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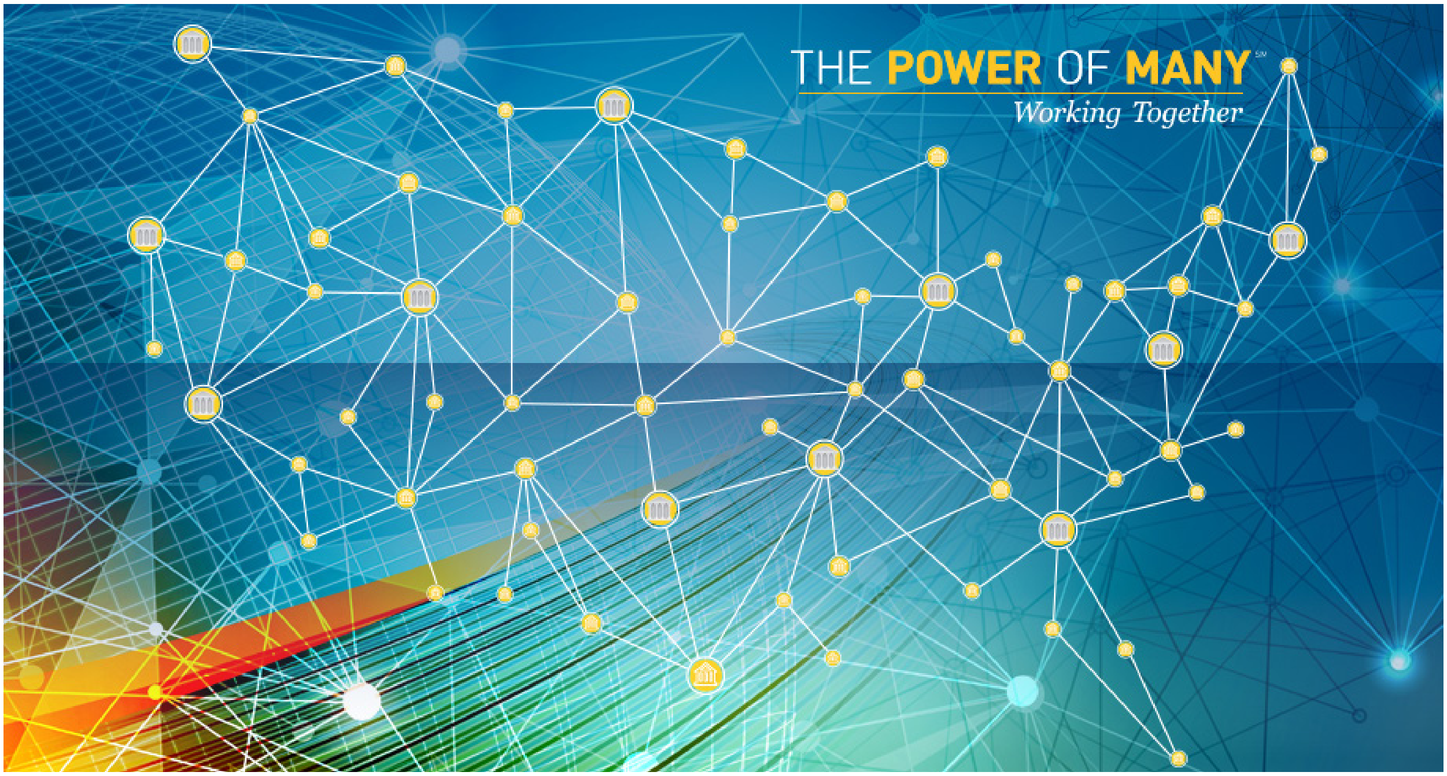
PARTNER INSIGHTS Promontory Interfinancial Network



DOING RIGHT AND DOING IT WELL:
PROMONTORY INTERFINANCIAL NETWORK'S POWERFUL NETWORK EFFECT

Promontory Interfinancial Network was founded on a novel concept in 2002: to help community banks create "synthetic size" to compete better against much bigger rivals. By joining the Promontory Network, banks benefit from "The Power of Many℠"—a network of financial institutions that enables each bank to offer services that otherwise might be too difficult or too costly to offer on its own.

It is an idea that has clearly caught on. From an original group of 10 banks, the Network has grown steadily and been chosen by more than 3,000 financial institutions over the past decade. Today, 46% of all the nation's community banks—those with fewer than $10 billion in assets—are part of the Network. About 80% of members are small banks with less than $1 billion in assets.

Explaining the philosophy behind Promontory Interfinancial Network's deep, long-time commitment to community banks, Steve Kinner, the company's Senior Managing Director of Sales, says: "Community banks are the unsung heroes of the local economy." He points out that according to the Independent Community Bankers of America (ICBA), nearly 20% of the counties in the U.S. are served by just one community bank, and that community banks make 56% of all loans to small businesses even though they hold just 18% of deposits nationally. These small businesses are the

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—Mark Jacobsen, President and CEO, Promontory Interfinancial Network

lifeblood of local communities. Indeed, according to the Small Business Administration, small businesses have provided 66% of all net new jobs since the 1970s.

Thus, it is vital that community banks remain healthy and competitive, and Promontory Interfinancial Network's products and services are increasingly seen as critical to this effort. Dan Clancy, Executive Vice President, Services of the ICBA, says, "Speaking on behalf of the only national trade group exclusively representing the interests of community banks, I can say that the services Promontory Interfinancial Network provides give Main Street a fighting chance in competing for customers with nationwide and global financial institutions."

Mark Jacobsen, President and CEO of Promontory Interfinancial Network, talks about the company's first—and most well-known—service: CDARS®. "From the outset, we designed it to serve community banks," he says. "We invented the concept of reciprocal deposits because that was their [community banks'] greatest need at the time—to retain their large-dollar depositors."

Reciprocal deposits help community banks to attract more large deposits from safety-conscious customers and to use the full amount of those deposits for local lending initiatives. Last year, Promontory Interfinancial Network helped its network of banks to make more than 650,000 bank-to-bank connections, most of which were based in reciprocal deposits. In 2015 alone, community banks used the Promontory Network to attract tens of billions of dollars that they could invest in their local communities.

Industry associations welcomed the company's innovation and were quick to realize the potential of this tool back in the early 2000s. Christine Walika, Executive Vice President of the American Bankers Association's Community Bank Group said, "ABA first endorsed the services that Promontory Interfinancial Network offers almost 15 years ago. Our ongoing due diligence and strong banker validation reinforce the value Promontory Interfinancial Network provides to our members and the banking industry."

CDARS: JUST ONE OF MANY PROMOTORY INTERFINANCIAL NETWORK SERVICES

CDARS is still the best known service from Promontory Interfinancial Network, but Jacobsen explains that the company has evolved to offer much more. "The biggest misconception is that all we do is CDARS," he says. In fact, the company's fastest-growing service today is Insured Cash Sweep®, followed by IND®. CDARS is now the third most popular offering among Network members.

Insured Cash Sweep, or ICS®, can be thought of as a more liquid version of CDARS, offering customers access to multi-million-dollar FDIC insurance on funds placed into demand deposit accounts, money market deposit accounts, or both (whereas with CDARS funds are placed into CDs).

Meanwhile, IND is a money market mutual fund alternative and the nation's leading FDIC-insured deposit sweep program. This service helps brokerage firms place customers' temporary cash awaiting investment into banks, including community banks; this gives customers the peace of mind associated with FDIC insurance eligibility and gives banks a cost-effective source of stable funding that can be used to make loans in the community. "Years ago, the emergence of money market mutual funds disintermediated banks from some deposits. But IND essentially re-intermediates banks," Jacobsen says.

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KEEPING PUBLIC FUNDS CLOSE TO HOME

Of note, the CDARS and Insured Cash Sweep services are becoming more and more popular among government finance officers, including city and county Treasurers, schools districts, police and fire districts, and other public entities. Across the United States, many thousands of local and state governmental organizations use these reciprocal deposit services to access multi-million-dollar FDIC insurance through a single bank relationship. In this way, they can safeguard taxpayer money, keep funds local so Main Street banks can use these funds to make loans in the community, and eliminate the burden of ongoing collateral tracking. By mid-2016, all 50 states had laws on the books allowing governmental entities to use CDARS, and 47 states had laws enabling ICS. Today, funds submitted by municipalities for placement through ICS and CDARS make up more than a third of all of the ICS and CDARS placements.

"Municipalities, school districts, and other governmental organizations understand the benefits of using a local bank that places funds through Promontory Interfinancial Network services; their money is not only protected, but the amount of their deposit also stays local," Jacobsen says. "That may not happen with a larger bank. Funds could leave the state and be treated on a consolidated basis and used to support projects elsewhere—even in a different country. That is not necessarily a bad thing, but the bottom line is that municipalities are collecting tax monies from local companies and individuals, and they would prefer to use those dollars to support the local community."

Besides the desire of many depositors to keep funds local, there is another development in the industry that is helping community banks attract deposits once held at large national and regional banks. New Basel III Liquidity Coverage Ratio (LCR) requirements are starting to affect the behavior of big banks.

These LCR requirements, which came about as a result of the financial crisis, are designed to ensure that the nation's largest financial institutions have the necessary funds on hand to ride out short-term disruptions to liquidity. As a result, the nation's largest banks—those with more than $50 billion in assets—must hold an amount of high-quality liquid assets, such as cash or Treasury bonds, equal to or greater than their net cash outflow over a 30-day period.

Thus, banks subject to LCR are incented to replace higher-outflow deposits, like public fund and financial institution deposits, with lower outflow deposits, such as retail deposits. This creates a unique opportunity for community banks and others not subject to the new LCR rules to pursue public fund deposits (plus the costs of those deposits are declining as the supply grows).

Adding to the opportunity for community banks are new money market mutual fund regulations, taking effect in October, which will ultimately make investments in prime money market funds somewhat less safe and liquid than in the past.

All of this is creating a perfect storm, with opportunities for community banks to win over substantial deposit business—deposits that can be used to fund additional lending in local communities. Call Report data indicates that a shift is already occurring; in 2015, public fund deposits at banks with assets of more than $50 billion fell by 3.5% and grew by 10.4% at banks with assets of fewer than $50 billion.[1]

[1] https://www.fdic.gov/bank/analytical/qbp/2016mar/qbp.pdf

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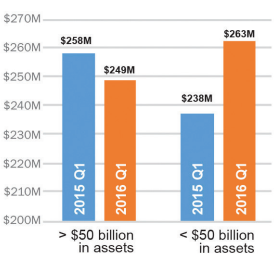
Public Fund Deposits Held at Banks Based on Asset Size



FDIC Statistics on Depository Institutions

For example, a community bank in the Midwest attracted these deposits by using the ICS service. When it started using ICS, the bank was holding a large amount of public fund deposits in its business portfolio and was allocating collateral to protect those deposits. This added to the bank's administrative tracking burden (as well as the public unit's tracking burden) and reduced its capacity to use the deposits to fund lending activities that could earn the bank higher yields.

Using ICS, the bank reduced the need for collateral and its associated costs while keeping the full amount of the governmental deposits available to use for local lending. The funds that were previously used to invest in collateral were repurposed, giving the bank more flexibility to increase the rate paid to customers on deposits (often up to 20 bps higher), thus making it easier for the bank to attract more public fund deposits while also increasing bank profitability. Also, the bank was able to lend more within the local community and to spend less time tracking constantly changing collateral values.

A COMMITMENT TO SOCIAL GOALS

Kinner points out that "Promontory Interfinancial Network is not only dedicated to helping community banks thrive, but also to encouraging socially responsible investors—including banks looking for Community Reinvestment Act credit—to deposit funds into financial institutions that serve economically disadvantaged communities where much-needed funds can be used for local lending initiatives." He adds that "The company has a social mission at its heart."

In 2015, Promontory Interfinancial Network's services helped mission-based banks—Community Development Financial Institutions (CDFIs) and minority-owned banks—to attract more than $2 billion in socially responsible investments. In fact, 75% of all CDFIs and 68% of all minority-owned banks are Promontory Network members. Like traditional financial institutions, CDFI depository institutions are profit-making enterprises. However, CDFIs have a socially driven mission that traditional banks do not have—to lend to underserved communities or provide other services in economically distressed areas.

According to Michael Grant, President of the National Bankers Association, "It's fair to say that Promontory Interfinancial Network's deposit placement services provide a lifeline to minority-owned banks by enabling our members to attract large deposits from civic-minded and socially motivated investors and to put those deposits to work in the communities we serve."

For example, City First Bank of DC, a CDFI and a member of the Community Development Bankers Association (CDBA), has focused on building the economic health of underserved communities in Washington, DC and the surrounding areas since it opened its doors in 1998. City First focuses its lending and investing on the difficult loans and projects that otherwise might not be completed, such as financing for community development, preservation of affordable housing, construction or renovation of community facilities (e.g., schools, churches, etc.), and business operations of small for-profit and nonprofit businesses. Over time, City First's lending and investment activities have helped to develop nearly 5,000 affordable housing units, to create or retain over 3,400 jobs, and to finance over 7,000 new charter school seats since the bank's formation.

"On average, the community development banks attract reciprocal deposits at four times the level of other community banks."

—Jeannine Jacokes, Chief Executive and Senior Policy Advisor of the Community Development Bankers Association

A key to meeting City First's mission is maintaining a strong funding source for loans. With CDARS, government agencies, nonprofit organizations, individuals, and businesses that are socially responsible investors can place deposits through City First and, at the same time, earn interest and access multi-million-dollar FDIC coverage on CD investments through a single relationship.

"Offering CDARS has been instrumental in helping us fulfill our mission of building the economic health of the underserved communities in the Washington, DC area," said Kimberly Levine, EVP Chief Operating Officer & Chief Financial Officer of City First Bank of D.C. "We have been able to address the investment policy constraints of many of our socially motivated investors—not-for-profits, foundations, and public agencies—by offering access to the multi-million- dollar levels of FDIC insurance coverage so critical to these depositors. In turn, we are able to put these large-dollar deposits to work in the communities that need it the most."

Jeannine Jacokes, Chief Executive and Senior Policy Advisor of the Community Development Bankers Association, echoes that sentiment stating, "Half of our members rely on Promontory Interfinancial Network's services to attract deposits so they can make loans supporting community development in some of the most underserved urban neighborhoods and rural communities in the country. On average, the community development banks attract reciprocal deposits at four times the level of other community banks. That translates into loans to small businesses, loans for mortgages and home improvement, loans for revitalization projects—loans that otherwise would not be made."

A COMPANY WITH A MISSION

As Kinner noted, Promontory Interfinancial Network is a fintech company with a mission. Its intent is to do right and do well, and that's become deeply ingrained in the culture of the company. It's no coincidence that the Washington Business Journal added the company to its list of the 2016 Best Places to Work in the Greater Washington, DC area. Placement on the list is based exclusively on employee responses to a survey that assesses overall job satisfaction in a number of areas, including personal growth, managerial effectiveness, and workplace satisfaction.

"Being a great place to work is the key to our ongoing success in the highly competitive fintech sector," Jacobsen says. "Employees are the foundation of our business. Because of their commitment, skills, and knowledge, we are able to provide our clients with the highest level of service and securely designed technologies."