

# The Impact of Standardized Basel II on Arizona Banks

Prepared for Arizona 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 79.3% of 29 Arizona banks and thrifts
  - Aggregate potential capital savings for all 29 banks of \$29 million
  - The median Arizona bank would save \$1.0 million or 6.3% 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

# Arizona Banks can save up to \$29 million in required capital under Standardized Basel II and improve risk management

## Capital savings estimate and asset category contribution

Regulatory Capital Requirement

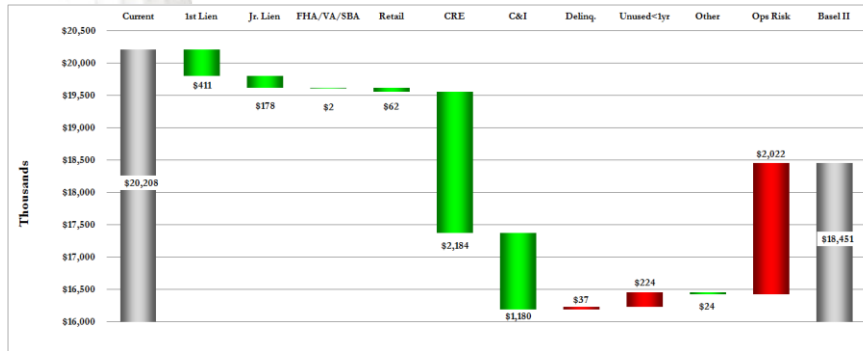


Source: 2008Q3 Call Reports; SPC estimates

# For Commerce Bank of Arizona, a representative Arizona bank, Basel II regulatory capital savings can be stockpiled or deployed

Capital Savings: \$1.8 million or 8.8%

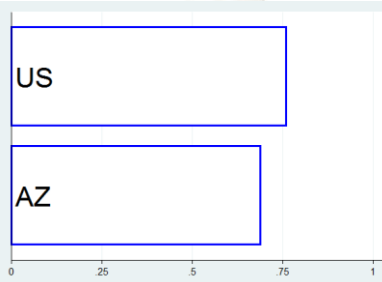
Regulatory Capital Requirement



## Commerce Bank of Arizona Tucson, AZ Highlights

- *Stockpile.* Under Basel II, total RBC increases from 13.1% to 14.3%, an amount equal to \$1.8 million or 8.8% of the existing capital base.
  - *Deploy.* Incremental capital can be deployed with a variety of balance sheet actions that preserve the current 13.1% total RBC ratio:
    - Issue a special dividend (per share information unavailable for private entity)
    - Repurchase shares (number of shares and impact on EPS unavailable for private entity)
    - Organically grow assets by \$15 million
- Upon request, Second Pillar Consulting can provide similar information for all 29 Arizona banks free of charge

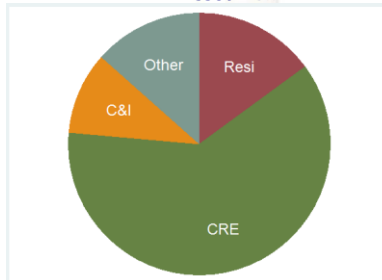
Capital Savings Percentile



Capital Metrics and Management

Total Assets (millions)	\$188	
Gross Income Margin	4.9%	
Tangible Common Equity	10.7%	
Leverage Ratio	10.6%	
Capital Estimates	Current	Basel II
Tier 1 RBC	12.2%	13.3%
Total RBC	13.1%	14.3%
Potential Use of Basel II Capital Savings		
Special Dividend (\$/share)	\$N/A	
Share Repurchase (7/29/2008 price)		
Number of Shares	70,277	
Change in EPS	\$N/A	
Organic Asset Growth (millions)	\$15	

Asset Mix



# Arizona 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
RepublicBankAz, N.A.	Phoenix	\$ 13,142	\$ 1,366	21.7%
Gold Canyon Bank	Gold Canyon	\$ 37,193	\$ 761	12.8%
Sonoran Bank, NA	Phoenix	\$ 32,279	\$ 823	12.7%
Mission Bank	Kingman	\$ 77,213	\$ 813	11.4%
Bank 1440	Phoenix	\$ 31,402	\$ 1,583	10.6%
Metro Phoenix Bank	Phoenix	\$ 46,628	\$ 1,488	9.9%
Valley Capital Bank, National Association	Mesa	\$ 49,358	\$ 537	9.6%
Commerce Bank of Arizona	Tucson	\$ 188,337	\$ 1,757	8.8%
Pinnacle Bank	Scottsdale	\$ 43,277	\$ 815	7.4%
Summit Bank	Prescott	\$ 93,259	\$ 632	7.3%
<b>Averages</b>		<b>\$ 61,209</b>	<b>\$ 1,058</b>	<b>11.2%</b>

Source: 2008Q3 Call Reports; SPC estimates

# Arizona 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
1st Bank Yuma	Yuma	\$ 121,009	\$ 372	3.1%
Nordstrom FSB	Scottsdale	\$ 176,126	\$ 2,025	2.0%
Foothills Bank	Yuma	\$ 129,796	\$ 188	1.1%
First State Bank	Flagstaff	\$ 122,434	\$ 126	1.1%
Mohave State Bank	Lake Havasu City	\$ 368,389	\$ (234)	-0.5%
Copper Star Bank	Scottsdale	\$ 266,366	\$ (219)	-0.9%
Canyon Community Bank, National Associ	Tucson	\$ 81,156	\$ (326)	-2.7%
Biltmore Bank of Arizona	Phoenix	\$ 248,525	\$ (1,100)	-3.0%
Union Bank, National Association	Gilbert	\$ 145,816	\$ (874)	-5.3%
Towne Bank of Arizona	Mesa	\$ 157,143	\$ (2,588)	-7.4%
<b>Averages</b>		<b>\$ 181,676</b>	<b>\$ (263)</b>	<b>-1.3%</b>

Source: 2008Q3 Call Reports; SPC estimates

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

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- 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

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- 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

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- 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

## Contact Information

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