Financial Institutions Practice Group Co-Chairs

Brandon Biegenzahn
biegenzahn@mbexec.com

Rod McDermott
mcdermott@mbexec.com

STATE OF THE MARKET IN 2018

As we prepare this year's State of the Market, we are again feeling optimistic. Our optimism stretches beyond banking and attaches to the economy as a whole. Silicon Valley Bank summarized it well in their recent State of the Market report, stating "[w]e see a continuation of attractive macro conditions, and prospects for robust growth and constructive equity markets in the United States and across global developed and emerging markets." Given the pervasive sense of this-is-too-good-to-be-true, we are not alone in believing we must make hay while the sun shines. Below we have attempted to address the macro conditions and trends impacting financial institutions, as well as pull back the curtain on the senior executive leadership market in which we operate daily.

After one full year of the Trump Administration, the economy is holding steady and unemployment has continued its downward trend and now stands at 4.1%, the lowest level since 2001. President Trump's influence has not yet been fully reflected in the regulatory environment and his objectives to reduce over-regulation in industry may yet emerge in banking. We can only hope so!

"2017 was a very good year for banks," says Aaron James Deer, Managing Director of Equity Research at Sandler O'Neill and Partners in San Francisco who covers small and midcap commercial banks on the west coast. "They saw steady loan growth in the single digits, their margins improved due to higher interest rates coming down from the Federal Reserve and they did a good job controlling their expenses." As national, regional and community banks invest more in mobile and online banking, they have been reducing their real estate assets by consolidating branches or putting their branches in smaller spaces since there is less consumer demand for face-to-face services. In 2018, Deer expects, banks will continue to spend money on technology (improvements may include cash management capabilities, streamlining back office operations, and security across the board) and managing the regulatory landscape.

From our perspective, looking forward, we expect a focus on digital innovation, continued consolidation and the never-ending war for talent to be prominent themes throughout the year.

MARKET TRENDS

MERGERS CONTINUE – By the third quarter of 2017, nationally the number of banks had declined from 5,912 in 2016 to 5,736 but their assets had increased to an average of $3 billion per institution from $2.8 billion in 2016 and the same holds true for credit unions. In the past five years, there have been 134 mergers in 13 western states covered in the Western Bankers Association (WBA) territory. The WBA represents 200 members, banks of all sizes from community banks to the largest financial institutions. "We continue to see consolidation in the region," says Simone Lagomarsino, President and CEO of the WBA (which formed in January when Western Independent Bankers merged with the California Bankers Association). The largest banks have not been active in M&A activity, but regional and smaller banks continue to consolidate. "We're certainly seeing a trend of branches closing due to mergers and an assessment of how much foot traffic is coming through the branch," she adds. "Many customers now conduct online banking and do remote deposits which has changed banking significantly, so the need and desire for branches is not historically where it was before but sometimes people still want to work with a person."

REGULATORY RELIEF – In 2018, banks will be focused on US Senate Bill S.2155 – Economic Growth, Regulatory Relief and Consumer Protection Act. If the bill passes this could give banks regulatory relief. Another concern facing banks is the legalization of marijuana especially as it pertains to people who are growing and dispensing the drug. Since banks are FDIC-insured, they need to be cognizant about whether they're dealing with drug money. "Banks may be put in a difficult position from a regulatory standpoint," Simone said. "The government may place more burden on banks to report suspicious activity and they may be hesitant to be involved with people in the marijuana industry."

Brandon Biegenzahn
biegenzahn@mbexec.com
Rod McDermott
mcdermott@mbexec.com

TAX REFORM – A recent survey of business economists by the National Association for Business Economics (NABE) shows that 84% anticipate individual tax cuts will be enacted before the end of 2018, and 82% expect corporate tax reform as well. Now that the Senate has passed the sweeping tax reform bill, banks in states with lower income taxes and property taxes may see more business come their way. Tax shifts could encourage local businesses to invest in new equipment and this could stimulate increased lending by banks. The tax change is positive for most banks although the loss of state tax deductions for those living in California is not so good. California's high cost of living compounded with the tax change means the state could begin to witness people leaving for more affordable states. Here in California, we are already seeing that exodus of businesses and residents to states like Nevada and Texas.

TRENDS IN EXECUTIVE LEADERSHIP

DIGITAL BANKING – Technology searches continue to make up nearly a quarter of the searches we're engaged to fill. This is a theme we saw in 2016 that continued throughout 2017 and will remain constant into the foreseeable future. The most interesting sub-theme of our technology searches in 2017 was the move to external (i.e. customer-facing) technology and the expansion of the scope of "digital" banking. What used to encompass only online banking, now includes mobile and tablet banking, credit cards and payments, ATMs, digital branches, contact centers, and deposit operations including account opening systems for consumer deposits. These digital banking leaders take a proactive approach to collaborating with banking product groups to understand emerging technology and operational needs. Additionally, today's digital banking leaders are focused on cross functional teams driving acquisition, cross sales, servicing and transactions. Digital banking has become wholly intertwined with marketing as banks focus on digital marketing and social media as well as traditional marketing channels. The top-flight digital banking leaders represent the next generation in banking. Many have long career runways still ahead of them. They have grown up digital and think digital. While they drive the digital function, the best digital bankers have operated cross-functionally and manage business outcomes with measurable data.

CREDIT UNIONS AS FIERCE COMPETITION FOR TALENT – 57% of our searches on behalf of credit unions were filled with candidates coming directly from banks. This theme is a carry-over from last year, and based upon our numbers, is becoming even more prevalent. As we shared last year, credit unions are competing and beating the compensation offers of their bank counterparts, offering tremendous value in addition to base and bonus. Because credit unions cannot offer equity, they entice with cash compensation which often exceeds competing bank offers. While long term incentives are hugely attractive, cash remains king.

- ***Adding value beyond base and bonus***: Credit unions offer a tremendous suite of add-on benefits to their employment offers. Here's a snapshot as to why credit unions can attract strong bank candidates. They offer perks such as: life insurance; long- and short-term disability; discounts on mortgages, auto loans and personalized credit lines; education reimbursement towards graduate degrees; budgets for professional development courses; and a budget towards child dependent college education.

INTERNAL CANDIDATES – 22% of our searches had an internal candidate as part of the vetting process, up 11% from 2015. Of those, however, less than a quarter hired the internal candidate.

- ***Our Analysis***: Senior Leadership and Boards are addressing succession planning and demonstrating to their employees that a career path does exist within the institution. However, given that so few institutions hire their internal candidates, we surmise that these same senior teams and boards are recognizing the need, and the opportunity, to bring in outside talent to aggressively execute today's business plans.

COMPENSATION HISTORY IN HIRING – Nationwide, many states (California, Oregon, and Washington (pending)) and cities have enacted or have pending legislation which bans employers from inquiring about a candidate's prior compensation. The theory behind the legislation is that women and minorities sometimes began their careers at a pay disadvantage, and if their past salary is used as a marker for future salary offers, their pay will remain behind. In California (which is similar to other states that are enacting such legislation), employers and their agents are prohibited from seeking a candidate's compensation history information. Many of our clients and our search firm peers, have taken the bright line stance that this includes, without limitation, base pay, bonus or commission, equity and benefits. Conversely, the law also requires that employers provide the pay scale for an open position to a candidate upon his or her reasonable request. Whether this has been enacted in your state, or is soon to be, we advise each financial institution to seek legal counsel to determine the appropriate course of action. The fines for failing to comply are steep. It will be necessary for each institution to identify an appropriate compensation range for the position, and provide a detailed explanation of the skills, experience, and characteristics required for the role. This information will allow you to compensate for the actual skills the candidate brings to the role, and ensure compliance with both the letter and the spirit of the law, which seeks to establish a process which avoids the opportunity for bias based on sex, race, religion, etc. Generally speaking, we don't see this as a hurdle to attracting and recruiting the right talent. Instead, we feel this will provide for an expedited negotiation process and less "muddying" of the waters during that process.

These above-mentioned themes represent those most prevalent in our practice over the last 12 months. We also anticipate the evolution of enterprise risk management to come to the forefront in 2018 as well. And while we can't anticipate all that 2018 will bring, we do know that things are as good as they've been in a long time. So, the time is right to capitalize on a frothy market. According to NABE's Vice President Kevin Swift in light of NABE's 2018 Business Conditions Survey report, "[m]ore respondents report that their firms are hiring—and having trouble filling positions—than in the October survey...Looking at 2018 as a whole, 63% of respondents expect their firms to increase sales, and three times as many expect hiring to increase rather than decrease." This is of course good for our business, but it's a great sign for your customers and their businesses. Surges in hiring only occur when the economy is in a good place. The right digital banking strategy will enable your institution to capitalize on a strong economy and the massive wealth transfer which is occurring right now. And a focus on succession planning will position your bank for continued sustainability for a long time to come. Allow us to reiterate, the time to act is now.

About the Firm and the Author

McDermott & Bull is a full-service retained executive search firm with a dedicated Financial Institutions practice. The firm's Financial Institutions Practice Group partners with boards and senior leadership teams to align talent strategies with business strategies for banks, credit unions, asset managers and investment advisory firms. Clientele include the likes of Columbia Bank, Golden 1 Credit Union, First Republic Bank, Silicon Valley Bank, SAFE Credit Union, First American Trust Company, Bank of Marin, Technology Credit Union, Wescom Credit Union, Western Federal Credit Union, Luther Burbank Savings, East West Bank, Houlihan Lokey, Washington Trust Bank, Exchange Bank and United Capital.

Brandon Biegenzahn is the President of McDermott & Bull, and he co-chairs the firm's Financial Institutions Practice Group. Brandon is a corporate attorney by trade having practiced with Sheppard, Mullin, Richter & Hampton, and Buchalter Nemer in their corporate finance and real estate finance departments, respectively. Brandon received his Bachelor of Arts from the University of Southern California and his Juris Doctorate from Penn State.