EXCLUSIVE INTERVIEW TRANSCRIPT

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Place: U.S. Bancorp Tower
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Participants: Andy Cecere (AC), Chairman and CEO of U.S. Bancorp
John Maxfield (JM), Executive Editor of Bank Director

JM: We'll spend most of our time talking about technology, but one thing I find interesting about U.S. Bancorp is how it performed in the financial crisis. Banking is a countercyclical industry. Good banks perform well in good times. But they perform best in tough times. That sums up U.S. Bancorp's performance through the crisis. You came out of it as the most profitable and highest-rated big bank in the country. Talk about that a little bit.

AC: That's right. During the crisis we actually strengthened. We're one of the very few banks that have more offices, people, capabilities and businesses after the crisis than before, because we expanded our trading desk and our people on the derivatives group and our FX because of some of the troubles other banks were having.

Our North Carolina presence is a great example, right? Many of the employees at our trading floor there were at other banks and lost their jobs during the crisis. That's why we have 700 people in North Carolina right now.

We just released earnings last week and one of the analysts wrote in the headline: "The Best Sleep at Night Bank There Is." We do perform well. Our former chief risk officer, Bill Parker, who retired last week, would say that all the time: "You know the cycle is going to happen, and the decisions you make in the good times are how you are impacted in the bad times."

JM: In one of the presentations you've given recently, you talked about the different eras of banking that you've seen in your career. Walk me through that. Where are we at right now?

AC: When I started in banking in 1985 there were 14,000 banks. Now there

are 5,000 banks. So, the years from 1985 to 2005 are the era of consolidation. Every morning you'd wake up and read *The Wall Street Journal* and you'd read about a bank acquisition. What's gonna be the name? Who's gonna be the CEO? Where are the branches going to be? How many jobs will be lost?

Then you go to 2006 to 2015—the era of the financial crisis. Capital. Liquidity. Increased regulation. Huge failures. Changes in structure. In that period of time, it was all about building a strong defense. Banks are coming out of that now.

I would maintain the era we're in now is the era of digital, innovation and technology. Now when you wake up on Monday morning, what do you read about? Amazon. Google. Fintech. Banks opening up digital branches. New technologies. It's really changing. We're in a new era.

JM: But how do we know we're really in a new era? People have made the same claim before. Union Bank & Trust rolled out a banking-by-mail service in 1928. By 1954, half its deposits were done through the mail as opposed to its office in downtown San Francisco. So, people thought branch banking was dead. Yet, since then, the number of branches in the country went from something like 6,000 to 80,000. And then we had phone banking, drive-through banking, ATMs. What's different today?

AC: When I started in banking in 1985, I was told that checks, cash, branches and ATMs were going to go away. And they didn't—for 30 years. But now, 65 percent of transactions are happening on this device [a smartphone] that wasn't here 10 years ago.

There are a few things that are different. Technology advancements, customers' expectations and nonbank entrants. In all those eras you're talking about, it was always banks competing against banks. But now, when I think about payments or money movement, I don't just have to think about Wells Fargo or JPMorgan Chase, I have to think about Amazon and Google and Apple. So, the entrants and the competition [are] different.

Also, if you think about banking all those years, what fundamentally did a bank do? Lending and deposit-taking. There was a great moat around banking because of that. Nobody else could do those things but banks. Today, the first transaction my daughter and most kids have with their bank is not a savings account, a passbook account [or] a mortgage, it's

money movement—Venmo, Zelle—and anybody can do that.

So, what I think is different is the technology capabilities have allowed digital interactions and transactions not only with banks, but with nonbank competitors. So, the level of competition and threat is greater today than in previous eras.

JM: Does that change how people choose a bank? For instance, one of the four pillars U.S. Bank is focused on right now is trust, which influences a person's decision when they choose a bank.

AC: The number one reason a consumer, small business or large company chooses a bank is not product, pricing, location or convenience—it's trust. That makes sense. If you're going to put your money with someone, you want to trust them. And we rate very highly on that. But if you enter banking on the payments side, those companies get all that data and can use it to create a central relationship with the customer. That's what worries me a little bit.

I don't believe the larger tech players want to be banks, but I could see them partnering with a bank on the backend and being the frontend to the customer. One of our objectives is to be central to our customers' lives. When you wake up in the morning, I want our app to be one of the apps you look at. What's going on in my financial life? What do I need to do? What payments do I need to make? I don't want that to be a big tech company. I don't want that to happen. So, in order to make sure that doesn't happen, I have to have all the payments capabilities to have that central relationship with the customer.

JM: Talk about U.S. Bancorp's payments business.

AC: At our strategic offsite this year we slightly changed how we think about our businesses. We break them down into how much we make from lending, deposit taking, money movement and advice. And it's about 29 percent from money movement, which is payments. That's a core component, but it's insufficient by itself to support a relationship with a customer. We want to be able to provide advice and be central to their lives, help them meet their goals and objectives, buy a car [or] a home. But oftentimes the entry, particularly for younger people, into the banking system is through payments. So, I could see a situation where you have a relationship with us as a bank which allows for these zero-cost things that are money movement for a membership fee or

something of that sort that allows you to do all those other things. But payments by itself won't be a core answer, though it's a component that's important to get the relationship started.

When you think about a bank, one of the major functions is moving money. Paying bills. Saving money. Moving money from one account to another. So that whole component is critical to that relationship. And it's part of what's happening when you move from physical to digital. So, when it was only checks for money movement, or cash, that's very different from when it's digital, which is the technology capability out there now. That's why it's so different now.

Here's the other thing I'd tell you. I want to be able to not just move money around for you as a customer, but to add value to your life. So, if you have goals or objectives or just information that would be helpful for you to know, and I send out texts to you, notifications, we'll use the information to your benefit to meet your goals or objectives. My daughter just moved into a new apartment. She's 22. They don't teach kids planning or budgeting. So, I sat down with her and went through a budget. What if our app helped you with that? And in addition, it helped plan to save for a down payment for a house or car? We can use those things to build a relationship with you to help you meet your objectives.

JM: What about switching costs? High switching costs have always been an important competitive dynamic in banking. Is the fact that people are now getting into banking through payments, as well using banking apps, lowering switching costs?

AC: I think it is changing. And I think the other thing that occurs is other entrants into the marketplace. People can be very frustrated with their banks for a lot of reasons, but there are so many connections they've established—automatic debits, credit card transactions—that switching costs are high. Two things: We're trying to make them easier, but there are always new entrants to the market. And they come in through payments.

Zelle growth is tremendous. It passed Venmo, and it's only been out for a short while. It's one of the great partnerships in banking. There are seven owners, but any bank can use it. All you need is a phone number or email, and you can use it.

JM: Roughly 10 percent of customers change banks every year. One of the

trends we've seen recently is that large banks like U.S. Bancorp are organically growing deposits, which is different than the past. Is the reason big banks are gaining deposits organically because they have better digital offerings and are therefore getting a larger share of new people into banking? And/or is it because they're gathering up a larger share of people who switch?

AC: I think it's "and." Larger banks are taking share from smaller banks. And one of the reasons for that is the digital capabilities are so important. That's why we spend $1.2 billion a year on technology.

JM: Will that number increase with the corporate tax cut?

AC: In our case, we gave the tax savings to all four of our constituencies. We went to a $15 minimum wage and gave a one-time bonus to the majority of our employees. We increased our contribution to our charitable foundation. We changed our benefits plan, so we're paying more of medical costs. We increased our technology spend for the benefit of our customers. And we increased our buyback and dividend.

JM: Is it fair to think that innovation will accelerate because of the freed-up capital?

AC: I do think technology spend is going to increase as well as the speed of change in innovation. But just as important, as we compare ourselves to our competitors—every year I do a chart for the board, and it's always JPMorgan Chase, Bank of America, Wells Fargo, PNC. Here's how we stack up against them. This year we had a second page—Amazon, Google, Apple. How do we stack up against them? There are things we're better at, but there are things we need to be better at to effectively compete against them. Again, if you think about the headlines, it's not just banks doing things, it's fintech and these larger players doing things in the financial services realm, too.

JM: You have a nationwide franchise, but there are some markets where you don't have a presence. In light of your earlier point that we're no longer in the consolidation era, but now are in the digital era, does that change how you'll expand into new markets?

AC: The calculus around acquiring a bank has changed dramatically. Twenty years ago, if I wanted to expand to Dallas, Texas, there was really only one way to do that, which was to buy a bank there. Otherwise it'd be

hard. You needed a physical presence. You needed a density of branches because people used branches for transactions. Today, first of all, we have 18 million customers. Three million of them are outside our 25-state footprint, because they either have a credit card, auto loan or mortgage from U.S. Bank. So, they're a single-service customer. But I can expand to Dallas with a few branches and the digital capability with far fewer locations and a much cheaper and less destructive way than acquiring somebody.

If I went into a new market and tried to acquire new customers that didn't know U.S. Bank, I'd either get negative selection, or I'd have to pay really high interest rates. Otherwise, why would they come to me? But if I go into a market where I already have customers or employees and extend that relationship with a few select branches and digital capabilities that are really good, I have a better chance, right? And I don't have the disruption from going into a new market and having 40 percent attrition of customers and employees. And, in fact, when an acquisition does happen in some of our markets, we can go in with our digital capabilities and try to pick up some of that attrition. So digital has changed the board in terms of how you play the game.

Fundamentally, to acquire a customer 20 years ago, what did you need? You needed a physical presence. That's what you needed. Today you don't necessarily need the same level of physical presence, and you can still acquire a customer. Seventy percent of transactions happen digitally. So, if you have really good digital capabilities, you can acquire a digital footprint, as opposed to a physical footprint, with much fewer branches. So, the way I acquire is much different.

In Dallas, for instance, we have hundreds of thousands of customers. What if I went into certain markets in Dallas with a handful of branches, or a dozen branches, strategically placed, perhaps close to where we already have a mortgage operation, and add wealth management and acquire more of their business and target very specifically on customers that are already U.S. Bank customers, expanding with digital capabilities? That's better than acquiring 100 branches, closing 50 of them, losing 40 percent of the customers and paying a big premium for the deposits.

JM: Does that mean you would never buy a bank in Dallas?

AC: The numbers would change. I wouldn't pay the same premium as I

would 20 years ago, because I have an alternative acquisition model that's different. That's why I say the calculus has changed.

JM: So, do you think this will impact M&A more broadly?

AC: I don't know for sure. I think there's going to be more consolidation of small and mid-size banks because of technology. I can spend $1.2 billion a year. I spend another $1.2 billion on operations. That's basically $2.5 billion a year on technology. A $50 billion bank can't do that, and a $5 billion certainly can't do that. We've already said that large banks are taking share from small banks, so if you're a small bank, what do you do? I think small banks will come together.

JM: If you look back to when the original U.S. Bancorp sold to First Bank System, where you worked, the rationale its CEO, Gerry Cameron, gave for selling was that technology was making it hard to compete without more scale. Is the same true today? In other words, is it not just the calculus of the buyer that technology is influencing, but also the calculus of the seller?

AC: If you look at the consolidation from 14,000 banks down to 5,000, I think technology was a component of that. But it was a different kind of technology, the spend was different, there was more capacity, again, it was back to the physical presence. Most of the acquisitions we did, and every other bank did, [were] to expand our marketplace, to leverage marketing dollars. I think today is different, because the technology spend is more core to customer acquisition and service than it was in the 1990s.

JM: Much more important?

AC: Much more important. No question about it. And part of it goes back to the fact that we're not just competing against other banks.

JM: So, when you visualize the competitive playing field, it's different today than it was, say, two decades ago?

AC: It's different, but let me make a distinction. I'm less concerned about small fintechs. So, if you think about everything a bank does, what a fintech typically does is take a thin sliver of the customer relationship and get really good at it. And it's typically an unregulated sliver where they have a frontend technology that's really good. But in and of itself, that doesn't add as much value, unless you have the rest of the

relationship. So, the partnership model is what works best for fintechs. It's what works for the banks, too. OnDeck is a perfect example. There [are] hundreds of these where a fintech succeeds by partnering with a bank. We do some fintech partnerships. Blend is a company we've worked with to develop a mortgage application you can complete on your phone in minutes and watch its progress like the Domino's pizza tracker app. I think the fintech model is based on partnership.

JM: When you talk about fintech partnerships, are most of these primarily on the deposit side?

AC: And lending too. Through an agile development process, in a matter of months, we developed this small business application that has taken what took weeks—days and weeks—to minutes and hours to get a small business loan approved and funded. We're improving our app to allow you to sign up for a credit card, home equity loan, mortgage. Seventy-four percent of our mortgages are going through our mobile app. We had our best marketing minds work on this. It's so easy. You can gather information much more easily and effectively.

When we rolled that out, I was worried what our mortgage brokers would think. I knew the customers would love it. It's easier, faster, more convenient. The mortgage process is hard. I also knew the bank would love it. It's more efficient. It's effective at customer acquisition. But I was worried about the mortgage bankers liking it. Because it was threatening. But you know who loves it the most? The mortgage bankers. Why? Because they spend their time now on advising and counseling clients instead of collecting paper and moving it around. They can spend more time talking about whether a customer wants a 30-year or 15-year mortgage, fixed or floating rates, rather than just collecting all this information. Their job function has been elevated. So, they love it more than anybody. Blend is the partner. I went to our mortgage bankers' conference and was worried, but they love it.

JM: Is it fair, then, to think that efficiency and employee engagement are not mutually exclusive? That's how a lot of bankers view it, as a trade-off. But you don't think that's necessarily the case?

AC: One of the reasons we have such a low efficiency ratio is our platform. We always had the discipline, nine months after an acquisition, to merge systems. And U.S. Bank is unique. We have one deposit system. One consumer loan system. One commercial loan system. One

corporate trust system. So, you think about changing products, and you think: Don't all banks have that? Many of the larger banks have a dozen deposit systems. One of the banks here in town, if you want to deposit money, you have to tell them where the account was opened, because the account numbers are different lengths and use different systems. Having a single platform is hugely important to our efficiency ratio. And it simplifies our employees' lives, too. And if you think about the new digital capabilities and the use of data, it also extends that advantage because you're going from one source—just one place—and it's common in terms of its approach and process. So, why didn't all these banks convert? It should be easy, right? It's not. It's hard. But what happened? The financial crisis. Now all the sudden you're building anti-money laundering and Bank Secrecy Act and Know Your Customer processes, and you're doing all this stuff. You don't have time to do a system conversion. We would always convert within nine months. Some banks didn't do that. Or they kicked the can down the road. Then the crisis hit.

JM: Last question: Where does digital banking stop in terms of assessing credit risk?

AC: Models have always been important, particularly on consumer credit risk, but technology will improve that process, especially if you think about artificial intelligence. But you have to test this through cycles. Right now, anyone can come up with a model that works. Because credit is pretty darn good. So, you have people say we're going to assess credit from your telephone number and your spending on your Amazon account. And they say, "you know, it works." Well, of course, it works. We're in the best economic time in history. We haven't been through a cycle. The question is: Will it work when we're in a recession? And no one knows the answer to that. So, we're very careful with that.

JM: Any final thoughts?

AC: Even though we're in the age of digital, banking is always going to be a combination of human and digital. The key to success is not one of them; it's all of them.