

# The Impact of Standardized Basel II on Iowa Banks

Prepared for Iowa Bankers Association



# Executive Summary

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

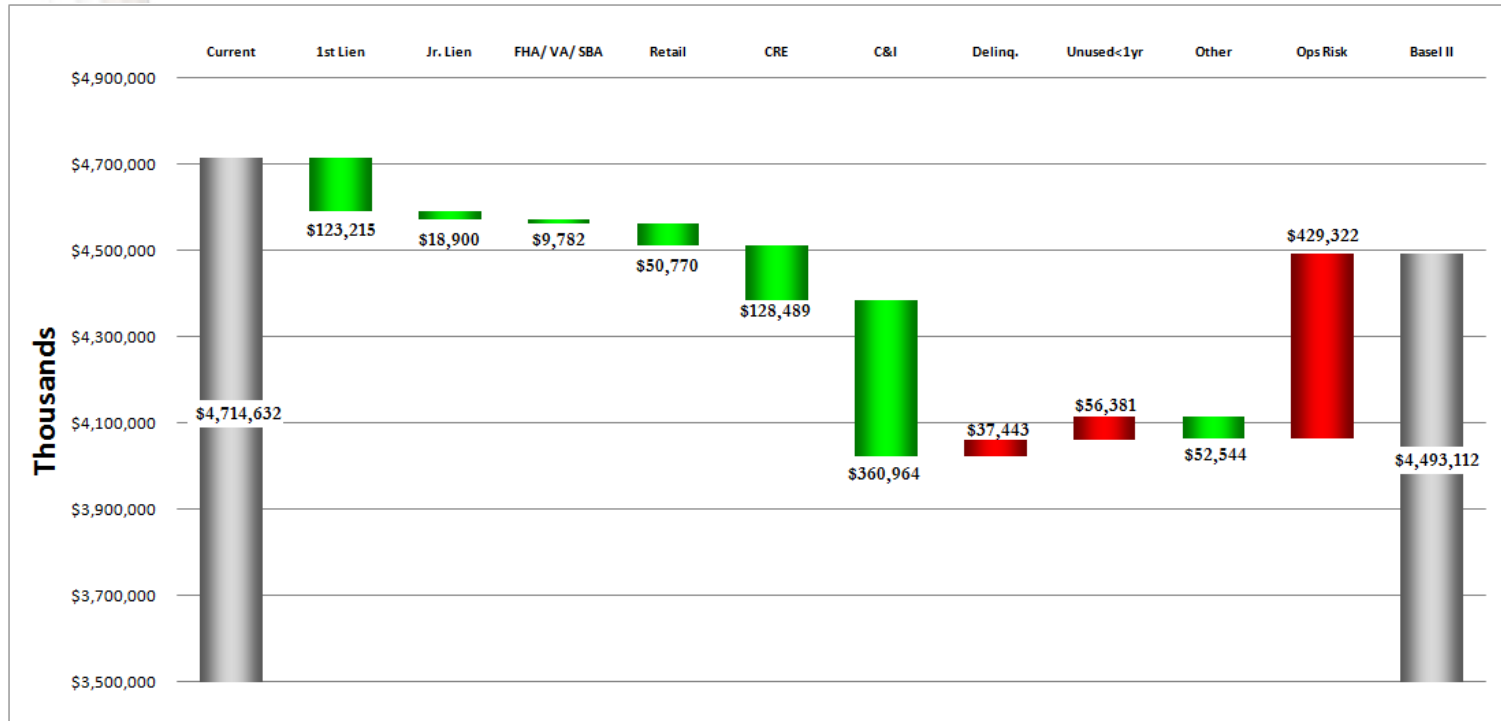


- We estimate that Standardized Basel II compliance will improve the regulatory capital ratios of 74.6% of 340 Iowa banks and thrifts
  - Aggregate potential capital savings for all 340 banks of \$222 million
  - The median Iowa bank would save \$0.4 million or 2.8% of their existing Tier 1 capital requirement
- 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

# Iowa Banks can save up to \$222 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 Hills Bancorporation, a representative Iowa bank, Basel II regulatory capital savings can be stockpiled or deployed

Capital Savings: \$5.3 million or 3.2%

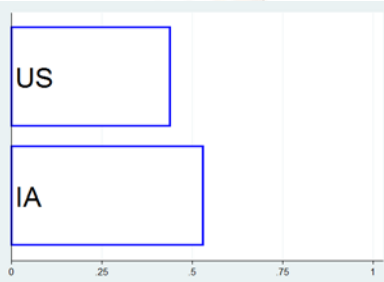
Regulatory Capital Requirement



## Hills Bancorporation Hills, IA Highlights

- *Stockpile.* Under Basel II, total RBC increases from 12.8% to 13.2%, an amount equal to \$5.3 million or 3.2% of the existing capital base.
- *Deploy.* Incremental capital can be deployed with a variety of balance sheet actions that preserve the current 12.8% total RBC ratio:
  - Issue a special dividend of \$1.17 per share
  - Repurchase 105,323 shares, increasing EPS \$0.09 or 2.4%
  - Organically grow assets by \$53 million

Capital Savings Percentile



Asset Mix



Capital Metrics and Management

Total Assets (millions)	\$1,728	
Gross Income Margin	3.6%	
Tangible Common Equity	9.1%	
Leverage Ratio	9.1%	
Capital Estimates	Current	Basel II
Tier 1 RBC	11.6%	11.9%
Total RBC	12.8%	13.2%
Potential Use of Basel II Capital Savings		
Special Dividend (\$/share)	\$1.17	
Share Repurchase (7/29/2008 price)		
Number of Shares	105,323	
Change in EPS	\$0.09	
Organic Asset Growth (millions)	\$53	

# Iowa 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
Commercial Savings Bank	Carroll	\$ 104,083	\$ 1,911	22.7%
First Security State Bank	Evansdale	\$ 85,000	\$ 1,558	19.3%
Corridor State Bank	Coralville	\$ 58,095	\$ 1,034	18.7%
Citizens First Bank	Clinton	\$ 116,780	\$ 1,698	18.2%
Independence Federal Bank For Savings	Independence	\$ 23,436	\$ 356	17.3%
United Security Savings Bank, FSB	Marion	\$ 44,563	\$ 489	16.0%
Peoples Trust and Savings Bank	Riverside	\$ 21,287	\$ 260	15.4%
White State Bank	South English	\$ 27,317	\$ 398	15.0%
First Trust & Savings Bank	Moville	\$ 78,020	\$ 2,322	14.7%
Fairfax State Savings Bank	Fairfax	\$ 118,340	\$ 2,175	14.4%
Hedrick Savings Bank	Ottumwa	\$ 60,289	\$ 732	14.4%
Two Rivers Bank & Trust	Burlington	\$ 275,148	\$ 3,119	13.8%
Farmers & Merchants Savings Bank	Manchester	\$ 225,665	\$ 2,659	13.6%
Buffalo Savings Bank	Buffalo	\$ 40,944	\$ 572	13.3%
South Story Bank & Trust	Slater	\$ 52,935	\$ 562	13.1%
Linn County State Bank	Coggon	\$ 21,950	\$ 350	12.4%
Peoples Savings Bank	Crawfordsville	\$ 27,321	\$ 273	12.4%
Midwest Heritage Bank, FSB	Chariton	\$ 120,795	\$ 762	12.3%
Charter Bank	Johnston	\$ 93,716	\$ 847	12.0%
Emmet County State Bank	Estherville	\$ 68,156	\$ 950	12.0%
<b>Averages</b>		<b>\$ 83,192.00</b>	<b>\$ 1,151.34</b>	<b>15.0%</b>

Source: 2008Q3 Call Reports; SPC estimates

# Iowa 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
Community Bank	Dunlap	\$ 62,421	\$ (322)	-4.3%
Farmers & Traders Savings Bank	Bancroft	\$ 47,051	\$ (258)	-4.9%
Valley Bank & Trust	Mapleton	\$ 55,659	\$ (291)	-5.0%
Moorhead State Bank	Moorhead	\$ 17,451	\$ (206)	-5.1%
Maxwell State Bank	Maxwell	\$ 21,291	\$ (158)	-5.3%
Peoples Savings Bank	Elma	\$ 57,911	\$ (302)	-5.3%
Home State Bank	Royal	\$ 36,793	\$ (649)	-5.5%
First National Bank	Davenport	\$ 72,206	\$ (509)	-5.6%
Glenwood State Bank	Glenwood	\$ 104,356	\$ (860)	-5.6%
Hardin County Savings Bank	Eldora	\$ 125,517	\$ (802)	-5.7%
Farmers Savings Bank	Walford	\$ 44,034	\$ (309)	-5.7%
First National Bank of Logan	Logan	\$ 26,699	\$ (231)	-5.7%
Farmers Savings Bank	Keota	\$ 61,687	\$ (616)	-5.8%
Watkins Savings Bank	Watkins	\$ 49,327	\$ (453)	-5.9%
Village Bank & Trust Company	Cedar Rapids	\$ 30,448	\$ (506)	-7.5%
State Bank of Schaller	Schaller	\$ 19,249	\$ (206)	-7.7%
First Community Bank	Newell	\$ 54,356	\$ (464)	-7.7%
Security State Bank	Waverly	\$ 60,018	\$ (559)	-8.1%
Okey-Vernon First National Bank	Corning	\$ 45,127	\$ (763)	-9.4%
Dysart State Bank	Dysart	\$ 9,613	\$ (158)	-11.0%
<b>Averages</b>		<b>\$ 50,061</b>	<b>\$ (431)</b>	<b>-6.3%</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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