regulators to open a full-fledged branch. If successful, it would be the first community bank to operate a branch there.

“We will capitalize on our ethnic heritage,” Kim said, noting that it also provides a business advantage with other ethnicities. For instance, Kyu Kim, while at Nara, made that bank a dominant player in lending to Dominican grocers in New York. The bank also found niches within the hotel business with Pakistani entrepreneurs and in Los Angeles’ garment district with Jewish and Armenian groups.

“...We are going to stay with the customer bases where we have competitive advantages,” Kim said. “It is premature to compete with the mainstream for now.”

But Kim understands the founders’ dream for a major mainstream bank. Lee said he trusts Kim “200%.”

“He knows why we started up a bank and he’ll carry that on,” Lee said. “I don’t know how long it is going to take to make this bank look like Bank of America, but I hope it happens.” □
SUSSEX BANCORP’S

Anthony Labozzetta

By Jackie Stewart

Anthony Labozzetta isn’t afraid of change.

As president and chief executive of Sussex Bancorp in Franklin, N.J., he is just as willing to try a new strategy as to reinvent past ones.

That propensity isn’t lost on the directors of the $809 million-asset company he helped salvage after the financial crisis.

On many occasions, Labozzetta has worked hard to sway the thinking of a board that was accustomed to moving forward at a much slower pace before his arrival in early 2010, said Edward Leppert, the company’s chairman.

“That’s a part of the job Tony relishes,” Leppert said.

Labozzetta’s powers of persuasion were tested after the financial crisis, when he convinced directors that his team should be allowed to keep investing in growth initiatives even as a handful of employees worked to build a firewall around bad assets.

His lobbying skills came in handy again in 2013, when Sussex decided it could no longer rely on its 40-year history of running branches in largely rural markets. To gain traction in the more populous and prosperous areas of New Jersey and New York, Labozzetta proposed resurrecting a hub-and-spoke model that other banks had used before the financial crisis.

However, he wanted to incorporate a twist. Rather than relying on traditional branch managers, he wanted business development professionals to oversee the expansion.

It was a lot for Sussex’s conservative board to process.

“We were a little bit cautious because it was a radical change,” Leppert said.

Still, Labozzetta prevailed in convincing the board, and so far the strategy has worked out well. Newly added branches, which are operating much more efficiently than traditional sites, also have shown the potential for accelerating deposit growth.

“The thing that has impressed me the most about Tony is that he’s always thinking about the business and how he can make it better, change it and keep it nimble and flexible as the environment changes,” said Collyn Gilbert, an analyst at Keefe, Bruyette & Woods. “He’s very pragmatic in his approach.”

Labozzetta’s persistence and creativity, willingness to adopt and adapt past concepts, and credibility with investors and directors, have played a big role in Sussex’s rebound while creating a blueprint for revitalizing the branch model.

For those reasons, American Banker has selected Labozzetta as one of its Community Bankers of the Year.

Road to Sussex

Before joining Sussex, Labozzetta had never gotten the chance to run a bank. He was close at Interchange Financial Services in Saddle Brook, N.J., where, as chief operating officer, he was arguably being groomed for the top job. Instead, the $1.6 billion-asset company sold itself to TD Bank in 2007 for more than four times book value.

Labozzetta, who eventually became TD’s executive vice president of retail distribution for the mid-Atlantic division, enjoyed a three-year stint that would prove instrumental to his career development. Notably, it gave him an opportunity to try retail strategies that he never had a chance to implement at Interchange.

Those experiments would eventually influence how he would run Sussex.

TD, for instance, sought out entrepreneurial employees with the “right personalities” to sell products to customers. The model, which Labozzetta would eventually use at Sussex, favored identifi-
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TD, for instance, sought out entrepreneurial employees with the "right personalities" to sell products to customers. The model, which Labozzetta would eventually use at Sussex, favored identifying employees who were geared more toward business development on a regional scale rather than branch management.

It would take years for Labozzetta to implement that model at Sussex, where his first order of business involved cleaning up the balance sheet in the wake of the financial crisis.

Noncurrent loans had begun to increase, peaking at 8.6% of total assets by the September 2011, according to data from the Federal Deposit Insurance Corp. Many turnaround artists followed a tried-and-true approach to address credit issues after the crisis. They completed bulk loan sales, wrote off huge losses and raised millions in capital to plug the holes. Those "fresh slate" efforts, however, were highly dilutive and damaging to existing shareholders, said Joseph Fenech, an analyst at Hovde Group.

Labozzetta and his team decided to chart a more difficult course to recovery, pursuing parallel paths where one small team would focus on internally working out problem loans while everyone else focused on building for the future. The company would eventually raise a small amount of capital, bringing in about $7 million in 2013.

At one of his first board meetings, Labozzetta told Sussex's directors that his team would be reinvesting in the bank rather than simply grappling with bad assets and slashing costs. The pitch met with some resistance, but directors eventually gave Labozzetta their vote of confidence.

The approach made total sense to the company's new CEO. "You're giving away shareholder capital if you do a bulk loan sale," Labozzetta said. "The key was to reignite the organization, solve legacy issues, bring in new talent and open regional offices."

Labozzetta held weekly Monday morning meetings with Chief Financial Officer Steven Fusco – a recruit from the Interchange days – and a credit workout team to discuss progress on loans, which were segmented into categories and sub-categories. Everyone else was insulated from those problems so they could focus on generating income.

"It was overwhelming to look at when you saw the dollar amount and number of problem assets," Fusco said. "But failure was not an option and we both looked at it as an opportunity to fix something."

By shielding most employees from credit woes, Labozzetta kept morale high. He installed regional lenders, brought in new technology and reversed a decision by previous managers by investing in the company's insurance business. The insurance business, which had been losing money, generated nearly $2.8 million in commissions and fees in the first half of this year.

Labozzetta's approach is "much harder and that's why it is so impressive," Fenech said, adding that it positioned Sussex to "jump off the launching pad" once its credit issues were addressed.

Old Is New Again

In some ways the prolonged recovery was a blessing in disguise to Sussex,
Labozzetta said. The company wanted to expand geographically, but doing so would require branches to drum up name recognition and new business.

The turnaround caused management to really think about what these new locations would look like, particularly at a time when banks of all sizes were beginning to rethink — and reduce — their dependency on branches.

That philosophical shift was top of mind as Labozzetta and his team began a more than yearlong process developing Sussex’s new branch model. They determined that wholesale changes would be needed — not only to branch appearances, but also to job descriptions and employee requirements.

“The bank paradigm has shifted,” Labozzetta said. “We see bank transactions no longer happening in the branches, but more on the digital side of the world.”

Labozzetta’s vision was built around his experience at TD. He wanted employees who would be far happier venturing out to meet with customers and prospects as opposed to staying inside the branch. Those managers would also need to oversee more than one location.

“The secret sauce is the business-development manager, who manages three locations and not just one,” Fusco said. “They are sales motivated and they’re out there getting new business.”

Each manager is responsible for a hub location and several “spokes.” Hubs aren’t much larger than 1,000 square feet and are packed with technology such as tablet stations to help meet customers’ needs. ATMs and full-service lending teams are also available. (Spokes are still in the works, but will be smaller.)

Labozzetta and his team have tapped into “the wave of the future,” said Bob Kafafian, president and CEO of Kafafian Group. Branches generally are getting smaller in size and fewer in number and are being built around giving customers advice rather than completing transactions. Sussex’s model hits on all of those notes.

“You still need some physical presence for your people to give advice and resolve issues and develop business and relationships,” said Kafafian, who has known Labozzetta for years and has worked with him as a client. “He’s one of the more forward-thinking CEOs that I know, and he is not afraid to make changes.”

The preliminary results have been positive. Sussex has opened two hub locations — in Astoria, N.Y., and Oradell, N.J. — and spoke locations are in the works. Labozzetta believes Sussex will only need six to nine branches to provide the same level of service that Interchange provided when it had 28 branches in Bergen County.

The branches also improve efficiency, with Fenech noting that the salary paid to a business development sales manager is lower than what it would cost to compensate multiple branch managers.

Expense management is a welcomed plus, but Labozzetta is insistent that the model was largely geared toward growing the company over the long term. “If you go cost first, you will end up looking at a lot of data and you’ll reduce staff — but you won’t add the pieces that get you the business,” he said.

Banks should instead look to “rethink costs so they’re going to the right jobs,” Labozzetta added. “And then along the way we got the cost saves.”

Eye on the Future
Labozzetta’s star continues to rise in an industry where he has been active for decades. He is currently serving a three-year term on the New Jersey Bankers Association, where he was also selected to join the group’s executive committee.

John McWeeny Jr., the association’s president and CEO who has known Labozzetta for about a decade, praised the veteran executive for being “a dynamic banker” who has earned the respect of his peers. “His experience working at a smaller bank — and a larger one like TD — gives him insights into our needs as an industry, which is helpful for our members,” he said.

Labozzetta’s reputation was cemented when he was at Interchange, Fenech said, pointing out that TD kept him for years after buying his bank. He also noted that Interchange’s loan book held up “better than most” during the crisis. TD “respected his work,” Fenech said. “I doubt they would have kept him on otherwise.”

Labozzetta’s reputation at Interchange also made an impact on Lawrence Seidman, a bank investor from New Jersey with a storied history in shareholder activism. Seidman began buying Sussex stock in late 2014 at about $10 each; those shares have appreciated by more than 60%.

“He’s an excellent banker and he’s doing a great job,” Seidman said, noting that he is not looking for the company to find an exit strategy to maximize value for investors. “His management has been beneficial to shareholders.”

The key to Labozzetta’s management style, evidenced by his post-crisis efforts, is his ability to make adjustments when necessary to survive and thrive in a climate of change.

The “formula isn’t a static one,” said Mark Hontz, Sussex’s vice chairman. “If a strategy isn’t building the right relationship with the customer, the shareholder or employees then it will surely be adapted or changed as time goes on.”

A willingness to change could help Sussex’s new branch model to meet customers’ needs as an industry, which is helpful for our members,” he said.

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A willingness to change could help Sussex as regulators scrutinize the banking industry’s reliance on commercial real estate lending. CRE loans amount to more than 400% of Sussex’s capital, which is well over the level that typically catches the eye of examiners.

The company is looking to diversify by adding more Small Business Administration and commercial-and-industrial loans. However, Labozzetta is confident in the strength of Sussex’s CRE book, noting that management has kept loan-to-value ratios low and lends to familiar customers.

A commitment to change also should help Sussex as regulators scrutinize the banking industry’s reliance on commercial real estate lending. CRE loans amount to more than 400% of Sussex’s capital, which is well over the level that typically catches the eye of examiners.

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A commitment to change also should help Sussex stay ahead of shifts in customer behavior. While the hub-and-spoke model seems to be working now, Labozzetta readily admits that Sussex might have to find new ways to reach customers in three to five years. So the bank is always looking for ways to improve.

For instance, Sussex taps an employee to serve as the customer advocate during strategic planning sessions. That individual is “basically the attorney for the client,” charged with voicing how customers might react to changes such as new fees, Labozzetta said.

Advocacy had led to meaningful change at Sussex, including a decision to adopt a private bank feel where clients sit at a desk to discuss their needs or complete transactions rather than standing at a counter.

In another instance, Labozzetta stepped in to the advocacy role during an annual credit summit, pushing for quicker turnarounds for loan applications. He successfully pressed his team to shorten some of the response times to 24 hours.

“You can’t be someone who doesn’t like change. We have to adapt,” Labozzetta said. “The worst thing you can do is nothing.” □

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AMERICAN BANKER
A TRUE INDUSTRY LEADER
GERMAN AMERICAN'S

Mark Schroeder

By John Reosti

German American Bancorp is unlike a lot of its small-town peers looking to expand. Under Chief Executive Mark Schroeder, the Jasper, Ind., company hasn’t moved into big cities, started national lines of business or negotiated any blockbuster deals.

German American is a frequent acquirer, but its deals have been small, with enough time in between to ensure thorough integration. Even as the company has grown, its commitment to the Midwestern values of its founders never wavered, and along the way it has managed to outperform its peers year in and year out.

The $3 billion-asset company hardly missed a beat during the financial crisis and since then has strung together six consecutive years of record earnings and is well on its way to making it seven. Through Sept. 30 it had earned $25.1 million, up 12% from the same period in 2015.

This formula – strategic acquisitions combined with quietly effective relationship banking – has made German American one of the most consistently profitable banks in the country, and it is why American Banker has selected Schroeder as one of its Community Bankers of the Year for 2016.

"German American is considered as part of the gold standard in Indiana as far as community banking," an approving S. Joe DeHaven, the longtime Indiana Bankers Association CEO, said in an interview. "Mark is extremely highly regarded, throughout the industry and in Indiana."

A Conservative Tradition

O. Leo Beckman would be every bit as proud.

Beckman, whose father, Fred, helped found German American in 1910, was a legend inside the company. Beckman spent his entire 52-year career there, starting as a teenager in 1930 and working his way up to CEO. He acted as a mentor to Schroeder, who joined the bank as a vault teller in 1972.

Beckman, who passed away in 1995, also was responsible in large part for German American’s enduring conservatism.

"Mr. Beckman was very much a traditionalist, very disciplined regarding time-tested banking principles," Schroeder said. "He [drilled into] me that banking is not supposed to be exciting. It’s supposed to be boring, and if it’s getting exciting, you’re probably doing it wrong."

Schroeder said the bank’s conservative approach to lending is just as much about protecting its customers as about protecting the bank. "If we have a credit that becomes a problem credit, it’s a problem credit for us, but it’s a serious dilemma for that client."

That’s not to say Beckman wouldn’t ever take a risk – as Schroeder first learned 44 years ago when he told his father, Clarence, he had landed an entry-level job at the bank.

"My father told me my grandfather wouldn’t bank anywhere else, because Fred Beckman backed him during the Depression," Schroeder recalled. "If the bank hadn’t hung in with him, he’d have lost the [family] farm."

Schroeder has been CEO since Jan. 1, 1999. He had a chance to become CEO in 1982 – the year Leo Beckman finally stepped down as Astrike who inaugurated German American’s growth-by-acquisition strategy, Schroeder said the bank’s conservative approach to lending is just as much about protecting its customers as about protecting the bank. "If we have a credit that becomes a problem credit, it’s a problem credit for us, but it’s a serious dilemma for that client."

When the head of the search committee called, "I remember laughing and saying that I very much appreciated the call, but I thought I needed a little more experience before I could tackle something like that. But I asked him to do me a favor and please call again when you’re looking for

However, Beckman finally stepped down March 1. It marked German American’s entry into the greater Louisville market.

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March 1. It marked German American’s entry into the greater Louisville market.
German American’s board reached outside the company for Beckman’s successor, tapping George Astrike, president of neighboring Tell City National Bank. Like Beckman, Astrike was a mentor to Schroeder, moving him up the ranks. “He was one of the brightest stars I had to work with,” Astrike said. “He was always very capable and very industrious. I learned to appreciate that from the start.”

A few months after his arrival, Astrike appointed Schroeder head of credit administration. “I remember being a little embarrassed to tell people that a $100 million bank had a 27-year-old head of credit administration, but I never had cause to regret my decision.”

Though just as conservative as Beckman fundamentally, Astrike was visionary in other respects, Schroeder said. It was Astrike who inaugurated German American’s growth-by-acquisition strategy, engineering the purchase of Ireland, Ind.-based Bank of Ireland in 1986. “What I took from George was the recognition that slow and steady wins the race, but there are times when you have to seize opportunities,” Schroeder said. “When those opportunities present themselves, you have to analyze them. You can’t jump into something unformed, but sometimes time is of the essence. From an M&A perspective, the bank that is choosing to join with you really sets the time when they’re ready to make a move. As an acquirer, you can’t call and say, ‘Well, that’s great but two years from now would be better for us.’”

Schroeder has continued down the acquisition path, doing a total of six deals in his 16-plus years as CEO. His most recent transaction, an $87 million cash-and-stock deal for the $514 million-asset River Valley Bancorp in Madison, Ind., closed March 1. It marked German America’s entry into the greater Louisville market.

In all, German American has closed 15 whole-bank acquisitions over the past 30 years. That’s probably enough to qualify the bank as a serial acquirer. Under Schroeder, though, it goes about the bank-buying business with a characteristic conservative twist.

Schroeder said he likes wait two or three years between deals to ensure enough time for integration. He is also content with relatively small transactions, where the seller is no bigger than one-quarter of German American’s asset size.

“If you do run into issues [buying a smaller bank], you can throw resources at them,” Schroeder explained. “If it is a huge transaction relative to your starting size, it can overwhelm you.”

What’s Next

These days, Schroeder refers to German American as a “regional supercommuntity bank.” The description has an impressive ring to it, but in its day-to-day operation, German American still pursues a plain-vanilla relationship banking strategy. The closest it comes to niche banking are the two large turkey producers it counts as clients.

Like most CEOs, Schroeder spends much of his time plotting strategy. With the integration of River Valley well underwa, he is considering the next step, and frequently glances south, across the state line, at Kentucky. “There are a couple of other candidates for us in southern Indiana, but past that we’re either going to have to move north around Indianapolis or move south,” Schroeder said.

As for his own future, Schroeder said he’d like to reach his 50th anniversary with the company in 2022, but he doesn’t plan to stay much beyond that. “One of the hallmarks of good organizations long term is that they do CEO succession seamlessly,” he said. “I consider it the ultimate test of any CEO.”
F ew banks in the country have undergone as thorough a transformation as Umpqua Bank has under Chief Executive Ray Davis.

When Davis took the helm at what was then South Umpqua State Bank in 1994, it had just $140 million of assets and five branches in southwest Oregon. Its main office was in Roseburg — population 21,181 — it was privately held, and its board was made up largely of local small-business owners with ties to the timber industry.

More than 15 acquisitions later, Umpqua — it dropped “State” in 1998 and “South” after the first merger in 2000 — is now the largest bank based in the Pacific Northwest, with more than $24 billion of assets and roughly 320 branches in Oregon, Washington, Idaho, California and Nevada. Its corporate headquarters is in Portland, its stock trades on Nasdaq and its board includes current or former high-ranking executives at such companies as Columbia Sportswear, Virgin America and Portland Gas and Electric.

Along the way, Davis established Umpqua as one of the industry’s most admired brands. Recognizing that Umpqua could never compete with larger banks on price, convenience or technology, he instead differentiated it by instilling a service culture that took cues not from other banks but the likes of Nordstrom and Ritz-Carlton.

Umpqua has won numerous accolades and awards for customer satisfaction over the years and is so highly regarded by its peers that bankers from all over the world — New England, China, Australia — regularly travel to Portland to study its approach. Many of the trends in retail banking these days — from open floor plans to the universal banker model — can be traced to ideas pioneered by Umpqua.

Richard Davis, the chairman and CEO at U.S. Bancorp, said few people have had as much influence on retail banking over the past two decades as Umpqua’s longtime CEO. Ray Davis’ vision was to make banks approachable and for customers to feel comfortable in them, and while Umpqua’s in-branch initiatives — like coffee bars, public meeting spaces and pop-up shops featuring the products of local small businesses — won’t work for all banks, “these ideas are very important as we all look to change the reputation of banking,” said Richard Davis, who is no relation to Ray.

“Ray did all this before it was popular, at a time when banks didn’t need to be considered more familiar, more personal,” he added. “He was way ahead of his time.”

Ray Davis, 66, will step down as Umpqua’s CEO on Jan. 1 and transition to a new role as executive chairman of the bank’s parent company, Umpqua Holdings, and CEO of its Silicon Valley-based innovation lab, Pivotus Ventures. In his 22 years overseeing the bank, he was largely responsible for building Umpqua into a regional powerhouse and internationally recognized brand, and it is for these accomplishments that American Banker is honoring Davis with its Lifetime Achievement award for 2016.

Equally important to Umpqua’s story is how well the bank survived the financial crisis. It had some problems, but unlike many of its peers that later failed, Umpqua was proactive in selling off underwater real estate assets at the first signs of trouble. It is a big reason Umpqua was able to raise more than $530 million in capital — without ever relying on private-equity money — and ultimately emerge from the crisis as the region’s breakout bank.

In some ways, the jury is still out on that deal, as even Umpqua officials have said that melding the cultures of the two midsize banks took longer than anticipated. As acquisitive as it has been, Umpqua is taking a breather from acquisitions in part because Davis knows that the culture he has built gets harder to maintain as the company gets larger.

“The culture is the greatest asset we have, but it’s also the greatest risk because, if we ever forsake it, we join the pack,” he said.

“Ray did all this before it was popular, at a time when banks didn’t need to be considered more familiar, more personal,” he added. “He was way ahead of his time.”
shops featuring the products of local small businesses — won't work for all banks, “these ideas are very impor-
tant as we all look to change the repu-
tation of banking,” said Richard Davis,
who is no relation to Ray.

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out ever relying on private-equity money — and ultimately emerge from the crisis as the region’s breakout bank. Umpqua acquired four failed banks in 2009 and 2010, bought the equipment-financing firm Financial Pacific Leasing in 2013 and a year later it doubled its size with its blockbuster acquisition of Sterling Financial in Spokane, Wash.

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“The culture is the greatest asset we have, but it’s also the greatest risk because, if we ever forsake it, we join the crowd,” Davis said in an interview at Umpqua’s Portland headquarters in September.

Still, size is important in banking these days, and the Sterling deal gave Umpqua the heft to control its own destiny. At $24 billion of assets, Umpqua can far better absorb the impact of stress tests, higher interchange fees and other regulatory costs than it could as an $11 billion-
asset institution. Davis would never rule out merging Umpqua with a larger rival, but in his view the bank is now at the “perfect” size because it is large enough to take advantage of new business oppor-
tunities — like Pivotus — yet small enough to implement new ideas quickly.

“If you want to stay independent, the best defense is to have a good offense,” Davis said.

Davis’ banking career began nearly five decades ago, when he took a job at a community bank while he was a student at the University of Nevada at Reno. He held a variety of jobs at the bank, eventually working his way up to vault teller, but left after graduation to join the military and later pursued a career in accounting.

Davis lasted just three years in ac-
counting — “too boring,” he said — and looking for his next opportunity he spotted an ad for a controller at a community bank near Lake Tahoe. It turned out that the CEO was an executive at the bank where Davis worked in college, and he was hired immediately. A few years later he was recruited away by the bank’s core processor, and after three years there he landed at the Atlanta-based consultancy U.S. Banking Alliance. It was there that Davis began to develop his vision for what Umpqua would become.

“Working for U.S. Banking Alliance was like going to graduate school in banking,” he said. “I dealt with CEOs at banks of all different sizes and I saw some ideas that were really great and I saw some others where I’d say, ‘Wow, I wish I was com-

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peting against that guy.’ ”

Itching to get back into banking, he was excited to receive a call from a head-hunter about an open CEO position at a small bank in southwest Oregon. Davis and his wife longed to get back to the West Coast after 15 years in Florida and Georgia, but when he was offered the job as South Umpqua’s CEO, he wasn’t entirely sure he wanted it.

During the interview process, Davis had proposed making drastic changes to the sleepy, five-branch bank, changes that he knew would cause significant disruption. “People weren’t going to be happy with what I was planning,” Davis said, “and I didn’t want to go out there and three months into it have the board say, ‘This is too much. We can’t do this.’”

But, once sufficiently convinced that the board would not stand in the way of his ideas, Davis accepted the job and set out to redefine what a bank was.

What Davis disliked most about banking was that it was so dull. It was the mid-1990s, when most activity still took place in the branch, and Davis could never understand why branch employees didn’t engage with customers waiting in teller lines. Not sell them stuff exactly, but “talk to them, pass out lemonade, hand out keychains, anything to make it interesting for these people,” he said.

A big problem was with branch design – velvet ropes, teller windows – that seemed to discourage interaction, so Davis set out to build a new type of bank branch. Importantly, he brought in a consultant who had worked with banks but with retailers, such as Gap.

“I did not want to hire a bank consultant because a bank consultant was going to tell me what he told the last five banks he worked with,” Davis said.

When the first concept “store” opened in Roseburg in 1996, “it was so different from a bank that we had a number of customers who would step in for the first time, look around, and go right back out to look at the sign on the door to make sure they were in the right place,” Davis wrote in his 2007 book, “Leading for Growth.”

The store was bright and open, featuring a computer café with free internet access, Umpqua-branded coffee and comfortable seating areas where customers could learn about investment and banking products. There was also a prominently placed phone that connected directly to Davis’ line – a feature that still exists in Umpqua stores today.

Umpqua rolled out similar concept stores in other markets and revamped existing branches as it expanded through acquisitions. The goal was to make branches more inviting, and key to this effort was dazzling customers with service. In hiring, people skills were valued over banking experience and those who needed extra seasoning were sent to training courses offered by the likes of Ritz-Carlton.

Davis also gave store managers the freedom to come up with their own ideas for bringing in foot traffic and, as he put it, “generate buzz.” There was a store that once offered free CD burning, back when that was a thing. Contests, movie nights, pet competitions and yoga classes are just some of the activities that go on inside Umpqua stores. Many stores also have public meeting and work spaces that are available to anyone in the community – not just customers – and designated areas where they display products sold by the bank’s small-business customers.

“Our people know that they are empowered to make any decision they want to improve the customer experience,” Davis said. “Don’t pick up the phone and ask your boss – just do it.”

The investments in branch design and training added up to strong organic growth for Umpqua. In the four years between opening its first concept store and closing its first acquisition, Umpqua more than doubled its deposits in its home state, according to Federal Deposit Insurance Corp. data.

Still, even though Umpqua had ditched the word “branch” in favor of “store,” Davis made clear that he did not want front-line employees to actively sell products and risk scaring off customers. If Umpqua bought a bank that had sales quotas for employees, it got rid of those quotas as soon as the acquisition closed.

“Nobody wants to walk into a bank and be inundated with pitches for products you don’t want,” Davis said. “It’s not fun. I want a service culture that creates a customer experience that’s one of a kind. If you are successful at that, you’ll get all the sales you want.”

Dave Martin, the founder of the consulting firm BankMechanics.com and an expert on retail banking strategies, called Davis “a master marketer” who recognized early that for a community bank to be relevant “it can’t be generic.”

“Umpqua was really early to the retail game, investing in employee development and customer experience” before other banks made it a priority, Martin said. “The name of the game is to get on people’s radars and get them interested in wanting to do business with you and Umpqua has done that as well as anybody.”

It was around 2000 that Umpqua also started showing up on the radar of other community banks that were looking for an exit strategy. By then it was a publicly traded company with close to $400 million of assets and Davis’ success in growing the bank organically gave him the credibility to start pursuing deals, said Robert Rogowski, a longtime Seattle-area investment banker who is currently a managing director at Wedbush Securities.

The first acquisition, Valley of the
Rogue Bank, came in late 2000, and over the next seven years Umpqua bought more than a dozen banks in Oregon and northern California (one of them a five-bank holding company), as well as a Portland-based broker dealer. The bank that was once confined to Oregon’s timber country now had a significant presence in California’s wine country and farm-rich Central Valley, as well as new markets across Oregon, including Portland.

Rogowski said a 2002 deal for the $870 million-asset Centennial Bank in Eugene, Ore., was particularly pivotal because it gave Umpqua meaningful market share in the state’s two largest business centers.

“Centennial was in Eugene, so it put Umpqua on the map there, and it also had been building up in Portland, and the deal gave Umpqua momentum there,” Rogowski said. The deal vaulted Umpqua over the $2 billion-asset mark, giving it the size and currency to pursue even larger deals, Rogowski said.

By 2006, Umpqua had more than $7 billion of assets and the No. 5 market share in its home state, trailing only U.S. Bank, Wells Fargo, Bank of America and Washington Mutual. It was around that time that Davis and his team began to worry about the housing bubble bursting and took steps to minimize the damage.

The bank had just closed a deal in the Sacramento area and, driving up Interstate 5 on the city’s outskirts, Davis was struck by the explosion of new home construction. “I looked to my left and to my right and all I saw were roofs, thousands and thousands of them,” Davis said. “My first thought was that if the housing market ever crashes, we’re going to have some problems.”

When Davis returned to Portland, he ordered a full review of Umpqua’s residential construction loan portfolio and did not like what he saw: a $680 million loan book that was already starting to show some cracks. The bank essentially halted its residential construction lending and not long after that, at the urging of its then-chief credit officer Brad Copeland, took a $6 million loss on a loan for a high-end condominium project in Bend, Ore.

“That number was sizeable, greater than half the loan balance, and we didn’t bat an eye,” said Ron Farnsworth, Umpqua’s chief financial officer. “We were able to come through the recession stronger than many of our competitors because we weren’t afraid to take the loss. So many other banks seemed to be burying their heads in the sand.”

Six Oregon banks failed during the crisis, as did 17 in Washington. Umpqua itself lost $109 million in 2009, mostly on soured real estate loans, but it was healthy enough in the eyes of regulators to gobble up four of the failures, including three in Washington, where it previously had just one branch.

“We’re not holding ourselves up as the poster child,” Davis said. “We had problems and we wrote off a lot of loans. But we came out of it OK.”

If there’s one knock on Umpqua, it’s that performance in recent years has lagged its peers. While its margins are higher and its credit quality is better, its returns on asset and equity are below the average for banks with $10 billion of assets or more, according to FDIC data. Meanwhile, its stock has declined slightly since it acquired Sterling in April 2014, while the Keefe, Bruyette & Woods index of regional bank stocks is up about 15% during that time.

Those issues can be traced in part to the costs associated with digesting Sterling, but mostly they are a function of the rate environment. Low interest rates are hard on all banks, but analysts say they have weighed more heavily on banks with high levels of core deposits, like Umpqua. “The cost of wholesale funds is not much more than the cost of running a branch network, and that’s weighing down on overall profitability ratios,” said Jared Shaw, an analyst at Wells Fargo Securities. “This is a platform that does better when rates are higher.”

While Umpqua’s loan portfolio is largely commercial, its deposit base leans more toward retail. Aaron Deer, an analyst at Sandler O’Neill, said he believes a stronger focus on commercial deposits would improve the bank’s performance.

Davis’ successor, Cort O’Haver, has a commercial background “and that’s the side of the bank I would hope to see Umpqua focus on” under O’Haver, Deer said. “Not to the detriment of the retail side, but I think they can do more with the commercial side of this bank.”

Davis, for his part, said a new leader is good for Umpqua and its shareholders, and though he will stay involved as executive chairman, he has no intention of meddling in day-to-day activities. “I will stay at 50,000 feet,” he said. □
John Hope Bryant is proving that you don’t need code or an app to innovate in banking.

After more than two decades bringing under-banked consumers into the mainstream, Bryant has found a way to combat financial illiteracy that also addresses two critical business problems facing banks today: keeping branches relevant and finding new customers.

Bryant founded Operation Hope in the wake of the 1992 Los Angeles riots, seeking to reverse the vicious cycle of poverty in communities around the country. For most of its history, the nonprofit operated out of its own brick-and-mortar field offices, helping individuals avoid foreclosure, build credit and start their own small businesses.

Operation Hope relied on grants and donations to advance its mission. But in 2013, a lucrative partnership with E-Trade ended, and that compelled Bryant to rethink the whole enterprise.

“In some ways we were fired from our own business plan and we had to reimagine it,” he said. “I’m not sure if E-Trade hadn’t done that, if we would have ever found the new model.”

Operation Hope had a co-location arrangement with Bank of the West in one of its Oakland branches, and it was notably self-sufficient. By putting counselors in existing bank branches, Bryant thought, the organization could focus on its core strengths and rapidly expand its outreach.

That idea grew into Hope Inside: a direct partnership with banks to install Operation Hope-trained financial counselors inside bank branches, paid for by the banks themselves at a cost of roughly $75,000 a year per site.

The counselors can offer free, unbiased financial advice to bank clients and prospective clients — including those with credit or debt problems that might preclude the banks from approving them for loans or other services. Clients can get guidance on how to build their credit, start a business, prepare to buy a home or avoid foreclosure.

The relationship is mutually beneficial. Operation Hope can widen its reach far beyond what it was able to achieve with its own locations, and the banks are able to cultivate new customers and earn Community Reinvestment Act credit.

Hope Inside answers a wide range of challenges facing banks — whose public image never fully recovered from the financial crisis — with a single solution.

“I think this is the first time that many of these CEOs saw community affairs, public affairs, community reinvestment, community engagement, trust — the business [banks are] in — relationship-building, race relations, economic prosperity, job creation, and even business development all line up,” Bryant said. “And it’s moral, which means that they can feel good about it, brag about it … and they can do it for the benefits it has on their bottom line.”

For developing a model that promotes financial inclusion, generates business for banks and gives branches a new purpose at a time of declining foot traffic, American Banker is honoring Bryant as the 2016 Innovator of the Year.

Since its inception 18 months ago, Hope Inside has grown from a pilot program of six branches to more than 40 today. And the number is rising rapidly — SunTrust, one of the program’s first bank partners, recently announced that it is expanding its partnership to 200 branches by 2020.

First Tennessee Bank also has expanded its partnership, with a $1 million contribution to Operation Hope and plans for a total of 15 locations, triple the number it has now. (Counseling offices also are open in partnership with nonbanks, including the Atlanta Police Department, churches and even Whole Foods.)

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Bryant said he is aiming for 1,000 Hope Inside branches to be open by 2020. The metrics indicate that the program helps banks as well as customers: SunTrust’s internal evaluation showed that its seven locations serve roughly 6,000 clients annually, with a corresponding 464% increase in bank referrals year over year in branches with a Hope Inside counselor.

One thing that sets Hope Inside apart from other financial literacy programs is that it is using banks’ profit motive to drive participation, rather than tugging on their heartstrings. Bryant said that is the crux of his vision—to appeal to banks’ bottom line. “I want the person who eats nails for lunch to respect what I’m saying—it’s just a different way of looking at business development,” Bryant said. “When you have a bank showing a 500% increase in bank referrals year over year, that sells itself.”

D. Bryan Jordan, president and CEO of First Horizon — parent company of First Tennessee Bank — said since the first few branches opened, the bank has counseled several thousand people, providing valuable services that might otherwise not be available. In the initial nine to 12 months, “we helped counsel 2,400, almost 2,500 people,” Jordan said. “It’s remarkable the folks that would show up for financial counseling. It’s remarkable the progress that can be made. It’s a real easy mission to connect with.”

SunTrust CEO Bill Rogers said that one of his bank’s business goals is to improve his customers’ ability to save and manage money. He cited a recent survey the bank conducted that found 40% of Americans, and 60% of millennials, have less than $2,000 in savings. Hope Inside has demonstrated an ability to make the bank’s customers and prospects more financially savvy and secure, he said. “Having HOPE Inside counseling in our branches helps us address these issues head on and provides another way to help move more people from financial stress to financial confidence,” Rogers said. “Working together, we can help people build their credit score, better manage debt and qualify for important financial services. Rather than saying ‘no,’ this is a path to ‘how,’ and it gives people
optimism to move forward.”

Some of the success of Operation Hope and the Hope Inside model can be attributed to the energy Bryant, 50, brings to the project. People who have met with him and heard his message tend to come away convinced of his authenticity.

This October, a group of about 25 graduates of Operation Hope gathered in Washington to share their experiences in the program and talk about the progress they have made toward starting their own businesses. Unexpectedly, Bryant walked in and thanked them for their initiative in pursuing and completing the program and working to improve their lives and their communities. “I just came in here to say thank you for your time. I know it’s hot in here, but that’s because of all your passion within,” Bryant said. “I don’t even know you, but I love you.”

Bryant told them they were part of a struggle for economic integration that is deeply ingrained in American history. As the Civil War drew to a close, Abraham Lincoln and the Republican-controlled Congress began thinking through how to integrate the millions of freed slaves into American society. To that end, Congress established the Freedmen’s Bureau and chartered the Freedman’s Savings Bank. But the bank and bureau withered and collapsed by the 1870s, along with the rest of postwar reconstruction programs.

Bryant’s mission, he told the group, is to pick up where the Freedman’s Bank left off. “The Freedman’s Bank’s mission was ... to teach freed slaves about money,” Bryant said. “So Lincoln thought the most important thing he could do for freed slaves wasn’t reparations, wasn’t an apology, wasn’t welfare programs, wasn’t a handout. No. It was to teach you how the free enterprise system – how capitalism – works.”

Financial exclusion, of course, is not a challenge faced by the black community alone. The Federal Deposit Insurance Corp. found in its annual survey of the unbanked and underbanked that 7% of the U.S. population in 2015 had no access to a bank account and nearly a fifth are underbanked, using high-cost alternative financial services instead of those offered by insured depositories.

Counteracting the worst effects of financial illiteracy is a challenge that dates back hundreds, even thousands, of years, and occupies a nebulous region between personal responsibility and financial predation. If a borrower doesn’t understand how interest works, the lender can charge more for the same loan than it could otherwise. That minimal level of financial savvy applies to other areas of personal finance — how to buy a home, how to obtain credit, how and why to maintain a good credit score, how to make the money one earns work efficiently, and so on.

Thomas Hoenig, vice chairman of the FDIC and former president of the Federal Reserve Bank of Kansas City, said various nonprofit and education groups have been trying to improve financial literacy for decades. Many states also have attempted to include basic financial literacy as part of high school curricula, but have been routinely hampered by budget shortfalls and a lack of consistency or focus. Meanwhile, the poor continue to rely on the resources available to them, even if they come at an excessive cost.

“Desperate people do desperate things,” Hoenig said. “If you’re not financially literate and you get yourself in trouble, where you don’t have a savings account as a fallback, then you find yourself in need and you take the shortcut.”

Laurie Richardson, deputy chief of staff to Treasury Secretary Jack Lew, said Bryant is able to deliver a convincing message largely because he views the problems he’s trying to tackle holistically, rather than as isolated issues.

“He’s found a way to reach into communities and have a personal impact on individuals,” Richardson said. “That’s absolutely necessary to be able to tackle this problem, but it’s hard to think about unless you’re the type of person who thinks in large-scale terms. He’s a dreamer, but he’s also very data-driven and analytical.”

Former Gov. Tim Pawlenty, R-Minn., has known Bryant for years through the Hope Inside program would likely be a plus for its Community Reinvestment Act evaluation – offering banks another regulatory incentive to open locations.

Barry Wides, deputy comptroller for community affairs at the OCC, said the agencies have not gone so far as to say that the mere presence of a Hope Inside branch is a panacea for CRA requirements. Much depends on the individual bank and the individual evaluation. But
the kinds of activities that do count for CRA consideration – that is, the community development service component of the statute – include things like advancing financial education, credit counseling, homebuyer counseling, financial planning or other similar programs.

“That, in a nutshell, is what Hope Inside does,” Wides said. “To the extent that a bank is interested enough to offer these products and services to their low-wealth customers, the unbanked or underbanked, or customers that have less-than-stellar credit, through the Hope Inside initiative, I think that furthers the objectives of the CRA.”

Jordan, at First Tennessee, said that whether Hope Inside itself counts toward CRA consideration is less important than how it helps institutions direct their CRA-eligible investments into businesses and individuals in a way that actually improves the communities they serve. By providing that greater precision and helping people become more financially savvy, Hope Inside offers banks more of a return on their CRA responsibilities.

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LEGAL – FOUNDATION NOTICES

NOTICE

The annual report of the Robert L. Fine Cancer Research Laboratory Foundation, Inc for the calendar year ended December 31, 2015, is available at its principal office located at 7 Ernst Place, Tenafly, NJ 07670, 201-568-8830, for inspection during regular business hours by any citizen who requests it within 180 days hereof. The principal manager of the Foundation is Robert L. Fine, MD.

NOTICE

The annual report of the J. Weinstein Foundation, Inc. for the calendar year ended December 31, 2015 is available at its principal office, 961 Route 52, Carmel, NY 10512, (845) 225-7647, for inspection during regular business hours by any citizen who requests it within 180 days hereof. The Principal Manager of the Foundation is Lloyd J. Shulman.
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KRISTIN LEMKAU
“They clearly like experiences more than stuff. It’s more fun to post a picture of a fish taco or of a sunset over a beach than of a new couch.”
JPMorgan Chase’s chief marketing officer, on why a credit card campaign offering triple points on dining and travel should resonate with millennials

MICHELLE MOORE
“What will banking be in two, three or four years? It’s going to be this.”
Bank of America’s head of digital banking, talking about its new chatbot “Erica”

ED SKYLER
“Any event that causes people to question the motives of any bank is bad for every bank.”
Citigroup’s head of global public affairs, on how a scandal like the one at Wells Fargo can undermine other banks’ reputations

SYLVIA HACK
“As one taxpayer, I say thank goodness for Elizabeth Warren. Somebody has to mind the store, and I don’t mean a banker.”
New York Times reader, in a comment on Roger Lowenstein’s op-ed criticizing the Massachusetts senator

BILL DUDLEY
“What does it mean for a firm to profess putting the customer first, if employees are compensated and promoted regardless of what’s good for customers?”
President of the New York Fed, arguing at a conference on bank culture that employees respond to the incentives they are given rather than the values they are directed to uphold

JIM MILLER
“This latest news is not going to have a bunch of principled millennials switch from Wells Fargo.”
J.D. Power’s senior director of banking services, saying public outrage doesn’t automatically translate to lost business

SCOTT TOBIN
“It’s rare that people think, ‘We’ll build another Bank of America.’ But my hope is that Cross River will be a giant bank.”
General partner at Battery Ventures, which is investing, along with two Silicon Valley heavyweights, in the $467 million-asset Cross River Bank

ALAN JOHNSON
“If you listen to politicians, you’d think bankers are still making money like it’s 2007. They’re not.”
Compensation consultant, on how year-end Wall Street bonuses have shrunk 30% since 2009

TIM SLOAN
“We failed to acknowledge the role leadership played and, as a result, many felt we blamed our team members. That one still hurts, and I am committed to rectifying it.”
Wells Fargo’s new CEO, apologizing to employees for how the company handled the phony-accounts scandal

J. D. Power’s senior director of banking services, saying public outrage doesn’t automatically translate to lost business
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