Guide to Growth: Leveraging Research and
Industry Experience to Achieve Best Practices

Recognizing the Opportunities for Growth

Overview/Background

The banking crisis and additional restrictive regulations have increased pressure on depository institutions to enhance fee income. But the income opportunity in meeting the investment and insurance needs of the bank's customers or the credit union's members has remained underdeveloped. Some depository institutions make poorly informed decisions about whether and how to offer investment and insurance services to their customers.

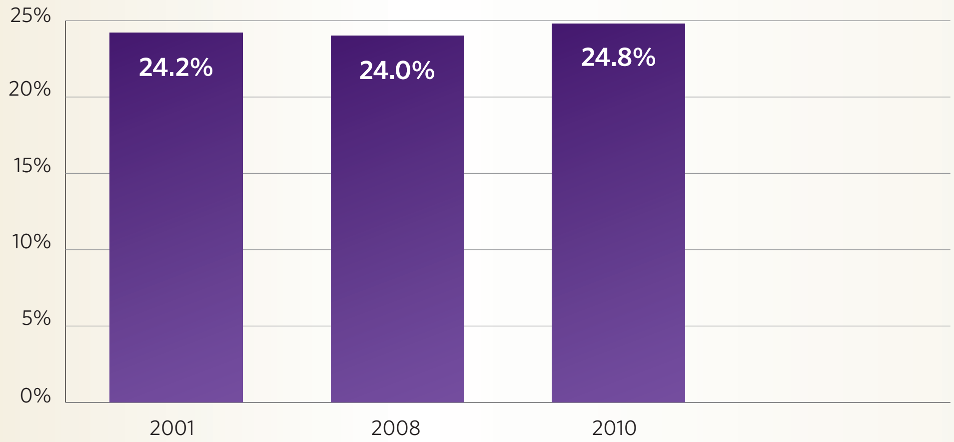
Banks and credit unions have now accumulated three decades of experience with investment and insurance services. Cetera Financial Group and Cetera Financial Institutions commissioned Dr. Kenneth Kehrer to examine this body of experience to help individual banks and credit unions and the broader financial services industry better leverage this opportunity. The resulting white papers, the *Guide to Growth: Leveraging Research and Industry Experience to Achieve Best Practices* series, help capital markets, the management of investment and insurance services businesses in banks and credit unions, and the management of their host institutions understand the scope of the opportunity and best industry practices.

The Investment and Insurance Revenue Potential of Banks

Savings and Loans began providing investment and insurance services such as mutual funds, annuities, and securities brokerage in the early 1980s. By the early 1990s, most major commercial banks had launched investment and insurance units, often in partnership with third-party broker-dealers, which came to be called TPMs. By the end of that decade, most major banks had internalized their investment services offerings, and the TPMs were focused on supporting the investment and insurance businesses of community and regional banks. But since then, the percentage of banks selling investments essentially has not grown.

Figure 1 | Percentage of U.S. Banks Selling Investments (year-end)

Source: FDIC Call Reports



Part of this stagnation is the result of the consolidation of the banking industry. The number of FDIC-insured banking institutions declined from 9,630 at the end of 2001 to 7,667 at year-end 2010. As banks merged, some banks that were selling investments acquired other banks that were also selling investments.

While only a quarter of all banks and savings institutions are offering investment services, those banks account for 72 percent of all bank domestic deposits, excluding the deposits of public units. That is because the larger the bank, the more likely it is to be selling investments. Two-thirds of the largest banks provide investment services, but only one-fifth with less than $500 million in non-public deposits offer retail investments to their customers.

Figure 2 | Number of Banks Offering Investment Services

Dec. 31, 2010 Source: FDIC Call Reports

Segment	Number of Banks	Banks Selling Investments	Percentage of Banks Selling Investments
Under $250 million	5,659	964	17%
$250 million-$500 million	992	399	40%
$500 million-$1 billion	506	249	49%
$1 billion-$5 billion	375	199	53%
$5 billion-$10 billion	62	41	66%
Over $10 billion	73	49	67%
Total	**7,667**	**1,901**	**25%**

Of course, non-public deposits are concentrated in the largest institutions, with over two-thirds held in institutions with over $10 billion in non-public deposits. Since larger banks are more likely to offer investment services, and those banks hold the lion's share of deposits, the largest banks have far greater opportunity to sell investments; 79 percent of the deposits in banks selling investments are in banks with more than $10 billion in non-public deposits.

Figure 3 | Deposits in Banks Offering Investment & Insurance Services

Dec. 31, 2010 Source: FDIC Call Reports

Segment	Aggregate Deposits *in millions*	Deposits of Banks Selling Investments *in millions*	Percentage of Total Deposits in Banks Selling Investments
Under $250 million	$544,431	$127,591	23%
$250 million-$500 million	$347,352	$242,319	70%
$500 million-$1 billion	$348,142	$172,288	49%
$1 billion-$5 billion	$715,757	$384,312	54%
$5 billion-$10 billion	$445,807	$291,686	65%
Over $10 billion	$5,083,590	$4,302,207	85%
Total	**$7,485,078**	**$5,420,403**	**72%**

So it is not surprising that the preponderance of investment services revenue is concentrated in the largest institutions—88 percent of investment services revenue is produced in institutions with more than $10 billion in deposits.

Figure 4 | 2010 Bank Investment Services Revenue

Segment	Investment Services Revenue* *in millions*
Under $250 million	$188
$250 million-$500 million	$121
$500 million-$1 billion	$107
$1 billion-$5 billion	$446
$5 billion-$10 billion	$274
Over $10 billion	$8,728
Total Industry	**$9,865**

*Investment banking, advisory, brokerage, and underwriting fees and commissions from the FDIC Call Reports.

Revenue Potential of Banks Selling Investments

Our research indicates that banks selling investments are performing, on average, very much below their potential. They have substantial capacity to add additional financial professionals, improve internal referral processes, and enhance their product mix.

To demonstrate the size of this potential, we modeled the actual investment services revenue experience by bank size, using deposit penetration data from our proprietary surveys. The average revenue penetration for the larger banks is taken from the *2010 Kehrer-LIMRA Financial Institution Investment Program Benchmarking Survey*, which included 59 banks and credit unions that collectively accounted for half of all bank investment sales. Because the *Kehrer-LIMRA Benchmarking Survey* includes very few of the smallest banks, we used the deposit penetration information from the *2010/2011 Kehrer TPM Survey* of the two dozen largest third-party broker-dealers. This survey encompassed revenue data from 2,809 financial institutions. Banks that work with third-party broker-dealers tend to have less than $5 billion in deposits.

We first used the model to estimate what total investment services revenue is, by bank size, for the institutions now selling investments. We excluded institutions with less than $250 million in non-public deposits because we did not have reliable data on their investment services revenue penetration of deposits. Note that our estimate for total investment services revenue of the U.S. banking industry of $9.830 billion is very close to the FDIC Call Report total of $9.865 billion.

Figure 5 | Revenue Potential in Banks Currently Offering Investment & Insurance Services

Segment	Deposits in Banks Selling Investments *in millions*	Average Revenue Penetration *per million*	Best Practices Revenue Penetration *per million***	Estimated Current Revenue Penetration *in millions*	Revenue Potential at Best Practices Penetration *in millions*
$250 million- $500 million	$242,319	$919*	$3,777	$223	$915
$500 million - $1 billion	$172,288	$919*	$3,989	$158	$687
$1 billion- $5 billion	$384,312	$876**	$2,964	$337	$1,139
$5 billion- $10 billion	$291,686	$1,490**	$3,168	$435	$924
Over $10 billion	$4,302,207	$2,017**	$3,168	$8,678	$13,629
Total Industry				**$9,830**	**$17,295**

* 2010-2011 Kehrer TPM Survey

** 2010 Kehrer-LIMRA Financial Institution Investment Program Benchmarking Survey

Then we used data on best industry practices from the *Kehrer-LIMRA Benchmarking Survey* to estimate the revenue potential of the banks that are currently selling investments. These "best practices" are the average revenue penetration of the banks in the top quartile of revenue penetration for their bank size. Note: The revenue penetration in the smallest size band is based on a sample size that is too small to be statistically significant.

This analysis indicates that banks that are currently selling investments could increase their revenue by 76 percent just by emulating the practices of the most successful bank investment services units.

The potential for improvement increases the smaller the bank. If all of the largest banks achieved best industry practices, their collective investment services revenue would increase 56 percent. If all the banks in the lowest tier adopted best practices, their revenue would increase fourfold.

Revenue Potential of Banks Not Yet Selling Investments

What about the potential revenue if all banks were selling investments? At average penetration levels, the banks not yet selling investments would add nearly $2.4 billion to industry investment services revenue, with two-thirds of that increase coming from the largest banks. And if the banks not yet selling investments could achieve best practices, total bank investment services revenue would increase by over $5 billion, with those incremental gains concentrated in smaller institutions.

Figure 6 | Revenue Potential in Banks Not Yet Offering Investment & Insurance Services

Segment	Deposits in Banks Not Selling Investments *in millions*	Average Revenue Penetration *per million*	Best Practices Revenue Penetration *per million***	Revenue Potential at Average Penetration *per million*	Revenue Potential at Best Practices Penetration *in millions*
$250 million-$500 million	$105,033	$919*	$3,777	$97	$397
$500 million-$1 billion	$175,854	$919*	$3,989	$162	$701
$1 billion-$5 billion	$331,445	$876**	$2,964	$290	$982
$5 billion-$10 billion	$154,121	$1,490**	$3,168	$230	$488
Over $10 billion	$781,383	$2,017**	$3,168	$1,576	$2,475
Total Industry				**$2,354**	**$5,044**

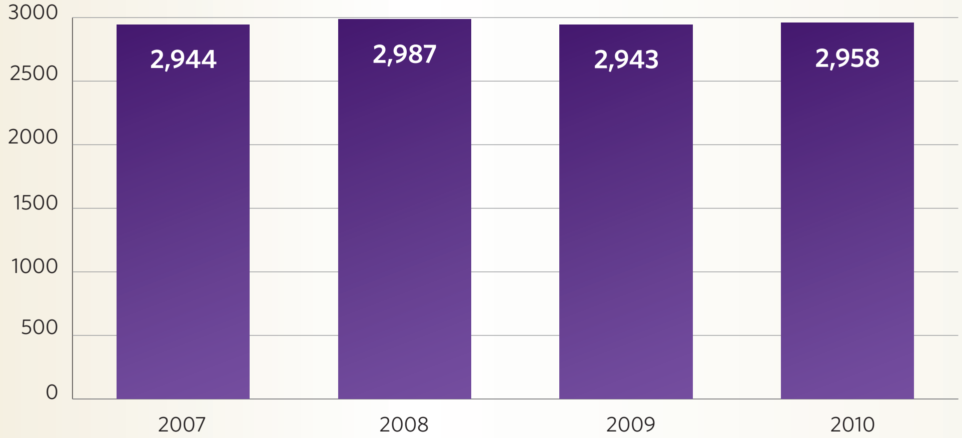
* 2010-2011 Kehrer TPM Survey

** 2010 Kehrer-LIMRA Financial Institution Investment Program Benchmarking Survey

Of course, that revenue potential could not be achieved immediately. First, the third-party broker-dealers would have to penetrate banks that are not yet offering investment and insurance services. That penetration has stalled in recent years, in part due to banking consolidation.

Figure 7 | Number of Financial Institutions Served by the Largest 12 TPMs

Source: 2010/2011 Kehrer TPM Survey



While the pace of penetration of banks not yet selling investments has been slow in recent years, the regulatory squeeze on other sources of fee income should make banks more receptive to entering this business.

Moreover, a fledgling bank investment services unit does not emerge fully productive—investment professionals have to be recruited, referral programs developed, and the investment professional has to build a pipeline of prospects. In a subsequent white paper in the *Guide to Growth* series, we will analyze data from several years of the annual *Kehrer-LIMRA Financial Institution Investment Program Benchmarking Survey* to identify the ramp-up time in a typical bank or credit union. We will apply those ramp-up times to alternative penetration scenarios to create year-by-year estimates of the revenue potential as banks without current investment and insurance offerings come on line.

Summary: The Investment Services Opportunity in Banks

While U.S. banks generate almost $10 billion in annual revenue from investment services, our analysis indicates that this is just a fraction of the industry's potential. Only one fourth of U.S. banks are currently selling investments, and they are performing, on average, substantially below their potential. If these banks could emulate the best practices of their peers, they could increase the total industry investment services revenue by $7.5 billion.

The banks not yet selling investments could add nearly another $2.4 billion in industry investment services revenue with just average penetration, and could double that if they achieved best industry practices.

For the third-party broker-dealers, this analysis also suggests that the larger revenue opportunity is to improve the operation of existing investment services units, rather than help banks launch investment offerings. But the largest gains to process improvement are concentrated in the smaller banks, which is the sweet spot for TPMs.

Among the banks not yet selling investments, the opportunity is concentrated, not surprisingly, in the larger banks. But again, the largest returns from achieving best practices are among the smaller institutions.

How do financial institutions achieve best practices? This series of white papers mines the almost three decades of experience of banks and credit unions with investment and insurance services to identify best practices. Subsequent analyses examine:

- The optimum number of financial consultants to deploy relative to the size of the financial institution
- Whether to manage an in-house broker dealer or outsource those functions to a third-party broker-dealer
- How life insurance sales complement and enhance the investment services offering and its contribution to an investment program's recurring revenue
- The optimum mix between traditional transaction business and advisory business
- Best practices in referral generation
- How the source of business changes as the financial institution's investment and insurance services mature
- For banks and credit unions contemplating an investment services offering, or for those relatively new to the business, how long it takes to become a mature business and see the "payoff" after starting an investment program

These studies, a collaboration between Cetera Financial Institutions, Dr. Kenneth Kehrer, and Kehrer-LIMRA, will reinforce the good decisions that banks and credit unions are already making and help them understand the ways they can do even better.

Methodology

Deposits of public units (government and government agencies) were excluded so that the analysis could focus on consumer deposits. Because the primary objective of a bank's investment services business is to capture the investment business of its customers, we measure the success of its business against the yardstick of its customer opportunity. Deposits are the best published information available to measure the size of that opportunity. The *Kehrer-LIMRA Benchmarking* data report investment and insurance revenue per million of bank consumer deposits.

FDIC-insured banks and savings institutions report investment services revenue in their quarterly Call Reports under the category "Investment banking, advisory, brokerage, and underwriting fees and commissions." Thus these totals overstate the revenue from retail investment services to individuals, because they include investment banking revenue.

Banks also report insurance revenue to the FDIC under the category "Other insurance commissions and fees." While life insurance commissions are reported under this category, they are relatively small compared to revenue from credit insurance, property casualty insurance, forced placed insurance, etc.

Since annuity sales revenue is reported under the brokerage category described above, we did not include the insurance commission data in our analysis. Similar analysis of the opportunity in credit unions is not possible because credit unions are not required to report revenue from investment and insurance sales to their regulator.

Investing in Your Future Success

Finding your financial institution's potential for more profitable investment and insurance services doesn't have to be the result of trial and error. For well over a quarter century, Cetera Financial Institutions has focused exclusively on serving the needs of banks and credit unions and their clients, and is a leader in helping them and their financial professionals grow their revenue stream and services to their clients.

But most important, Cetera Financial Institutions can also provide the additional wide-ranging services and best practices that banks need to service their clients holistically. Going beyond merely piecemeal product and service offerings, Cetera Financial Institutions delivers more comprehensive solutions designed to help your clients grow, protect, and one day transfer their assets as part of their financial legacy. Designed to allow financial professionals to take a more consultative approach to managing wealth, its full range of resources helps them forge the deeper client relationships that foster greater success in pursuing their clients' financial goals.

Investment and insurance services is an important part of delivering a holistic financial planning approach to clients and executing your growth strategy. To learn more about how Cetera Financial Institutions can help you utilize best practices to grow your program revenue effectively, contributing to your financial institution's fee revenue, contact Sean Casey by phone at 800.245.0467, ext. 65014; by email at sean.casey@ceterafi.com; or visit us at www.ceterafinancialinstitutions.com.

About Kehrer-LIMRA

Dr. Kenneth Kehrer is a consultant to financial institutions and their product and service partners on their distribution of investment and insurance services. His research on sales penetration, sales force productivity, sales compensation, profitability, and sales management metrics has helped many institutions improve the performance of their investment and insurance businesses, and helped the industry identify best practices. In 2004, Dr. Kehrer received the prestigious Lifetime Achievement Award from the Bank Insurance and Securities Association. The research that his firm initiated on financial institutions as financial services stores 26 years ago is now carried on by the successor organization, Kehrer-LIMRA.

About Cetera Financial Institutions

Cetera Financial Institutions delivers customized investment and insurance solutions to more than 500 financial institutions. With its focus exclusively on banks and credit unions, Cetera Financial Institutions offers flexible program options that help deepen relationships with clients, grow fee income and fulfill financial institution goals. Cetera Financial Institutions is a member of Cetera Financial Group, Inc., which provides award-winning wealth management and advisory platforms and innovative technology for more than 6,500 independent financial professionals nationwide. For more information, see www.ceterafinancialinstitutions.com.

Cetera Financial Institutions is a marketing name of Cetera Investment Services LLC, a self-clearing, registered broker-dealer and registered investment adviser. Cetera Investment Services is a member of the Depository Trust and Clearing Corporation (DTCC), the Securities Investor Protection Corporation (SIPC), and the Financial Industry Regulatory Authority (FINRA). For more information, see www.ceterainvestmentservices.com.

About Cetera Financial Group

Cetera Financial Group, Inc. is one of the nation's largest privately held, independent broker-dealer and registered investment adviser families. It provides award-winning wealth management and advisory platforms, comprehensive broker-dealer and registered investment adviser services, and innovative technology for more than 6,500 independent financial professionals and more than 600 financial institutions nationwide. Through its four distinct broker-dealers, Cetera Financial Group offers the benefits of a large, established and well-capitalized firm, while serving advisors in a way that is customizable to their unique needs and aspirations.

Cetera Financial Group is committed to helping advisors grow their business and strengthen their relationships with clients. For more information, visit www.cetera.com.

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