

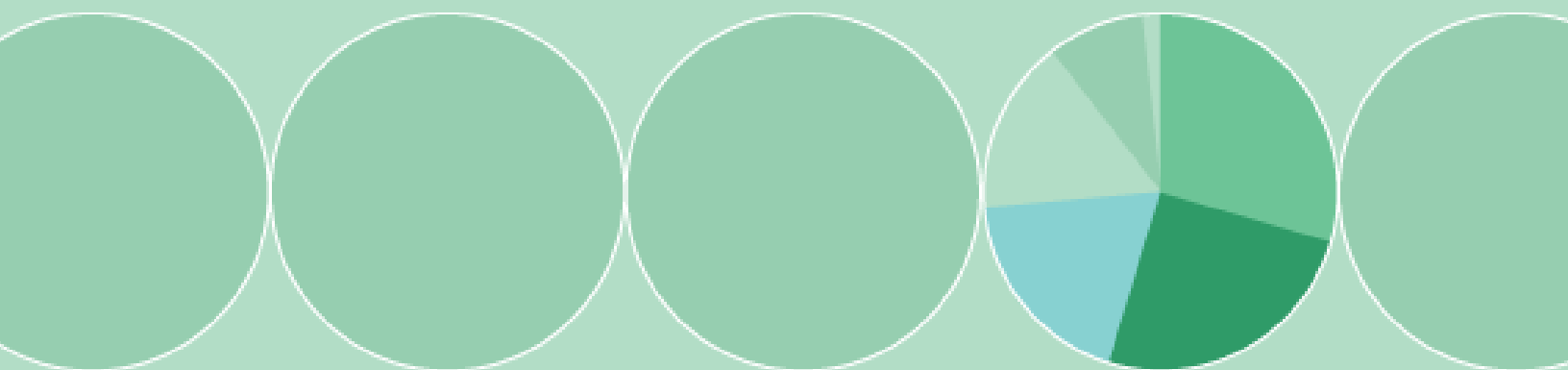


**WHERE KNOWLEDGE IS POWER**

IBISWorld Industry Report

December 04 2008

## Commercial Banking in the US: **52211**



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## Recession Update: January 06 2009

### Immediate Impact - DISASTER

IBISWorld believes that the impact of the current recession on this industry will be disaster.

Commercial Banks have faced significant turmoil in light of this credit crisis, but the drop in revenue does not materially reflect this. It's through the industry's profit margin that shows just how severe commercial banks have been affected. Over 2008, the industry's profit after tax dropped by 41.7%, while for 2009 a further fall of about 8% is expected (revised from the December forecast of 5.3%).

### Headwind

Although the credit crisis has revolved around the issue of subprime loans in default, the industry may face a second round of delinquencies, this time revolving around mortgages named Alt-A or Option Adjustable Rate (or Option-ARMs). A large proportion of mortgage holders in these categories have fallen behind on their payments, and further delinquencies may occur in the coming year. This will see further losses as a result, through loan loss provisions.

### Tailwind

The opportunities that have risen as a result of companies with large losses will see strong prospects to gain customers as banks fail. Additionally, troubled companies may present good valued acquisition opportunities to increase market share and grow customer base.

### Structural Changes

The commercial banking industry is highly regulated, and given the recent turmoil, greater regulations will be implemented. Given the moderately strong level of competition and heavy regulatory environment, barriers to entry are high. However, for those established firms in the industry, profit levels tend to be strong and this improves the industry's structural conditions.

### Can the Industry Weather the Storm?

A number of banks have and will continue to default under the pressure of increasing mortgage defaults. The low demand for housing and low interest rate environment will make it very difficult to expand interest income and grow profits. However, firms with enhanced liquidity flow, capital positions, and minimal subprime exposure will be able to push through this difficult year ahead.

### FORECAST - Slower industry expansion to occur

After years of solid growth through relaxed credit conditions, the outlook will be less prosperous. Although growth will be over 7% in 2010 and 2011, this will be far below the double digit expansions observed in the mid-2000s. Banks will be managed more conservatively, fewer risks will be taken, while new regulations will also mitigate growth. The industry is expected to turn in the 3rd qtr of 2010.

	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10
Quarterly Revenue \$m	177018.8	173435.5	179885.5	186335.6	187809.1	188578.8	194736.5	198585.0
Real Revenue Growth		-2.0	3.7	3.6	0.8	0.4	3.3	2.0

Forecast real revenue growth %	2008	2009	2010	2011	2012	2013

as published December 2008	-5.9	-3.2	6.8	6.7	4.8	1.9
New Revised Forecast	-9.7	-6.5	7.4	9.1	4.5	4.2

NOTE: This one page recession update discusses industry dynamics since the last update of the industry report and over the next few months. The purpose of this update is to provide additional information for the short term. The full report analyses the fundamentals of the industry over a longer time frame, and reflects the situation at the time of publication.

### Recession 2009: Whitepaper Available

If you would like a broader view of the factors driving this recession, please download our special report from [www.ibisworld.com/recession2009](http://www.ibisworld.com/recession2009).

## Industry Definition

This industry comprises establishments primarily engaged in accepting demand and other deposits and making commercial, industrial, and consumer loans. Commercial banks and branches of foreign banks are included in this industry.

### ACTIVITIES (PRODUCTS AND SERVICES)

The primary activities of this industry are:

- Accepting demand and other deposits and making commercial, industrial, and consumer loans.


The major products and services in this industry are:

- Deposits
- Business Lending
- Mortgages
- Home Equity
- Other

### SIMILAR INDUSTRIES

Industry:  52212 - Savings Banks in the US


Description:

Industry:  52213 - Credit Unions in the US

Description:

Industry:  52219 - Money Market & Other Banking in the US

Description: Establishments known as industrial banks and primarily engaged in accepting deposits

Industry:  52221 - Credit Card Issuing in the US

Description: Establishments primarily engaged in credit card banking


### DEMAND & SUPPLY INDUSTRIES


 11 - Agriculture, Forestry, Fishing and Hunting in the US

 21 - Mining in the US

 23 - Construction in the US

 51 - Information in the US

 52111 - Central Banking in the US

 53112 - Commercial Leasing in the US

## Key Statistics

### INFLATION ADJUSTED (CONSTANT) PRICES

	2005	2006	2007	2008	2009	
Industry Revenue	694,983.3	810,799.1	848,834.8	798,541.1	*773,011.3	\$Mil
Industry Gross Product	*355,763.3	*376,821.5	*332,362.3	*265,523.2	*260,800.7	\$Mil
Number of Establishments	*81,781	*82,000	*81,300	*80,000	*80,100	Units
Number of Enterprises	7,526	7,401	7,282	7,203	*7,100	Units
Employment	*1,880,000	*1,905,000	*1,956,586	*1,860,000	*1,855,000	Persons
Exports	--	--	--	--	--	
Imports	--	--	--	--	--	
Total Wages	134,238.3	141,232.3	145,714.3	136,000	*133,000	\$Mil
Total Assets	9,879.8	10,689.9	11,533.8	11,426.2	*11,824.4	\$Bil
Domestic Demand	NC	NC	NC	NC	NC	\$Mil

### REAL GROWTH

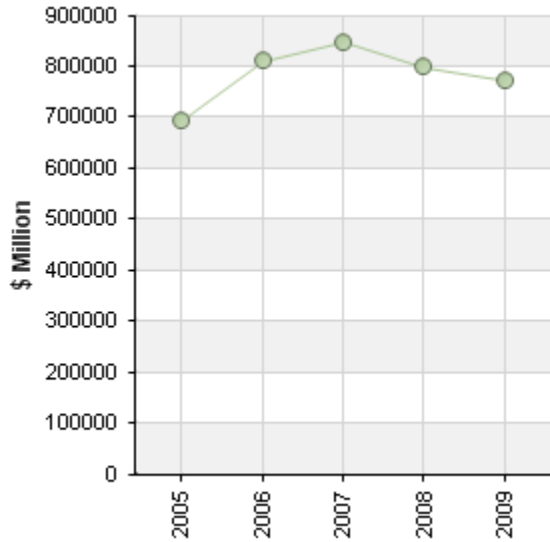
	2005	2006	2007	2008	2009	
Industry Revenue	16.1	16.7	4.7	-5.9	*-3.2	%
Industry Gross Product	*7.6	*5.9	*-11.8	*-20.1	*-1.8	%
Number of Establishments	*-1.5	*0.3	*-0.9	*-1.6	*0.1	%
Number of Enterprises	-1.4	-1.7	-1.6	-1.1	*-1.4	%
Employment	*2.7	*1.3	*2.7	*-4.9	*-0.3	%
Exports	NC	NC	NC	NC	NC	%
Imports	NC	NC	NC	NC	NC	%
Total Wages	7.4	5.2	3.2	-6.7	*-2.2	%
Total Assets	4.1	8.2	7.9	-0.9	*3.5	%
Domestic Demand	NC	NC	NC	NC	NC	%

### RATIO TABLE

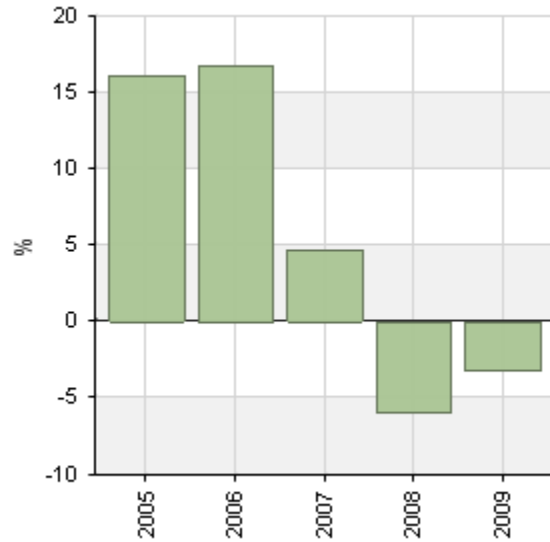
	2005	2006	2007	2008	2009	
Imports share of Domestic Demand	NC	NC	NC	NC	NC	%
Exports Share of Revenue	NC	NC	NC	NC	NC	%
Average Revenue per Employee	*0.37	*0.43	*0.43	*0.43	*0.42	\$Mil
Wages and Salaries Share of Revenue	19.32	17.42	17.17	17.03	*17.21	%

## GRAPHS

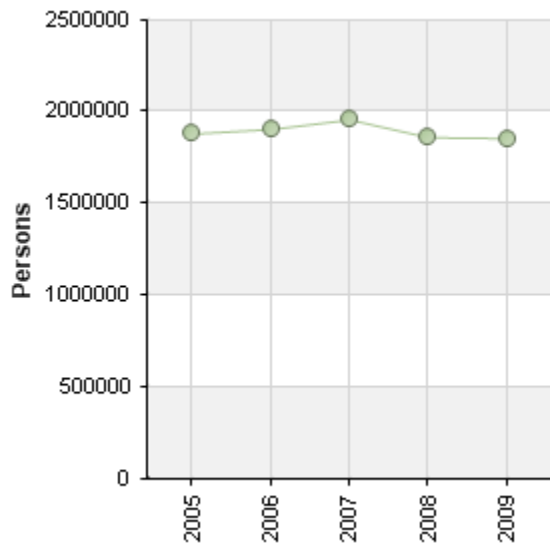
Revenue



Revenue Growth Rate



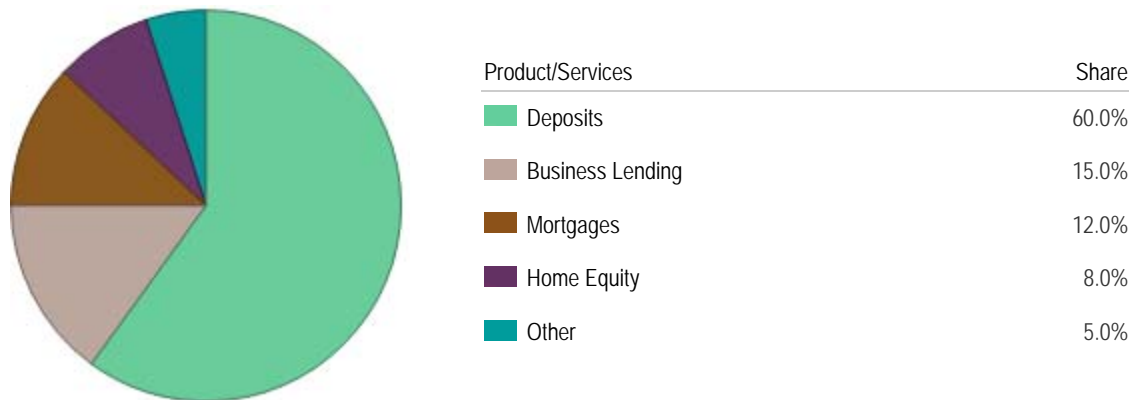
Employment



Note: Unless specified, an asterisk (\*) associated with a number in a table indicates an IBISWorld estimate and references to dollars are to US dollars.

# Segmentation

## PRODUCTS AND SERVICE SEGMENTATION



### Deposits

The Deposits product segment provides a comprehensive range of products to consumers and small businesses. These products will generally include traditional savings accounts, money market savings accounts, certificates of deposits (CDs), Individual Retirement Accounts (IRAs), and regular and interest-checking accounts.

Deposit products provide a relatively stable source of funding and liquidity for commercial banks. Firms will earn interest revenue from investing deposits in earning assets, through client facing lending and asset and liability management activities. Deposits also generate various account fees such as non-sufficient fund fees, overdraft charges and account service fees, while debit cards will generate interchange fees. Interchange fees are volume based and paid by merchants to have the debit transactions processed.

This is by far the largest product segment for banks, where IBISWorld estimates it accounts for around 60% of the industry.

### Business Lending

The Business Lending product segment includes a range of lending-related products and services. These are primarily offered to customers through client relationship teams and various product partners that are associated with the commercial banks. Products include commercial and corporate bank loans and commitment facilities which will cover business banking clients, middle market commercial clients, and large multinational corporate clients. Real estate lending products are likely to be issued to public and private developers, homebuilders and commercial real estate firms. Products also include indirect consumer loans which allow firms in the commercial banking industry to offer financing through automotive, marine, motorcycle and recreational vehicle dealerships across the US.

IBISWorld believes that this product segment generates around 15% of industry related revenues (segment related revenues tends to be larger for the major commercial banks).



## Mortgage

The Mortgage product segment generates revenue by providing a range of mortgage products and services to customers. Mortgage products are typically available to customers through a commercial bank's retail network, geographic branch centers, as well as through sales account executives and sales force personnel who offer customers direct telephone and online access to products. Firms will also serve customers through any partnerships they may have with various mortgage brokers.

In general, mortgage product offerings are for home purchasing and refinancing needs, where these mortgage products will have either fixed or variable rates. Commercial Banks will manage these mortgage portfolios through their balance sheets for asset and liability management purposes, or, as increasingly being observed, re-packaged into products and then on-sold into the secondary mortgage market to investors (i.e. collateralized debt obligations and securitization) - however still retaining customer relationships.

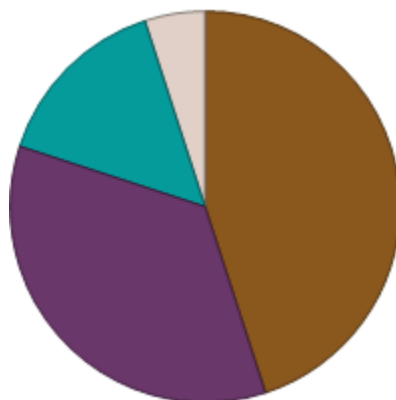
The mortgage business includes the origination, fulfillment, sale and servicing of first mortgage loan products. Servicing activities primarily include collecting cash for principal, interest and escrow payments from borrowers, and accounting for and remitting principal and interest payments to investors and escrow payments to third parties. Servicing income includes ancillary income derived in connection with these activities, such as late fees.

## Others

The Home Equity product segment generates revenue by providing a range of home equity products and services to customers. Home Equity products include lines of credit and home equity loans.

The Other product segment is comprised of various other consumer-related business activities that Commercial Banks may partake in, that fall within this industry. This may include forms of insurance, card services (although this area is primarily specific to industry NAICS code 52221 - Credit Card Issuing), and the allocation of interest income from loan activities not elsewhere classified. IBISWorld believes that this segment accounts for around 5% of industry revenues.

## MAJOR MARKET SEGMENTS



Market Segment	Share
Consumer/Retail Customers	45.0%
Small Business, Corporates, and Institutional	35.0%
Governmental Clients	15.0%
Other	5.0%

## Consumer/Retail Customers

The consumer and retail customer market segment is expected to account for the largest part of a commercial bank's customer base. Although these customers most often deal in relatively small transaction sizes, the sheer proportion of customer numbers makes this market segment significant.

Consumer and retail customers provide a substantial amount of deposits for commercial banks, where account keeping fees and investments made on the deposits make these customers highly profitable. Furthermore, with the high degree of competition in the Commercial Banking industry, the ability to attract and retain these customers is considered essential. If a commercial bank has a satisfied base of retail customers, they are then able to market various other products and services to them at minimal costs. For example, enticing customers to branch out from their primary banking activities (deposits) into mortgage products, fund management services, credit cards, and other banking sectors within that specific company.

## Small Business, Corporates, and Institutional Clients

Unlike the previous market segment, small businesses, corporates and institutional clients will deal in a much larger scale of transaction value. Although there may be fewer clients in this category, their dollar value of dealings is substantially larger. Corporate clients require large forms of business lending, and they too deposit cash into commercial banking accounts.

Generally speaking, larger corporates and institutional clients will deal with commercial banks whose assets are greater than \$1 billion. According to data from the Federal Deposit Insurance Corporation, commercial banks with assets in excess of \$1 billion had a greater exposure to commercial and industrial (C&I) and credit card loans. On the other hand, commercial banking institutions with less than \$1 billion in assets had a greater exposure to residential mortgages, commercial real estate and agriculture loans.

IBISWorld believes that this market segment accounts for 35% of the industry.

## Governmental Clients

Commercial banks in this industry provide loans to and accept deposits from government institutions. Loans will vary across regions and governmental departments, but tend to be similar to other market segments and can include various types of real estate lending, personal loans, auto loans, and various other governmental-type loans.

## Other

Customers in the 'Other' market segment demand a range of other products and services. The Other category holds only a small market share, and generally involves a once-off, niche type of transactional service. These customers can often be involved in student loan services, retirement services, auto finance, and other forms of real estate.

## INDUSTRY CONCENTRATION

Concentration in this industry is low

Commercial banking in the US displays low concentration, with the four largest players accounting for an estimated market share of 23%. This market share includes Wachovia, which holds an estimated 4% of the market. Wachovia has

been acquired by JP Morgan, and once the two companies eventually merge, the combined entity is set to hold a market share of around 5-6%.

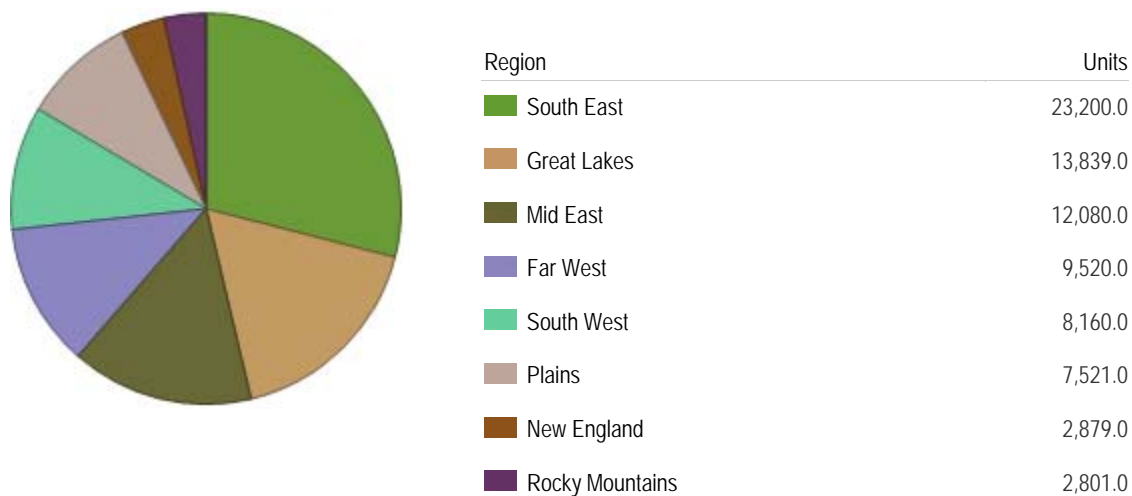
According to Staff Studies at the Board of Governors of the Federal Reserve System, concentration of US generally has increased since 1980. For example, the twenty-five largest commercial banking organizations accounted for 29.1% of deposits in 1980, 34.9% in 1990, 41.5% in 1994, and 51.2% in 1998. Share of deposits for the 100 largest banking organizations during the same years were 46.8%, 61.4%, 65.9%, and 70.9%. Since then, the Commercial Banking industry has continued to operate in a highly competitive environment that has continued to experience intensified competition. Continued merger activity has produced larger, better-capitalized companies that grow to offer a wider array of financial products and services, and at more competitive prices.

The relatively modest concentration levels indicates that the United States as a whole probably is not a meaningful banking market even for wholesale banking services for midsize corporations, and much less for retail banking services for households and small business, which generally rely on banks with local presence. Very large corporations have access to the capital markets and banking services from foreign banks so the relevant geographic market may be international in scope. For middle-size companies, banking markets may be statewide or regional in scope, but less than nationwide, for many of their banking services.

## GEOGRAPHIC SPREAD

Year: 2008

Number of Establishments by Region



The geographic spread of Commercial Banking establishments across the US is vast. Unlike many other industries, there is no single state that holds a prominent market share of establishment numbers.

In terms of geographic spread by region, the South East region has the largest proportion of establishments, estimated to hold about 29% of total industry establishments. This region holds some major economic areas such as Florida (5.9% of establishments), North Carolina (3.6% of establishments), and Georgia (3.3% of establishments). Accounting for a total of 12 states, the South East Region is clearly the largest region by size and population, which somewhat reflects the amount

of establishment numbers within this region. This region also holds the largest proportion of revenue, expected to be 25% in 2008, with North Carolina generating an estimated 6.5% of industry revenue.

Although the Mid East region holds the third largest percentage of establishments, at 15.1% (behind the Great Lakes at 17.3%), this region generates the second largest amount of revenue, estimated to be about 22.5%. The Mid East region holds the largest financial state, that of New York, which is expected to generate about 16.5% of total industry revenue, while only accounting for 5.6% of the total amount of establishments over 2008. As the New York region headquarters the majority of the largest banking operators, this region has recently been impacted by the subprime troubles. Many employees have lost their jobs in this region, as large financial corporations have had to scale down their operations in order to save cash. Despite this, the region continues to generate the greatest amount of income, and will remain the financial hub of the US for some time.

Other major commercial banking areas across the US include the Great Lakes region (17.3% of establishments), with Illinois accounting for an estimated 5.5% of total revenue and 5.1% of all establishments, and the Far West region (11.9% of establishments), with the state of California generating an estimated 9.9% of industry revenue over 2008, with only 7.8% of the establishments.

## Market Characteristics

### MARKET SIZE

After a tumultuous 2007 and 2008, the Commercial Banking industry in the US will be banking on a better 2009. The subprime crisis erupted in mid-late 2007 and has sent shockwaves through the entire commercial banking sector. With billions of dollars lost in financial assets, profits, and revenue, financial companies have had to shed employment numbers. Large multinational companies that have had exposure to subprime debt have experienced some of the most difficult operating conditions in years, and this subprime turmoil has been the catalyst towards a US and global financial collapse, which could ultimately pull the US into recession.

The Commercial Banking industry is expected to experience a drop in revenue of nearly 6% over 2008, which will reduce revenue to \$798.5 billion. Profits will also fall, dropping by a staggering 41.7% to about \$58.8 billion. Many banks and investment institutions have tumbled as a result, including Bear Stearns, IndyMac Bank, Washington Mutual, and Wachovia Corporation, with further shake-outs expected throughout the coming year. Industry losses are forecast to continue throughout 2008, and drag into 2009 as more subprime, alt-A, and option ARM loans are reset, and consumers fall further behind on mortgage repayments.

Loan loss provisions have been the major area where commercial banks have suffered, with each quarter of financial results throwing numerous analysts off guard. Home prices have fallen considerably throughout 2008, and these tough mortgage market conditions are expected to lead to further reductions in enterprise numbers. Overall, the Commercial Banking industry has not seen the end of this liquidity crisis, and it may drag out for many years to come.

### LINKAGES

#### Demand Linkages

##### 11 - Agriculture, Forestry, Fishing and Hunting in the US

Establishments in the agricultural sector will require financing from Commercial Banks.

##### 21 - Mining in the US

Establishments in the mining sector will require financing from Commercial Banks.

##### 23 - Construction in the US

Construction industries often require financing and loans in order to pay for their building and construction activities.

##### 51 - Information in the US

These industries are fairly capital intensive, which lead to an increase in demand for commercial loans.

#### Supply Linkages

##### 52111 - Central Banking in the US

Commercial Banks often require liquidity and funding from the Federal Reserve.

##### 53112 - Commercial Leasing in the US

Commercial Banks will require rental properties for many of their branch and retail networks.

### DEMAND DETERMINANTS

## Deposits

The demand for bank deposits is affected by the real after-tax return on such deposits relative to alternative investments. Increased volatility of equity prices and deteriorating economic conditions boosts the demand for deposits, as the demand for liquidity increases. The overall level of household income, corporate profits and free cash flows will also determine the inflow of funds to bank deposits.

## Loans

The demand for loans is determined by the real after-tax cost of debt relative to the cost of equity. The demand for debt financing typically falls as the real cost of such financing increases. Commercial and Industrial (C&I) loans depend on investment spending by businesses on plant and equipment and other capital goods, as well as financing related to mergers and acquisitions. C&I loans are quite cyclical and tend to fall as general economic activity slows and increase when the economy recovers again.

Commercial Real Estate loans are largely determined by investment in nonresidential structures, such as multifamily housing, construction and land development, where investments in multifamily housing tend to be more volatile.

The demand for consumer loans largely depends on consumer expenditure, and particularly durable goods expenditure. The level of securitization also determines the size of such loans on banks' balance sheets. A fall in the level of securitization, which results when the cost of funding these loans on the balance sheet declines relative to the cost of securitizing them, will boost the loans on banks' books. The housing market also largely impacts the demand for Real Estate loans, which again are driven by factors such as mortgage rates.

## DOMESTIC AND INTERNATIONAL MARKETS

### Domestic and International Markets Exports

Exports in this industry are low

Exports in this industry are steady

### Domestic and International Markets Imports

Imports in this industry are low

Imports in this industry are steady

### Domestic and International Markets Analysis

There are no imports or exports

## BASIS OF COMPETITION

Competition in this industry is high

Competition in this industry is increasing

The activities within the Commercial Banking industry in the US are highly competitive. Generally, the lines of activity and markets served by this industry involve competition with banks, thrifts, credit unions, government agencies, mortgage brokers and other nonbank organizations offering financial services. Firms in this industry will also compete against banks

and thrifts owned by nonregulated diversified corporations and other entities which offer financial services through alternative delivery channels, such as the internet.

The basis of competition center around various factors, such as customer service, interest rates on loans and deposits, quality and range/variety of products and services, lending limits and customer convenience, such as locations of offices. Customers' ease of access to banks' services is an important aspect of a banks' competitiveness. Relatively modest concentration levels indicate that local, state and regional markets are very important to banking organizations, which highlights the importance of an accessible network of distribution channels, such as bank branches, ATM's, EFTPOS, telephone and internet banking, in gaining a competitive advantage. The importance of such a distribution network is further highlighted by the observation that, despite the large decline in the number of commercial banks and the explosion in the number of ATM's, growth in the number of banking offices has continued. Transaction execution, innovation, technology, reputation and price are also methods on which firms compete in this industry.

IBISWorld believes that competitive conditions will continue to intensify as continued merger activity in the financial services industry produces larger, better-capitalized and more geographically diverse companies that are capable of offering a wider array of financial products and services at more competitive prices.

Competition among banking organizations is changing its focus from the quality and extent of services to the price of services. This change emerged with the deregulation of commercial banking in the US. The removal of federal limits on the interest rates that banks could pay depositors initiated this change. The inability of commercial banks to pay market interest rates resulted in competition for depositors' funds taking the form of "quality" and other "nonprice" rivalry.

Deregulation of commercial banking in the US has resulted in increased competitive pressure from other bank and nonbank organizations. The Depository Institutions Deregulation and Monetary Control Act of 1980 permitted federally chartered savings banks to engage in commercial and industrial (C&I) lending, up to 5% of their assets. The Garn-St Germain Act of 1982 empowered federally chartered savings and loans associations to engage in C&I lending, up to 10% lending of their assets, and increased the limit on federally chartered savings institutions to 10% of their assets. The most recent change to federally chartered thrift institutions' (savings and savings and loans institutions) C&I lending has come with the enactment of the Economic Growth and Regulatory Paperwork Reduction Act of 1996, which increased the limit to 20% of assets, with the stipulation that all C&I lending in excess of 10% of assets must be small business loans. Although the degree of actual competition provided by thrift institutions may be modest, their role as potential competitors is important.

## LIFE CYCLE

### Life Cycle Stage

The life cycle stage is mature

### Life Cycle Reasons

- Industry growth rate has slowed to that of the overall economy
- Merger and acquisition activity has subsided
- Number of enterprises declining slowly
- Stable and clearly segmented product groups
- Slowdown in the rate of technological change

### Life Cycle Analysis

Commercial banking in the US has been in a mature stage of the life cycle since the early 1990s, with industry growth rates, as measured by Industry Gross Product, declining throughout the decade, reaching that of the general economy by the end of the 1990s. The industry has experienced increased competition in recent years, as regulatory requirements have become more relaxed. The following scramble for market share triggered considerable merger and acquisition activity, particularly in the five years to 2000. The result has been a slow decline in the number of industry participants.

Industry revenue will have grown at an average real rate of 2.5% per annum in the ten years to 2008, while industry gross product has experienced an average annualized growth of 0.7%. This is reasonably solid growth given the recent losses made in the industry due to the subprime turmoil. IBISWorld is also forecasting that into the outlook period, the industry will recover, and experience more normal operating conditions and profit growth. Hence the industry is still considered to be in a maturity phase of its life cycle.



## Industry Conditions

### BARRIERS TO ENTRY

Barriers to entry in this industry are medium  
These barriers are decreasing

- Approval of Federal Reserve System
- Regulatory Requirements
- Strong competition

In order to operate as a commercial bank in the US, the corporation or a similar organization has to receive prior approval of the Board of Governors of the Federal Reserve System.

Commercial banks in the United States are subject to the supervision of, and regular inspections by, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and other federal and state regulatory agencies. Banks are restricted in their range of activities, in acquisitions of other banks and in interstate banking activities. Furthermore, commercial banks are subject to capital and operational requirements based on risk and leverage.

The relaxation of federal restrictions starting in the early 1980s has led to increased competition in the commercial banking industry. Thrift institutions (savings and loan associations and savings banks) are financial intermediaries that raise funds primarily through time and savings deposits and invest principally in residential mortgages and consumer loans. Regulations at both state and federal level has limited the types of deposit accounts that thrifts were permitted to offer and the extent to which they were allowed to invest in non-mortgage assets. The Depository Institutions Deregulation and Monetary Control Act of 1980 permitted federally chartered savings banks to engage in commercial and industrial (C&I) lending. Subsequent acts have increased the percentage of C&I loans to total assets, currently standing at 20% for federally chartered thrift institutions, where all C&I lending in excess of 10% of assets must be small business loans.

The relaxation of restrictions has led to greater portfolio diversification by many thrift institutions, although, few thrifts have taken full advantage of their expanded powers. Their role as potential competitors is important, however.

### TAXATION

Goods	Tax Rate	Tax Type
Federal statutory rate	35%	Other

The Commercial Banking industry observes a federal statutory tax rate of 35%. This measure ensures comparability of Net Interest Income arising from taxable and tax-exempt sources.

The industry is subject to the Income tax laws of the US, its states and municipalities and those of the foreign jurisdictions in which a company may operate in. These tax laws are complex and subject to different interpretations by the taxpayer and the relevant government taxing authorities. In establishing a provision for income tax expense, a firm must make judgments and interpretations about the application of these complex tax laws. The commercial bank must also make estimates about when in the future certain items will affect taxable income in the various tax jurisdictions, both domestic and foreign.

## INDUSTRY ASSISTANCE

The level of Industry Assistance is none  
The trend of Industry Assistance is steady

There are no specific tariffs for this industry

Commercial Banking does not receive any protection by way of direct or indirect tariffs.

## REGULATION AND DEREGULATION

The level of Regulation is heavy  
The trend of Regulation is decreasing

### Federal Reserve System

The Federal Reserve is the federal supervisor and regulator for all US banks and bank holding companies, including financial holding companies formed under the authority of the Gramm-Leach-Bliley (GLB) Act of 1999, and of state-chartered commercial banks that are members of the Federal Reserve System. In overseeing these organizations, the Federal Reserve seeks primarily to promote their safe and sound operation and their compliance with laws and regulations.

The Federal Reserve exercises important regulatory influence over entry into the US banking system and the structure of the system through its administration of the Bank Holding Company Act, the Bank Merger Act (with regard to state member banks), the Change in Bank Control Act (with regard to bank holding companies and state member banks), and the International Banking Act. In carrying out its responsibilities, the Federal Reserve coordinates its supervisory activities with other federal banking agencies, state agencies, functional regulators, and the bank regulatory agencies of other nations.

### Bank Holding Company Act

Under the Bank Holding Company Act, a corporation or similar organization must obtain the Federal Reserve's approval before forming a bank holding company through the acquisition of one or more banks in the United States. Once formed, a bank holding company must receive Federal Reserve approval before acquiring or establishing additional banks. Bank holding companies generally may engage only in those activities that the Board of Governors of the Federal Reserve (the Board) has previously determined to be closely related to banking under section 4(c)(8) of the act. Since 1996, the act has provided an expedited prior notice procedure for certain permissible non-banking activities and for acquisitions of small banks and non-bank entities.

Since 2000, the Bank Holding Company Act has permitted the creation of a special type of bank holding company called a financial holding company (see sub-section Gramm-Leach-Bliley Act). These are allowed to engage in a broader range of non-bank activities: Among other things, they may affiliate with securities firms and insurance companies and engage in certain merchant banking activities. Bank holding companies seeking a financial holding company status must file a written declaration with the Federal Reserve System, which are then acted on by one of the Reserve Banks under authority delegated by the Board. Financial holding companies do not have to obtain the Board's prior approval to engage in or acquire a company engaged in new financial activities under the GLB Act. Instead the financial holding company

must notify the Board within thirty days after commencing a new activity or acquiring a company engaged in a new activity.

### **Bank Merger Act**

The Bank Merger Act requires that all proposals involving the merger of insured depository institutions be acted on by the appropriate federal banking agency. If the surviving bank is a state member bank, the Federal Reserve has primary jurisdiction. Before acting on a merger proposal, the Federal Reserve considers financial and managerial resources of the applicant, the future prospects of the existing and combined institutions, the convenience and needs of the community to be served, and the competitive effects of the proposed merger.

### **Change in Bank Control Act**

The Change in Bank Control Act requires persons seeking control of a US bank or bank holding company to obtain approval from the appropriate federal banking agency before completing the transaction. The Federal Reserve is responsible for reviewing changes in the control of state member banks and bank holding companies. In its review, the Federal Reserve considers the financial position, competence, experience, and integrity of the acquiring person; the effect of the proposed change on the financial condition of the bank or bank holding company being acquired; the effect of the proposed change on competition in any relevant market; the completeness of information submitted by the acquiring person; and whether the proposed change would have an adverse effect on the federal deposit insurance funds.

### **International Banking Act**

The International Banking Act, as amended by the Foreign Bank Supervision Enhancement Act of 1991, requires foreign banks to obtain Federal Reserve approval before establishing branches, agencies, commercial lending company subsidiaries, or representative offices in the United States. In reviewing proposals, the Federal Reserve generally considers whether the foreign bank is subject to comprehensive supervision or regulation on a consolidated basis by its home country supervisor. Furthermore, whether the home country supervisor has consented to the establishment of the US office.

### **Gramm-Leach-Bliley Act (GLBA)**

The GLBA repealed those provisions of the Glass-Steagall Act and the Bank Holding Company Act that restricted the ability of bank holding companies to affiliate with securities firms and insurance companies. The provisions of GLBA establish conditions that a bank holding company or a foreign bank must meet to be deemed a financial holding company to engage in expanded activities. Consequently, a financial holding company, and the companies under its control, are permitted to engage in activities considered 'financial in nature' as defined by the GLBA and Federal Reserve Board interpretations, and therefore may engage in a broader range of activities than permitted for bank holding companies and their subsidiaries. A financial holding company may engage directly or indirectly in activities considered financial in nature, either de novo or by acquisition, provided the financial holding company gives the Federal Reserve Board after-the-fact notice of the new activities. The Gramm-Leach-Bliley Act also permits national banks, to engage in activities considered financial in nature through a financial subsidiary, subject to certain conditions and limitations.

In addition to controlling depository institutions, financial holding companies may engage in securities underwriting and dealing, serve as insurance agent and insurance underwriter, act as a futures commission merchant, and engage in merchant banking. Permissible activities also include activities that the Board and the Secretary of the Treasury jointly determine to be financial in nature or incidental to financial activities and activities that the Federal Reserve determines

are complimentary to a financial activity. Under the GLBA, the Federal Reserve has supervisory oversight authority and responsibility for bank holding companies including those that operate as financial holding companies.

### **Riegle-Neal Interstate Banking and Branching Efficiency Act**

According to the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the "Interstate Banking and Branching Act"), a bank holding company may acquire banks in states other than its home state without regard to the permissibility of such acquisitions under state law, but subject to any state requirement that the bank has been organized and operating for a minimum period of time, not exceeding five years, and the requirement that the bank holding company, after the proposed acquisition, controls no more than 10% of the total amount of deposits of insured depository institutions in the US and no more than 30% or such lesser or greater amount set by state law of such deposits in that state.

Subject to certain restrictions, the Interstate Banking and Branching Act also authorizes banks to merge across state lines, with the surviving bank retaining interstate branches. Furthermore, the Interstate Banking and Branching Act permits a bank to open new branches in a state in which it does not already have banking operations if such state enacts a law permitting de novo branching.

### **Supervision for Safety and Soundness**

To ensure the safety and soundness of banking organizations, the Federal Reserve conducts on-site examinations and inspections and off-site surveillance and monitoring. The review entails an assessment of the quality of the processes in place to identify, measure, monitor, and control risk; an appraisal of the quality of the institution's assets; an evaluation of management, including an assessment of internal policies, procedures, controls, and operations; an assessment of the key financial factors of capital, earnings, liquidity, and sensitivity to market risk; and a review for compliance with applicable laws and regulations.

At the end of 2006, around 2,000 state-chartered banks were members of the Federal Reserve System. These banks represented approximately 27% of all insured US commercial banks and controlled approximately three-quarters of US's bank deposits. The guidelines for examination of state member banks are fully consistent with section 10 of the Federal Deposit Insurance Act, amended by section 111 of the Federal Deposit Insurance Corporation Improvement Act of 1991 and by the Riegle Community Development and Regulatory Improvement Act of 1994. A full-scope, on-site examination of state member banks is required at least once a year; exceptions are certain well-capitalized, well-managed institutions having assets of less than \$250 million, which may be examined once every 18 months.

Federal Reserve guidelines call for annual inspections of large bank holding companies as well as smaller companies that have significant non-bank assets. In judging the financial condition of the subsidiary banks owned by holding companies, Federal Reserve examiners consult examination reports prepared by the federal and state banking authorities that have primary responsibility for the supervision of these banks.

The Federal Reserve conducts specialized examinations of banking organizations in the areas of information technology, fiduciary activities, transfer agent activities, and government and municipal securities dealing and brokering. The information technology reviews have been integrated into the overall process of safety and soundness supervision.

US bank holding companies are required to submit period regulatory financial reports, referred to as FR Y-9 and FR Y-11. This is to provide information that is essential to the supervision of the organizations. The FR Y-9 series of reports provides standardized financial statements for the consolidated bank holding company. The reports are used to detect

emerging financial problems, review performance and conduct pre-inspection analysis, monitor and evaluate risk profiles and capital adequacy, evaluate proposals for bank holding company mergers and acquisitions, and analyze the holding company's overall financial condition. The FR Y-11 series of reports aids the Federal Reserve in determining the condition of bank holding companies that are engaged in non-banking activities and in monitoring the volume, nature, and condition of their non-banking subsidiaries.

## Capital and Operational Requirements

The Federal Reserve Board, the Comptroller and the FDIC have issued substantially similar risk-based and leverage capital guidelines applicable to United States banking organizations. These regulatory agencies may, from time to time, require that a banking organization maintain capital above the minimum levels either due to its financial condition or actual or anticipated growth.

The Federal Reserve Board risk-based guidelines define a three-tier capital framework. Tier 1 capital consists of common and qualifying preferred shareholders' equity, less certain intangibles and other adjustments. Tier 2 capital consists of preferred stock not qualifying as Tier 1 capital, subordinated and other qualifying debt, and the allowance for credit losses up to 1.25% of risk-weighted assets. Tier 3 capital includes subordinated debt that is unsecured, fully paid, has an original maturity of at least two years, is not redeemable before maturity without prior approval by the Federal Reserve Board and includes a lock-in clause precluding payment of either interest or principal if the payment would cause the issuing bank's risk-based capital ratio to fall or remain below the required minimum. The sum of Tier 1 and Tier 2 capital less investments in unconsolidated subsidiaries represents qualifying total capital, at least 50% of which must consist of Tier 1 capital.

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), among other things, identifies five capital categories for insured depository institutions (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized) and requires the respective federal regulatory agencies to implement systems for "prompt corrective action" for insured depository institutions that do not meet minimum capital requirements within such categories. FDICIA imposes progressively more restrictive constraints on operations, management and capital distributions, depending on the category in which an institution is classified. Failure to meet the capital guidelines could also subject a banking institution to capital raising requirements.

An "undercapitalized" bank must develop a capital restoration plan and its parent holding company must guarantee that bank's compliance with the plan. The liability of the parent holding company under any such guarantee is limited to the lesser of five percent of the bank's assets at the time it became "undercapitalized" or the amount needed to comply with the plan. Furthermore, in the event of the bankruptcy of the parent holding company, such guarantee would take priority over the parent's general unsecured creditors. In addition, FDICIA requires the various regulatory agencies to prescribe certain non-capital standards for safety and soundness relating generally to operations and management, asset quality and executive compensation and permits regulatory action against a financial institution that does not meet such standards.

The various regulatory agencies have adopted substantially similar regulations that define the five capital categories identified by FDICIA, using the total risk-based capital, Tier 1 risk-based capital and leverage capital ratios (Tier 1 capital divided by adjusted average total assets) as the relevant capital measures. Such regulations establish various degrees of corrective action to be taken when an institution is considered undercapitalized. Under the regulations, a "well capitalized" institution must have a Tier 1 risk-based capital ratio (Tier 1 capital divided by risk-weighted assets) of at least 6%, a total risk-based capital ratio (Total capital divided by risk-weighted assets) of at least 10% and a leverage ratio of at least 5%

and not be subject to a capital directive order. Under these guidelines each of the banks (of a Bank holding company) is considered well capitalized.

### **Subprime Mortgage Lending**

In mid-2007, the Federal Financial Regulatory Agencies issued a final Statement on Subprime Mortgage Lending to address issues relating to certain adjustable-rate mortgage (ARM) products that can cause payment shock.

The statement describes the prudent safety and consumer protection standards that institutions should follow to ensure borrowers obtain loans they can afford to repay. These standards include a fully indexed, fully amortized qualification for borrowers and cautions on risk-layering features, including an expectation that stated income and reduced documentation should be accepted only if there are documented mitigating factors that clearly minimize the need for verification of a borrower's repayment capacity. Consumer protection standards include clear and balanced product disclosures to customers and limits on prepayment penalties that allow for a reasonable period of time, typically at least 60 days, for customers to refinance prior to the expiration of the initial fixed interest rate period without penalty.

The statement also encourages institutions to work constructively with residential borrowers who are financially unable or reasonably expected to be unable to meet their contractual payment obligations on their home loans. Workout arrangements that are consistent with safe and sound lending practices are generally in the long-term best interest of both the financial institution and the borrower.

### **Basel II**

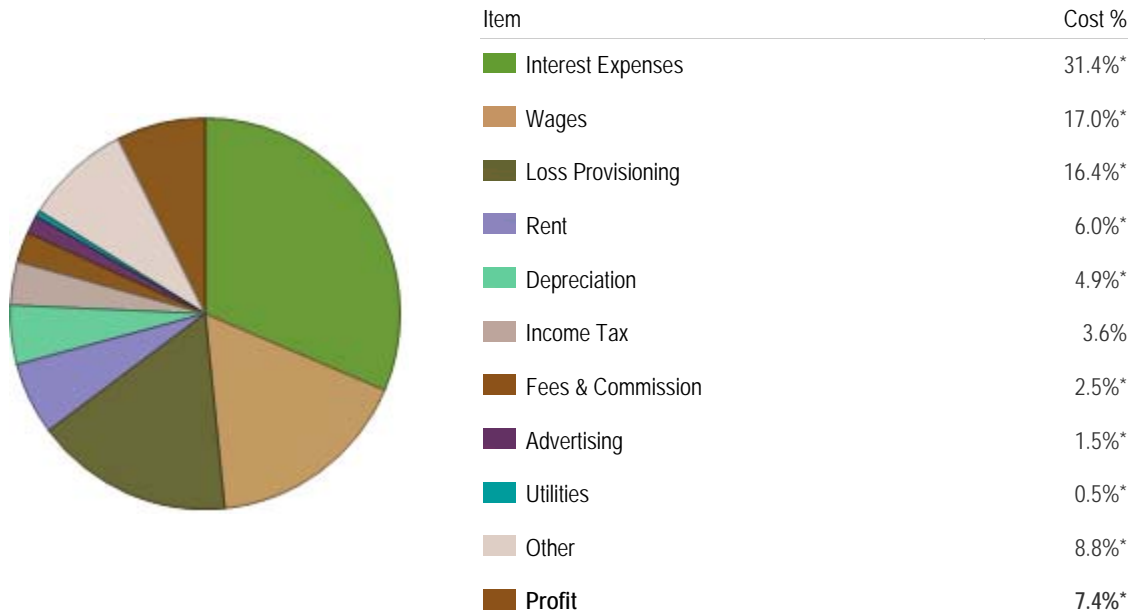
The Basel Committee on Banking Supervision finalized Basel II by the fourth quarter of 2004, with implementation effected in member countries by year-end 2007. Basel II builds on the first capital accord, and attempts to obtain important public policy benefits by improving banks' capital adequacy framework along two important dimensions; by developing capital regulation that encompasses not only minimum capital requirements, but also supervisory review and market discipline; and, by increasing substantially the risk sensitivity of the minimum capital requirements.

Basel II aims to match the level of capital to the amount of risk, while ensuring that all the components of the risk are provided against. The more complex the risk, the more complex is the Basel II solution. This implies that the new accord attempts to eliminate the "one-size-fits-all" risk approach, indicating that banks can decide where on the complexity scale they wish to operate. In general, Basel II is seeking a level playing field for banks operating across national boundaries. However, a bank unnecessarily applying a complex capital regime will pay the substantial cost of implementing and operating that regime but will receive a poor return on that investment in terms of capital reduction and cost of funding. Furthermore, the flexibility of Basel II arrangements and a number of national directions will create issues of globally operating banks and their supervisors.

Although representing a move away from the "one-size-fits-all" approach through the introduction of flexibility and enabling the reflection of complexity of the business undertaken by specific banks, Basel II is expected to increase compliance costs, resulting in increased merger activity or exiting by smaller banking organizations.

## **COST STRUCTURE**

Year: 2008



## Profits and Taxes

Profit for the Commercial Banking industry will amount to \$58.79 billion over 2008. Profitability is expected to be 7.4% of industry revenue, which is a significant drop compared to a couple of years ago, when the margin sat at healthy double digit levels. The global credit crunch, brought about by the subprime market, has significantly reduced margins for many Commercial Banks, and in the two year period from 2006 to 2008 profits have fallen by 25.8% and 41.7% per year respectively. This sharp drop in profits has primarily been as a result of rising interest expenses from consumer and small business credit costs, higher credit costs and wholesale funds, higher loan loss provisions, and a greater amount of debt write-offs from loan foreclosures.

As a percentage of revenue, income tax has dropped in recent years as profits have tumbled. For 2008, income tax will be about 3.6%, while in the four years to 2006 it averaged about 8.8%. In terms of income tax as a percentage of profit before tax, the rate is generally stable with commercial banks having to fork out between 30% and 33% of their earnings to the tax department. In 2008 it is expected to be 31.6%.

## Major Expenses

In 2008, loan loss provisions are set to reach a record \$130.6 billion, which will represent 16.4% of revenue. This is a significant increase compared to the five year average between 2002 and 2006 of just 4.8%. Loan loss provisions have been significant, as mortgage customers have simply foreclosed on their properties and handed back their keys.

The single largest cost faced by commercial banks is interest expenses. These are determined by the amount of liabilities, type and maturity of the liabilities, market interest rate conditions, and competition in lending markets. The most significant item in interest expenses comes from domestic office deposits (over 50% of interest expenses), while other areas of interest expenses for Commercial Banks comes from foreign office deposits, federal funds purchased, trading liabilities and other borrowed money, and subordinated notes and debentures. Over the past four years, interest expenses have typically been around the 30% mark.

Labor costs are another significant expense item for Commercial Banks, estimated to account for 17% of industry revenue at the end of 2008. The profitability of a Commercial Bank can be directly related to the quality of its employees and consumer satisfaction; as a result, staff expenses will always be high for this industry. Commercial Banks will employ numerous salespeople, tellers, and customer service personnel across their network of branch offices. As there are an estimated 80,000 establishments in this industry and 1.86 million people are employed within the Commercial Banking sector the average establishment will hold 23 people. Total wage costs in 2008 will be about \$136 billion, where each establishment will spend \$1.7 million on wages. The average wage per employee in 2008 is set to be about \$73,118.

### The minor costs

A key to success in attaining and retaining banking customers is to have an easily accessible branch. Banks are ever expanding their presence across the US, although the number of enterprises is in decline (primarily as a result of acquisitions). Consequently, commercial banks have found it difficult to purchase the location of a bank branch, and therefore must rent or lease the premises. IBISWorld estimates that about 2 in every 3 bank branches are under rental/lease agreements, hence the significant costs associated in this area, at about 6% of industry revenue.

There are various other expenses related to this industry, including professional fees and commissions, loss provisioning, advertising, utility expenses, depreciation, data processing, and telecommunication fees. As competition has intensified in this industry, IBISWorld believes that these costs have also escalated.

## CAPITAL AND LABOR INTENSITY

The level of Capital Intensity is medium

- Human resources form the basis of this industry
- There are substantial investments in branches and technology infrastructure
- There are ongoing costs involved with keeping up-to-date with technological equipment

The industry is characterized by establishments providing financial services on a state level to a national level. In order to compete effectively, a physical presence is required in the form of branches and ATMs. Industry participants have invested substantially in a branch network as a means of distributing their services. Further and continuous investments in technology and communication infrastructure are necessary to remain competitive. Such investment costs will include keeping up with technology improvements, maintaining a strong branch network and distribution status, increasing ATM presence, and aims to increase efficiencies with internet and other electronic means.

There have been efforts to reduce capital intensity by selling property and closing branches, aided by the development of direct distribution channels and technological improvements.

The industry requires a substantial amount of personnel to operate effectively. Labor costs are in the hundreds of billions of dollars, and continue to rise as branch networks expand. Overall the level of capital intensity is medium, as indicated by the capital to labor ratio of 3.5:1, meaning that for every unit spent on capital, another 3.50 units are spent on labor.

## TECHNOLOGY AND SYSTEMS

The level of Technology Change is medium



Firms in this industry operate in a highly competitive environment that is experiencing intensified competition as merger and acquisition activity continues to be prevalent. This activity produces larger, better-capitalized companies that are capable of offering a wider array of financial products and services, and at more competitive prices. The technological advances and the growth of e-commerce have made it possible for many 'nondepository' institutions to offer products and services that traditionally were banking products, and for financial institutions to compete with technology companies in providing electronic and Internet-based financial solutions.

In addition, technology has significantly changed the commercial banking industry by lowering the cost of storing, processing and accessing data through the growth of low-cost communications equipment. Technology will continue to contribute to significant changes in retail payments systems and financial services distribution channels, bank risk management and data assessment.

The increasing need for technologic empowerment and continuous improvement of equipment, new pricing structures and distribution channels have emerged. It is expected that these developments will encourage customers to adapt to these new, low-cost distribution channels in favor of more costly alternatives.

Access to the internet, restricted internal intranets and increasingly secure transmission of information is expected to accelerate the use of network use as a means to reduce costs.

## INDUSTRY VOLATILITY

The level of volatility is medium

Industry revenue is affected by fluctuations in the level of interest rates, as higher interest rates will flow through to the industry in the form of higher average rates charged to loan balances. However, rising interest rates will also dampen the demand for credit, reducing lending growth and offsetting increased revenue from higher average interest rates charged. The industry is also affected by general economic conditions, as good times often lead to greater consumer and business confidence which sees greater demand for the industry's products and services. When times get tough, the industry can be hit hard, as observed in 2008 through the subprime crisis and in 2001 after 9/11. Overall, the industry displays a moderate level of volatility, as the absolute value of differences in revenue over the past five years to 2008 has been 8.5%.

## GLOBALIZATION

The level of Globalization is low

The trend of Globalization is increasing

According to the Federal Reserve Board's data on domestically chartered insured commercial banks with consolidated assets of \$300 million or more at the end of June 2008, 15.1% of assets were held overseas. Furthermore, only 0.8% of the total number of branches were outside the US. This indicates that commercial banks operations are focused largely within the US, and the globalization level is expected to be low.

However, banking is increasingly becoming global in nature. This has largely been facilitated by deregulation of financial markets in a rising number of countries across the globe. Furthermore, individual countries' regulation is becoming more uniform, which acts as to lower entry barriers for international banking organizations to gain access into a given country's banking markets. International capital standards, outlined in the Basel II capital accord, implies that very little adjustment to a bank's operational and capital standard is required in order to enter banking markets of participating countries. Such

international alignment of financial market regulation and capital requirements opens up for increased international competition and consolidation. All of the industry's largest players have global operations, and have offices set up across many countries.

# Key Factors

## KEY SENSITIVITIES

The key sensitivities affecting the performance of the Commercial Banking industry include:

### Competition from Substitutes - Deposit Taking Financiers - Commercial Banking

Commercial banks are sensitive to substitutes. Competition is high in the banking industry and substitute competition can come from thrifts, credit unions, government agencies, mortgage brokers and other nonbank organizations offering financial services. Firms in this industry will also compete against banks and thrifts owned by nonregulated diversified corporations and other entities which offer financial services through alternative delivery channels, such as the internet.

### Dow Jones Industrial Average

Description: Dow Jones Industrial Index; close rate; calculated annual average; historical and forecast data.

The performance of equity markets affects both the demand for bank lending and the quality of banks' lending portfolios. A positive development in the stock market will generally result in increased lending due to the wealth effect of rising share prices - investors feel wealthier and may therefore increase their demand for credit. Rising stock prices will also impact on the quality of the lending portfolio because borrowers have an increased ability to meet repayments. Conversely, a fall in share prices will have a negative impact on borrowers' ability to service debt, resulting in increased risk for banks. This risk is often accentuated by the fact that the demand for credit tends to rise with rising asset prices. However, an increase in the Dow Jones makes returns more appealing for equities, which could result in a shift in asset allocation from property to securities. This could reduce some demand from investors and affect retail loan volumes. Despite this, in aggregate IBISWorld believes that the net effect on industry revenue is positive following for an increase in various stock market indices, such as the Dow Jones.

### Interest Rates - Prime Rate

Description: Interest rate movements affect investment mix.

Low mortgage rates boost the demand for housing finance. Consumers and businesses are more likely to enter into a loan portfolio when the prime rate is low, as the cost of money is reduced. However, a low prime rate has also negative affects, as there is lower revenue through interest income for the commercial banking sector.

### Property Yields - REIT Dividend Yields

Description: Real Estate Investment Trust - Dividend Yield - percentage change - historical and forecast data and analysis

The performance of property markets affects the demand for bank lending products and the quality of the banks' lending portfolio. REIT's (Real Estate Investment Trust) invest in a variety of properties, with the most common being residential, office, shopping centers and regional malls. An increasing yield on these properties is likely to generate greater demand for commercial bank lending as return on investments are greater.

### Real GDP Growth

Description: Real GDP (Gross Domestic Product) is a measure of general economic activity.

The level of general economic activity determines the level of savings, demand for credit, the quality of lending portfolios and the level of financing transactions

## KEY SUCCESS FACTORS

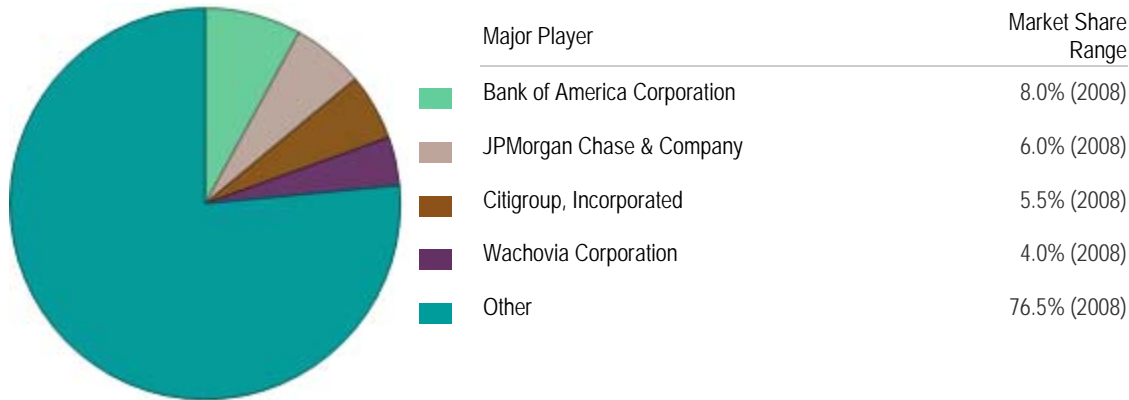
The key success factors in the Commercial Banking industry are:

- **Having a good reputation**  
A firm's ability to attract and retain customers and employees can adversely affect the reputation of a company. The failure to address various issues could give rise to reputational risk and can lead to the loss of market share.
- **Membership of joint marketing/distribution operations**  
Banks need to develop innovative alliances/joint ventures to establish new distribution channels and extend their reach.
- **Willingness to outsource when appropriate**  
Banks need to outsource non-core activities and transfer routine transactions and sales to call centres, the Internet or central processing operations.
- **Ability to accommodate environmental requirements**  
Banks need to place an increased focus on the customer rather than the product. Customers need accessibility, flexibility, convenience and choice. Successful banks will understand customer needs, develop product options and a range of delivery channels.
- **Superior financial management and debt management**  
Commercial banks need good interest rate, foreign exchange and operational risk management processes. Commercial banks must maintain a rigorous and conservative risk management approach. Customer perception of credit worthiness is important.
- **Ability to raise revenue from additional sources**  
Commercial banks need to be able to cope with slower lending growth by increasing non-interest income. Banks may need to make an aggressive push on non-traditional products by providing other financial services.
- **Economies of scale**  
Reducing unit costs is a key driver of profitability. Pressures for standardization, ease of use and cost efficiency are increasing. Specialization in processing may become an integral part of the banking system.
- **Easy access for clients**  
Having a strong branch presence across the US makes it easier and more appealing for customers to begin business with a particular bank. This will likely provide opportunities for great loan volumes.

## Key Competitors

### MAJOR PLAYERS

#### Market Share



### PLAYER PERFORMANCE

#### Bank of America Corporation

Market Share: 8.0%

#### History

Bank of America's predecessor NationsBank was formed as the Commercial National Bank in 1874 in Charlotte, North Carolina. Commercial National Bank merged with American Trust Co. in 1957 and became American Commercial Bank, which merged with Security National in 1960 to form North Carolina National Bank. The bank formed holding company NCNB in 1968, which was the largest bank in North Carolina by 1980. In 1983, NCNB became the first southern bank to span six states. NCNB profited from the savings and loans crisis in the late 1980s by managing assets and buying defunct thrifts at fire-sale prices. The company nearly doubled its assets in 1988, when the Federal Deposit Insurance Corporation chose it to manage the shuttered First Republic Bank, then Texas' largest bank. NCNB renamed itself NationsBank in 1991.

NationsBank acquired Chicago Research & Trading, a government securities dealer and provider of oil and gas financing in 1993. In 1997, NationsBank acquired St. Louis-based Boatmen's Bancshares and Montgomery Securities (now Banc of America Securities). In 1998, Barnett Banks, Florida's largest bank, was purchased. In the same year, NationsBank merged with BankAmerica, once the US's largest bank, but subsequently fell behind as competitors consolidated. In 1999, NationsBank changed its name to Bank of America.

#### Bank of America (BoA)

Headquartered in Charlotte, North Carolina, Bank of America is the largest commercial bank in the US. Through its banking subsidiaries and various nonbanking subsidiaries, BoA provides a diversified range of financial services and products. BoA operates through three business segments, Global Consumer and Small Business Banking, Global Corporate and Investment Banking and Global Wealth and Investment Management. The company's 'All Other' segment consists of equity investment activities including principal investing, corporate investments and strategic investments,

merger and restructuring charges, intersegment eliminations, and the results of certain consumer finance and commercial lending businesses that are being liquidated.

BoA operates in 32 states, the District of Columbia and more than 30 foreign countries, serving around 59 million consumers and small business relationships across the US alone. The company has more than 6,100 retail banking offices and over 18,500 ATMs. Bank of America is the number one small business bank, and has relationships with 99% of the US Fortune 500 Companies and 83% of the Global Fortune 500 Companies.

As of the end of calendar year 2007, there were around 210,000 staff associated within Bank of America and its subsidiaries. Of these employees, around 116,000 were employed within its Global Consumer and Small Business Banking segment, around 21,000 were employed within its Global Corporate and Investment Banking segment, and around 14,000 were employed within its Global Wealth and Investment Management segment. The remainder of employees are employed elsewhere within the company including various staff and support functions.

### Recent Acquisitions and Events

Over the past five years, Bank of America has maintained an aggressive strategy of acquiring companies. This is exemplified through 2008, where global financial troubles have seen many companies go under, which have been snapped up by rivals. In September of 2008, BoA agreed to buy Merrill Lynch, in a deal worth between \$40 billion and \$50 billion. This deal is still subject to approval by shareholder, though it is believed that the deal will be closed in the first quarter of 2009. Another major acquisition occurred in late 2007, where BoA made a \$2 billion investment in Countrywide Financial, and in early 2008 agreed to buy the troubled company. The deal was initially valued at \$4 billion, however was finalized at about \$2.5 billion. The acquisition made Bank of America the largest residential mortgage lender and servicer in the US.

In October 2007, Bank of America acquired ABN Amro North America and LaSalle Bank Corporation from ABN AMRO for \$21 billion. With this combination of acquisitions, Bank of America expanded its assets beyond \$1.7 trillion. A Dutch court blocked the sale until it was later approved in July. The acquisition was completed on October 1, 2007. The deal increased Bank of America's presence in Illinois, Michigan, and Indiana by about 400 branches, 17,000 commercial bank clients, 1.4 million retail customers and 1,500 ATMs.

In late 2006, Bank of America announced that they were to acquire US Trust Corporation for \$3.3 billion. US Trust was one of the largest US firms which focused exclusively on managing wealth for high net-worth and ultra high net-worth individuals and families. The acquisition increased the size and capabilities of BoA's wealth business, and positioned it as one of the largest financial services companies managing private wealth in the US. Also in 2006, Bank of America acquired MBNA Corporation, for \$34.6 billion. The acquisition expanded Bank of America's customer base by delivering deposit, lending and investment products and services to MBNA's customers. Additionally, the acquisition allowed Bank of America to significantly increase its credit card operations and sell these credit cards through their branch network.

In October 2003, Bank of America announced the acquisition of FleetBoston Financial Corporation for about \$47 billion. The merged company had close to 5,700 branches throughout 29 states. FleetBoston Financial is a financial services company with assets of \$196 billion, bringing the value of the merged company's assets close to \$1 trillion at that time.

### 2007 Consolidated Financial Performance

During 2007, BoA reported a drop in revenue of 8.6% compared to 2006, to \$66.32 billion (net of interest expense). The drop in revenue over the year was primarily due to a sharp drop in noninterest income, while interest income was

stagnant. Over the year, the provision for credit losses increased by about 67%, to \$8.4 billion, which was a direct result of the rising delinquencies in the US mortgage market. Expenses also managed to expand, which put pressure on margins, and as a result the company observed a 29.1% drop in net income, to \$14.98 billion. The following identifies Bank of America's segment results over 2007.

The Global Consumer and Small Business Banking segment is particularly relevant to this industry, as it incorporates deposits, mortgages and home equity. There is also a segment named Card Services, however revenue from this area is better classified under industry NAICS code 52221 - Credit Card Issuing in the US.

For the year, noninterest income increased by around 13%, to \$18.9 billion on the back of higher card, service charge and mortgage banking income. Net interest income however increased by only 2%, to \$28.8 billion, and this growth was due to the impacts of organic growth and the LaSalle acquisition on average loans and leases, and deposits. BoA notes that these increases in revenues were more than offset by the increase in provision for credit losses of 51%, to \$12.9 billion. This increase was primarily a result of the impact of housing market weakness on the home equity portfolio, and growth and deterioration in the small business portfolio.

Net income for BoA's Global Corporate and Investment Banking segment decreased by a substantial 91%, to \$538 million in 2007. Total revenue also fell, declining by 37%, to \$13.4 billion in 2007 compared to 2006. The decrease in revenue was driven by losses resulting from the company's exposure to collateralized debt obligations and other trading losses, however this was somewhat offset by an increase in net interest income, primarily market-based. The provision for credit losses also increased, which reflected the weak housing market.

The Global Wealth and Investment Management segment has little relevance to the Commercial Banking industry. However, for the year, net income declined by around 6%, to \$2.1 billion, while revenue managed to increase by around 8% to \$7.9 billion. The revenue growth was driven by higher non-interest income, due to growth in investment and brokerage services income.

## Financial Performance 2006

Over 2006, Bank of America reported total revenue of \$72.58 billion (revenue figures are stated with interest expenses already accounted for). This represented a significant increase over the previous financial year, with growth of 26.9%. The increase in revenue over the year was primarily a result of acquisitions, specifically resulting from growth from the acquisition of MBNA. Net income managed to expand by 28.4%, to \$21.13 billion over 2006.

Bank of America's recent financial performance can be summarized as:

### Bank of America Corporation - Financial Performance (Total Operations)

Year end Dec	Million Dollars Revenue	Percent Growth Change	Million Dollars Net Income	Percent Growth Change	Million Dollars Assets
2003	38755.0	N/C	10762.0	N/C	749104.0
2004	50689.0	30.8%	13947.0	29.6%	1044631.0
2005	57175.0	12.8%	16465.0	18.1%	1269892.0
2006	72580.0	26.9%	21133.0	28.4%	1466681.0
2007	66319.0	-8.6%	14982.0	-29.1%	1602073.0

Source: SEC Filings

Note: Revenue figures take into account interest expense.

## JPMorgan Chase & Company

Market Share: 6.0%

### History

JP Morgan Chase & Co. has its origin in The Manhattan Company, which was created as early as 1799 to bring water to New York City. The Manhattan Company had a provision in its incorporation documents to provide banking services, and was brought into competition with The Bank of New York as the Bank of Manhattan. The Bank of Manhattan merged with Chase National, named after Abraham Lincoln's secretary of the treasury and the architect of the national bank system, Salomon Chase, in 1955. The merged company renamed itself Chase Manhattan, and remained the largest US bank into the 1960s.

In 1996, Chase Manhattan Bank acquired Chemical Bank, a bank, like Chase Manhattan, that started as an unrelated business. After the merger with Chase, Chemical Bank was the surviving entity, but assumed Chase's more prestigious name. In 1999, Chase Manhattan Bank created Chase.com to manage Internet and new technology-based operations. Chase Manhattan Bank closed its \$30 billion purchase of JP Morgan in 2001, and renamed itself J.P. Morgan Chase & Co.

In July 2004, Bank One Corporation merged with and into JPMorgan Chase & Co. The transaction united the investment and commercial banking strength of JPMorgan Chase with Bank One's large consumer banking operations. The combined company's assets totaled \$1.1 trillion as well as having 2,300 branches in seventeen states. The merged company, which continued to trade under the name JPMorgan Chase & Co., eliminated an estimated 10,000 jobs as part of an effort to save \$2.2 billion in the three years to 2007. The cuts were concentrated within the retail banking segment.

In April 2006, JPMorgan Chase announced it would be swapping its corporate trust unit for The Bank of New York Co.'s retail and small business banking network. The swap valued The Bank of New York business at \$3.1 billion and JPMorgan's trust unit at \$2.8 billion. This has given Chase access to around 340 additional branches and 700,000 new customers in the New York, New Jersey, and Connecticut Tri-State area.

In 2008 JP Morgan Chase agreed to buy Bear Stearns, in a deal worth around \$236 million. Additionally, in September 2008, JPMorgan acquired Washington Mutual after Washington Mutual suffered a run on the bank and saw its liquidity effectively disappear. Both of these acquisitions has bolstered JPMorgan's presence within this industry, however it is unclear as to how the company will incorporate these acquisitions. It is estimated that the company holds a market share of about 6%.

### J.P. Morgan Chase

Today, JPMorgan Chase is one of the largest banking institutions in the US, with about \$1.6 trillion in assets. The firm is considered to be the third largest financial firm in the US, holding strong positions in investment banking, financial services for consumers and businesses, financial transaction processing, asset management and private equity. Under the JPMorgan and Chase brands, the firm serves millions of customers across the US along with many prominent global corporate, institutional and government clients.



JPMorgan Chase's principal bank subsidiaries are JPMorgan Chase Bank, a national banking association with branches in 17 states; and Chase Bank USA, a national bank that is the firm's credit card issuing bank. JPMorgan Chase's principal nonbank subsidiary is J.P. Morgan Securities Inc., the firm's US investment banking firm.

JPMorgan Chase's activities are organized into six business segments. The firm's wholesale businesses comprise the Investment Bank, Commercial Banking, Treasury & Securities Services and Asset Management segments. The firm's consumer businesses comprise the Retail Financial Services and Card Services segments. Specific to this industry, IBISWorld believes the Retail Financial Services and Commercial Banking segments have relative importance. The four other business segments are more relevant to other financial industries. Consequently, IBISWorld has provided a description of the two core business segments that are specific to the Commercial Banking industry in the US.

The Retail Financial Services segment aims to help meet the financial needs of consumers and businesses through regional banking, mortgage banking and auto finance segments. Retail Financial Services provides consumer banking through United State's fourth-largest branch network and third-largest ATM network. Through this segment, JP Morgan has become a top-five mortgage originator and servicer, and holds strong market positions in home equity originating and noncaptive originating of automobile loans, as well as being one of the largest student loan originators.

RFS serves customers through more than 3,100 bank branches, 9,100 ATMs and 290 mortgage offices, and through relationships with more than 15,000 auto dealerships and 4,300 schools and universities. More than 14,500 branch salespeople assist customers across 17 states, with checking and savings accounts, mortgage, home equity and business loans, investments and insurance. Over 1,200 additional mortgage officers provide home loans throughout the country.

Secondly, the Commercial Banking segment serves more than 30,000 clients, including corporations, municipalities, financial institutions and not-for-profit entities. These clients generally have annual revenues ranging from \$10 million to \$2 billion. Commercial bankers serve clients nationally throughout the Retail Financial Services segment and in offices located in other major markets.

JP Morgan positions Commercial Banking to deliver extensive product capabilities - including lending, treasury services, investment banking and asset management - to meet its clients' US and international financial needs. This segment produces a far smaller amount of industry related revenue compared with the Retail Financial Services segment; however it does provide services related to the Commercial Banking industry report.

## 2007 Consolidated Financial Performance

Total net revenue of \$71.37 billion represented growth of 15.1%, from the previous year. For the year revenue was bolstered by higher net interest income, strong private equity gains, record asset management, administration and commissions revenue, higher mortgage fees and related income and record investment banking fees. The company notes that these increases were offset partially by lower trading revenue.

During the year, the provision for credit losses increased by \$3.6 billion, which was attributable to increases in both the consumer and wholesale provisions. The increase in the consumer provision from the prior year was largely due to an increase in estimated losses related to home equity, credit card and subprime mortgage loans. JP Morgan Chase, being one of the largest mortgage and home equity providers in the US, was impacted by the subprime mortgage crisis and subsequent fall in home values over the year. It was estimated that around one third of the company's loans are home equity loans, where the company had to write off more than \$500 million in these loans over the year.

## 2006 Consolidated Financial Performance

The company reported record 2006 net income of \$14.4 billion compared with net income of \$8.5 billion in 2005, representing an increase of 69%. The record results were affected positively by global economic conditions, investment in each line of business and the successful completion of milestones in the execution of its merger integration plan. A key milestone related to the merger integration was the New York Tri-state consumer conversion, which linked more than 2,600 branches in 17 states on a common systems platform.

Total net revenue for 2006 was \$62 billion, up by 14.3% from the prior year. The increase was due to higher principal transactions, primarily from strong trading revenue results, record asset management, administration and commission revenue, and record investment banking fees. Also contributing to the increase was higher net interest income and lower securities portfolio losses. These improvements were offset partially by a decline in other income partly as a result of the gain recognized in 2005 on the sale of BrownCo, and lower mortgage fees and related income.

The provision for credit losses in 2006 declined \$213 million from the prior year and was due to a \$1.3 billion decrease in the consumer provision for credit losses, partly offset by a \$1.1 billion increase in wholesale provision for credit losses.

Total noninterest expense for 2006 was \$38.8 billion, down slightly from the prior year. The decrease was due to material litigation-related insurance recoveries of \$512 million in 2006 compared with a net charge of \$2.6 billion in 2005. Also contributing to the decrease were lower merger costs, the deconsolidation of Paymentech, the sale of the insurance business, and merger-related savings and operating efficiencies.

JPMorgan Chase's recent financial performance can be summarized as:

### JPMorgan Chase & Co. - Financial Performance (Total Operations)

Year end Dec	Million Dollars Revenue	Percent Growth Change	Million Dollars Net Income	Percent Growth Change	Million Dollars Assets
2003	33191.0	N/C	6719.0	N/C	770912.0
2004	42731.0	28.7%	4466.0	-33.5%	1157248.0
2005	54249.0	27.0%	8483.0	89.9%	1198942.0
2006	61999.0	14.3%	14444.0	70.3%	1351520.0
2007	71372.0	15.1%	15365.0	6.4%	1562147.0

Source: SEC Filings

Note: Results for 2004 include six months of the combined company's results and six months of JP Morgan Chase results. All other periods reflect the results of JP Morgan Chase only. Note that revenue figures are stated net of interest expense.

## Citigroup, Incorporated

Market Share: 5.5%

### History

Citigroup's predecessor, Travelers Group Inc. (TRV), was founded in 1864 by businessmen in Hartford, Connecticut, as the first US accident insurer. In the late 1970s and early 1980s TRV entered into financial services, but was forced to sell its home mortgage units following the falling real estate market in the late 1980s. A weakened TRV was acquired by Sanford Weill. Weill's company Commercial Credit, acquired in 1986, also bought Primerica, a canning company that had

expanded into paper and retail industries before it turned to financial services in 1986. Primerica bought brokerage Smith Barney, Harris Upham & Co.

Weill restructured TRV, selling the life subsidiaries and bought Aetna's property/casualty business in 1995. All the property/casualty operations were consolidated in 1996, forming Travelers Property Casualty, before it was taken public. In 1997, TRV bought investment bank Salomon Brothers and formed Salomon Smith Barney Holdings. Citigroup was formed when Citicorp merged with and into a newly formed, wholly-owned subsidiary of Travelers Group Inc in October 1998. Following the effectiveness of the merger, that subsidiary changed its name to Citicorp, and Travelers changed its name to Citigroup Inc.

During April 2000, The Travelers Insurance Group Inc, an indirect wholly owned subsidiary of Citigroup, completed a cash tender offer to purchase all of the outstanding shares of Travelers Property Casualty Corp. not previously owned. In November 2000, Citigroup completed its acquisition of Associates First Capital Corporation.

## Citigroup

Citigroup, Inc. is a diversified holding company whose businesses provide a broad range of financial services. The company has over 200 million consumer and corporate accounts in over 100 countries. Citigroup's activities are divided into five segments and product lines, these being its Global Consumer Group, Corporate and Investment Banking, Global Wealth Management, Alternative Investments, and Corporate/Other segment.

Within the above segments, and specific to this industry, Citigroup's US operations include Retail Distribution, Consumer Lending, and Commercial Business. The US Retail Distribution category provides banking, lending, investment and insurance products and services to customers through approximately 1,000 Citibank branches, 2,500 CitiFinancial branches, the Primerica Financial Services (PFS) salesforce, the Internet, direct mail and telesales. Revenues are primarily derived from net interest revenue on loans and deposits, and fees on banking, insurance and investment products.

The US Consumer Lending category provides home mortgages and home equity loans to prime and non-prime customers, auto financing to non-prime consumers and educational loans to students. Loans are originated throughout the US and Canada through the Citibank, CitiFinancial and Smith Barney branch networks, Primerica Financial Services agents, third-party brokers, direct mail, the Internet and telesales. Loans are also purchased in the wholesale markets. This category also provides mortgage servicing to a portfolio of mortgage loans owned by third parties. Revenue comprises loan fees, net interest revenue and mortgage servicing fees.

The Commercial Business category provides equipment leasing, financing, and banking services to small and middle-market businesses, and financing for investor-owned multifamily and commercial properties. Revenue comprises net interest revenue and fees on loans and leases.

## Recent Major Events

In September 2008, Citigroup announced plans to acquire Wachovia Bank in a \$2.16 billion deal. The acquisition would have created the third-largest branch network in the US and give Citigroup a 10% share of total US deposits. However, this bid was raised by Wells Fargo in October, after submitting a \$15.1 offer for all of Wachovia. Wachovia accepted this bid and Citigroup abandoned their plans to purchase the company.

In 2008 the company announced that it was scaling back its US mortgage business after it suffered nearly \$10 billion worth of fourth-quarter losses in 2007 due to mortgages and the subprime crisis. At this time, the company combined its home equity and residential lending unit into its Citi Mortgage subsidiary and either sell to Fannie Mae or securitize itself the majority of its mortgage loans. In November of 2007, Citigroup sold about 4.9% of itself to the Abu Dhabi Investment Authority, a Middle Eastern sovereign fund, for \$7.5 billion. This was done to support its balance sheet at a time when the company was being hit hard by the subprime crisis.

In October 2007, Charles Prince resigned as Citigroup CEO as the bank revealed new losses of \$8 billion to \$11 billion related to subprime mortgages. Citigroup also sacked its head of structured credit and co-head of collateralized debt obligations, who were both responsible for the company's mortgage-backed investments business. These sackings occurred amid concerns that it could face further heavy writedowns on its holdings of subprime-linked securities.

### **Turmoil in 2008**

For the first nine months of 2008, Citigroup reported a net loss of \$10.4 billion. This severe loss was mainly due to higher write-downs on fixed income assets and higher credit loss provisions. Revenue was also down considerably over the nine months, with the bank having to sell stakes of itself to several outside investors to shore up the capital necessary to ride out the credit crunch.

### **2007 Consolidated Performance**

In 2007, Citigroup recorded disappointing results, as the company was significantly affected by write-downs related to direct subprime exposures, including collateralized debt obligations (CDOs), leveraged lending, and by significantly higher credit costs in the company's US Consumer business. In 2007, Citigroup managed to earn net income of \$3.6 billion and revenue of \$81.7 billion.

Revenues of \$81.7 billion represented a decrease of 8.8% from 2006, which was primarily driven by significantly lower revenues in mortgage backed securities due to write-downs related to subprime CDOs and leveraged lending. Company revenue declines were largely observed within the US operations, while the company's international operations recorded relatively strong revenue growth of 15% over the year.

On November 4, 2007, Charles Prince, Chairman and Chief Executive Officer, elected to retire from Citigroup. Robert Rubin served as Chairman between November 4 and December 11. On December 11, 2007, the Board appointed Vikram Pandit as CEO and Sir Win Bischoff as Chairman.

### **2006 Consolidated Financial Performance**

In 2006, Citigroup managed to generate net income of \$21.5 billion on revenues of \$89.62 billion. Net income fell 12.4% from the prior year, reflecting the absence of significant gains on sales of businesses recorded in 2005. Over the year, revenue growth benefited from increased loan volumes, including corporate loan growth of 29% and consumer loan growth of 13%. Transaction Services assets under custody increased 21% and Global Wealth Management client assets increased 10%.

Net interest revenue in 2006 was \$39.5 billion, up 1% from net interest revenue of \$39.2 billion in 2005. Increases in business volumes during 2006 were offset by spread compression, as the company's cost of funding increased more significantly than the rates on interest-earning assets. Net interest margin in 2006 was 2.65%, down 41 basis points from 2005. Non-interest revenue increased 13% from 2005, reflecting fees from higher customer business volumes, as well as

increased principal transactions revenues. Total commissions and fees and administration and other fiduciary fees revenue of \$26.5 billion was up 14% in 2006. Strong investment banking results, higher business volumes in transaction services, the integration of Legg Mason in Smith Barney, and the absence of a \$565 million write-off of deferred rewards costs recorded in 2005 drove the increase. Insurance premiums of \$3.2 billion in 2006 were up \$70 million, or 2%, from 2005 driven by higher business volumes. Principal transactions revenues of \$7.7 billion in 2006 increased 20%, from 2005, primarily in equity markets.

Operating expenses increased \$6.9 billion, or 15%, to \$52 billion in 2006. The increase was primarily in compensation and benefits due to higher headcount and increased incentive compensation in CIB. At December 31, 2006, the Company had approximately 144,000 full-time and 10,000 part-time employees in the United States and approximately 183,000 full-time employees outside the US.

Citigroup's recent financial performance can be summarized as:

#### Citigroup Inc. - Financial Performance (Total Operations)

Year end Dec	Million Dollars Revenue	Percent Growth Change	Million Dollars Net Income	Percent Growth Change	Million Dollars Assets
2002	66246.0	N/C	15276.0	N/C	1097590.0
2003	71594.0	8.1%	17853.0	16.9%	1264032.0
2004	79635.0	11.2%	17046.0	-4.5%	1484101.0
2005	83642.0	5.0%	24589.0	44.3%	1494037.0
2006	89615.0	7.1%	21538.0	-12.4%	1884318.0
2007	81698.0	-8.8%	3617.0	-83.2%	2187631.0

Source: SEC Filings

Note: Revenue Figures are net of interest expense. Also all figures are stated in current dollars

## Wachovia Corporation

Market Share: 4.0%

### History

In September 2008, Citigroup announced plans to acquire Wachovia Corporation in a \$2.16 billion deal. The acquisition would have created the third-largest branch network in the US and give Citigroup a 10% share of total US deposits. However, this bid was raised by Wells Fargo in October, after submitting a \$15.1 offer for all of Wachovia. Wachovia has since accepted this bid, and the two companies will merge. However, at this stage they are operating as two separate entities, and therefore are discussed separately.

Wells Fargo bid to buy all of Wachovia was approved on October 2008, and in November, Wachovia was valued at \$13.6 billion. Wells Fargo announced plans to sell at least \$10 billion in stock, along with the \$25 billion of preferred stock being sold to the US Government through the Treasury's \$700 billion industrywide bailout.

In 2007, Wachovia bought brokerage chain A.G. Edwards, which was combined with Wachovia Securities to create an asset management and brokerage firm with more than \$1 trillion of assets under management. A.G. Edwards' investment banking operations were merged into Wachovia Securities' Wachovia Capital Markets unit. Wachovia is believed to own more than 62% of Wachovia Securities.

In 2006, Wachovia acquired Westcorp, an auto dealer financial services business that covers 46 states and also has a small retail branch network in California. Also in 2006, Wachovia announced the completion of the acquisition of Golden West Financial Corporation. As a result of the acquisition, the combined company had an estimated \$700 billion in assets and a \$107 billion market capitalization. The acquisition strengthened Wachovia's core markets and added 255 branches to its network. As Wachovia bought Golden West, whose primary purpose was adjustable rate mortgages, the housing bust hit the company relatively hard. In response, Wachovia has been exiting the subprime and nonconforming loan market. The company sold its HomeEq loan division to Barclays Bank in 2006, and its AmNet division halted all subprime activity in 2006 as well, and in 2007, Wachovia dissolved its EquiBanc nonconforming loan operations.

In February 2004, Wachovia announced its intention to enter the Texas general banking market by year-end. The plans included wholesale and retail banking operations in the Dallas-Fort Worth Metroplex, Houston, Austin and San Antonio. It was stated that Texas would provide tremendous opportunity within both wholesale and retail banking. Texas is forecast to provide 12% of the nation's population growth over the next 25 years. Wachovia stated that it wants to position itself to match the pending demand.

Prior to the merger, Wachovia was a major interstate financial holding company offering banking and financial services to individuals primarily in Florida, Georgia, North Carolina and Virginia and to corporations and institutions throughout the United States and globally. The company faced significant merger-related expenses, most of it in 2000 when these expenses surged to more than \$2 billion. Consequently, net income declined to a modest \$92 million in 2000.

On September 4, 2001, First Union Corporation and Wachovia Corporation announced that they had formally completed a merger of equals to create the new Wachovia Corporation. The combined company became the largest financial holding company in the Southeast/East Coast region, and the fourth largest nation wide. In order to meet the US Department of Justice's antitrust guidelines, both companies had to divest a total of 38 branches totaling \$1.5 billion in deposits.

## **Wachovia Corporation**

Wachovia Corporation is one of United States' largest financial services companies, serving about 14 million customers with a broad range of retail banking and brokerage, asset and wealth management, and corporate and investment banking products and services. Wachovia services retail and commercial banking customers through approximately 3,400 retail banking offices across 21 states. In addition the company also serves customers' brokerage and asset management needs through a large retail brokerage firm, under the Wachovia Securities brand name which manages more than \$1.2 trillion in client assets through 14,600 financial advisors in 3,700 locations nationwide. Wachovia's other nationwide businesses include mortgage lending in all 50 states and auto finance covering 46 states. Globally, Wachovia provides international correspondent banking services and trade finance through more than 40 international offices.

Wachovia operates through four major business segments: General Bank, Corporate and Investment Bank, Capital Management, and Wealth Management. The operations of these segments are outlined below.

The General Bank segment provides a broad range of banking products and services to individuals, small businesses, commercial enterprises and governmental institutions in 21 states and Washington, D.C. Here, the company focuses on small business customers with annual revenues up to \$3 million; business banking customers with annual revenues between \$3 million and \$15 million; and commercial customers with revenues between \$15 million and \$250 million. In addition, Wachovia serve mortgage customers in 50 states and provide auto finance covering 46 states. This segment is particularly relevant to this industry.

The Corporate and Investment Bank segment offers a range of products and services to public and private companies, institutional investors, financial institutions and the financial sponsor community. Investment banking and the global markets businesses (fixed income and equities) operate under the Wachovia Securities brand and holds a strong position in the capital markets arena by providing comprehensive advisory, capital raising, structuring and execution services. This business also includes a large Treasury Services business, as well as asset-based lending, global correspondent banking services and principal investing activities.

The Capital Management segment provides a full line of proprietary and nonproprietary investment and retirement products and services to retail and institutional clients. Retail brokerage services are offered through the 2,700-odd offices of Wachovia Securities in 47 states and Washington, D.C., and through affiliate offices in Latin America. Evergreen Investments, a large and diversified asset management company, provides investment solutions to individuals, institutional investors and endowments. Securities lending services are offered through Metropolitan West Securities. The Retirement and Investment Products Group is a leading provider of retirement services for individual investors, corporations and plan participants.

The Wealth Management segment tailors the capabilities of a major financial institution to the individual needs of high net worth individuals, their families and businesses. Wachovia will serve clients with \$2 million or more in investable assets, while four family offices focus on families with \$25 million or more in investable assets. Wachovia Insurance Services provides commercial insurance brokerage and risk management services, employee benefits, life insurance, executive benefits and personal insurance services to businesses and individuals.

### **2007 Consolidated Financial Performance**

Net income in 2007 was \$6.3 billion, which represented a drop of 19% compared to 2006. As with most commercial banks, Wachovia was also hit by the fallout of the subprime crisis, and observed an increase in credit costs, as well as a \$1.8 billion increase in the provision for credit losses to \$2.3 billion. The provision exceeded net charge-offs by \$1.3 billion, which included \$50 million of market disruption-related valuation losses related to impaired loans. However, the company did manage to expand revenues by 5%, to \$31.58 billion. The increase in revenue was attributable to both rises in interest income and noninterest income.

Wachovia's business segment most relevant to this industry, General Bank, achieved total revenue of \$17.7 billion (net of interest expenses) in 2007. This accounted for 55% of the company's consolidated income. Wachovia notes that the General Bank segment had over \$297.1 billion in loans, \$290.4 billion in core deposits, \$4.9 billion in investment sales, over 12 million household customers, and 55,653 employees at the end of 2007.

### **2006 Consolidated Financial Performance**

Wachovia's net income in 2006 was \$7.79 billion, up 17.3% from 2005. Results reflect the impact of acquisitions from the date on which each closed, including Golden West Financial Corporation in October 2006, and Westcorp and WFS Financial in March 2006. Also contributing to the result was 14.7% revenue growth, where net revenue (after accounting for interest expenses) managed to reach \$30.07 billion. This growth was driven by a 19% increase in fee and other income, largely from market-driven businesses, as well as growth in service charges, other banking fees and other income. Moreover, net interest income growth of 11% occurred, reflecting a larger balance sheet, although growth was dampened by margin compression. Average loans grew 35% over the year, including the addition for three months of \$124 billion from Golden West and the addition for 10 months of \$13.5 billion from Westcorp.

For the year, fee and other income experienced growth of 19%, to \$14.55 billion, and largely followed from increased service charges and other banking fees driven by strength in consumer service charges and higher interchange income on higher rates and increased volume; strong growth in retail brokerage managed account assets, which drove higher fiduciary and asset management fees; and, strong results in advisory and underwriting largely related to record performance in real estate capital markets, merger and acquisition advisory services, equities underwriting, investment grade debt and loan syndications. Noninterest expenses increased 10% to \$17.3 billion, largely reflecting acquisition activity. In addition, expenses reflected higher revenue-based and other incentives. By the end of 2006, Wachovia had around \$707 billion in assets, representing growth of 35.8% compared to 2005.

Wachovia's recent financial performance can be summarized as:

#### Wachovia Corporation - Financial Performance (Total Operations)

Year end Dec	Million Dollars Net Revenue	Percent Growth Change	Million Dollars Net Income	Percent Growth Change	Million Dollars Assets
2002	18063.0	N/C	3560	N/C	342033
2003	20345.0	12.6%	4259	19.6%	401188
2004	22990.0	13.0%	5214	22.4%	493324
2005	26223.0	14.1%	6643	27.4%	520755
2006	30069.0	14.7%	7791	17.3%	707121
2007	31579.0	5.0%	6312	-19.0%	782896

Source: SEC Filings

Note: Revenue figures are net of interest expense

## OTHER PLAYERS

There are thousands of players within this industry, however the most significant are the five largest. These include Bank of America, JP Morgan Chase, Citigroup, Wachovia (which has announced that it will be sold), and finally Wells Fargo. Collectively these five players hold a market share of about 27% of the industry. Other than these players, no industry operator generates revenue that is above 3%. The discussion within major players is focused around these five companies as they have a great deal of power and hold a significant amount of deposits and make a great deal of loans. As four of the five have already been discussed, Wells Fargo remains.

Wells Fargo is one of the US's top banks, operating about 3,300 bank branches in 23 western and midwestern states. The company also has 3,400 mortgage and consumer finance offices nationwide. Services include consumer and business banking, investment management, insurance, and venture capital investment. The company is a top residential mortgage lender in the US and one of the largest mortgage servicers, making it an important player in this industry.

Although Wells Fargo has been impacted by the global credit crisis, it remains one of the strongest of the surviving banks in the US, reporting net income of over \$5 billion for the first nine months of 2008. The company has also capitalized on takeover targets at this dire time, as it made an aggressive bid for Wachovia. This bid was approved on October 2008, and by November, Wachovia was valued at \$13.6 billion. Wells Fargo announced plans to sell at least \$10 billion in stock along with the \$25 billion in preferred stock to the US Government as part of the industrywide bailout plan. With this acquisition, Wells Fargo is set to observe a significant increase in its market share, where it currently holds about 3.5%. Wachovia has a market share close to 4%, and over time IBISWorld estimates that Wells Fargo will rival Citigroup and JP Morgan with its market presence once this deal is officially put together and the companies 'merge'.



By the end of 2007, Wells Fargo announced that they had around \$575 billion in assets, nearly 6,000 stores and over 6,900 ATMs. In terms of the business diversity, 34% of the company is associated in community banking, 17% is associated in home mortgage and home equity, 17% of the company is associated in investments and insurance, 17% is associated in specialized lending, 9% in wholesale banking/commercial real estate, and the remaining 6% of the company is associated in consumer finance.

In 2006 the company bought commercial real estate broker Secured Capital, and merged it with existing subsidiary Eastdil Realty - forming Eastdil Secured. Wells Fargo later acquired multifamily real estate finance firm Reilly Mortgage Group (now Wells Fargo Multifamily Capital). These acquisitions, together with the fact Wells Fargo has somewhat escaped the problems plaguing other financial services companies that were overexposed to subprime mortgages has strengthened the company as an industry player. Wells Fargo has not carried a great deal of subprime mortgages and has not invested heavily in extreme derivative products based on securitized subprime mortgages. The company's credit rating remains, and IBISWorld estimates that the company holds a market share of around 3.5%. Consolidated revenues for 2007 increased 10.4%, to \$39.39 billion (net of interest expense).

## Industry Performance

### CURRENT PERFORMANCE

The Commercial Banking industry experienced a relatively topsy-turvy five year period ending 2008. The industry began 2004 with revenue sliding slightly, before experiencing three good years of growth. Then as a subprime credit crisis hit, the industry plummeted, and severe losses were made. Over the five year period to 2008, revenue increased at an average annualized rate of 5.7%, rising from \$606 billion at the end 2003, to \$798.5 billion by 2008. Industry profits on the other hand experienced an average annualized decline of 13.2% per annum over the five-year period, falling from \$119 billion at the end of 2003, to just \$58.8 billion by 2008. This saw the profit margin drop from 19.6% to 7.4%, as the industry was greatly impacted rising loan loss provisions. In line with revenue, industry assets managed relatively good growth, expanding at an average annual rate of 5.3% per annum in the five years to 2008.

Over the five years, commercial banks experienced an annualized decline in enterprise numbers of 1.5% (primarily from mergers and acquisitions). Over the past decade, the industry observed a steady decline in establishments, and as the subprime crisis emerged in mid-2007, the declines continued. Consequently, with falling enterprises, establishments also declined, falling by an annualized 0.2%, to an estimated 80,000. Firms in this industry generally find the need to expand their branch network in order to appropriately serve and satisfy customers across the US, however the subprime crisis has increased costs and therefore bank expansion has slowed. Although establishments have fallen in the five years to 2008, the industry has actually experienced a growth in employment, averaging an annualized growth of 0.8%, to 1.86 million people. Wages also continued to expand, growing from \$125.1 billion in 2003 to an expected \$136 billion by 2008.

Annualized Industry Growth Rates: 2004 to 2008

Commercial Banks	Percentage Annualized Growth
Revenue	5.7
Profit	-13.2
Establishments	-0.2
Enterprises	-1.5
Employment	0.8
Wages	1.7
Assets	5.3

Source: IBISWorld Estimates

### General business and economic conditions

One area that IBISWorld has identified as a critical factor that affects the performance of the Commercial Banking industry is that of the general business and economic condition within the US and abroad. In particular, firms are largely exposed to the downturns and upturns experienced in the US economy.

Between 2002 and mid-2007, the US economy performed favorably, which helped bring the Commercial Banking industry out of a revenue slump post September 11. The Commercial Banking industry was severely hit as a result of the downturn from the terrorist attacks, which saw industry revenues decline for four consecutive years between 2001 and 2004. Furthermore, the low interest rate environment over these years saw little opportunity for Commercial Banks to generate

any substantial income from interest. As GDP growth gained upon the lows in 2001, and interest rates began to increase, revenue declines eased, and in 2005 and 2006, the industry experienced some high growth rates of 16.1% in 2005 and 16.7% in 2006, reaching turnover of \$810.8 billion.

Into 2007, the industry continued to perform strongly, with many firms reporting strong performance gains in the half year. However, in the latter part of 2007, a subprime credit crisis occurred, which affected the performance of many financial institutions across the US and abroad. As 'honeymoon' rates reset to higher interest rate levels, homeowners found it difficult to keep up on their loan repayments. As a result, property foreclosures increased which sparked the subprime crisis. This has seen some substantial declines in turnover, value added, establishment numbers and employment levels within the financial sector, in particular within the Investment Banking & Securities Brokerage and Other Nondepository Credit Intermediation industries. Although the Commercial Banking industry has not been the hardest hit as a result of the subprime credit crisis (as many banks repackage their loans and on-sell them into the secondary market as debt collateralized obligations), banks still own and are involved with many home and business loans that are not securitized or re-packaged. As a result of the downturn, industry revenue growth rates fell from the highs experienced in 2005 and 2006, to growth of only 4.7%, which was backed largely through the strong growth experienced in the first half of 2007.

As 2008 arrived, the economic performance of the US and its general business conditions began to experience some serious effects of a subprime mortgage meltdown. General liquidity issues hampered banks' performances, and it has been very difficult to generate income as revenue sources have been limited. Firms have found it tough to operate in an environment where debt write downs continue, and the availability of money is scarce. Consequently, the industry has experienced a strong decline in the final year of the current performance period.

### The Credit Crisis

Over the second half of 2007, and into the final year of the current performance period (2008), the commercial banking industry experienced a very poor performance. Revenue in 2008 will decline by 5.9% to \$798.5 billion, while industry profits will drop by 41.7%, to \$58.8 billion, or a margin of just 7.4%.

The subprime credit crisis worsened in 2008 compared to 2007, with a number of loans being reset to higher interest rates. This posed significant problems on borrowers to repay loans, and lead to a rise in the number of delinquencies and loan loss provisions in this year skyrocketed by 123.4% compared to 2007, to reach \$130.6 billion, or 16.4% of industry revenue. This was after a 116.3% increase in loan loss provisions over 2007, to \$58.5 billion. These losses were generated as home buyers fell too far behind on their mortgage repayments, and as their home values declined, their mortgages began to be worth more than their actual home. This was called 'underwater mortgages', which meant people's equity was less than their actual loans. This led to many buyers sending their keys back to the bank, and effectively foreclosing on their mortgages. Billions of dollars in losses were made, and as seen through the figures stated, the commercial banking industry has suffered. Furthermore, the industry observed higher credit and wholesale costs, as the availability of money was scarce. Banks were unwilling to lend to one another, as there was the risk that their money may not get paid back. These higher funding costs saw banking margins squeezed, which had further impacted towards a low profit level over 2007 and 2008.

To act on this severe problem, the Federal Reserve began to aggressively reduce interest rates. In the period from September 2007 to October 2008 (latest available), the Federal Reserve slashed the funds rate on nine occasions from 4.75% to a mere 1%. It is unclear as to whether this monetary policy will have any effect on consumer and business confidence, as the problems relating to subprime are deep and unclear. This slashing of rates however will act to cushion the costs of funding for banks, and they should be better able to manage their funds at a time where costs and losses have skyrocketed.

In addition to the use of monetary policy, the Government proposed a \$700 billion bailout of the financial system. More specific to this industry was actions taken in October of 2008, where the Treasury announced a plan to buy \$250 billion of stock in banks. This was done to restore confidence in the markets, give the banks greater flexibility to make new loans and lure private capital, and essentially help with the liquidity problems. Of this \$250 billion buyout was a \$125 billion stake in nine of the largest banks. The Treasury noted that they will buy \$25 billion in preferred stock from Bank of America, including Merrill Lynch (bought by Bank of America), and \$25 billion from JP Morgan, Citigroup and Wells Fargo, while \$10 billion will be bought from Goldman Sachs and Morgan Stanley, and \$3 billion from Bank of New York, and \$2 billion from State Street. The remaining funds will be allocated to the small and medium sized institutions for an investment.

### Years of Expansion

The economic environment was a strong contributing factor to the performance of the Commercial Banking industry for 2005 and 2006. The overall economic expansion, strong level of capital market activity, and positive performance in equity markets helped drive new business volume and organic growth for many commercial banks. The strength in profitability and growth of bank balance sheets over the two years was a further reflection of the favorable US financial market conditions and the generally solid economic expansion. Profitability was supported by growth in non-interest income and generally strong asset quality.

The financial market during 2005 and 2006 saw short-term interest rates move higher with the target federal funds rate, which increased on 12 occasions by 25 basis points, from a low of 2.5% to 5.25%. Strong fundamentals in the commercial real estate sector, including rising property values and declining vacancy rates, bolstered the demand for commercial mortgages. However, in the household sector, higher mortgage rates and a cooling of the pace of house-price appreciation combined to damp residential housing activity. By the end of 2006, home sales had diminished markedly, and home construction activity had slowed significantly. Despite this, overall interest revenue managed to expand by nearly 23%, which pushed overall revenue growth by over 16% in each year, to \$810.8 billion by the end of 2006.

These financial and economic conditions shaped balance sheet developments at commercial banks. On the asset side, borrowing by businesses to finance capital expenditures and merger and acquisition activity contributed to the rapid growth in commercial and industrial loans. The financing of residential home construction likely helped fuel the construction and land development component of commercial real estate loans in recent years, but the pace of such lending moved lower in 2006 as home construction activity slowed. Growth in consumer loans, which had been particularly lackluster in 2005, when households apparently substituted mortgage debt for consumer debt, picked back up to a moderate pace. Overall, industry assets managed to expand by 4.1% in 2005 before a solid 8.2% growth in the year to December 2006.

Profits over these years were also reasonably strong, expanding by 6.2% and 9.1% per year respectively. By the end of 2006, the profit margin had reached 16.8%, which was a very favorable percentage. Banks were able to gain solid profits from the high interest rate environment from the numerous loans that were demanded. This bolstered their interest income while there were also good gains from noninterest incomes such as service charges on deposit accounts as well as trading account gains and fees.

## HISTORICAL PERFORMANCE

In the past two decades, the industry has seen major structural changes driven by advances in technology, efforts to increase efficiency and reduce costs, the general performance of the economy, and the globalization of financial services

markets. The regulatory environment in banking has changed dramatically in the direction of deregulation. The removal of federal limits on the interest rates that banks could pay depositors changed the focus of competition among banking organizations from the quality and extent of service to their price. The inability of commercial banks to pay market interest rates severely affected the industry, particularly in the late 1970s and early 1980s when the gap between market interest rates and regulated deposit rates was widest. The Congress acted in the early 1980s to remove interest rate ceilings on deposit accounts, and by 1986, banking institutions were almost entirely free of such restrictions.

Before 1975, intrastate restrictions on branching by commercial banks were commonplace. Banks were allowed to branch statewide with few or no restrictions in only seventeen states. During the 1980s, most states repealed or liberalized their laws restricting intrastate branching by commercial banks.

Until the late 1970s, no state permitted out-of-state commercial banking organizations to operate in-state banking subsidiaries. State barriers to interstate banking began to fall in 1978, when Maine relaxed restrictions on entry by out-of-state holding companies. During the 1980s and early 1990s, every state except Hawaii followed suit by allowing some degree of interstate banking, which provided banking organizations with new opportunities to restructure and expand their banking office networks.

Consolidation in the industry has resulted from mergers of previously independent institutions, the failure of a large number of commercial banks, and consolidation within bank holding companies. Consolidation is primarily a response to an oversupply of banking institutions and offices. This overcapacity has resulted from advances in technology, the easing of some regulatory restrictions, and inroads by nonbank financial institutions into traditional banking service markets. Some consolidation is also motivated by strategic considerations, which may have anticompetitive effects.

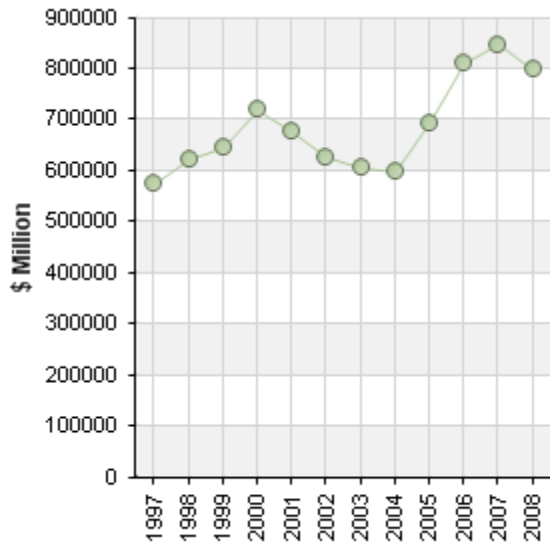
Over the five years from 1997 to 2002 the commercial banking industry observed an average annualized growth in revenue of 1.7%. This is a relatively solid performance given the fact that the industry was greatly affected by the economic slowdown in 2001 and 2002 due to the 9/11 terrorist attacks. Revenue in these two years dropped by 5.9% and 7.3% per year respectively. Profits however managed to improve at a better rate, expanding by an annualized 5.4% over this period. Overall the sector was bolstered by good asset growth (averaging annual growth of 5.3%), which was backed by strong demand for commercial and residential mortgages. Banks were also important suppliers of consumer credit, with consumer loans originated by banks growing at a steady pace throughout the five years. Banks also relished high fee income and increased efficiency, which helped the industry gain a good profit margin over the period.

#### Revenue (constant prices)

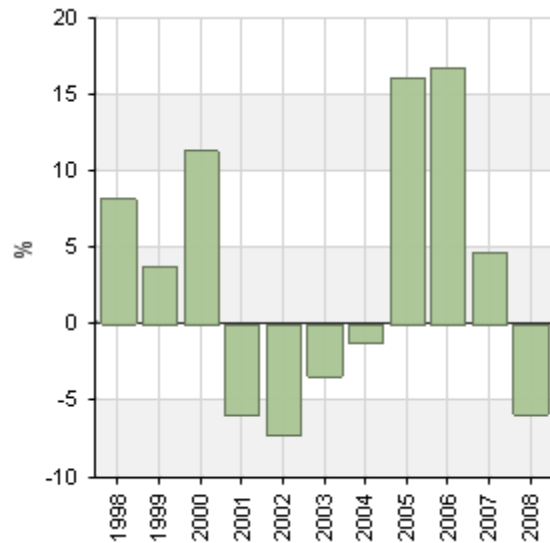
	Revenue \$ Million	Growth %
1997	575,483.8	N/A
1998	622,875.6	8.2
1999	646,078.4	3.7
2000	719,222.4	11.3
2001	676,646.8	-5.9
2002	627,362.7	-7.3
2003	605,997.1	-3.4
2004	598,742.5	-1.2
2005	694,983.3	16.1
2006	810,799.1	16.7
2007	848,834.8	4.7

2008	798,541.1	-5.9
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Revenue



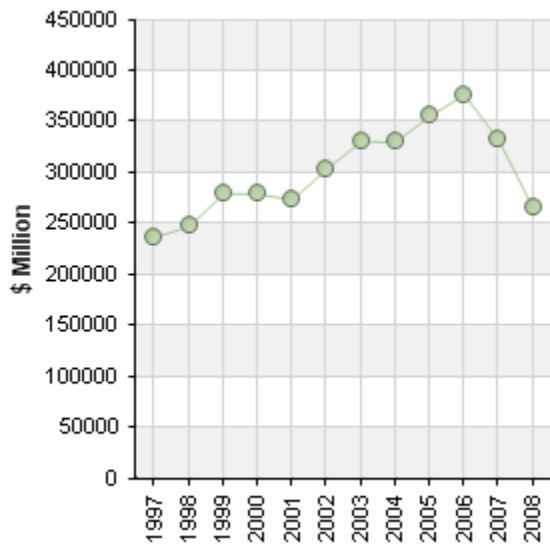
Revenue Growth Rate



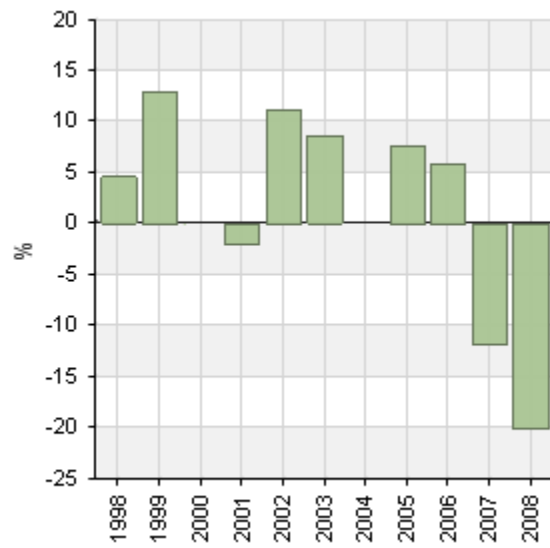
Gross Product (constant prices)

	Gross Product \$ Million	Growth %
1997	236,839.6	N/A
1998	247,787.7	4.6
1999	279,866.7	12.9
2000	279,499.9	-0.1
2001	273,698.1	-2.1
2002	304,210.3	11.1
2003	330,759.5	8.7
2004	330,599.5	0.0
2005	355,763.3	7.6
2006	376,821.5	5.9
2007	332,362.3	-11.8
2008	265,523.2	-20.1

Gross Product



Gross Product Growth Rate

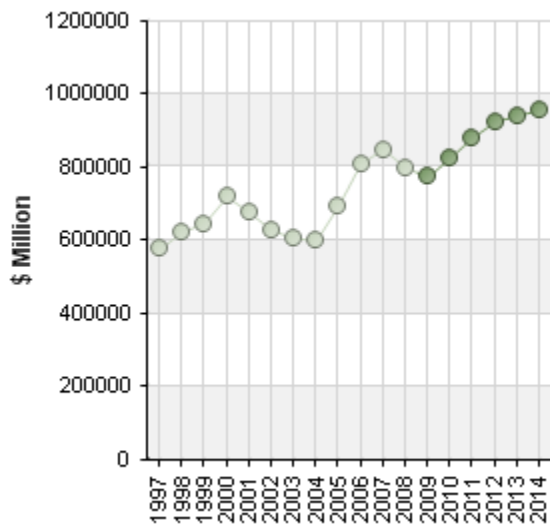


# Outlook

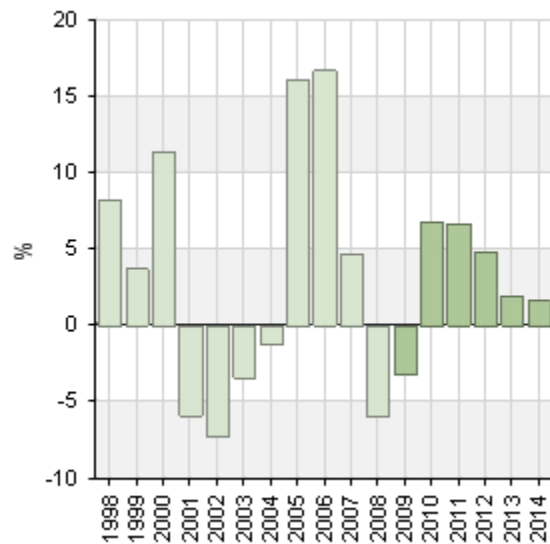
Revenue (constant prices)

	Revenue \$ Million	Growth %
2009	773,011.3	-3.2
2010	825,764.7	6.8
2011	881,364.2	6.7
2012	923,987.3	4.8
2013	941,194.1	1.9
2014	955,930.2	1.6

Revenue



Revenue Growth Rate

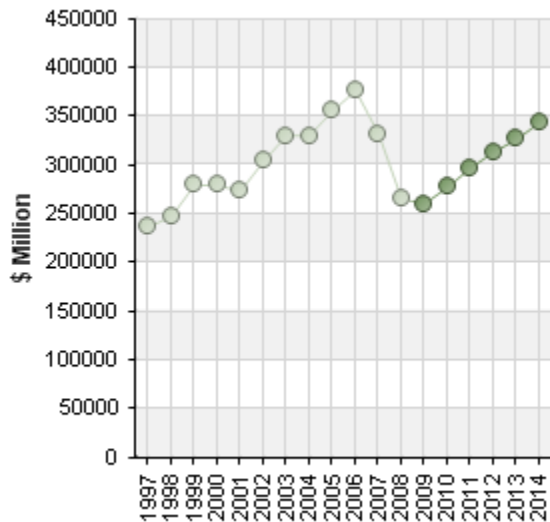


Gross Product (constant prices)

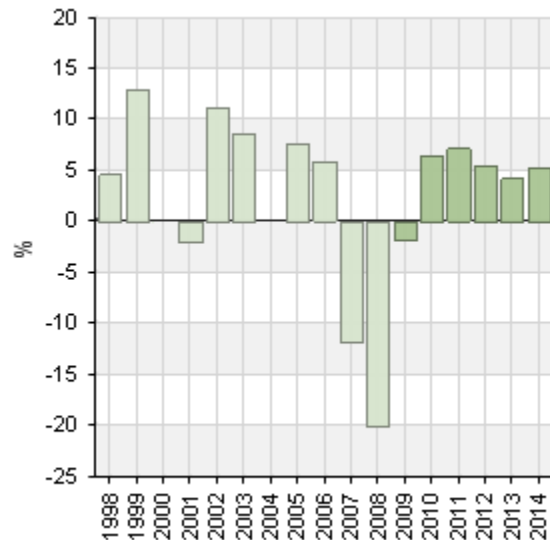
	Gross Product \$ Million	Growth %
2009	260,800.7	-1.8
2010	277,690.1	6.5
2011	297,551.7	7.2
2012	313,652.0	5.4
2013	326,797.8	4.2
2014	344,159.0	5.3



Gross Product



Gross Product Growth Rate



Industry revenue is expected to grow at a slightly slower annualized rate in the coming five year period than that observed in the previous five year period. By 2013, commercial banks are set to observe an annualized growth in revenue of 3.3%, increasing from \$798.5 billion in 2008 to \$941.2 billion by 2013. The growth is expected to be achieved on the back of solid growth in industry assets, which is expected to increase at an average real rate of 5.2% per annum, from \$11.43 trillion in 2008 to \$14.71 trillion by the end of December 2013. Industry profits are expected to grow at an average real rate of 9% per annum over the same five-year period, rising from \$58.8 billion in 2008 to \$90.35 billion in 2013.

Annualized Industry Growth Rates: 2008 to 2013

Commercial Banking	Percentage Annualized Growth
Revenue	3.3
Profit	9.0
Establishments	0.7
Enterprises	-1.2
Employment	1.6
Wages	2.1
Assets	5.2

Source: IBISWorld Estimates

As discussed, the commercial banking industry will observe a shaky 2008. A number of banking customers have become delinquent on their home loans and various other products that commercial banks hold. This, in turn, has resulted in a higher level of charge-offs and provision for credit losses, all of which has adversely affected the earnings for the Commercial Banking industry. As a result, IBISWorld has forecast that industry revenue will decline by 5.9% in 2008, with profits falling by 41.7%, as disruptions in the financial subprime market continues. Interest rates have continued to be cut throughout the year, and this is expected to be both beneficial and detrimental for the Commercial Banking industry. The

detrimental side towards a lowering interest rate environment is that commercial banks will generate a lower level of interest income. Interest incomes are the primary source of revenue for many Commercial Banks, and a reduction here will mean a loss of downstream investment possibilities and also a loss of liquidity. However on the positive aspects, the lowering interest rate environment will aid consumers who are close to foreclosure maintain their mortgages and loans, while also acting as a demand determinant to a greater customer base. The lower interest rate environment may act as a selling point, as potential customers can then afford loan repayments. This however is expected to only transpire into industry related revenue in the years to come, as there is a lag between when customers first take out their loans and when the banking industry will really begin to see financial gains. Also the continuing falling of house prices is not expected to translate into housing loans, despite the rapid drop in interest rates. It is expected that only in late-2009 will the US begin to see housing sales on the rise once again.

As a result of the lowering of interest rates from 2007 and into 2008, it is expected that demand for credit into the mid-latter part of the outlook period will occur. As the US economy moves out of its subprime credit crisis and shaky economic situation, consumer and business confidence is set to rise, and the willingness to take out finance will increase. However 2009 is not expected to be a positive year for the commercial banking industry, as lingering credit problems and a likely US recession sees the demand for credit reduced. Overall, banks will remain restricted and observe millions more in loan loss provisions. From 2010 onwards the industry is set to expand, but growth rates will not be as strong as the double digit expansions observed in the middle part of the current performance period.

### **Problems exist in 2009**

IBISWorld has identified that commercial Banks will continue to observe subprime related problems in the coming year, but conditions in this area will be far more favorable than that experienced in 2008. Problems from the subprime losses are forecast to ease, but banks may observe a second round of delinquencies, revolving around mortgages named Alt-A or Option Adjustable Rate (or Option-ARMs). Firstly a subprime mortgage is a mortgage given to a customer with a low credit rating. In terms of resetting, these mortgages peaked in 2008. However, the Alt-A and Option ARM mortgages are set to peak in 2009. This could see further losses within this industry. These two mortgage categories identified are similar to subprime, however they have different characteristics such as different payment methods (i.e. principal and interest, interest only, or lower than interest), and are offered to customers with slightly better credit ratings than those subprime candidates. Of most importance are the Option-ARMs, as a vast majority of the customers that have these mortgages have fallen behind on their payments. Customers in this area and are set to be hit with a significant 'reset' in 2009, where they will have to pay far higher monthly repayments. As noted, delinquencies are set peak in 2009, and initial estimates have the pool of these mortgages at about \$500 billion. This will see additional losses in 2009, where IBISWorld is predicting revenue to drop by 3.2% to \$773 billion, and profit will drop by 5.3% to 55.66 billion (or a margin of 7.2%).

### **Slow and Steady**

From 2010, commercial banks are expected to observe relatively slow and steady growth in revenue. Although growth will be over 6% in 2010 and 2011, this is far below the double digit expansions observed in 2005 and 2006. Banks will be managed more conservatively, as fewer risks will be taken given the recent mortgage troubles. In the mid-part of the outlook, growth in revenue of over 6% is expected, while profits are set to observe more favorable growth of 11.3% in 2010 and 16.7% in 2011. This strong expansion will be due to the more severe reductions in profits in the latter part of the outlook, when margins dropped to a low of 7.4%. Profit margins will rise to 8.2% by 2011, as fewer loan loss provisions exist. Banks are also expected to generate strong demand for mortgages in these early years, as the massive stock pile of unsold homes are quickly lapped up given their low prices.

In the remaining few years, revenue and profit growth will continue a steady expansion, and by 2013 the industry is set to reach \$941.2 billion in turnover. Profit will rise to \$90.35 billion, which will represent a margin of 9.6%. Contributing to this growth is the expected property dividend yields over the mid-latter part of the outlook period. IBISWorld expects that growth in property dividend yields will be substantial over this period, after some years of decline. This will create demand for consumers to enter into mortgage loans as their relative investment will be less of a risk. This demand will occur due to the lag times related to residential loans reaching a peak in these years.

## Assets Expansion

Industry assets will expand by an average annualized rate of 5.2% in the five years to 2013, reaching \$14.71 trillion. The growth in industry assets will mainly transpire from growth in the loan portfolio's over the outlook period. However, the structure of commercial banks' loan portfolio is expected to change as the demand for credit from the business sector is set to increase. Commercial and Industrial (C&I) loans are expected to become a bigger driver of total loan growth in the five years to 2013, whereas residential real estate finance is expected to remain quite moderate. Residential finance is expected to be low in 2008, as the subprime credit crisis forces banks to become far more stringent on who they lend to. This has been emphasized through the September 3rd 2007 edition of Fortune, where John Mack, Chairman and CEO of Morgan Stanley stated that "investment banks and commercial banks will be much more conservative with their leveraged loans (for private equity buyouts)." Furthermore, the US economy is expected to be rather shaky over 2008, which will diminish the demand for credit, particularly among the residential mortgage market. Assets are expected to experience its strongest expansion in 2011, as the demand for mortgage loans increase strongly.

## Establishments and Employment

Many firms in the Commercial Banking industry are expected to benefit from a continued expansion of the branch network. Firms are increasingly being compelled to expand their geographic presence, making it easier and less demanding for customers to find their banking branch. As a result, IBISWorld expects that establishment numbers will grow by an average annualized rate of 0.7%, reaching 83,000 by 2013. However, industry consolidation is expected to continue in the five years to 2013, as the high levels of competition remain. This in turn is expected to reduce the level of enterprise numbers, while maintaining growth in establishments. The trend of consolidation and merger and acquisition activity is expected to be more prevalent in the small and mid-size banking organizations. As a result of the continued growth in competition levels, many enterprises will be forced to sell their operations, merge, or exit the industry (likely to be small to medium sized enterprises). Consequently firms are expected to expand in size and dominance, with the level of enterprises expected to decline by an average annualized rate of 1.2% over the five year period, to only 6,780. The growth in establishments however will lead to further demand in employment, where an estimated 2.01 million people will be employed in the Commercial Banking industry by 2013. Industry wages are therefore expected to reach \$151 billion. An increased sales force and the opportunity to improve sales productivity and cross-selling in the banking branches are expected to help the Commercial Banking industry in the outlook period, however as mentioned loan and deposit spreads are expected to experience continued compression due to the interest rate and competitive environments, which will hinder industry profit growth.