Residents Bank

Business Simulation Case Study

Leadership Group
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Introduction
This program aims to build Leadership Team awareness and alignment around Citizens Bank’s strategy; in it you will manage a fictional financial institution modeled after Citizens. The business simulation will challenge you to collaborate across the business, enhance client centric culture and promote a more holistic view of how leadership and talent can drive differentiation.

Business Simulation
At the beginning of the session, participants will be divided into teams of 5-6 LG members and assigned to one of five identical companies. Together you and your management team will lead Residents Bank, the fictional financial institution.

Over three simulated years, you will compete against your colleagues based on the performance of your firm: the way you execute your strategy and the decisions you make. Your company will use a customized, computer-based planning tool to assist you in implementing your strategic decisions.

Simplicity v. Reality
Since the simulation is customized to reflect Citizens’ business and market dynamics, your strategy and decisions should be consistent with real-life experience. The tool and supporting materials are designed to optimally convey the decisions, impacts and tradeoffs involved in executing Citizens Bank’s real-life strategy.

Keep in mind, the simulation is not intended to be an exact replica of Citizens’ business or the markets in which the company operates; some simplifying assumptions have been made so that participants can run the simulated company for three years in just two days.

Know-How Sessions
Throughout the program, you will participate in two lecture/discussion sessions to delve into pre-determined topics. Knowledge gained from these sessions will be applicable both during the simulation and again in executing Citizens Bank’s real-life strategy.

Feedback Sessions
Once you have submitted your decisions after each simulated year, you will receive an analysis of your simulated company’s results. The goal of these sessions is to build a bridge between the decisions made in the simulation and the competitive results from all teams.

Application Session
At the conclusion of the program you will develop a commitment to action based on the insights gained from the program. This commitment should contain actions you plan to take that are applicable both to yourself and to those you lead. You also will have an opportunity to reflect on what it will take for Citizens Bank to successfully execute its corporate strategy, and ultimately you will be able to translate those reflections into additional actions.
Letter from the Chairman

Dear Leadership Group Member:

Congratulations! You have been selected to join the Executive Committee of Residents Bank, the tenth largest bank in the country. Prior to Year 0, Residents Bank was a subsidiary of the large commercial bank “Broad Bank of Scotlandia (BBS)”. Since then, Residents Bank has become an independent regional bank and has completed one of the largest bank IPO’s in its region’s history.

Today, Residents positions itself to operate as a top tier publically traded bank, providing the new Executive Committee the opportunity to discuss improved coordination, decision-making, and accountability in order to better serve the strategic and financial needs of all stakeholders. As a new committee member, you and your colleagues will officially take the reins of Residents Bank on January 1st, Year 1. You will have time before the beginning of Year 1 to assess the current situation, determine specific goals and develop a strategy. At the program, you will receive additional information, including financial reports from the prior year (Year 0) and more detailed information about specific markets and potential opportunities.

Best Regards,
Chairman, Board of Directors
Residents Bank

Your Challenge

There are many problems and prospects associated with managing a publically traded financial institution today’s environment. Not only are there concerns about external factors such as competition, deposit growth and the overall lending environment, but there are also internal concerns about talent management, regulatory remediation and building the bank’s infrastructure.

The critical incidents and trade-offs that you and your team encounter will present opportunities to create value for your key stakeholders, manage risk and profitably grow your business. Over the course of the next three years you will have ample chances to take action and execute your strategy.

Success at the end of the three simulated years will look like the following...

Residents Bank aspirational goals over the next 3-years:

- ROTCE 10%+
- ROA 1%+
- Efficiency Ratio = 60%
- LDR ≤ 100%
- Increased Customer Satisfaction
- Increased Employee Engagement
- Increased Fee Income Mix
Overview
For Residents to effectively compete in the market and drive overall firm value, it must gain competitive differentiation and assert itself as a community leader. Residents must also leverage a balanced mix between Consumer and Commercial as well as operate as a “fast follower” in technology. Executing as a community leader will involve three key themes for both the Consumer and Commercial Banks: acquiring new customers, building trust with those already existing and ultimately deepening relationships to retain everyone who banks with us.

Business Structure
Residents divides its business into Consumer and Commercial and each are further segmented into three business units with their own income statement. The three Consumer business units are Everyday Banking, Consumer Lending and Small Business. The three Commercial business units are Corporate Banking, Capital/Global Markets, and Treasury Services.

Consumer
For the Consumer Bank, our value proposition is simple; we are the financial partner with simple, clear and personal products and services. Acquiring new relationships with a solid checking product is paramount to being able to build trust overtime with everyday interactions. Executing well will open doors for us to deepen our consumer relationships with lending services and wealth management.

- Everyday Banking: Simple, clear and personal deposit solutions, credit card offerings, wealth management and basic banking services
- Consumer Lending: Simple, clear and personal solutions for home, student and auto lending needs
- Small Business: Business banking checking, cash management services and lending for businesses up to 25M in annual revenue

Commercial
In the Commercial Bank our value proposition is thought leadership. We aim to acquire new customers with our great ideas, industry expertise and sound advice while establishing an initial credit relationship.

Building thought leadership will allow us to build trust over time. Additionally, improving our cash management business will position us as our clients’ primary banker. Eventually we will earn the right to deepen our commercial relationships with foreign exchange or hedging products.

To execute we will need to prioritize the firm’s resources and, as the executive committee, your ability to deliver is paramount to Residents’ overall success.

- Corporate Banking: Industry expertise and capabilities in lending, asset finance and commercial real estate for middle market and mid corporate organizations
- Capital/Global Markets: Advisory and execution services in sponsor finance, syndications, FX and Interest Rate Derivatives
- Treasury Services: Cash management services, online tools and foreign trade resources for middle market and mid corporate organizations
External Environment
Firms in financial services compete in an increasingly regulated environment, and since the financial crisis in 2008, investors and regulators have grown ever more cautious. Analysts from the street are demanding certain fees and greater returns from operational improvements. To make matters worse, interest rates have remained low, compressing bank margins and increasing costs for banks struggling to raise deposits.

Additionally, competition has increased from national banks in the commercial space. These banks are giving away “spread" to gain lucrative fee-based businesses where they can use their scale to increase profitability.

Key Trends in Banking
Increasing Fee Income
- Low interest rates have eaten into lending margins and increased funding costs, highlighting a need for more productive use of the balance sheet and capital
- Competitors are building fee-based businesses to provide less volatile revenue and income streams

Investing in IT
- Peer group banks are investing an average of 10%-15% of revenue on IT investments of their platform to compete
- IT platforms are increasingly being used to lower operational costs, improve risk management and enhance commercial and consumer customer experiences

Scaling Up Digitally
- Consumers are using bank branches less and digital access points more
- Consumers are increasing making banking decisions based on banks digital access points and convenience features

Optimizing Branch Footprint
- When consumers use physical branches they do so for specific needs
- Banks are rationalizing their branch footprint, optimizing their design and often opting for smaller, targeted branch sizes

Key Customer Segments
Pre-Mass (Consumer)
In Consumer, pre-mass customers are the largest customer segment, but yield the lowest overall profit to Residents.

Mass Affluent (Consumer)
Mass affluent customers can be characterized as looking to pay off debt, manage bills and put away money for retirement.

Affluent (Consumer)
Affluent customers are the most profitable consumer customer segment, but are also the smallest. They differ from mass affluent in the fact that they are additionally concerned with managing investments and being protected from fraud.

Small Business (Consumer)
Small business customers carry the highest balances and still use many of the convenience services as the mass affluent segment. Today, small business is Residents Bank’s smallest segment in terms of accounts, but has been highly profitable.

Middle Market (Commercial)
Middle Market companies are organizations with annual revenues between 25MM and 500MM dollars. Their needs are more complex than small businesses.

Mid-Corporate (Commercial)
Mid-Corporate organizations are similar in nature to middle market, but larger, with 500MM or greater with more complex needs.
Strategic Priorities

1. **Evolve the Consumer Bank** to better meet the needs of our mass affluent and affluent customers
   - Build a strong residential mortgage business in our footprint
   - Invest in and grow business banking
   - Move toward smaller format branches with fewer, but more productive bankers and enhance online and mobile functionality for a seamless customer experience
   - Ensure our technology is reliable and always available for customers
   - Expand and enhance our wealth business as a way to deepen relationships with customers

2. **Continue our momentum in Commercial**
   - Enhance expertise and training of bankers to drive thought leadership and differentiate our customer experience
   - Deepen customer relationships with a focus on capital/global markets and treasury solutions

3. **Grow our balance sheet** to build scale so we can better leverage our cost base and investments
   - Focus on growing a cost-effective, sustainable deposit base in support of business loan growth

4. **Develop a high-performing, customer-centric organization and culture**
   - Drive talent management, with a focus on attracting, developing and retaining great people
   - Continue to focus on our customer-centric culture of excellence, leadership, and teamwork

5. **Embed risk management throughout the organization** and build strong relationships with regulators

6. **Tightly manage expense base** while funding technology, colleague, and regulatory needs and maintaining sufficient investment in our infrastructure

Key Considerations

Each decision you make will reverberate throughout the organization in multiple ways. When executing Residents’ strategy and “operationalizing” the six Strategic Priorities, you will face a number of trade-offs. For example:

- How do we provide the best customer experience while tightly managing our expense base?
- How do we grow our balance sheet in a way that considers incremental funding, capital costs, and effective risk management?
- What ways can we allocate resources to continue momentum in the commercial sphere while simultaneously evolving the Consumer Bank to better meet the needs of our mass affluent and affluent customers?
- How do we handle our hiring needs to grow the business while simultaneously developing a high-performing and customer-centric culture?
- How do we balance an increase in wallet share while at the same time seeking new customer relationships?
- What is the best way to make capital investments in our future while also looking to improve our efficiency ratio?

“With new pressure from Wall Street, how will Residents execute on its strategy and drive returns?”

- *Industry Analyst; December 31, Year 0*

“Residents has a large chasm to cross with its internal systems. It’s a peer group laggard with investment in tech”

- *Maturia Financial Times; November 13, Year 0*

“Interest rates are low and may be so for a while. How much more efficient can banks get?”

- *The Maturia Economist; October 12, Year 0*
Opportunities Overview
Embedded within the challenges of operating each of Residents six businesses are unique opportunities to grow topline revenue, increase profitability, attract talent and drive operational efficiency. Some of those opportunities are highlighted below.

Consumer Opportunities
Everyday Banking
- Our customers are multi-channel - branch, online, email, phone, mobile and ATM
- Both mass affluent and affluent customers value reward for the depth of their relationship
- Mass affluent key financial goals include saving for retirement and saving for an emergency versus more affluent customers looking to maximize their returns on finances and investments
- Mass affluent look for advice from those they trust

Consumer Lending
- Managing debt most efficiently is important to the mass affluent segment
- A trusted advisor or referral is important in selecting a financial provider
- Loan officers in the field are critical for driving growth in home lending

Small Business
- Small Businesses are always looking for capital to expand, but the value they get relative to what they pay in APR is important
- Access to credit can drive growth in small business
- Having solid business bankers in the field help drive loan production and deposit growth

Commercial Opportunities
Corporate Banking
- In addition to pricing and access to credit Corporate Banking customers want strong relationship managers
- Corporate Banking customers want ideas that come from an industry expertise in lending
- Quality products that can be tailored for use is attractive in this segment

Capital/Global Markets
- Capital/Global Markets is an important part of many clients finance strategy so knowledgeable bankers are key to growing the business
- Many capital market transactions are event driven
- Both FX and IRD products, in addition to lending, can drive business as we deepen customer relationships

Treasury Services
- A solid treasury offering is a great way to increase fee revenue in a low rate environment
- Commercial clients have low tolerance for downtime and tech issues so a solid services platform is key
Potential Risks
Increased Competition in Commercial Banking
- National banks compete harder in the mid-market and mid-corporate space
- Larger banks “give-away” spreads to cross-sell their Capital/Global Markets and treasury solutions products

Deposit Funding
- External factors cause liquidity to tighten and makes it difficult to meet aggressive deposit-raising targets at competitive rates

Challenged Growth in Lending Services
- Possible difficulty in growing scale businesses like home lending because of difficulty hiring and retaining talent
- Current risk appetite can shrink our available customer market

Attracting & Retaining Top Talent
- The massive change within the organization increases workloads and stretches the organization thin.
- Compensation pressure from competitors creates hiring and retention pressure

Regulatory Issues
- Enough progress is not made in regulatory remediation programs, resulting in loss of stakeholder confidence
- Unforeseen long or near term federal or local regulation affecting our core businesses

Infrastructure
- Some of our poor system reliability and downtime increases customer attrition (and reduces growth from new customers)
- Digital formats and online/mobile capabilities do not evolve quickly enough to remain relevant with customers

Winning Metrics

- Top tier customer satisfaction
- Top tier revenue growth
- Healthy capital adequacy ratios
Enablers Overview
Our ability to execute our strategy and take advantage of the business opportunities in front of us will be largely dependent on developing the right internal operating environment, such as infrastructure, systems and culture.

Talent
The firm’s talent policy can affect the rate of change in the organization and its ability to execute the overall strategy. Is it better to hire skills and thought leadership from outside the bank or develop internally?

Distribution
Having an optimized branch footprint, the tools and analytics to drive sales, strong self-serve capabilities, and knowledgeable commercial relationship managers can help you capture deposits, new customers, wallet share and drive revenue.

Delivery
A competitive advantage can be gained by prioritizing delivery criteria such as ease of doing business, willingness to customize, responsiveness and security.

Technology
Years of acquisitions and underinvestment in technology has left an unstable, fractured back-end platform that lacks reliability. This makes operations, customer service, reporting and risk management challenging.

Development
Product/Service innovation can help create differentiation in the market depending on operational capabilities and strategic alignment.

Risk Culture
Allowing employees greater flexibility and discretion in how they operate the business could increase overall business risk; however, a culture of centralized control and decision making could slow growth.

Strategic Initiatives
Strategic Initiatives are enterprise or business unit level projects designed to enhance the capability of the company to execute the overall strategy.
### Consolidated Profit & Loss Report

*(In Millions)*

<table>
<thead>
<tr>
<th></th>
<th>Consumer</th>
<th>Commercial</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Deposits</strong></td>
<td>$55,012</td>
<td>$14,203</td>
<td>$69,215</td>
</tr>
<tr>
<td><strong>Total Balance/Loans</strong></td>
<td>$36,759</td>
<td>$26,815</td>
<td>$63,574</td>
</tr>
<tr>
<td><em>Loan/Deposit Ratio</em></td>
<td>66.8%</td>
<td>188.8%</td>
<td>91.9%</td>
</tr>
<tr>
<td><strong>Net Interest Income</strong></td>
<td>$1,468</td>
<td>$834</td>
<td>$2,302</td>
</tr>
<tr>
<td><strong>Non-Interest Income</strong></td>
<td>$731</td>
<td>$335</td>
<td>$1,066</td>
</tr>
<tr>
<td><strong>Total Revenue</strong></td>
<td>$2,199</td>
<td>$1,169</td>
<td>$3,369</td>
</tr>
<tr>
<td><strong>Non-Interest Expense</strong></td>
<td>$1,661</td>
<td>$629</td>
<td>$2,291</td>
</tr>
<tr>
<td><em>Efficiency Ratio</em></td>
<td>75.5%</td>
<td>53.8%</td>
<td>68.0%</td>
</tr>
<tr>
<td><strong>Net Charge-offs</strong></td>
<td>$225</td>
<td>$46</td>
<td>$271</td>
</tr>
<tr>
<td><strong>Net Income After Tax</strong></td>
<td>$203</td>
<td>$321</td>
<td>$525</td>
</tr>
<tr>
<td><em>NIAT % of Revenue</em></td>
<td>9.2%</td>
<td>27.5%</td>
<td>15.6%</td>
</tr>
<tr>
<td><strong>ROTCE</strong></td>
<td>5.14%</td>
<td>11.41%</td>
<td>7.75%</td>
</tr>
</tbody>
</table>

*Unaudited BTS estimates only, actuals may vary*
Residents Bank

Charts

Revenue Breakdown - Overall
- Consumer: 35%
- Commercial: 65%

NIAT Breakdown - Overall
- Consumer: 61%
- Commercial: 39%

Revenue Breakdown - Consumer
- Everyday Banking: 37%
- Consumer Lending: 50%
- Small Business: 13%

NIAT Breakdown - Consumer
- Everyday Banking: 17%
- Consumer Lending: 72%
- Small Business: 11%

Revenue Breakdown - Commercial
- Corp. Banking: 28%
- Treasury Svc.: 9%
- Capital Mkts.: 63%
Winning Metrics
The markets will be watching your team closely as you develop and execute your strategy. Over the next three years you and your team will compete against similar competitors: making strategic decisions, recruiting talent, investing for the future and implementing broad company-wide initiatives in order to perform over both the short and long-term.

Each year we will publish a thorough analysis of your company’s financial results and will benchmark them against your major competitors. The market will determine where customers bank, and reward the best companies with increased revenues, enhanced profitability, and ultimately superior returns on capital.

You and your team will be evaluated against your competitors according to the metric ROTCE. However, to make sure that you are leaving a viable company for the future and not just managing for the short term, your team must cross three additional financial hurdles. Your team must be in the top tier in both overall customer satisfaction and accumulated revenue growth. Your team must also maintain a superior capital adequacy ratio. More information will be provided for you at the session about the winning metric and hurdles (see page 9).

Summary
Residents Bank operates in a fast paced, changing environment as it enters a period in which revenue growth will become more difficult to achieve. Residents business model is under pressure: the Maturia economy remains sluggish, high margin products have been negatively impacted by market and regulatory issues, and there are no clear signs that indicate interest rates will rise again anytime soon.

In addition to these challenges, the financial services industry as a whole is facing a dramatic increase in legal and regulatory scrutiny, and Residents can only expect to face more in the future. These are some of the challenges that your bank must overcome in order to continue to grow.

In order to successfully navigate these challenging times, we have identified five critical behaviors executive leaders from your bank must master. Teams that demonstrate these behaviors should flourish during the session and beyond.

Good Luck!

Critical Leadership Behaviors
1. Better operator: Make decisions based on a deeper understanding of financial drivers with an eye toward being more commercial and a better operator

2. Customer: Focus on the customer to acquire, build and deepen relationships

3. Do the right thing: Employ an end-to-end perspective when accepting and management risk

4. Think long-term: Drive talent management; attract, develop and retain great people

5. Work together: Increase cross-functional awareness and collaboration
<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allowance (Provision) for Loan Losses</td>
<td>An item on a bank’s balance sheet that shows the amount of funds the bank has set aside to absorb future loan losses expected from its existing loan portfolio. As the bank experiences actual loan charge-offs, these charge-offs reduce the bank’s allowance. Funds used to increase the Allowance are shown on a bank’s profit and loss statement as the provision for loan losses. See also Provision for Loan Losses.</td>
</tr>
<tr>
<td>Borrowed Funds</td>
<td>Also called borrowings or purchased funds, these are funds (other than deposits) that are loaned to an institution for which it pays interest. These may include short-term borrowings and repurchase agreements.</td>
</tr>
<tr>
<td>CAGR (Compound Annual Growth Rate)</td>
<td>The year over year growth rate of revenue or an investment over a specified amount of time</td>
</tr>
<tr>
<td>Capital</td>
<td>The funds raised by a company through the sale of stock (shares) or debt securities and retained earnings. In banking, it is also divided into primary or core capital (stockholders equity), secondary or supplementary capital (debt and loan loss reserves) and tertiary or market risk capital (short-dated subordinated debt).</td>
</tr>
<tr>
<td>Capital Adequacy</td>
<td>The ability of a bank to absorb losses or shrinkage in the value of assets. Banking supervisory agencies have set standards to ensure that a bank’s capital is sufficient to absorb a reasonable degree of losses and remain a going concern. These standards have been established primarily to protect depositors and the global banking system as a whole.</td>
</tr>
<tr>
<td>Capital Charge</td>
<td>The capital charge is the total invested capital raised via equity or debt multiplied by the weighted average cost of capital.</td>
</tr>
<tr>
<td>Capital Ratio</td>
<td>A measure of a bank’s capital and liquidity. It is expressed as a percentage of a bank’s risk weighted credit exposures compared to its overall capital.</td>
</tr>
<tr>
<td>Cash Equivalents</td>
<td>Any assets that can be quickly sold for cash. These can typically include money market funds and government treasury bills.</td>
</tr>
<tr>
<td>Cost/Income Ratio</td>
<td>Measure of a bank’s efficiency in using expenses to generate revenues. The ratio is calculated by dividing operating costs, both interest and non-interest expenses, by operating revenues.</td>
</tr>
<tr>
<td>Earning Assets</td>
<td>Assets that create earnings for a financial institution. Earning assets can typically be loans and securities as they generate interest income for the institution.</td>
</tr>
<tr>
<td>Earnings Per Share</td>
<td>A ratio used to determine the amount of profit generated per share of stock owned. It is determined by dividing net income (minus dividends) by the amount of outstanding common stock (shares).</td>
</tr>
<tr>
<td>Efficiency Ratio</td>
<td>A measure of how a financial institution is utilizing its’ employees, facilities and operations in relation to the revenues they are creating. The ratio is calculated by taking the non-interest expense and dividing it by the sum of the net interest income and non-interest income. Institutions continually try to lower their efficiency ratio as that will result in higher profits.</td>
</tr>
<tr>
<td>Equity</td>
<td>Ownership interest held by stockholders in a corporation. In the context of a brokerage account, it refers to the market value of the securities minus debit balance and credit balance.</td>
</tr>
</tbody>
</table>
**Federal Funds (FedFunds)**

Short-term borrowings and investments (typically overnight) between other banks transferred using each bank's Federal Reserve District Bank. One bank (borrowing bank) requires short-term funding and refers to that transaction as FedFunds purchased. The other bank (lending bank) has excess funds and refers to the transaction as FedFunds sold. FedFunds are not loans from the Federal Reserve.

**Loan to Deposit (LDR) Ratio**

A commonly used statistic for assessing a bank's liquidity by dividing the banks total loans by its total deposits. This number, also known as the LTD ratio, is expressed as a percentage. If the ratio is too high, it means that banks might not have enough liquidity to cover any unforeseen fund requirements; if the ratio is too low, banks may not be earning as much as they could be.

**Net Charge-Offs**

Net charge-offs are calculated by adding a financial institutions allowance for loan losses with its realized losses minus any recoveries.

**NIAT (Net Income After Taxes)**

An accounting term, most often found in a company's annual report that is meant to show the company's definitive "bottom line" for the accounting period. In other words, it shows what the company earned after all its expenses, charge-offs, depreciation and taxes have been subtracted.

**Net Interest Income**

Net interest income is the difference between interest earned and interest paid, and is commonly tracked by banks and other institutions that lend money. As banks both pay interest (to other banks or to individuals with deposits at the bank) and earn it (from loans), interest is both an expense and a revenue stream.

**ROE (Return on Equity)**

The amount of net income returned as a percentage of shareholders equity. Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

**ROTCE (Return On Tangible Common Equity)**

ROTCE is computed by dividing net income by tangible common shareholders' equity. This non-GAAP financial measure is favored by banks and financial institutions because it measures profitability generated from shareholder money minus intangibles.

**Tombstone Deal**

Among financial firms, and more specifically, the investment & commercial banking community, the term "tombstone" has come to be used as shorthand for a trophy or deal tombstone, also known as a deal toy. Throughout the 1980s and 1990s tombstones became a fixture within the culture of investment banking, both as a means of recognizing the work of its employees in successfully completing a transaction, and more importantly, and as a branding tool among the investment bank's clients.