

The Impact of Standardized Basel II on Alabama Banks

Prepared for Alabama Bankers Association



Executive Summary

- Basel II bank capital regulations are in the news ...



- We estimate that Standardized Basel II compliance will improve the regulatory capital ratios of 86.8% of 144 Alabama banks and thrifts
 - Aggregate potential capital savings for all 144 banks of \$392 million
 - The median Alabama bank would save \$0.9 million or 4.7% of their existing Tier 1 capital requirement
- Implementation is not without its challenges
 - Pillar II reporting can be complex and costly
 - Compliance requires demonstrated capital management capabilities
- Are your members aware of and prepared for these changes?
 - Second Pillar Consulting is uniquely positioned to help banks comply with Pillar II and obtain the capital relief they deserve

Alabama Banks can save up to \$392 million in required capital under Standardized Basel II and improve risk management

Capital savings estimate and asset category contribution

Regulatory Capital Requirement

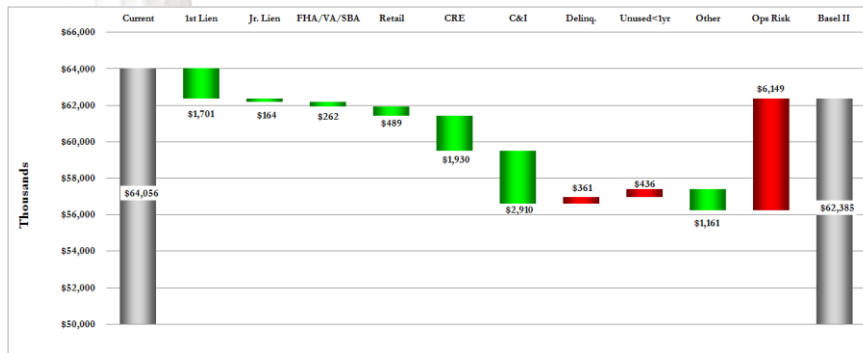


Source: 2008Q3 Call Reports; SPC estimates

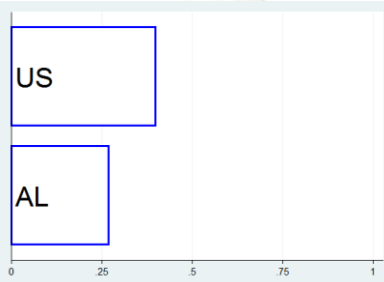
For Auburn National Bancorporation, Inc., a representative Alabama bank, Basel II regulatory capital savings can be stockpiled or deployed

Capital Savings: \$1.7 million or 2.5%

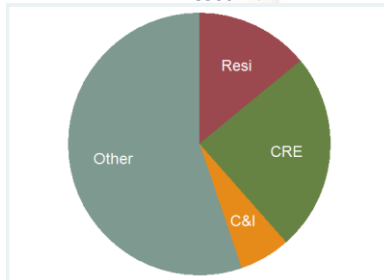
Regulatory Capital Requirement



Capital Savings Percentile



Asset Mix



Capital Metrics and Management

Total Assets (millions)	\$735	
Gross Income Margin	3.0%	
Tangible Common Equity	7.1%	
Leverage Ratio	8.9%	
Capital Estimates	Current	Basel II
Tier 1 RBC	14.5%	14.9%
Total RBC	15.5%	15.9%
Potential Use of Basel II Capital Savings		
Special Dividend (\$/share)	\$0.45	
Share Repurchase (7/29/2008 price)		
Number of Shares	75,961	
Change in EPS	\$0.04	
Organic Asset Growth (millions)	\$18	

Auburn National Bancorporation, Inc. Auburn, AL Highlights

- *Stockpile.* Under Basel II, total RBC increases from 15.5% to 15.9%, an amount equal to \$1.7 million or 2.5% of the existing capital base.
- *Deploy.* Incremental capital can be deployed with a variety of balance sheet actions that preserve the current 15.5% total RBC ratio:
 - Issue a special dividend of \$0.45 per share
 - Repurchase 75,961 shares, increasing EPS \$0.04 or 2.1%
 - Organically grow assets by \$18 million

Upon request, Second Pillar Consulting can provide similar information for all 144 Alabama banks free of charge

Alabama banks with the highest percentage changes in regulatory capital under Standardized Basel II

Name	City	Asset Size (\$000's)	Basel II Capital Impact	
			Dollar Change (\$000)	Percent Change
Keystone Bank	Auburn	\$ 100,643	\$ 3,243	23.3%
Citizens State Bank	Vernon	\$ 83,205	\$ 1,942	23.1%
SouthCity Bank	Vestavia Hills	\$ 68,228	\$ 2,190	23.0%
Vantage Bank of Alabama	Albertville	\$ 50,748	\$ 1,820	22.0%
Southern Independent Bank	Opp	\$ 95,539	\$ 2,132	21.7%
Citizens Bank of Fayette	Fayette	\$ 189,057	\$ 6,618	21.0%
First Cahawba Bank	Selma	\$ 37,278	\$ 1,694	19.9%
Progress Bank and Trust	Huntsville	\$ 102,308	\$ 4,116	18.2%
Bank of Walker County	Jasper	\$ 74,750	\$ 1,401	17.4%
Southern States Bank	Anniston	\$ 114,444	\$ 4,311	17.3%
Southern Bank Company	Gadsden	\$ 101,216	\$ 2,095	16.6%
Trinity Bank	Dothan	\$ 64,871	\$ 1,051	14.9%
Camden National Bank	Camden	\$ 115,959	\$ 1,645	14.1%
Citizens Bank & Trust	Guntersville	\$ 236,190	\$ 2,816	14.0%
Bank of Evergreen	Evergreen	\$ 46,418	\$ 440	13.7%
Red Mountain Bank, National Association	Birmingham	\$ 350,108	\$ 3,702	13.0%
Farmers & Merchants Bank	Piedmont	\$ 175,847	\$ 2,235	12.7%
Bank of Vernon	Vernon	\$ 194,559	\$ 2,453	12.5%
Covenant Bank	Leeds	\$ 107,556	\$ 832	12.2%
SouthPoint Bank	Birmingham	\$ 201,744	\$ 2,241	12.1%
Averages		\$ 125,533.40	\$ 2,448.67	17.1%

Source: 2008Q3 Call Reports; SPC estimates

Alabama banks with the lowest or negative percentage changes in regulatory capital under Standardized Basel II

Name	City	Asset Size (\$000's)	Basel II Capital Impact	
			Dollar Change (\$000)	Percent Change
FirstState Bank	Lineville	\$ 156,403	\$ 22	0.2%
Central State Bank	Calera	\$ 159,840	\$ (68)	-0.3%
First Bank of Boaz	Boaz	\$ 147,985	\$ (107)	-0.4%
Peoples Southern Bank	Clanton	\$ 134,762	\$ (226)	-1.1%
Farmers & Merchants Bank	Waterloo	\$ 55,170	\$ (229)	-1.9%
Colonial BancGroup, Inc.	Montgomery	\$ 26,262,575	\$ (68,133)	-2.5%
Samson Banking Company	Samson	\$ 50,204	\$ (227)	-2.8%
FNB Bank	Scottsboro	\$ 304,600	\$ (1,485)	-3.1%
Liberty Bank	Geraldine	\$ 91,888	\$ (463)	-3.3%
Union Bancshares, Inc.	Pell City	\$ 305,588	\$ (1,312)	-3.7%
Merchants & Farmers Bank of Greene Cou	Eutaw	\$ 49,344	\$ (212)	-4.0%
Phenix-Girard Bank	Phenix City	\$ 180,182	\$ (1,060)	-4.2%
SouthBank, A Federal Savings Bank	Huntsville	\$ 290,191	\$ (2,131)	-4.8%
Citizens Bank	Enterprise	\$ 78,220	\$ (665)	-5.1%
Nexity Financial Corporation	Birmingham	\$ 1,083,254	\$ (5,365)	-5.3%
Alamerica Bank	Birmingham	\$ 106,216	\$ (678)	-5.8%
Bank of York	York	\$ 69,299	\$ (539)	-5.8%
First Progressive Bank	Brewton	\$ 28,153	\$ (485)	-5.9%
United Security Bancshares, Inc.	Thomasville	\$ 670,231	\$ (6,639)	-7.6%
Peoples Bank of Red Level	Red Level	\$ 13,842	\$ (223)	-9.3%
Averages		\$ 1,511,897	\$ (4,511)	-3.8%

Source: 2008Q3 Call Reports; SPC estimates

But banks must be prepared to answer the tough risk management questions posed by Basel II compliance

- Do you have a well-functioning risk oversight structure?
- Do you have clear risk management policies and procedures?
- Have you identified the important risks faced by your institution?
- Have you articulated an institutional appetite for risk-taking?
- Do you have accessible data on the risk characteristics of your existing portfolio?
- Do you have accessible data on the past performance of your portfolio?
- Do you have personnel that can fill critical risk assessment gaps?
- Do you actively manage and plan your capital position?
- Are you committed to enhancing your overall risk and capital management?

Second Pillar Consulting can help banks prepare for Basel II compliance

- Our principals have over thirty years of experience in enterprise risk management, regulatory capital compliance, and regulatory relations
 - Supported International Basel II compliance at a top-ten bank
 - Developed analytical and reporting capabilities
 - Created governance structure and supporting policies
 - Led regulatory exams for approval
 - Managed risk in retail banking, commercial banking, and insurance
 - Focused on building strong regulatory relationships
 - Active participants in several Basel II industry and regulatory forums that facilitated drafting the new rules
 - Frequent speakers at industry and regulatory conferences on Basel
 - Several Basel II academic papers written jointly with regulators

Summary

- Second Pillar Consulting is uniquely positioned to help banks comply with Basel II and get the capital relief they deserve
 - Services
 - Detailed Capital Savings Estimate
 - Gap Analysis
 - The Internal Capital Adequacy Assessment Process or ICAAP
 - Education
 - We conduct seminars for institutions and organizations on topics including Basel II compliance, Enterprise Risk Management, Capital Management, and Balance Sheet Strategy
 - Facilitation
 - We are currently coordinating the NPR response for the Risk Management Association and can help organizations and institutions with their response

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