

The Impact of Standardized Basel II on Indiana Banks

Prepared for Indiana Bankers Association



Executive Summary

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

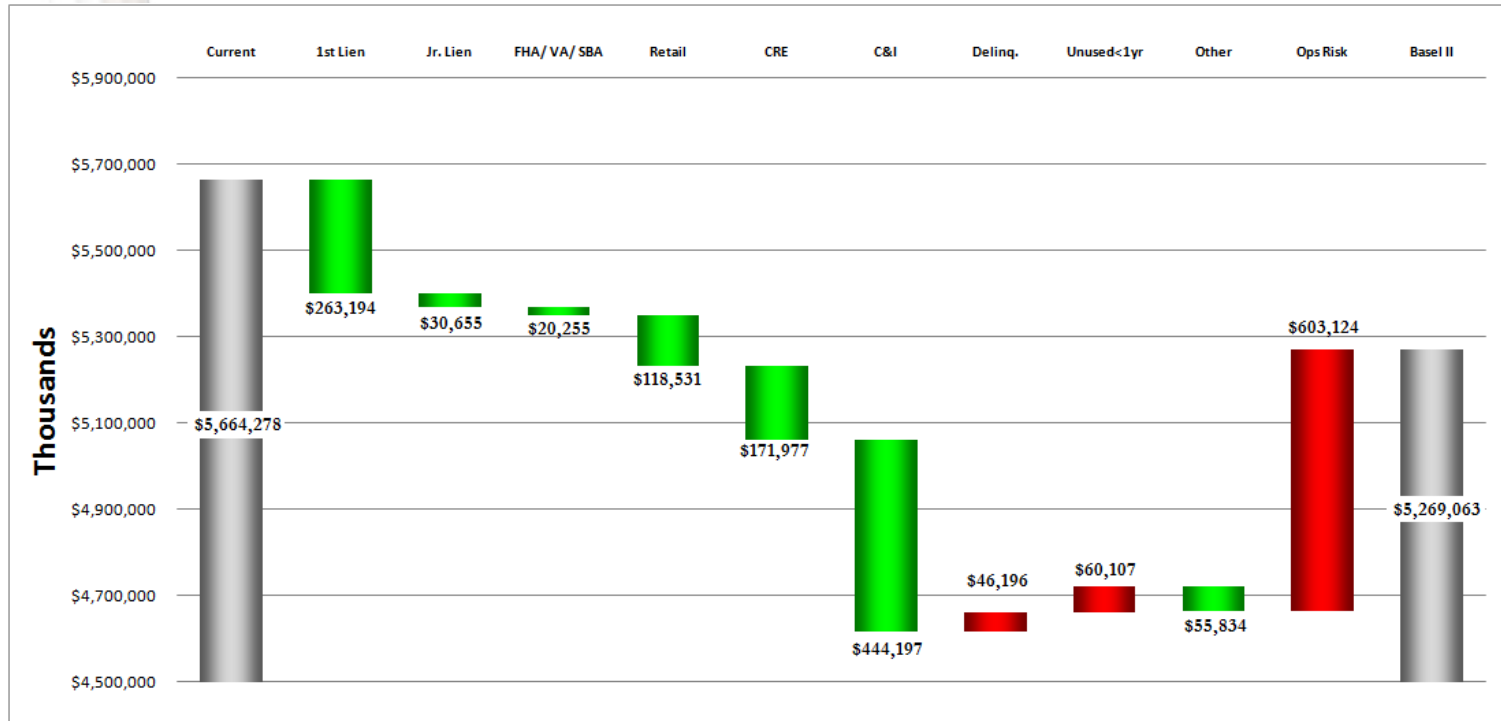


- We estimate that Standardized Basel II compliance will improve the regulatory capital ratios of 88.4% of 146 Indiana banks and thrifts
 - Aggregate potential capital savings for all 146 banks of \$395 million
 - The median Indiana bank would save \$1.3 million or 6.3% of their existing Tier 1 capital 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

Indiana Banks can save up to \$395 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 Lakeland Financial Corporation, a representative Indiana bank, Basel II regulatory capital savings can be stockpiled or deployed

Capital Savings: \$12.3 million or 6.5%

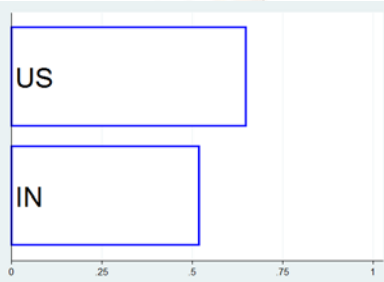
Regulatory Capital Requirement



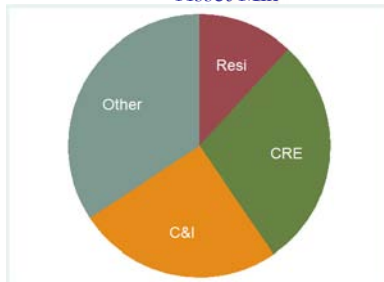
Lakeland Financial Corporation Warsaw, IN Highlights

- *Stockpile.* Under Basel II, total RBC increases from 10.8% to 11.5%, an amount equal to \$12.3 million or 6.5% of the existing capital base.
- *Deploy.* Incremental capital can be deployed with a variety of balance sheet actions that preserve the current 10.8% total RBC ratio:
 - Issue a special dividend of \$1.02 per share
 - Repurchase 554,497 shares, increasing EPS \$0.07 or 4.7%
 - Organically grow assets by \$138 million

Capital Savings Percentile



Asset Mix



Capital Metrics and Management

Total Assets (millions)	\$2,255	
Gross Income Margin	3.3%	
Tangible Common Equity	6.6%	
Leverage Ratio	8.3%	
Capital Estimates	Current	Basel II
Tier 1 RBC	9.8%	10.4%
Total RBC	10.8%	11.5%
Potential Use of Basel II Capital Savings		
Special Dividend (\$/share)	\$1.02	
Share Repurchase (7/29/2008 price)		
Number of Shares	554,497	
Change in EPS	\$0.07	
Organic Asset Growth (millions)	\$138	

Upon request, Second Pillar Consulting can provide similar information for all 146 Indiana banks free of charge

Indiana 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
Farmers and Merchants Bank	Boswell	\$ 89,685	\$ 2,293	23.7%
Community First Bank of Howard County	Kokomo	\$ 177,825	\$ 2,910	20.4%
Indiana Business Bank	Indianapolis	\$ 92,700	\$ 1,732	18.8%
United Commerce Bank	Bloomington	\$ 171,396	\$ 2,194	17.7%
Crossroads Bank	Wabash	\$ 316,523	\$ 3,360	17.6%
Mutual Bank	Muncie	\$ 1,398,266	\$ 16,722	17.4%
American Community Bancorp, Inc.	Evansville	\$ 292,246	\$ 4,812	17.3%
1st Source Corporation	South Bend	\$ 4,409,619	\$ 69,983	17.0%
First Federal Savings and Loan Association	Hammond	\$ 47,441	\$ 684	16.8%
Bedford Federal Savings Bank	Bedford	\$ 111,145	\$ 1,300	15.7%
Liberty Savings Bank, FSB	Whiting	\$ 77,352	\$ 1,010	15.7%
Symphony Bank	Indianapolis	\$ 56,688	\$ 989	15.7%
First Federal Savings and Loan Association	Greensburg	\$ 112,947	\$ 1,376	15.1%
First Federal Savings Bank	Huntington	\$ 256,973	\$ 2,895	14.9%
Mid-Southern Savings Bank, FSB (MHC)	Salem	\$ 176,237	\$ 2,349	14.4%
West End Bank, S.B.	Richmond	\$ 177,979	\$ 2,014	13.8%
SCB Bank	Shelbyville	\$ 257,309	\$ 2,271	13.5%
Bank of Indiana, National Association	Dana	\$ 70,772	\$ 834	13.1%
Logansport Savings Bank, FSB	Logansport	\$ 160,431	\$ 2,241	12.7%
First Federal Savings Bank	Evansville	\$ 352,964	\$ 2,562	12.5%
Averages		\$ 440,324.90	\$ 6,226.53	16.2%

Source: 2008Q3 Call Reports; SPC estimates

Indiana 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
Salin Bancshares, Inc.	Indianapolis	\$ 786,382	\$ 759	0.8%
Fountain Trust Company	Covington	\$ 198,465	\$ 106	0.4%
First Bank of Berne	Berne	\$ 401,652	\$ 133	0.4%
Ossian State Bank	Ossian	\$ 84,096	\$ 17	0.2%
Community State Bank	Royal Center	\$ 78,271	\$ (9)	-0.1%
Tri-County Bank & Trust Company	Roachdale	\$ 131,925	\$ (30)	-0.1%
Central National Bank and Trust Company	Attica	\$ 57,586	\$ (121)	-1.0%
New Washington State Bank	New Washington	\$ 211,519	\$ (236)	-1.1%
First Farmers Financial Corporation	Converse	\$ 630,965	\$ (1,093)	-1.6%
Fowler State Bank	Fowler	\$ 130,122	\$ (250)	-1.6%
Citizens Exchange Bank	Fairmount	\$ 54,246	\$ (130)	-1.7%
Farmers State Bank	Sweetser	\$ 16,935	\$ (58)	-2.0%
First National Bank of Odon	Odon	\$ 51,555	\$ (129)	-2.5%
Irwin Financial Corporation	Columbus	\$ 5,259,458	\$ (22,722)	-4.1%
Community Bank	Noblesville	\$ 223,874	\$ (1,716)	-5.1%
Pedcor Capital, LLC	Carmel	\$ 382,114	\$ (6,488)	-5.9%
Fairmount State Bank	Fairmount	\$ 34,355	\$ (466)	-7.3%
Greensfork Township State Bank	Lynn	\$ 157,593	\$ (2,692)	-9.0%
MMA Trust Company	Goshen	\$ 4,461	\$ (388)	-9.9%
Newton County Loan & Savings, FSB	Goodland	\$ 6,999	\$ (128)	-10.2%
Averages		\$ 445,129	\$ (1,782)	-3.1%

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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